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Common Area Maintenance in a Lease

In this article I discuss common area maintenance (CAM) expenses in a real property lease.

In a triple net lease, the tenant pays a share of the building or shopping center's expenses, including common area maintenance expenses. CAM usually is the longest and densest section of a lease, and landlords and tenants negotiate CAM harder than anything else. Bargaining strength wins, meaning the party with more leverage gets to pass off more CAM expenses on the other.

Definition of Common Areas. Common areas are hallways, sidewalks, parking lots and other areas not held out to be leased, but rather are available for common use by all tenants.

Tenant's Proportionate Share. A tenant pays its percentage share of total CAM for the building or shopping center. Tenant's share is based on the ratio of tenant's premises to the total area of the building or shopping center. Expressed as a fraction, this is:

$$\frac{\text{Tenant's total sq. feet}}{\text{Total sq. feet in the center } (\textit{sq. feet leasable } \underline{\textit{OR}} \textit{ actually leased})}$$

Tenant wants a smaller share, and landlord wants tenant to pay a bigger share. In terms of the equation above, tenant wants a small numerator and a big denominator, and landlord wants the opposite. For this reason, tenant wants the denominator to be all leasable sq. feet existing in the center, not sq. feet actually leased (since the center might have empty units). A middle ground for the denominator is "leased sq. feet, but not less than 90% of leasable."

In a high-end mall, the landlord might pull anchor tenants completely out of the equation (because anchor tenants have the bargaining strength to get special deals), or landlord might use cost pools for certain types of tenants (e.g. restaurants). But that goes beyond the scope of this little article.

Inclusions & Exclusions. Once the parties have settled on the tenant's share, it's time to argue about what's in CAM. CAM covers a laundry list of expenses. In the interests of brevity, I'll focus on administrative and management fees, and capital improvements.

- Most leases give the landlord an administrative fee of, say, 15% of total CAM costs, plus third-party management fees of, say, 3% of gross center revenues. Tenants who are still awake at this point in the lease object that the landlord is double-dipping and demand that landlord choose one or the other.

- Capital improvements are changes to the common areas that go beyond repair and maintenance. A capital improvement creates new value in the real property, which benefits everyone in the here-and-now, but which might continue to benefit the landlord long after the tenant has left the center. Capital improvements also can be sudden and expensive, and if passed through can cause unexpected cash flow problems. In the battle over capital expenditures, the middle ground is to amortize the tenant's share over the life of the improvement (usually 15 years). In this way the tenant pays its share of the capital expenditure each month, in installments, but doesn't pay for the improvement beyond the lease term.

Cap. A tenant can demand a cap on CAM if it doesn't want to pick through the lease's CAM sections. With a cap, the tenant only pays annual increases in CAM under, say, 5% of the prior year's CAM. This cuts off dramatic increases in CAM costs and makes negotiation of the details of CAM a bit easier. Landlords hate caps for obvious reasons, and also because random caps among tenants make the landlord's accounting more difficult. Landlords might exclude from the CAM cap those costs that it can't control, such as utilities.

Alterations to Common Areas. A landlord must preserve its right to make changes in the common areas, for example, to construct a new building in the parking lot. A tenant might object because the new construction will hurt its business, for example, by impeding access, visibility sight lines or parking space. This is a tricky negotiation that is sometimes solved by permitting landlord's development in certain pre-identified common areas (but not others), while prohibiting material impediments to tenant's access, exposure and parking.

I hope this article helps you. Call me if you want to talk more.

Humbug:

We all know that sometimes a gift isn't free. Givers have both good and mixed intentions, including to create a sense of obligation, to establish a moral advantage or to demand gratitude. In his *Book of the Eskimo*, Peter Freuchen tells how one day, after coming home hungry from an unsuccessful walrus-hunting expedition, he found one of the successful hunters dropping off meat for him. He thanked the hunter, who replied:

"Up in our country we are human! And since we are human we help each other. We don't like to hear anybody say thanks for that. What I get today you may get tomorrow. Up here we say that by gifts one makes slaves and by whips one makes dogs."

"Help this poor wretch, Lord."