

Negotiating the Operating Costs as Rent

By Jeff Grandfield and Dale Willerton – The Lease Coach



Dale Willerton is the founder of The Lease Coach and Jeff Grandfield recently joined him as partner. Dale and Jeff are commercial lease consultants who work exclusively for tenants, and are also professional speakers and co-authors of Negotiating Commercial Leases and Renewals FOR DUMMIES. Got a leasing question? Need help with your new lease or renewal?

*Call 1-800-738-9202, email DaleWillerton@TheLeaseCoach.com, or visit www.TheLeaseCoach.com. For a copy of our free CD, *Leasing Dos & Don'ts for Commercial Tenants*, please email your request to JeffGrandfield@TheLeaseCoach.com.*

Readers of our new book, *Negotiating Commercial Leases & Renewals FOR DUMMIES*, will learn (in-part) that although most commercial real estate professionals may tell you that operating costs are not negotiable, there are aspects of these costs that can indeed be changed to the tenant's favour.

When it comes to operating costs (also known as Common Area Maintenance / CAM charges), the landlord wants to make sure that the tenants pay all these costs for the building. There's nothing unusual about that. However, when The Lease Coach analyzes operating costs for groups of tenants in a building, we often find that the tenants are subsidizing capital improvements that the landlord is using to enhance or increase the building and/or property's total value.

If a formal lease document uses sufficient detail to define what constitutes an operating cost, then the tenant has a fighting chance to at least examine, question, and negotiate each listed item. We remember one Florida landlord who charged all of his tenants an annual fee to have a pool of money available for hurricane damage not fully covered by insurance. With being skeptical about this claim, we inspected closer and noticed there was no end to this billing or reserve fund ... tenants were required to pay it for the entire duration of their tenancy. If a tenant moved out at the end of their lease term, they did not receive any of the money back they had paid – even if there had been no hurricane damage. In this case, this landlord was simply creating a slush fund to do with as he pleased. With that said, look for odd clauses in your formal lease document and scrutinize them carefully – after all, it's your money! Look at what you're paying for.

The majority of commercial, office, and retail lease agreements may stipulate that the specific components of the operating costs that the tenants need to pay for. Typical examples of operating costs include general property maintenance, painting, lawn cutting, snow removal, property insurance, and so on. Remember, a **valid** operating cost is one

that will benefit **all** of the tenants in the commercial property – not just one or two. Almost every lease agreement an operating cost clause and typically defines these common area maintenance charges in a short- or long-form manner. From your perspective as an optometrist tenant, longer is better as it creates more certainty for you.

Operating costs are charged proportionately to all tenants. If one tenant occupies seven percent of a commercial property, he/she can typically be required his/her proportionate share – 7% – of the operating costs as additional rent to the landlord. But consider for a moment that not all tenants use or consume operating costs proportionately. Would a convenience store or a bank contribute more to parking lot trash collection? Would a tenant on the first floor or the 20th floor of an office tower use the elevator more often?

We remember one dry cleaner who felt it was unfair that he had to pay his proportionate share of trash removal. He claimed that he created only one bag of garbage each week – he happily put this bag in his van, took it home with him, and then set it outside for pickup with his own household garbage. Yet he was forced to pay his proportionate share of trash removal just like all of the other tenants.

With ever-rising operating costs, you may wonder if it is possible to negotiate a cap on these expenses. Yes. In some cases, a slothful or cash-strapped landlord may have skimped on regular maintenance but after the property is sold to a more reasonable landlord several years' of deferred maintenance has to be caught up on at the expense of the present tenants. If you are trying to budget costs for the year, and your overhead rents are important to you, you may want to negotiate a 5 – 10 percent cap on operating costs so that your landlord can only raise them that amount annually as a maximum.

In response, your landlord may be willing to cap *controllable* operating costs – meaning that they won't cap property taxes or other such items that are beyond their own management

control. As a tenant, you may want to agree to this as a compromise – consider that any ceiling or restrictions that you can put on rising operating costs will ultimately benefit you.

Over the years, The Lease Coach has analyzed operating costs for many groups of tenants in commercial retail or office buildings. Often, this begins with a phone call from a disgruntled tenant who wants to challenge the landlord on payment of these costs. It is far more cost effective for that tenant to get his neighbours together and share in the cost of an operating cost analysis. Although some lease agreements state that the landlord provides the tenant with access to financial operating cost records, many leases do not. Some leases build in a 90-day or one-year statute of limitations, drawing the line on how far back the tenants can go. Remember that, as a tenant, you have rights. The landlord is acting as a steward of your money. Operating costs should not become a profit center for the landlord.

Operating cost discrepancies come in two flavours: honest mistakes or dishonest (deliberate, negligent, or fraudulent) calculations. In a building where the property is close to fully occupied or fully occupied, the landlord may have less reason to try to profit from operating costs. Still, the landlord may try to enhance the property with the tenant's money. On the other hand, however, when a commercial property has a number of vacancies, the landlord may want to avoid paying his proportionate share of operating costs for the vacant units. Therefore, the landlord may put language into the lease agreement stating that the operating costs for vacant units may be passed on to the tenants occupying the building. Obviously, in some cases, tenants can be carrying a very heavy financial burden if the commercial property is not fully leased.

Communicating with the landlord (both verbally and in writing) about any operating cost concern(s) you may have is imperative. And don't wait too long because the lease may stipulate a statute of limitations on adjustments. Sometimes the problem originates with the property manager but sometimes it comes from the owner or landlord purposefully taking advantage of the tenants in the property. Dale remembers his time as a commercial property manager when one landlord told him to find creative ways to charge every penny spent on the property back to the tenants. If you catch your landlord with his hand in the cookie jar, don't be too surprised if he's not communicative or cooperative with you.

Any number of other issues could be buried deeply within operating cost clauses. Optometrist tenants should be aware of the following as several examples:

Administration Fees

If tenants are paying the property manager's salary through operating costs, but the landlord adds a 15% administration fee to CAM costs, this can be considered *double-dipping* (or double-billing for essentially the same service). If the landlord levies administration fees on property taxes and/or insurance, note that can also be defined in the same manner as there is very little landlord's administrative work involved with these.

Utilities

Electricity, natural gas, and water may be provided by the landlord or separately metered for each tenant. In some cases, the landlord may have one meter on the property and a check meter on each tenant's unit to measure consumption. If you're paying your own utilities to the utility company you'll have your own meter. Often, the landlord bills back utilities to tenants in operating costs. Make sure that you know in advance what the lease agreement calls for so you don't pay twice.

Tenant Audit Rights

The landlord has a fiduciary responsibility for accountability to the tenants for the money collected from and spent on behalf of the tenants. The lease should include tenant audit rights which allow you the opportunity to examine the landlord's books, if necessary.

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