

IN THE SPOTLIGHT: NAVIGATING THE CAM MINEFIELD

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As seen in Forbes*

Once the simplest of lease provisions, common area maintenance (CAM) expense provisions have grown quite complex.

In the past, a CAM provision might simply provide: The tenant shall pay its pro rata share of the expenses of maintaining the common areas of the property. Maybe there was another sentence or two even a paragraph describing the types of expenses and the method of estimating, paying, and reconciling that share of expenses.

Then some wunderkind invented the personal computer and the 60-page lease. Now landlords have multi-page, throw in the kitchen sink CAM provisions and tenants attempt to gut every word of them.

Certainly, some of the innovations have been appropriate. Take, for example, the well-crafted gross-up provision. Here, the landlord recognizes that if the tenant pays its pro rata share of CAM expenses for the entire property, vacancies at that property could distort that calculation.

For example, if the tenant occupies 10% of a property, and the property is 50% vacant, then the tenant should pay 20% not 10% of the variable expenses (which are incurred only for the occupied premises).

If there is a trash removal charge which, by its very nature, only applies to occupied premises that generate trash, the tenant occupying 10% of the property should nevertheless pay 20% of the trash removal charges because this tenant occupies 20% of the space that benefits from this variable trash removal expense.

A simplified version of such a gross-up provision might read as follows: All common area maintenance expenses of the property shall be computed for all purposes hereof as if the property is 100 percent occupied. Accordingly, for the purpose of calculating the tenants pro rata share of the common

area maintenance expenses, all common area maintenance expenses which vary with the percentage occupancy of the property shall be multiplied by a fraction, the denominator of which shall be the average percentage occupancy of the gross rentable area of the property for the time period in question and the numerator of which is 100 percent.

Under such a provision, a \$500 expense for a service provided to the 50% of the property that was occupied (for the time period in question) would be multiplied by $100\%/50\%$, or 2, thereby grossing up the expense to \$1000. In this process, the 10% tenant (that actually occupied 20% of the area receiving this \$500 service) would appropriately pay \$100, which is 10% of the grossed-up variable expense a fair, if somewhat complicated, result.



However, some landlords go overboard. In a close (but twisted) cousin of the gross-up provision, some landlords try to charge their tenants for all of the costs of their vacant space. Here, the landlord defines the tenants pro rata share as the ratio of the tenants square footage to the total of leased versus leasable square feet of the property. Under this formulation, the tenant bears the expense of insurance, taxes, and other costs associated with the vacant premises at the property. Consequently, the tenant bears a fundamental cost associated with the ownership of the property. The savvy tenant bargains for paying a pro rata share of the expenses of the entire property, subject to grossing up for variable expenses as described above.

Other landlord abuses of the CAM provision include charging for both reserves and depreciation of the same expenditures; charging for management fees in addition to the cost of management personnel; charging for the landlords legal fees (although it is appropriate to pass-through legal fees for attempts to reduce real estate taxes); and charging for costs of compliance with existing laws.

In addition, landlords may attempt to increase the pro rata share of smaller tenants because anchor tenants have bargained to be excluded from the payment of CAM expenses. Similarly, some landlords rent a considerable amount of space to kiosks, yet do not reduce the pro rata share of expenses paid by the tenants to reflect the space leased to the kiosks, even though the kiosks may benefit more from the common areas than the ordinary tenants. The present reality is that only landlords' imaginations limit what expenses they will try to foist upon their tenants. Tenants combat the landlords' proposed CAM provision with a variety of countermeasures. Usually, and quite reasonably, the tenant will submit its own list of items to be excluded from the CAM calculation. Such lists often include exclusions of capital expenditures; cost of compliance with legal requirements; hazardous materials remediation expenses; political and charitable contributions; the property owners' costs of operation, such as preparation of tax returns and financial statements, etc.

Tenants also seek to limit (versus exclude) other expenses, such as management fees and similarly require competitive pricing when the owner procures services from related entities. It has also become quite common, although not often justified, for tenants to attempt to limit the annual increases in CAM expenses. While the uncontrollable expenses are excluded from this annual cap, the cap can effectively force a reduction in rent if the cap prevents the pass-through of appropriate expenses.

Many tenants also have their own outrageous demands

for limiting CAM expenses. Some tenants argue for a most favored nations (MFN) clause that would exclude any CAM expense that any other tenant of the property is not required to pay. This MFN clause disregards the fact that each lease is the product of a unique negotiation and one tenant may insist on and the landlord (to make the deal) may agree to the exclusion of a particular expense, despite the fact that the expense is appropriate. Other tenants will attempt to limit expenses, such as real estate taxes, that are clearly beyond the control of the landlord.

Some of the clashes between the landlords' form lease and the tenants' proposed limitations cause considerable sparks. The tenants' attempt to limit capital expenditures is often contentious because the parties may differ markedly in their view of the purpose of the CAM provision: Tenants may take the position that capital expenditures are a cost of ownership, and landlords may believe that all expenses associated with the property should be borne by the tenants. Here, compromise can bridge the gap. For example, the tenant may agree to the inclusion of capital expenditures if the amount that can be included in the CAM charge is limited each year to an amount per square foot of the premises (eg, \$0.50/sf).

CONCLUSION

Ultimately, the final CAM provision in any lease is the product of knowledge and bargaining power. You will obtain the best deals if you place yourself in a position where time is on your side; you have multiple choices, and you have the expertise on your team to understand the consequences of those all-too-complicated lease provisions.

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Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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