

## Case: Property Management Company uses snowfall hedges to transition from variable to fixed CAM costs

A property management company with a portfolio of 8 large, multi-tenant corporate properties all located within the snow belt grappled with tenant complaints about high Common Area Maintenance (CAM) costs in years where seasonal snowfall was above average. The company's corporate tenants seemed to have very short term memories. Of course, there were no complaints when below average snowfall resulted in lower CAM costs. But these same tenants would be upset in subsequent years when CAM costs rose to reflect higher snow removal costs. The increase prompted many tenants to insist on auditing CAM costs, which was both burdensome and costly for the property management company.

In an effort to avert the unpredictable variability of snow removal expense on CAM costs, the Chief Operations Officer decided to engage snow removal contractors that were willing to offer seasonal snow removal on a fixed price basis. The experience was particularly disappointing during a season where snowfall exceeded the average. First of all, few of the company's traditional snow removal providers were willing to work on a fixed-price basis, so they had to engage new snow removal providers with whom they had little or no experience. Even at the best of times, many of these new snow removal providers failed to meet expected service levels. However, things got worse once snowfall quantities surpassed the seasonal average. Some providers let the level of their services fall even further to minimize their losses resulting from above average snowfall. A number of providers simply disappeared, leaving the company to find another provider to remove snow for the remainder of the season. Fixed-price seasonal snow removal contracts were clearly not the answer, and the company reverted back to working with its traditional snow removal providers on a pay per push basis.

The property management company finally solved the problems associated with the unpredictable variability of snow removal expense when it discovered the snowfall hedge. By employing the hedge, the company was able to cap snow removal expenses in seasons with above average snowfall. The snowfall hedge enabled the company to convert CAM costs from a variable cost to a fixed cost. In the process, the company no longer had to support tenant audits of CAM expenses. As significant, were the savings the property management company realized in the very first year it employed the snowfall hedge. Snow removal expense in a season with average snowfall (38") would amount to slightly more than \$500,000. The actual snowfall in the 2010-11 season was 57.3", resulting in actual snow removal expense of 689,129. A snowfall hedge that cost \$65,973 paid out \$250,592, resulting in net snow removal expense for the season that was at the level for an average season despite well above average snowfall.

### Exhibit A: Snow Removal Figures for the 2010-11 Season

Snow removal expense in an average year	\$	501,184
Annual average snowfall		38"
Actual seasonal snowfall		57.3"
Seasonal snowfall in excess of that annual average		19.3"
Actual seasonal snow removal expense	\$	689,129
Cost of snowfall hedge	\$	65,973
Snowfall hedge payout	\$	250,592
Seasonal snow removal cost after hedge payout	\$	504,509