

OPERATING EXPENSE (OPEX) ESCALATION GROUPS

Concepts & Applications

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In a modified gross lease, an increase in the property's operating expenses, *above the tenant's base year*, is escalated as additional rent to the tenant at their proportionate share. Escalation operating expenses have routinely been assembled into two classifications (groups) - 1. Operating Expenses (including utilities expenses) and 2. Real Estate Taxes.

If a tenant's operating expense recovery (escalation) lease clause stipulates one consolidated group of operating expenses, this group typically comprises all operating expenses including real estate taxes and utilities expenses. Although the most common CRE lease standard has typically comprised two (2) operating expense groups (OPEX and RE Taxes), a recent trend with select owners and tenants has defined and incorporated a 3rd category - utilities expenses - as a distinct operating expense group.

The primary real estate owner benefit of multiple operating expense classifications (groups) 1. Operating Expenses; 2. Real Estate Taxes and 3. Utilities Expenses, occurs in a comparison year when at least one group experiences an overall decrease in expenses 'below' the tenant's base year.

When the operating expense escalation lease clause combines expense categories into one group, in what would otherwise be two or three distinct expense escalation groups, a decrease in one category's annual expenses will 'offset' increases in other categories' annual expenses dollar for dollar. This 'offset of expenses' can result in the property owner not being able to escalate and recover what would be an increase above a base year in a distinct separate operating expense group.



OPERATING EXPENSE (OPEX) ESCALATION GROUPS - CONCEPTS & APPLICATIONS



Because the utilities market and, in some cases, real estate taxes can experience expense volatility, establishing three operating expense groups can provide added value to the property owner by assuring operating expense escalation recovery in each individual group despite a decrease in expenses in another operating expense group (s).

The 3 operating expense escalation tables below illustrate the benefit of multiple operating expense escalation groups. While the total (combined) property expenses decrease (following a tenant's base year) the property owner could maximize expense recovery in one expense group if the tenant lease stipulates three (3) distinct operating expense escalation groups.

One (1) collective operating expense escalation group 1. Operating Expenses (including Real Estate Taxes & Utilities)

Total Operating Expenses	Base Year 2015		2016 Operating Expenses		Increase (Decrease)
		\$6,400,000	\$13.32	\$6,350,000	\$13.22
Base Year - One (1) Operating Expense Escalation Group				RSF	480,500
Operating Expense Group	Base Year 2015		2016 OPEX		Increase (Decrease)
1. Total Operating Expenses	\$6,400,000	\$13.32	\$6,350,000	\$13.22	-\$50,000
No Increase = No OPEX Recovery					\$0
Total Operating Expense Group = All Operating Expenses including Utilities and RE Taxes					

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Two (2) operating expense escalation groups

1. Operating Expenses (including utilities) and 2. Real Estate Taxes

Total Operating Expenses	Base Year 2015		2016 Operating Expenses		Increase (Decrease)
		\$6,400,000	\$13.32	\$6,350,000	\$13.22
Base Year - Two (2) Operating Expense Escalation Groups				RSF	480,500
Operating Expense Groups	Base Year 2015		2016 Operating Expenses		Increase (Decrease)
1. Operating Expenses	\$4,100,000	\$8.53	\$4,200,000	\$8.74	\$100,000
2. RE Tax Expenses	\$2,300,000	\$4.79	\$2,150,000	\$4.47	-\$150,000
Maximum Potential Recovery					\$100,000
The Operating Expense Group includes Utilities					

Three (3) operating expense escalation groups

1. Operating Expenses, 2. Real Estate Taxes, and 3. Utilities

Total Operating Expenses	Base Year 2015		2016 Operating Expenses		Increase (Decrease)
		\$6,400,000	\$13.32	\$6,350,000	\$13.22
Base Year - Three (3) Operating Expense Escalation Groups				RSF	480,500
Operating Expense Groups	Base Year 2015		2016 Operating Expenses		Increase (Decrease)
1. Operating Expenses	\$2,800,000	\$5.83	\$3,000,000	\$6.24	\$200,000
2. Utilities Expenses	\$1,300,000	\$2.71	\$1,200,000	\$2.50	-\$100,000
3. RE Tax Expenses	\$2,300,000	\$4.79	\$2,150,000	\$4.47	-\$150,000
Maximum Potential Recovery					\$200,000