

How to Prepare for Upcoming 2020-2021 Operating Expenses & Real Estate Taxes

COVID-19 has put a halt on business operations and in turn dramatically affected the accessibility of physical office space. We believe that Annual Pass-Throughs (i.e. Operating Expenses and Real Estate Taxes) will be impacted one way or the other. Whether this means Tenants will receive a credit at the beginning of 2021 or Tenants will owe a payment, we cannot conclusively tell yet. However, there are a few main contributors as to why a TDKCA lease analysis is highly recommended:

1. "Occupancy" has reduced dramatically, but what does this mean?

Commercial Office Buildings were officially open in 2020, however business and office space were "unoccupied". Expenses based on building usage and occupancy, variable expenses, will be affected. Expenses such as Janitorial, Utilities & Management Fees should be reviewed in detail because they could reduce from 2019's value, in theory.

2. Janitorial Expense May Increase

Due to COVID-19 regulations, Commercial Office Buildings must implement specific Janitorial guidelines which follow the CDC recommendations. Due to this, there may be an increase in Janitorial Supplies & Salaries, when compared to 2019's value.

More information here: <https://www.cdc.gov/coronavirus/2019-ncov/community/office-buildings.html>

3. Amenity Space Closures

Due to the shared-space nature of Fitness Centers, Rooftops and Conference Rooms, most of these spaces will continue to be unavailable for Tenant use until a vaccination is implemented. This begs the question, should Tenants in Commercial Office Buildings be proportionally charged for Amenity expenses?

4. HVAC Capital Expenditure

Capital Expenditures (CapEx) are included (with restrictions) in Operating Expense calculations on a Lease by Lease basis. Newly installed, repaired or replaced Capital Expenditures are included in Operating Expenses based on if the newly installed mechanical system provides cost savings from the older mechanical system. For example, a new energy efficient HVAC system can vastly reduce utility costs by managing the hours and extent of HVAC equipment usage in a building. If a new HVAC system is installed, due to a COVID-19 mandate on airflow, should the Tenant have to pay for this?

5. 2020 Operating Expense & Real Estate Tax Base Year (Full Service Lease)

If a Tenant moved into their Office Space in 2019 or 2020 and received a 2020 Base Year for Expenses, how will a major reduction in expenses due to COVID-19 be accounted for within said Base Year? A gross-up provision may help, but protective language within the Lease should be retroactively added to protect any major fluctuations that may occur during the Lease Term. For example, 2021 Operating Expenses may be drastically larger than 2020 Operating Expenses due to people returning back to their office space.

Please feel free to call me directly if you would like to hear more about our process, meet the team or discuss any related topics. During these times, it is most important to get a handle on your Real Estate costs and that begins with a conversation.

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