CAM Reconciliations: An Art or Science?

How to Become a CAM Rec Artist

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Tara Platt has over 20 years of property management experience. She is accomplished at forecasting and budgeting, common area maintenance (CAM) reconciliations, operating expense efficiencies, and capital and tenant improvement (TI) oversight in addition to mentoring teams and business development. Tara has been responsible for day to day operations, and led management teams for over 130 commercial buildings. She has provided oversight for nearly 20 million SF of real estate including retail, office, medical, industrial, and mixed use. She has extensive experience with both institutional and private ownerships.

Tara is a licensed principal broker in the state of Oregon and designated broker in the state of Washington. She holds the Certified Property Manager (CPM®) designation from the Institute of Real Estate Management. Tara earned a Master of Arts degree from George Fox University and a Bachelor of Science degree in business administration from the University of Phoenix.

Tara is a member and immediate past chapter president of the Institute of Real Estate Management (IREM), a member of NAIOP, a member of Commercial Real Estate Women (CREW), and a member of Commercial Association of Brokers (CAB).

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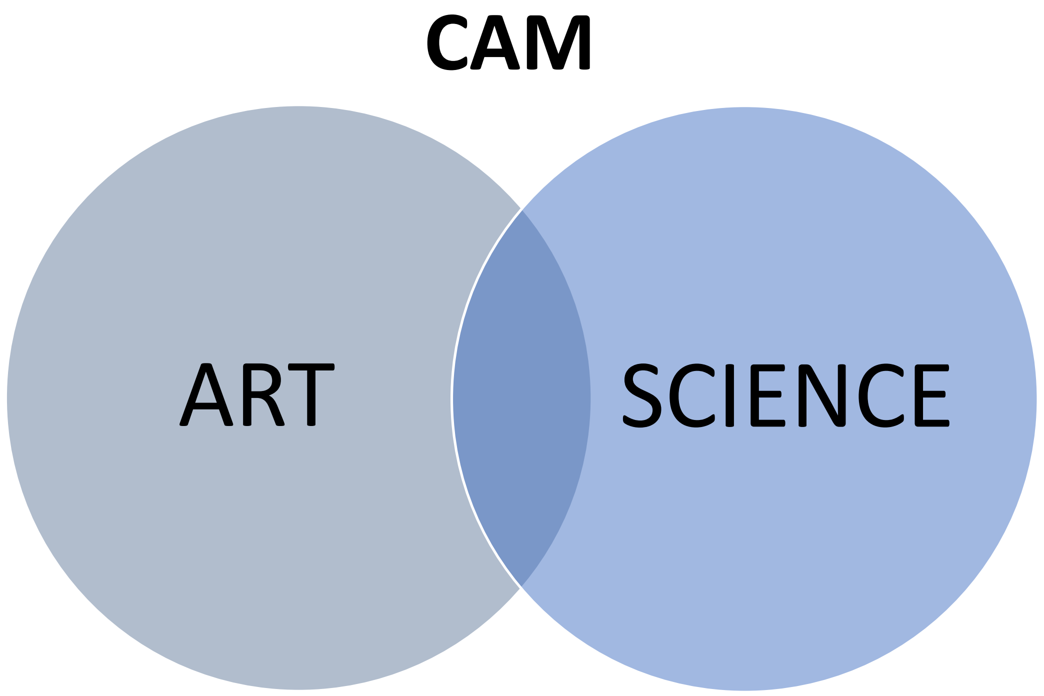
CAM Recs: An Art or Science?



Calculating CAM reconciliations is a “science” when it comes to straightforward concepts such as lease type, prorata shares, expense caps and exclusions.

The “art” of CAM reconciliations begins by understanding the owner’s investment strategy, how capital expenses may be recovered, and how gross-ups benefit both the tenant and the landlord.

Introduction to CAM Reconciliations

- Overview
- Gathering Information
- Lease Types
- Expenses
- Gross Up Calculations
- Sample Calculations

Budget is created for the following year → Tenant's CAM estimates are calculated based on the budget → During that budget year, Tenants are billed for their share of budgeted expenses → 1st Q of the following year, actual expenses are reconciled for previous year → Tenant's billing for the prior year is reconciled against their share of actual expenses → Tenants are sent an invoice showing amount owed or due

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Gathering Information

- Rent Roll
  - Assists in determining average occupancy
  - Manager needs to determine if a tenant was “dark” during the year, received a new base year, or expanded or contracted
- Original Lease, Lease Amendments and Lease Abstracts
  - Determine Lease type
  - Review for Operating Expense clauses: exclusions, expense stops, caps
  - Verify pro rata share: may be fixed, may change with building SF change
  - Gross Up (GU) percentage, if any
- Receivables Ledger
  - Verify prior year tenant estimate billings
- Year End Income Statement
  - Used to establish initial expense pool
- General Ledger
  - Determines operating expenses and should be reviewed on a monthly basis
  - Should be “scrubbed” prior to year-end (YE) close

Gathering Information

Other Information/Reconciliation Support

- Copies of Prior Reconciliations
- Base Year Schedules
- Prior Year CAP Calculations
- Prior Expense Pool Information
- Copies of Real Estate Tax Bills
- Copies of Insurance Bills

Lease Types - NNN

Industrial (True) NNN	• Tenant responsible for contracting for all services • Tenant directly pays RE Taxes & Insurance
Triple Net (NNN)	• Landlord responsible for obtaining all services and contracts • Tenant will fully reimburse landlord for their pro rata share of expenses
Managed Net (Mnet)	• Similar to NNN but Landlord maintains roof, HVAC or some other component • Tenant will fully reimburse landlord for their pro rata share of expenses

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Lease Types – Modified Gross (MG)

Base Year

Limits the tenant's reimbursement of future years' costs to the extent those expenses exceed expenses established for a specific year

Expense Cap

An amount stated in Dollars/psf on an annual or monthly basis. Tenant pays expenses up to Cap amount.

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Lease Type Summary

Net

- Landlord maintains services and all expenses passed through
- Or Tenant maintains all services and pays all expenses directly
- Investment is protected from inflation

Modified Gross

- Tenant pays increases in expenses over their Base year

Full Service Gross

- All services included during lease term, no CAM
- Landlord receives a fixed sum regardless of operating costs

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Sample Lease Language:

"Expenses" means all costs and expenses incurred in each calendar year in connection with operating, maintaining, repairing, and managing the Building and the Property. Expenses include, without limitation: (a) all labor and labor related costs, including wages, salaries, bonuses, taxes, insurance, uniforms, training, retirement plans, pension plans and other employee benefits; (b) management fees; (c) the cost of equipping, staffing and operating an on-site and/or off-site management office for the Building, provided if the management office services one or more other buildings or properties, the shared costs and expenses of equipping, staffing and operating such management office(s) shall be equitably prorated and apportioned between the Building and the other buildings or properties; (d) accounting costs- e) the cost of services; (f) rental and purchase cost of parts, supplies, tools and equipment used in the maintenance, repair and operation of the Building and/or the Property; (g) insurance premiums and deductibles; (h) electricity, gas and other utility costs; “

BOMA 2018 Lease Definition of “Operating Expenses”

“operating expenses” shall mean all costs of operating, maintaining, and repairing the Building as determined by standard real estate accounting practice, including, but not limited to: all water and sewer charges; the cost of natural gas and electricity provided to the Building; janitorial and cleaning supplies and services; administration costs and management fees; superintendent fees; security services, if any; insurance premiums; licenses; and permits for the operation and maintenance of the Building and all its component elements and mechanical systems; ordinary and emergency repairs and maintenance, and the annual amortized capital improvement cost (amortized over such a period as Landlord may select but not shorter than the period allowed under the Internal Revenue Code and at a current market interest rate) for any capital improvements to the Building required by any governmental authority or those that have a reasonable probability of improving the efficiency of the Building. “Operating expenses” shall also include all assessments under recorded covenants or master plans and/or by owners' associations.

Operating Expenses

- Insurance Expenses
  - Includes casualty losses not reimbursed by deductible
  - Check leases – some tenants have specific insurance exclusions
- Business licenses and similar fees and taxes related to the building
  - Including bank and lockbox fees
- Fees imposed by a government authority
  - For fire and police protection or other special services
  - For charges of services supplied to the building by the City or County
- Costs of complying with any governmental laws, codes, regulations or ordinances
  - Costs may be capital in nature
  - Common expense would be those for ADA compliance

Non-Operating Expenses

- Costs that are not associated with managing, operating, maintaining, and repairing a building. Also referred to as non-escalatable or non-recoverable
- Leasing costs, leasing commissions, financial expenses, closing costs, and costs specifically associated with a tenant: marketing, legal, consulting, advertising fees and tenant improvements
- Costs Separately reimbursed to Landlord
- After hours electricity/HVAC, tenant specific cleaning, tenant work orders, vacant electricity
- Any other expenses expressly excluded pursuant to any provisions of the lease document

Real Estate Taxes

- Property Taxes, Assessments and Services
  - Fees associated with consultants and appeals
- Actual versus accrual entries
  - Leases often distinguish between estimates and actual payments
- Handling Tax Refunds – do not include prior year refunds in current year pool
- With respect to Base Year
- With respect to Expense Pool
- With respect to applicable tax year
- What about the new Oregon Corporate Activity Tax (CAT)? Recoverable or NOT?

Capital Expenses

- If the building value is increased by the expenditure, it is a capital expense rather than an operating expense
  - Capital Expenses are not usually considered an operating expense for recovery purposes.

- Capital Expenses can be included as an operating expense, if it is considered a "cost saving improvement"

"The cost of capital improvements shall be amortized by Landlord over the lesser of the Payback Period(defined below) or the useful life of the capital improvement as reasonably determined by Landlord. The amortized cost of capital improvements may, at Landlord's option, include actual or imputed interest at the rate that Landlord would reasonably be required to pay to finance the cost of the capital improvement. "Payback Period" means the reasonably estimated period of time that it takes for the cost savings resulting from a capital improvement to equal the total cost of the capital improvement."

Capital Expenses

- Cost Saving Capital Expense:
  - Any equipment or other improvement acquired after substantial completion of the building that is reasonably anticipated to achieve economies in the operation and/or maintenance of the building
- Major Repairs:
  - Repairs made that can demonstrate that the life of the asset has been extended beyond what was originally estimated as its useful life
  - Substantial overhaul of an air conditioning system that extends its life or reduces energy consumption
- Improvements:
  - An improvement is a substitute that increases an asset's usefulness only in terms of quality or value such as lobby/corridor renovation
- Replacement:
  - A replacement is a substitution of an existing asset. Unlike an improvement, it is no better than the old item when it was newly acquired, but may extend the useful life. May involve replacement of a whole unit or extensive replacement parts

Capital Expenses

- Cost saving Capital Improvements can be considered a recoverable operating expense and handled in one of the following ways:
  - Expense in one year
  - Expense over the useful life without a percentage applied as amortization
  - Expense over the useful life with a percentage applied as amortization

Note: One time capital expenses that will be recovered should not be included when establishing the base year. Only normal occurring expenses should be used to determine a base year

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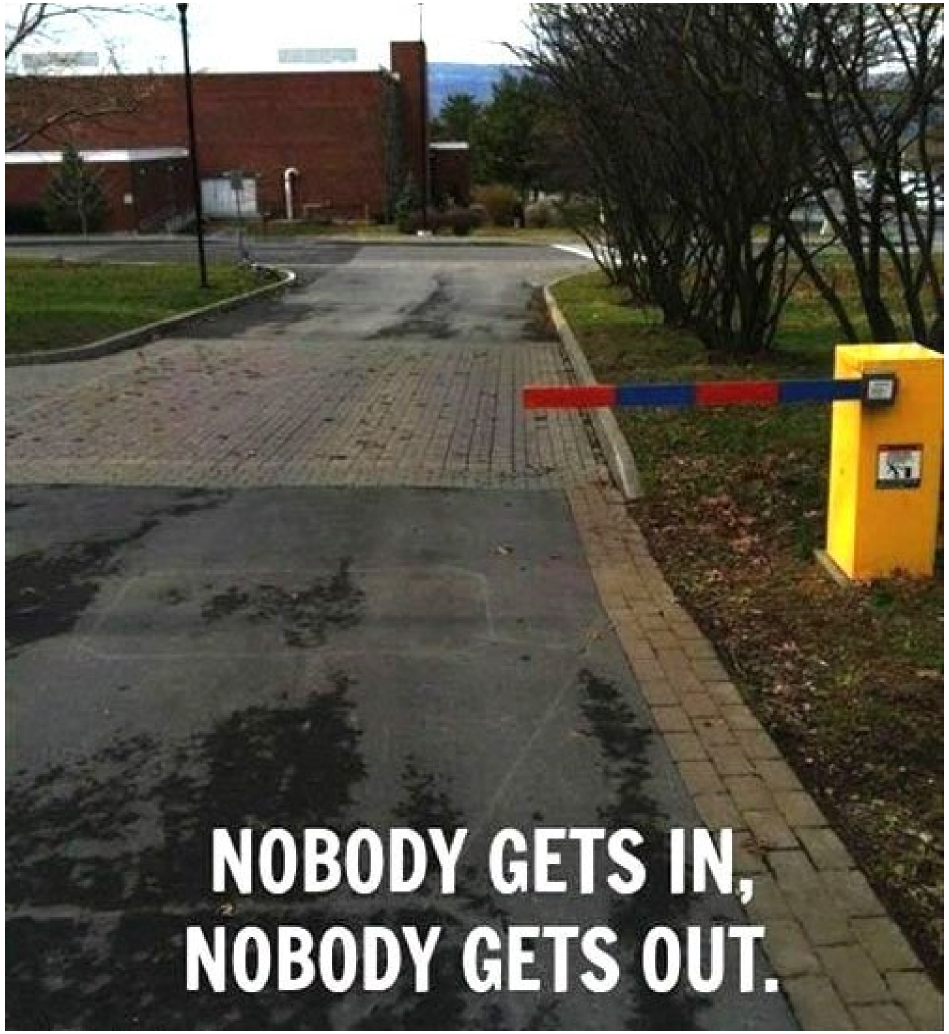
Capital Expenses

- Some Tenants have an option to review and audit the expenses. Read the lease and don't assume! Audit language can be included in the Operating Expense section, or in a separate exhibit

- Leases are usually very specific about the recovery of capital expenses. If leases are vague, it is the Landlord's decision whether to capitalize the expense or to recover as an operating expense

- Consider what the market will handle and stay competitive with competing buildings when determining if a capital expense should be recovered



Establish Expense/CAM Pools

- Initial Operating Expense Pool must tie to Operating Income Statement
- Expense Codes – Property Manager reviews the general ledger and makes the necessary adjustments to determine the expense pool
- Determine which expenses are tenant specific items or non-escalatable
- Each year's
- Expense Pool must be
- tracked to ensure
- accurate calculations
- from year to year

56030100 Management Fees	$44,075	$44,119
Total Management Fees	**$44,075**	**$44,119**
60010100 Corporate Payroll	($3,180)	($2,889)
60400245 Dues & Subscriptions	$5	$0
60400255 Travel	$27	$0
60400335 Regional Office Exp - CY Adj	($88)	($94)
60600170 Penalties Interest Tax Related	$55	$0
60600190 Tenant Relations/Retention	($123)	$0
60600195 Miscellaneous Construction	$605	$0
60600205 Marketing & Promotion	$4,566	$0
60700110 Legal Fees	($283)	$0
Total G&A Non-Escalatable	**$1,584**	**($2,983)**
Total Expenses	**$487,566**	**$513,331**
GAAP NOI	**$1,014,965**	**$1,011,189**

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Basic Calculations

Initial Expense Pool – ties to the Income Statement
+/- GL/Tenant Adjustments
= Adjusted Expense Pool

x Pro Rata Share
= Tenant's Expense Pool

x Occupancy Percentage
= Adjusted Tenant Expense Pool

– Tenant's Estimate Billings
= Total Charge/(Credit) due Tenant

Sample Calculations

MG – 2017 Base Year

Total 2017 Actual Expenses	$179,000
Less 2017 base year expenses	($123,000)
	$56,000
x tenant's pro rata share (10.67%)	$5,975
/ % occupancy share (100%)	$5,975
less 2018 tenant estimate billings	($6,612)
Total charge/(credit) due	($637)

NNN – No Base Year

Total 2018 Actual Expenses	$179,000
x tenant's pro rata share (10.67%)	$19,099
/ % occupancy share (100%)	$19,099
less 2018 tenant estimate billings	($18,240)
Total charge /(credit) due	$859

Why Separate Expense Pools?

- Example 1

	2018 Base Year Expense	2019 Operating Year Expense	Differential Tenant is Responsible for PSF
NNN	$ 11.00	$ 11.50	$ .50

- Example 2

	2018 Base Year Expense	2019 Operating Year Expense	Differential Tenant is Responsible for PSF
CAM	$ 5.00	$ 4.00	$ -
UTI	$ 2.00	$ 1.75	$ -
INS	$ 1.50	$ 1.75	$ 0.25
TAX	$ 2.50	$ 4.00	$ 1.50
Total	**$ 11.00**	**$ 11.50**	**$ 1.75**

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Gross Ups

- Variable Operating Expenses are grossed up by Landlord so that a Tenant's share of Operating Expenses is an amount that it would have been if the property was fully occupied
- Lease provisions allowing for gross up are usually stated in a percentage (%), example-gross expenses up to 95%
- The ability to gross up may depend on the actual average occupancy of the property of the coverage year
- If the average occupancy is 95% then the expenses are considered to be grossed up already
- If a tenant has other lease provisions in regard to the recovery calculation (Base Years, Caps, etc), those limitations must also have been grossed up if the current year expense pool is grossed up

"If at any time during a calendar year the Building is not at least 95% occupied or Landlord is not supplying services to at least 95% of the total Rentable Square Footage of the Building, Expenses shall be determined as if the Building had been 95% occupied and Landlord had been supplying services to 95% of the Rentable Square Footage of the Building."

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Variable & Fixed Expenses

Variable

These expenses vary depending on occupancy

- Janitorial Service
- Janitorial Supplies
- Utilities
- Management Fee

Fixed

Cost of these expenses do not change when occupancy increases

- Property Insurance
- Real Estate Taxes
- Majority of monthly service contracts

Gross Ups

- Grossing up expenses is on a tenant-by-tenant basis. It should not be assumed that all tenants have a gross up provision. Additionally, just because one tenant's expense pool is grossed up, does not mean that all the tenants' expense pools will be grossed up.

- Most clauses discussing gross ups in a tenant's lease are usually found within the same area in the lease where operating expenses are discussed.

- Based on each tenant's lease, it is the Property Manager's ultimate decision to determine if expenses will be grossed up and sometimes, the landlord may choose not to gross up expenses so that expenses stay competitive

Calculating the Gross Up Multiplier

Building's total SF is 20,000

195,000/12 = avg. occupancy = 16,250

16,250/20,000 = denominator = .81

100% gross up multiplier = 1/.81 = 1.23

95% gross up multiplier = .95/.81 = 1.17

90% gross up multiplier = .90/.81 = 1.11

Monthly Occupancy	
January	15,000
February	15,000
March	15,000
April	12,000
May	12,000
June	18,000
July	18,000
August	18,000
September	18,000
October	18,000
November	18,000
December	18,000
Total	195,000

Electrical GU at 95%

Electricity per the adjusted expense pool = $30,000
Fixed cost is assumed to be 35%

$30,000 x .35 = $10,500	Fixed Cost
$30,000-$10,500 = $19,500	Variable Cost

Can only gross up the variable cost

$19,500 x 1.17 = $22,815
add the fixed cost = $10,500

New expense pool amount for electricity @ 95% Gross Up = $33,315

Janitorial Gross Up – Based on Contract Price

Cleanable SF of building = 20,000

Contracted cost psf/mo = $.14

20,000 x $.14 = $2,800	Monthly Cost
$2,800 x 12 = $33,600	Yearly Cost

At 100% gross up = $33,600 x 1 = $33,600

At 95% gross up = $33,600 x .95 = $31,920

Management Fee Gross Up

Management Fee GU – Based on Contract Price

Total Income collected applicable to Management fees = $40,000

Management Fee = 3%

Total Property SF = 25,000 / 95% of Property is 23,750 SF

Average Occupied SF = 20,000 (which earned $40,000 of Mgt Fees)

95% Gross Up = 23,750 SF – 20,000 SF = 3,750 SF X Fair Market Rent X 3% Management Fee = ___________

100% Gross Up = 25,000 SF X Fair Market Rent X 3% Mgt Fee = ______

Don’t forget you are grossing up annually!

More on Base Years

- Base years and subsequent operating years should be comparable:
  - To the extent that earthquake insurance is added to operating expenses subsequent to Tenant's Base Year, Tenant’s Base Year calculation shall be increased to include such subsequently added earthquake insurance.
  - To the extent that services to the building are minimized or reduced in subsequent operating years, Tenant’s Base Year will be similarly reduced the comparable aggregate annual amount.

1

Base Year Insurance	Operating Year Insurance	Tenant Share
$54,000	$86,000	$32,000

2

Base Year CAM	Operating Year CAM	Tenant Share
$436,000	$382,000	$0

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Expense Caps

Cumulative

The nature of this cap allows Landlord to recover any unused increases from prior years.

5% cum. cap: CAM expenses increase by 2% in yr 1, tenant pays 2% increase. If CAM expenses increase 10% in yr 2, tenant pays 8% increase (3% from PY plus 5% CY)

Non-cumulative

Sets a ceiling on annual increases and does not allow the landlord to recover any unused increases from prior years.

5% non-cumulative cap in the previous example; the tenant would pay the 2% increase in year one and 5% increase in year 2.

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Expense Caps Cont.

- Expense Cap – An artificial ceiling is created to limit the amount the tenant will pay. Used to control the amount of expense increase from year to year.
- Can be placed on specific expenses (usually controllable expenses) to limit the amount of increase on those expenses from year to year.
  - Controllable expenses usually exclude utilities, real estate taxes, insurance and management fees since these expenses cannot be controlled by management.
- May be placed on a single expense category
  - Ex. Management Fee not to exceed 5% of Tenant's base rent

Handling Caps

EXAMPLE A

PY controllable expenses	$258,000
5% CAP	$270,000
CY controllable expenses	$263,000

In this scenario, you would use the $263,000 (non Cap) as your controllable expense pool and add your uncontrollable expenses back in for a total expense pool.

EXAMPLE B

PY controllable expenses	$237,000
2% CAP	$242,000
CY controllable expenses	$251,000

In this scenario, you would use the $242,000 (Cap) as your controllable expense pool and add your uncontrollable expenses back in for a total expense pool.

Handling Caps Cont.

- The previous year's expenses may be different for each tenant due to gross up clauses that may increase one tenant's controllable expense pool over another tenant's expense pool
- Current year expense pools, before any Cap calculation, may also be different per tenant due to gross up clauses
- Because of the above two possibilities, each tenant must be taken on a case by case basis when determining their expense pool and calculating their operating expense reconciliation
- Because of the variables involved in Caps, it is imperative that you track the expense pools for each tenant each year

Items to Remember….

- Once you have completed the Operating Expense Reconciliation; take a breather!
- To review the Operating Expense Reconciliation, use a “Slippage Report” to determine the amount of expenses being recovered.
    - A property that is 100% leased/occupied SHOULD recover 100% of Operating Expenses. However, if any tenants have CAPs, exclusions, etc. the recovery will not be 100%
    - A property that is 72% leased/occupied SHOULD recover 72% of Operating Expenses (NNN); 95% or 100% if expenses grossed up.
    - It is important to understand where the “slippage” is coming from.
    - Document adjustments!

CAM Recs: Art or Science?

Art	Science
Property/Client Strategy	Lease Type
Landlord Reimbursed Expenses/Refunds	Expense Caps
Recoverable Capital	Pro Rata
Gross Ups	Expense Exclusions

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