

## Protect Yourself When Negotiating Fixed CAM Charge

Because CAM costs are one of the biggest sources of tension between tenants and owners, many shopping center owners are switching to fixed CAM charges. Under a fixed CAM charge system, you agree to pay a flat, predetermined amount each month toward the center's CAM costs. Since the CAM charges are fixed, there's no need for end-of-the-year reconciliations of your estimated CAM payments and the center's actual CAM costs to determine whether you underpaid or overpaid your share of CAM costs. There's also no need for the time-consuming and costly audits that can result from them.

But that doesn't mean that fixed CAM charges don't raise issues for tenants. With help from attorney Ryan A. Schreiber, corporate and real estate counsel for New York & Company, and Connecticut attorney Robert A. Machson, coordinator of the National Retail Tenants Association's legal program, we'll explain the benefits and drawbacks of fixed CAM charges and tell you about some issues to consider when negotiating a fixed CAM clause. We'll also give you a Model Clause that you can add to your lease's fixed CAM section to address one of those issues (see p. 3).

### Benefits and Drawbacks of Fixed CAM Charges

Paying fixed CAM charges has both benefits and drawbacks for tenants, says Schreiber. Here's how such charges may benefit you. They can:

- Simplify lease negotiations, because the parties don't need to agree on what items to include or exclude from CAM costs;
- Create certainty about the amount you must pay annually toward the center's CAM costs, allowing you to project your actual costs more accurately over the lease's term;
- Eliminate the danger of getting hit with a big bill if the center's costs increase;
- Eliminate CAM cost audits, which can be time-consuming, costly, and burdensome for everyone; and
- Remove a major source of tension between you and the owner.

But there are some drawbacks to paying fixed CAM charges, such as:

- Your fixed CAM charge may be higher than a traditional CAM payment because the owner will include a "hedge," or contingency, factor in your fixed CAM charge to protect itself against unexpected cost increases or expenses, says Schreiber;

- If the center's costs decline, those savings won't be passed on to you; and

- Because the owner will have an incentive to keep its costs down, the quality of the center's services and maintenance could diminish.

### Fixed CAM Charge Issues

If you decide that the benefits of paying fixed CAM charges outweigh the drawbacks, you'll still need to protect yourself when negotiating the fixed CAM charge clause in your lease. Some of the issues you'll need to address include the following:

**Costs covered by fixed CAM charge.** Don't let the owner carve out certain costs, such as snow removal, from the costs covered by your fixed CAM charge, says Machson. If you let the owner exclude charges that it argues are too uncertain, your fixed CAM charge clause will start to look more and more like a traditional CAM clause, he explains. And you and the owner will waste time negotiating which costs should be included and which should be excluded, defeating the point of a fixed CAM clause, notes Schreiber. Plus, with fixed CAM charges, you're taking the risk that the center's CAM costs will decrease, so it's only fair that the owner bear the risk that its costs will increase, adds Machson.

**PRACTICAL POINTER:** If an owner insists, you may have to agree to certain limited exclusions, such as insurance and taxes.

**Amount of fixed CAM charge.** You and the owner will have to decide what your fixed CAM charge will be, says Schreiber. You'll want the charge to be based on the center's actual CAM costs, he says. The owner will also want to consider what the center's CAM costs are likely to be in the future, notes Schreiber. And of course the owner will want to add a contingency factor to protect it in case it underestimated the center's CAM costs, or unforeseen circumstances increase the center's costs, he warns. Since the owner will be bearing the risk of any increases in the center's CAM costs, including a contingency factor is fair. But the factor must be reasonable, says Schreiber.

Setting the fixed CAM charge is a risky process for a tenant because you have only a limited number of ways to check whether the charge is grounded in reality. To confirm that the owner didn't just pick a number out of a hat, request the center's actual CAM costs for at least the last two to three years, suggests Schreiber. You can then compare those figures with the fixed CAM charge the owner proposes, he says. Of course, if there were unusual charges during those years, say, unusually heavy snowfall, you'll have to take that into account.

You can also try to get the right to audit the center's CAM costs for a set period early in the lease and then adjust the initial CAM charge based on the audit's findings, advises Machson. To get this protection, add a clause to your lease's CAM cost section. Your clause, like our Model Lease Clause, should do the following:

- Set an initial CAM charge for the first accounting period after your lease's commencement date, which you'll pay in equal monthly installments [Clause, par. a].

- Get the right to audit the center's CAM costs at the end of the first accounting period. To exercise that right, the owner will most likely require you to give it notice of your intent to do so within, say, 60 days after it gives you the center's actual CAM costs for that period. The owner will also probably require you to give it a report

detailing any objections you have to the CAM costs within a certain time, say, 90 days after your audit. These are reasonable demands to which you should agree, says Machson [Clause, par. b].

- Explain that if you don't exercise your audit right, your initial CAM charge will become your fixed CAM charge, subject to annual increases as provided elsewhere in the lease [Clause, par. c(i)].

- Say that if you do exercise your audit right, you and the owner

## MODEL LEASE CLAUSE

### Use Audit to Set Fixed CAM Charge

Here's a Model Lease Clause, drafted with help from attorney Robert A. Machson, that sets an initial CAM charge (par. a), then lets you audit the center's CAM costs (par. b), and use

the results to set your fixed CAM charge (par. c). You can adapt this clause and add it to your lease's section on CAM costs. Show this clause to your attorney before using it.

#### SETTING FIXED CAM CHARGE

- Initial CAM Charge.** For the first annual Accounting Period following the Commencement Date, Tenant shall pay in equal monthly installments a CAM cost payment of \$[insert amount] ("Initial CAM Charge").
- Audit of CAM Costs.** At the end of the first annual Accounting Period, Tenant shall be provided a reconciliation of Center's actual CAM Costs ("First Reconciliation"). Tenant shall have a right to audit said CAM Costs for the first annual Accounting Period as long as Tenant provides notice of its intent to exercise said audit right to Landlord within [insert #, e.g., 60] days of its receipt of the First Reconciliation. Tenant must then provide Landlord with a written report detailing any objections to the CAM Costs within [insert #, e.g., 90] days of the date on which Landlord provides the books and records necessary to audit the CAM Costs.
- Fixed CAM Charge.** For the remainder of the Lease term, Tenant shall pay a Fixed CAM Charge, which shall be determined as follows:
  - If Tenant does not exercise its audit right, the Initial CAM Charge will become the Fixed CAM Charge, which shall be fixed and increased annually in the manner provided herein, or
  - If Tenant does exercise its audit right, Landlord and Tenant will make a good-faith effort to agree on an adjustment to the Tenant's Initial CAM Charge to reflect the audit's findings, if necessary, which shall become the Fixed CAM Charge and thereafter be fixed and increased annually in the manner provided herein. In the event, Landlord and Tenant cannot agree upon adjustments to Tenant's Initial CAM Charge, Tenant shall continue to pay the Initial CAM Charge and annual increases as provided herein until such time as Landlord and Tenant either agree upon a Fixed CAM Charge or the Initial CAM Charge is revised by order of a Court or other tribunal.

will make a good-faith effort to adjust your initial CAM charge to reflect the audit's findings, if necessary. If you agree on an adjustment, the adjusted initial CAM charge will become your fixed CAM charge, subject to annual increases as provided elsewhere in the lease. If you can't agree on an adjusted CAM charge, you'll continue to pay the initial CAM charge (plus any annual increases provided for elsewhere in the lease) until either you and the owner can agree on a fixed CAM charge or the fixed CAM charge is set by a court or other tribunal, such as an arbitrator [Clause, par. c(ii)]

**PRACTICAL POINTER:** Will an owner agree to the above clause? It might if you make it a condition to agreeing to pay a fixed CAM charge, says Machson. Keep in mind that owners may view this clause as a small price to pay to get you to agree to do so, he explains.

**Annual increases in fixed CAM charge.** The term "fixed CAM charge" is somewhat mis-

leading, observes Schreiber. Your CAM charge will be fixed for any given year of your lease term—but not for the entire lease term, he notes. That is, the owner will demand that your fixed CAM charge increase annually to reflect inflation and increased costs. And you'll probably have to agree to such increases, he adds.

You and the owner will have to negotiate how the annual increase will be determined. Tenants want to keep the annual increase as small as possible and generally prefer to base it on the Consumer Price Index (CPI), says Schreiber. Owners prefer to base it on a fixed rate—say, 3 percent to 5 percent, says Machson. If you must agree to a fixed rate increase, don't accept a rate over 4 percent, he warns. Or try to get the owner to agree that the increase will be the lesser of either the CPI or a fixed rate, suggests Schreiber.

**Center maintenance.** You want the owner to continue to maintain the center in the same manner as it

did when the tenants made traditional CAM payments, says Schreiber. But the owner will want to keep costs down, especially since it will have to pay out-of-pocket for any atypical costs. So rather than shoulder the cost, it may forgo expensive extras like repainting or renovating, explains Machson.

As protection, if your lease doesn't already require the owner to continue to maintain the center as, say, a Class A property, require it to do so, Machson advises. And be extra vigilant in ensuring that it complies with this requirement, he adds. But note that it's in the owner's best interests to maintain the center anyway, Schreiber says.

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#### **Insider Sources**

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