Gross-Ups during Covid-19

Who would have thought this would be such a difficult and interesting issue?
What an impact a virus can make (to operating expense calculations)

Gross it up!

Occupancy vs Leased. Comparison Year or Base Year?

• Most leases provide for a “Gross-up” using Occupancy for variable costs
• Past methodology (likely) used Leased percentage to Gross-up variable costs
• Methodology consistency of past OpExp calculations (usually a good thing) may now inequitably hurt or help one side in virtually all leases due to Covid/the Shelter in Place
• Leases generally allow you to include Covid related costs. However, check your Leases as some have limitations for ‘extraordinary’ costs meant to be protective of increases (such as the cost of Covid ?). It may not be clear if a SIP or related costs apply.
The concept of the Operating Expense Provision in leases: To fairly attribute any costs or savings.

Or

Look Mom, a magic trick!

- Grossing up using actual Covid related low “Occupancy” in a 2020 Comparison year will make the landlord more money

- Building a new Base Year for a tenant by deducting Covid related costs and/or using the actual high “Leased” percentage for Gross-up will make the Landlord more money
The Tricks and Traps:

What is this the right decision for your building?

Before determining your 2020 methodology, fully ascertain and evaluate the following:

– How to construct 2020 Methodology vs. maintaining defendable consistency vs. the spirit and intent of the Opex rationale.
– Can you and should you change methodology – with a good reason why?
– Test the impacts of methodology differences for materiality and equity.
– Understand/accept that an improperly calculated 2020 OpExp year may result in a plethora of Tenant Audit disputes. Note: these will begin to occur in 2021 after the reconciliations are delivered.
– Assess any reputational risks to the Landlord, leasing program, building, and management company.
Thank you

Wesley Powell
Real Estate License #01856260