

Gross Up Provisions

What is a Gross-Up Provision?

A lease clause that allows the Landlord to increase recoverable expenses, which vary with occupancy to an amount that would be incurred if a defined level of occupancy were achieved. Gross-up clauses typically allow the Landlord to gross-up variable operating expenses to 95% or 100% occupancy.

Why Have a Gross-Up Provision?

Fairness. The intent is to allocate to the Tenant only an estimated amount of the operating expenses that are properly attributable to the Tenant's occupancy.

When Should You Negotiate for a Gross-Up Provision?

	Landlord	Tenant
Low Occupancy		✓
High Occupancy	✓	

What You Must Include to Make Sure the Provision is Fair:

- ❖ A clause to make sure the Landlord cannot recover more than 100% of actual expenses
- ❖ A clause that stipulates that the Gross-Up applies only to variable expenses; and
- ❖ The Tenant must have the right to audit the Landlord's accounting records.

Lack of Gross-Up Clause: Landlord Loses

A ten-story building contains one Tenant who occupies nine floors or 90% of the building on a triple net basis. The balance of the building is vacant. The building has incurred \$90,000 of cleaning expenses. For illustration purposes, cleaning is the only expense presented and is assumed to be 100% variable.

	100% Gross-Up	No Gross-Up
Actual Cleaning Expenses	\$90,000	\$90,000
Occupancy	90%	90%
Grossed-Up Cleaning Expenses	\$100,000	-----
Tenant's Pro-Rata Share	90%	90%
Tenant's Share of Cleaning Expenses	\$90,000	\$81,000
Landlord's Share of Cleaning Expenses	\$0	\$9,000



Occupancy Declines: Landlord is Protected

Now our ten-story building contains multiple tenants and is 90% occupied. In Year Two occupancy decreases to one tenant who occupies 70% of the building. The decline in occupancy results in a decrease in recoverable variable operating expenses. As illustrated below, without a gross-up clause, the Landlord is burdened with an unfair amount of recoverable variable operating expenses ("VOE").

	100% Gross-Up	100% Gross-Up	No Gross-Up	No Gross-Up
	Base Year	Year Two	Base Year	Year Two
Actual VOE	\$90,000	\$75,000	\$90,000	\$75,000
Occupancy	90%	70%	90%	70%
Grossed-Up VOE	\$100,000	\$107,143	-----	-----
Tenant's Pro-Rata Share	70%	70%	70%	70%
Tenant's VOE Payment	\$0	\$5,000	\$0	\$0
Landlord's Share of VOE	\$90,000	\$85,000	\$90,000	\$75,000

Tenant Saves Money with Gross-Up

A recently constructed building containing multiple tenants is only 25% occupied. The building successfully leases up to 90% occupancy resulting in a large increase in variable recoverable operating expenses. Without a gross-up provision, the Tenant would be responsible to pay an unfair amount of operating expenses. As reflected below, with a gross-up clause, Tenant is responsible to pay their fair share of recoverable variable operating expenses resulting in a savings of \$13,438 (\$17,188 - \$3,750).

	100% Gross-Up	100% Gross-Up	No Gross-Up	No Gross-Up
	Base Year	Year Two	Base Year	Year Two
Actual VOE	\$21,250	\$90,000	\$21,250	\$90,000
Occupancy	25%	90%	25%	90%
Grossed-Up VOE	\$85,000	\$100,000	-----	-----
Tenant's Pro-Rata Share	25%	25%	25%	25%
Tenant's VOE Payment	\$0	\$3,750	\$0	\$17,188