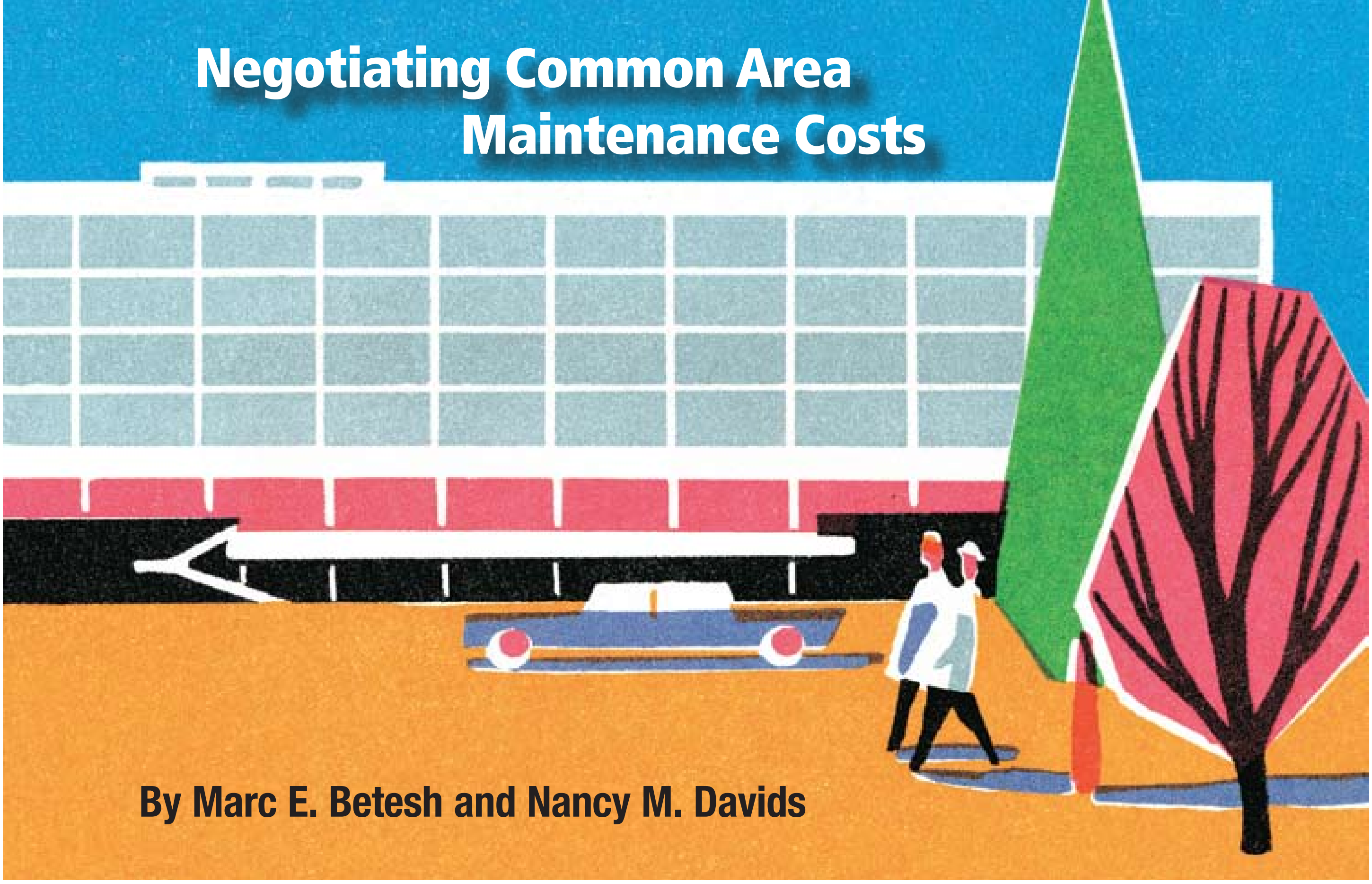

# Negotiating Common Area Maintenance Costs

By Marc E. Betesh and Nancy M. Davids

The common area maintenance (CAM) clause is one of the most heavily negotiated sections in a retail lease. The original quaint, simple concept was that the CAM provision would deal with the cost of maintaining sidewalks, parking lots, and other common areas. That concept has given way to clauses that cover all of a landlord's retail development operating costs. This expansion has rendered the term "common area maintenance costs" somewhat of a misnomer. In fact, many landlord leases have changed the CAM caption to "operating costs." Because CAM costs can be nearly as high as the minimum rent, much attention has been paid to how CAM clauses can be used to fairly manage the landlord's and tenant's risks and obligations for these costs.

The CAM clause found in most modern retail leases obligates the tenant to pay a specified share of certain defined costs of operating the center, although such definitions vary widely from lease to lease. Tenants often negotiate limits or caps on these obligations and often insist on the right to audit the landlord's records to verify that their particular charges are valid. Because of the unpredictability of CAM obligations and the burdens CAM audits have placed on both landlords and tenants, some landlords and tenants use a fixed, negotiated CAM charge in lieu of passing through a share of actual costs.

This article will explore how CAM pass-throughs generally operate, the evolution of CAM clauses over the years, and the variations in these clauses.

Marc E. Betesh is founder and president of KBA Lease Services in Woodbridge, New Jersey. Nancy M. Davids is a director in the Boston, Massachusetts, office of Goulston & Storrs, P.C.

## Includible Operating Costs

Costs includible in CAM generally depend on two main variables: the parts of the center for which the tenant must pay a share of expenditures, and the nature of the expenditures included in the tenant's obligations.

### Areas Covered

From the landlord's perspective, CAM costs should include the common areas, all facilities of the shopping center, and all improvements serving the shopping center. These include the roof, structural elements, adjacent parcels, and outdoor areas used only by specific tenants or the landlord. Tenants would like to define these areas as narrowly as possible and limit CAM charges to those incurred in relation to the parking and enclosed areas meant for their customers' use. In many leases, the extent of the area covered by the common area charge is unclear and has been the cause of disputes.

### Types of Expenditures

From the landlord's perspective, the CAM clause should cover all of the landlord's costs of ownership, management, maintenance, repair, replacement, inspection, improvement, operation, and insurance of the center together with any costs allocated to administration and overhead. For the landlord, every cost must be covered to preserve its economic model for ownership. The landlord needs a highly expansive CAM definition to avoid the risk that necessary costs of operation have no corresponding revenue to cover them.

Given the "net" nature of their leases, shopping center tenants generally understand that they need to compensate the landlord

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for operating and maintaining the center. They view the landlord's ownership costs, however, as part of the landlord's cost of doing business and not a recoverable operation cost of the center. Such items, they argue, should be paid by the landlord from resources other than CAM.

This "maintenance versus ownership" struggle shapes many of the issues relating to inclusion in and exclusion from CAM costs, as shown in the following examples.

**Capital Expenditures**. Capital expenditures are generally objectionable to tenants because they see them as ownership's investment in its property, which should not be recoverable. Capital expenditures generally fall into three categories: capital improvements (additions or "betterments"), capital replacements (replacement of existing capital assets), and capital repairs (significant repairs that rise to the equivalent of capital replacements).

Capital improvements include items such as new structures, equipment, or other improvements. Of the three types of capital expenditures, capital improvements are most ownership-like and therefore most likely to be objectionable to tenants. Tenants assert that they should not be at risk of landlords freely making such investments at the tenant's expense. Indeed, without strict controls on capital improvement expenditures (requiring prior tenant approval, for example), the tenant is exposed to significant risk controlled only by the landlord's discretion.

Landlords would argue that not all capital improvements are discretionary and that they should not have to bear the risk of unexpected but necessary capital improvements. For example, they assert that unexpected capital improvement costs incurred as a result of the passage of new laws and ordinances or by new insurance requirements are not factored into the existing rent structure and should be passed on to tenants.

Landlords would also argue that tenants have no logical basis for objecting to capital expenditures that have no net effect on CAM costs, such as those that otherwise reduce CAM costs. Examples are HVAC or other utility equipment upgrades, replacements, or new equipment that will ultimately reduce utility costs. Tenants generally will concede this point and allow the amortization of these types of capital improvements, at least to the extent of the savings these improvements generate.

Any capital expenditure included in CAM should be spread out over the useful life of the capital improvement. Sound accounting principles require that to accurately measure and report the financial performance of a real estate asset its cost must be amortized, or allocated, over the time periods during which the asset provides a benefit. Amortization also avoids the inequitable result of having a tenant pay for the entire cost of such an expenditure in one year, even though the tenant may not be in occupancy to enjoy the benefits in future years.

A replacement, unlike an improvement, is a substitution of a similar asset for an existing asset. Repairs that are significant enough to constitute replacements are generally treated as capital items for accounting purposes, so landlords are well-advised to provide examples or other standards in leases to clarify the distinction between replacements and improvements.

Whether replacements and major repairs of capital assets should be included in CAM is also the subject of heated negotiations because landlords view the cost of replacing the old and obsolete components of their center as normal maintenance. Often no clear line separates "maintenance" and "replacement," and most leases do an inadequate job of distinguishing between these two terms. Landlords argue that when an asset is old and needs replacement, it makes no financial sense to continue spending money on maintenance when a replacement would be less costly. Therefore, the argument goes, replacements should be included in CAM because they are less costly than maintenance, which otherwise is includible.

Tenants argue that the key economic model for owning commercial real estate assumes that the negotiated (base) rent covers the annual "use" of the center and its equipment, as reflected by the owner's debt service and the center's depreciation. The center consists of the entire structure, including all of its physical improvements, systems, equipment, and other attributes; and the owner's investment in such assets is allocated to each year through depreciation. Over the years, most of these components will wear out and need to be replaced. From a tenant's perspective, because rent essentially compensates the landlord for the use of these assets, when a landlord spends money to replace these components it is simply replacing part of what the rent is already covering. Therefore, including these replacement costs in the center's operating expenses is arguably equivalent to charging the tenant twice for the same item.

**Management and Administrative Fees**. CAM costs also often include management and administrative fees. The lease will provide that as an administrative fee the tenant must pay between 5% and 18% of the total costs of operating and maintaining the center. Although this fee is a fairly standard CAM inclusion, some leases allow landlords to charge a management fee in addition to the administrative fee. For example, if the landlord has hired a third-party management company to manage the center, that company's management fee might be charged to the tenant in addition to the administrative fee. Many tenants feel that a management fee in addition to the administrative fee is "double dipping." In the tenant's view, the administrative fee and the management fee essentially pay for the same thing.

In negotiating this issue from either side, practitioners must be careful. A broadly drafted CAM clause may allow the landlord to charge a management fee in addition to an administrative fee. Including a provision on behalf of the tenant that there shall be no duplication of charges under the lease may be helpful for a tenant, as courts have found such language sufficient to strike down a charge by the landlord of both an administrative fee and a management fee. See *Fifth Ave. of Long Island Realty Assoc. v. LCI Holdings, Inc.*, No. 9458-05, 2007 WL 4846229, 2007 N.Y. Slip Op. 33602(U) at *3 (N.Y. Sup. Ct. Oct. 31, 2007). In addition, the tenant should pay attention to which cost items should be included in the administrative fee. Tenants with leverage may insist that administrative fees not be assessed on big ticket items over which the landlord has little administrative responsibility, such as utility charges and insurance premiums. Certainly, if a tenant is paying both an administrative fee and a management fee, it will not want to pay the administrative fee percentage on the management fee amount.

**Other Inclusions and Exclusions.** Numerous other inclusions and exclusions to CAM generally are described in the definition of "common area costs" or "operating expenses." It is in the landlord's interest to define the included costs broadly to protect its ability to recover any unknown future charges from the tenant.

In contrast, the lease of a highly desirable tenant will define CAM inclusions quite narrowly and contain broad exclusions. The extent of the CAM components will be based on the size, credit, and desirability of the tenant and the center. For example, major tenants and other highly desirable strong tenants may be able to exclude costs associated with the building structure, roof, and exterior, as well as capital expenditures, from the CAM charges. For a list of CAM exclusions, see *63 Items to Exclude from Owner's "CAM's Costs" Definition*, Comm. Tenant's Lease Law Insider (Feb. 2006). Landlord repair obligations for the roof and structure (whether or not capital in nature) are usually excluded from CAM. Given the disparity between a favorable landlord provision and a favorable major tenant provision, landlords and major tenants must spend substantial time and energy negotiating satisfactory exclusions from CAM.

**Definition of Pro Rata Share**

Traditionally, CAM provisions in leases are structured on a pro rata basis. Each tenant pays its pro rata share of the CAM charges. The definition of pro rata share can vary from lease to lease, but generally it is a fraction that resembles the following:

$$\frac{\text{leasable floor area of the premises}}{\text{some or all of the leased or leasable floor area of the shopping center}}$$

The numerator is always the leasable floor area of the premises, though for anchors and big boxes space not on the "main" selling floor (for example, selling space on lower or upper levels that sees less traffic) may be discounted and only counted at half its actual size. In addition, space that is devoted to mechanical or nonselling space or is "unusable," such as surplus basement space, may be completely ignored for purposes of calculating pro rata share.

The denominator can vary depending on how much of the floor area of the shopping center is included, and such floor area can either be the actual *leased* floor area or the *leasable* floor area. In strip centers, the denominator is likely to be a fairly straightforward 100% of the leasable floor area in the shopping center (simply, the tenant's share of the total center). In an enclosed regional mall, the denominator is likely to be something less than the total leasable floor area, driving up the tenant's share. The denominator may be modified to reflect one or more of the following:

- Exclusion of major tenants of a predetermined size (for example, all retail premises of at least 50,000 contiguous square feet in the shopping center), in which case the CAM costs should be reduced by any contribution by such occupants. The definitions of terms such as "department store," "major store," "anchor store," "specialty store," and "outparcel" also present key areas for dispute between landlord and tenant, both at the time of the lease negotiation as well as during an audit. The test for excluded space can be solely size (that is, square footage) or size plus use and location. If the term "department store" is defined solely as an entity occupying a certain amount of square footage, disputes may center on whether a theater is a "department store." Also, by excluding tenants of a certain size from the denominator, the other tenants end up supplying some sort of subsidy. Although most landlords agree to credit cost contributions of major tenants before determining a tenant's pro rata share, if that major tenant is not paying its full share, the rest of the tenants end up making up the deficiency. Major tenants often do not pay their full pro rata share, primarily because of the strength of their leverage in lease negotiations.
- Use of the concept of leased, instead of leaseable, floor area of the shopping center with a predetermined minimum floor for leased areas. For example, not less than 80% of the gross leasable floor area of the shopping center will be deemed leased if the actual total leased floor area is less than 80%. Traditionally, in the enclosed mall setting, a denominator of leased floor area with a minimum of 80% or more of the leasable floor area has been quite common.

For community shopping centers, strip centers, and similar projects, typically the denominator is leasable floor area with exclusions for nonselling areas, floor areas occupied by a major store (again, of some predetermined size), any tenants located on a so-called "pad" or "outparcel" in the parking lot, and other tenants that perform their own maintenance. This CAM denominator may be adjusted to deduct the floor area of a particular tenant for purposes of one portion of the CAM charge, such as insurance, if that cost is unique to the particular tenant and that party pays its own cost on that particular item. This approach, however, can become problematic if the landlord seeks to exclude the floor area of an outparcel tenant (such as, for example, a restaurant located in the parking lot) from the denominator because that outparcel tenant maintains its own parcel. For example, the premises leased to that outparcel tenant may not include sufficient parking from a zoning perspective. Although this outparcel tenant may be maintaining its parcel, because the parcel does not meet the applicable parking standards, the other tenants again end up subsidizing the costs. Obviously, it is important when representing a tenant to ensure that the exclusions from the denominator are appropriate.

## CAM Caps

Because of retailers' desire to have some predictability in their occupancy costs, the use of CAM caps has become much more common throughout the shopping center industry. The tenant is concerned that it will wind up paying higher charges than its projected sales will justify if the landlord's CAM charge is more than the tenant was expecting following the deal negotiations. A CAM cap limits the amount by which the tenant's share of CAM costs can increase above the initial CAM charge. Generally, a CAM cap can take some pressure off the negotiation of CAM inclusions and exclusions. There are several types of CAM caps.

**First-Year CAM Cap**

Capping the CAM charge for the first year of the lease can assure a tenant that the starting CAM will not exceed the amount discussed during the initial lease negotiations.

**Ongoing CAM Cap**

Although an ongoing cap may not provide any protection for the first lease year, it protects the tenant from unexpected increases through the rest of the lease term. Typically an ongoing cap will provide that CAM will not increase by more than the lesser of (1) the actual increase in tenant's pro rata share of the CAM costs or (2) a set percentage over the immediately preceding year. The amount of the CAM cap increase may be tied to a consumer price index or some other index. If an ongoing cap is used without a first-year CAM cap, then the cap is of limited use to the tenant if the first-year actual costs are unexpectedly high. This situation can cause the tenant to feel misled by the landlord. Therefore, some tenants seek both a first-year cap and an ongoing cap. This permits the tenant to have more control over its costs. Some landlords prefer fixed initial CAM increased annually by a fixed percentage, such as 4% to 5%, without any tie to the landlord's actual costs. With a new center or a newly redeveloped center, it is often very difficult for a landlord to provide a first-year CAM cap because it may not have much information or data about the appropriate number.

**Cumulative vs. Noncumulative Caps**

Caps can be either cumulative or noncumulative and can be calculated as year-over-base or year-over-year, resulting in the four different cap variations discussed below.

**Year-over-Base Cumulative**. Year-over-base cumulative caps are negotiated by those parties that want a known maximum expense exposure for each year of the lease term. Year-over-base cumulative caps limit expense increases to a fixed amount each year, determined as a percentage of the expenses at the beginning of the lease term. These caps are simple in that they are constant every year. They often read: "The annual increase in expenses is limited to 5% over the base year expenses on a cumulative basis."

As an example, if the starting base amount is $100,000 and the cap is 5% per annum, the cap for year one is 5% of base year expenses ($105,000) and later rises to 10% of base year expense ($110,000), to 15% of base year expenses ($115,000), to 20% of such expenses ($120,000), and so on.

This cap is not affected by the actual expenses (unlike year-over-year caps, discussed below). For example, if the expenses in year two, when the cap is $105,000, drop to $90,000, year three's cap is unaffected and will still be $110,000. The landlord is not pressured to keep expenses down and has the latitude to permit them to increase by $20,000 without fear of hitting the cap.

**Year-over-Base Compounded**. Unlike caps based on cumulative increases, which are always calculated as a percentage of the base year, caps based on compounded increases are calculated as a percentage of the *prior year's cap.* This difference causes the cap to rise slightly faster (allowing more expenses). The following language provides for a compounded increase: "The annual increase in expenses is limited to 5% of the prior year's capped amount on a compounded basis."

Continuing with the prior example, if the cap is 5%, the first year's maximum is $105,000 (5% over the $100,000). Because this amount is now compounded, the next year's cap is 5% over the first year's 5%, resulting in a maximum expense amount of $110,250, which is 10.25% more than the initial $100,000 amount. Each subsequent year's cap is calculated as a percentage of its respective *prior year's cap,* making the caps in this example 15.7625% greater than the initial $100,000 amount, 21.551% greater than the initial amount, and so on. This results in slightly higher annual CAM expense limits than the cumulative caps, at $110,*250* (as opposed to $110,000), $115,*763* (as opposed to $115,000), $12*1,551* (as opposed to $120,000), and so on.

Because a compounded cap rises at a slightly higher rate than a cumulative or simple cap, more expenses can be passed through to tenants. Of the four caps discussed, compounded year-over-base caps are the least restrictive and most favorable to landlords. The annual maximums are known to the parties; the compounding just allows for slightly higher increases.

**Year-over-Year Cumulative**. Year-over-year caps are different from year-over-base caps in that they are calculated by applying the cap percentage to the *prior year's expenses,* not to the original starting expenses and not to the prior year's cap. They are generally very simple in concept. Typical language would be: "The annual increase in expenses is limited to 5% of the prior year's expenses." If the expenses do not reach the cap, the next year's cap is the allowable percentage increase over the prior year's actual expenses. On the other hand, if the expenses exceed the cap and are limited to the capped amount, the subsequent increase is calculated over the lower capped amount.

Returning to our example, if expenses during the initial year of the term are $100,000, the cap for year two becomes $105,000. If actual expenses for that year are only $102,000, the cap does not apply. Unlike the year-over-base compounded cap, the third year's cap becomes 5% over $102,*000* ($107,*100*) as opposed to 5% over the second year's cap of $105,*000* ($1*10,250*). This type of calculation repeats each time the actual expenses fall below the cap. In each year in which the expense amount is less than the cap, the trajectory of the cap is affected for all future periods, because the cap is thereafter calculated based on the prior year's lower actual costs.

Because they reduce allowable expenses to a lower trajectory for the balance of the lease term whenever actual expenses dip below the cap, year-over-year caps are the most restrictive

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to landlords and the most favorable to tenants. Although for budgeting purposes the annual maximum is unknown, tenants may want to accept the uncertainty because over the lease term their total expense liability could be lower.

**Year-over-Year Compounded.** Year-over-year compounded caps are unusual and are restrictive to landlords in a manner similar to year-over-year cumulative caps. They do, however, permit slightly larger pass-throughs. These caps allow the increase to compound each year, but such increase is applied to the prior year's expenses. Lease language would read: "The annual increase in expenses is limited to 5% of the prior year's expenses, calculated on a compounded basis."

In the example, the 5% cap is compounded each year so that the 5% *cap itself* grows with inflation. Thus, the 5% that would apply in the first year grows to 5.25% the second year, 5.512% the third year, 5.788% the fourth, and so on. As with cumulative year-over-year caps, if expenses do not reach the cap, the next year's cap is calculated based on the actual expenses. This percentage, however, is always applied to the lower of the prior year's expenses or the capped amount.

The philosophy behind these caps is unclear, other than to maximize the landlord's return. If the cap is intended to limit increases to a certain agreed percentage, it seems that the percentage itself should remain static.

**Uncontrollables**

CAM caps can exclude certain types of costs from the cap. These exclusions are typically referred to as "uncontrollables," because these types of costs are outside of the landlord's control. For this reason, landlords argue that such costs should not be reduced by the cap. As a result, the tenant pays its straight pro rata share of uncontrollable costs, which usually include utilities, insurance, snow and ice removal, and security. The tenant should understand that if there is a first-year cap on all charges, then the uncontrollable costs are backed out of the first-year number used to calculate the allowable increase for the second and succeeding years. If the uncontrollable costs are included in this base amount, then the first-year number will be artificially inflated and all future increases will be based on that inflated starting figure.

## Fixed CAM Clause

**Emergence of Fixed CAM**

Since the early 1990s, the industry has moved toward the so-called "fixed CAM." By adopting fixed CAM, tenants achieve predictability in their costs, making it easier for them to budget and administer their leases. Landlords also benefit because the fixed CAM reduces the time and expense of negotiating the CAM charge and related provisions, computing the CAM charge for each tenant (that is, for various tenants with different CAM limitations and exclusions in their leases), and dealing with tenant audits.

> **Although CAM caps and fixed CAM help a tenant achieve some predictability in its occupancy costs, they also pose a risk to the landlord and the tenant that the landlord will not receive full reimbursement of its costs.**

The fixed CAM clause is a relative newcomer to the retail scene; it has been in use only over the last 15 years. After Pyramid introduced the concept of the flat CAM to its portfolio in the early 1990s, other major developers, including General Growth and Simon, announced their adoption of fixed CAM provisions in some of their portfolios. The fixed CAM charge is now also making a move into lifestyle and power centers. See 5 Retail Law Strategist (June 2005). The fixed CAM charge can be determined by several methods, all of which use a fixed initial amount with a predetermined rate of increase. The fixed CAM charge can be limited to traditional CAM or it can be expanded to include all occupancy costs including marketing, promotional funds, real estate taxes, insurance, sprinkler, and all similar charges under an aggregate so-called occupancy charge.

**Initial CAM Charge**

The most heavily negotiated issue in a fixed CAM clause is the amount of the initial CAM charge. Unlike a CAM cap, the initial fixed amount represents the actual amount the tenant will pay for the first year and provides the base amount for all future increases. Although a tenant typically wants the initial amount to reflect the amount it would have otherwise paid under a pro rata CAM clause, the landlord seeks to include a cushion to protect it from unanticipated, overlooked, or underestimated costs. If the fixed CAM amount exceeds the actual expenses, the tenant will likely have an inflated charge for year one of the term. Conversely, a low estimate can cause the landlord to subsidize the tenant's share of CAM over the life of the lease.

Large developers and owners may have a track record that allows them to set initial CAM figures with some degree of accuracy and give them some ability to absorb loss if a small number of tenants pay fixed CAM payments that turn out to be below the actual cost. Large tenants also may have a track record of charges they have paid in similar centers both locally and across the country. Not all landlords, however, have the experience to predict CAM costs accurately or the luxury of being able to pick up the difference if the fixed CAM number turns out to have been incorrectly low. Some approaches for negotiating the initial amount of fixed CAM include looking at past CAM history for existing shopping centers and at historical increases in inflation, CAM increases for similar shopping centers in the same geographic region, and full disclosure from the landlord of estimated and projected costs for the shopping center. Although tenants might feel that they will benefit if the landlord misjudges the actual CAM cost by providing a low initial fixed number, this is not always the case. If a landlord cannot recoup its costs, it will be motivated to find ways to cut expenses. The landlord and tenant are then likely to find themselves in a disagreement over whether or not the landlord has satisfied the required standard of maintenance for the shopping center. One solution to this problem is to reset periodically the fixed CAM amount based on actual costs. Resetting the number requires that the parties still negotiate the CAM inclusions and exclusions in the lease;

however, the numbers will likely only be reviewed periodically. For example, a 10-year lease with fixed CAM could be reset every five years. Thus, the parties are exposed for a shorter period against inaccurately estimated increases.

### Effect on Relationship

Because the amount of the CAM payment is fixed, tenants have much less incentive to negotiate the lease provisions to narrow or limit the items included in CAM. Similarly, because the number is fixed, landlords typically demand that tenants forego the right to audit CAM. The landlord's theory is that the fixed CAM clause represents an element of additional negotiated rent for occupancy that is not based on, and therefore does not vary because of, the actual costs incurred by the landlord. Both the landlord and the tenant enjoy advantages from a fixed CAM charge, including the avoidance of CAM audits, easier administration of CAM charges, and easier lease negotiations once the CAM starting number has been determined and increases have been fixed.

### Variations: Controllable Items Only

Fixed CAM provisions also have been devised so that only controllable CAM is, in fact, fixed. This concept is very similar to the uncontrollable expenses typically excluded from a CAM cap. Volatile expenses such as snow and ice removal, insurance, security, and utilities can be excluded from the fixed CAM calculation and billed on the basis of actual costs. Obviously, the benefit to the tenant of the fixed CAM is reduced if these uncontrollable costs are carved out of the fixed CAM calculation. These costs, however, are not controllable from the landlord's perspective and landlords feel that they should not be required to bear the risk of these items exclusively. If these uncontrollables are excluded from the cap, however, tenants typically will then insist on audit rights for these items. When uncontrollable expenses are carved out, both the landlord's and the tenant's administrative audit burdens are not completely avoided.

### Stepped Increases

Fixed CAM increases are also specifically negotiated as part of the business deal. Possibilities include fixed annual increases (3% annually, for example), or a tie to a consumer price index with some sort of a ceiling (the lesser of the consumer price index or 3% annually). A tie to the consumer price index with both a floor and ceiling is also a possibility (the increase in the consumer price index, but not less than 2% or more than 5%, for example). In a true fixed CAM scenario, however, increases will not be tied to any floating escalator. Some developers have discontinued the use of CPI or similar market indicators altogether.

### Additional Issues with Fixed CAM

An additional issue in a fixed CAM lease relates to the exercise of an extension option. A typical CAM cap might reset to actual CAM charges on the exercise of an option to extend the term, thereby providing the landlord the opportunity to "catch up" CAM costs if the cap resulted in a significant difference between actual CAM and the amount the tenant is paying. In a fixed CAM situation, CAM cannot reset to actual CAM without the parties first going through a fresh negotiation to define the meaning of "actual" CAM. Therefore, many landlords include a somewhat artificial catch-up provision in the option exercise language. A fixed CAM might reset at the greater of the fixed increase or compounded consumer price index increases over the term.

From the tenant's perspective, other issues with fixed CAM include the inability to verify or adjust the fixed CAM charge based on landlord's actual costs. The tenant is often unable to determine how much of a cushion the landlord has put in the fixed number. If uncontrollable costs are excluded from the cap, many of the disadvantages of a pro rata CAM provision still exist. Finally, if the landlord is not receiving full reimbursement of its operating costs, the landlord may well be forced to reduce the quality or scope of the CAM services. Some tenants require additional language in leases obligating landlords to provide certain services, such as security and advertising. This language will prevent the landlord from cutting back on services previously provided because of budget concerns related to CAM provisions. Landlords, however, do not desire to let their shopping centers deteriorate, nor would it be smart from a business perspective. In addition, if a shopping center is used as collateral for a mortgage loan, it is very likely the loan documents will require the landlord to be in compliance with various laws and loan document maintenance covenants, or risk being in default. Because of the nature of the competitive retail market, the center will need to be kept in excellent condition to continue to attract the most desirable tenants, and language can be added to the lease to that effect.

From the landlord's perspective, fixed CAM provides no protection for unanticipated spikes in CAM costs over the lease term. If the uncontrollable costs are the reason for the spike in costs, exclusion of these uncontrollables is helpful, although this exclusion brings the baggage of the audit and disclosure issues inherent in a pro rata CAM provision.

Although fixed CAM certainly has some advantages, it is not without problems. A fixed CAM number that has been set in a manner that is too favorable to the tenant can have a long-term negative effect for a smaller or mid-size shopping center owner. Fixed CAM with uncontrollables carved out can be more workable, but that solution begins to have many of the pitfalls of pro rata CAM or pro rata CAM with a cap. Tenants are generally not willing to trade a lesser quality of shopping center maintenance for the benefit of fiscal certainty.

## Conclusion

CAM remains a critical issue in any lease negotiation. Although pro rata CAM presents many concerns, including drafting and negotiation issues and auditing and lease administration costs, it is also the primary method to permit a landlord to receive full reimbursement for its expenditures in maintaining the common areas of a shopping center. Although CAM caps and fixed CAM help a tenant achieve some predictability in its occupancy costs, they also pose a risk to the landlord and the tenant that the landlord will not receive full reimbursement of its costs. If the landlord is not fully reimbursed, the chances are higher that services and maintenance will be reduced to save costs. Both landlords and tenants need to continue to be creative in approaching these issues to meet the shared goal of a well-managed, well-maintained center in accordance with the standards set forth in the lease. ■