SCT Shopping Centers Today
shopping center news magazine
New York, NY
January 2017

SCT SHOPPING CENTERS TODAY

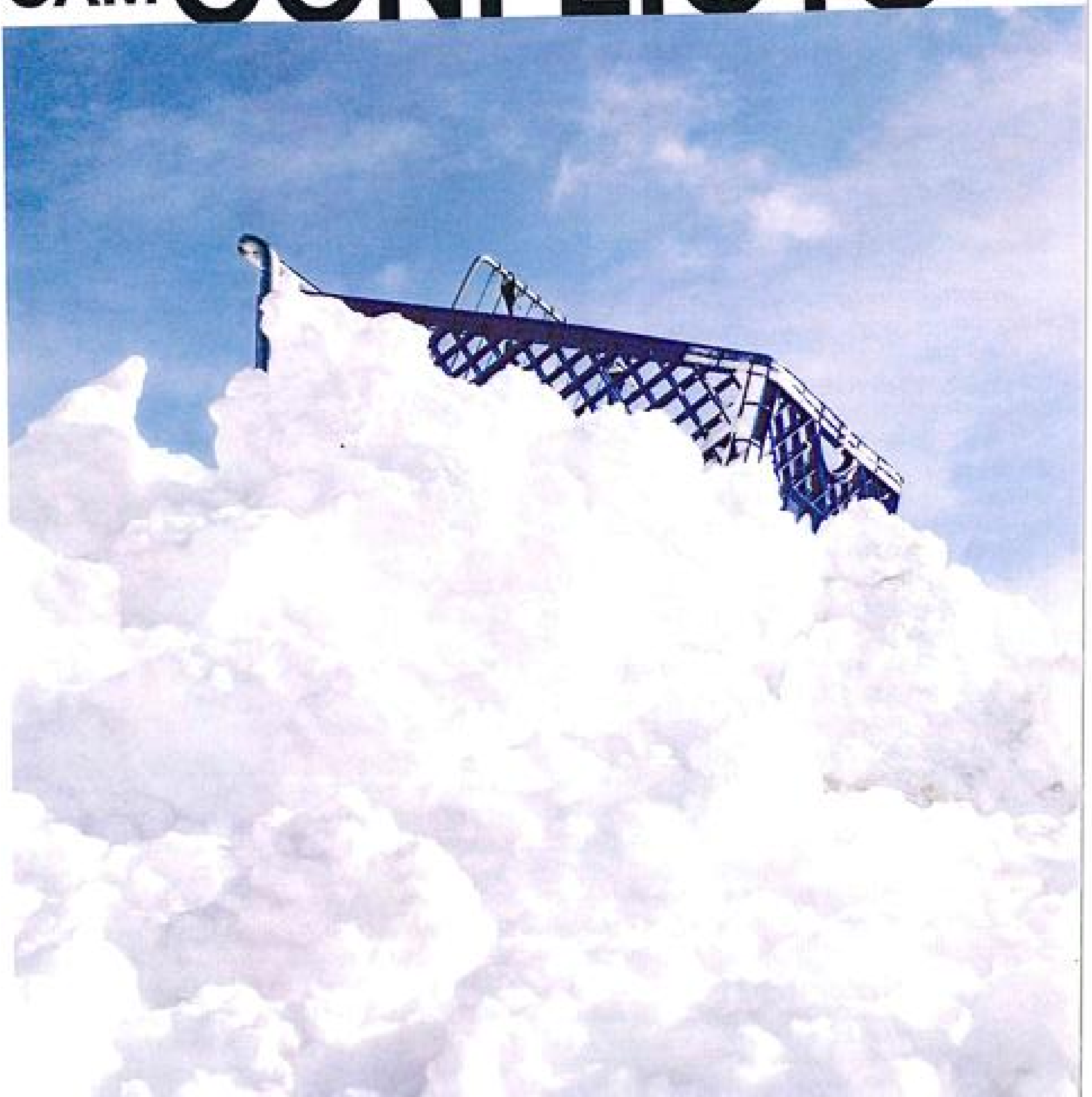
JANUARY 2017
www.icsc.org

what's trending in 2017

The opportunities, players and markets that you need to know about in the coming year.

ICSC

CAM CONFLICTS



Tenants want malls to look good and offer great experiences but sometimes balk at their common-area-maintenance bills

BY STEVE McLINDEN

IF THERE'S ONE AREA OF SHOPPING CENTER OWNER-TENANT relations more contentious than rent negotiation, it's Common Area Maintenance (CAM) fees, those charge-backs merchants pay to fund the upkeep of shared spaces. So says transactional real estate attorney Scott Brooks, who has more than a quarter-century of experience representing both developers and retailers under his belt.

Brooks, a partner with California-based Cox, Castle & Nicholson, said he's never seen a more widespread effort by retail tenants, particularly large leaseholders, to rein in or set limits on CAM costs. "There's an increasing number of national and regional chain tenants now who engage in systematic auditing of CAM charges, either through use of third-party auditors or in-house personnel," Brooks said. "Generally, this results in an effort to question enough items — sometimes with and sometimes without merit — that a compromise reduction in charges will occur."

Because of the shrinking number of big-box chains, there are fewer major tenants to fill big anchor spaces, giving remaining anchors added CAM clout, says the lawyer. "Landlords who need to fill anchor spaces often have little choice but to accept this," he said. They're wagering that the anchor's presence will compel enough small tenants to sign on and pay the standard pass-through fees, he said.

Some of these anchors' biggest targets are management and administrative CAM fees, along with tax, insurance and some renovation work, Brooks says. Many are agreeing only to pay for projects such as lot repaving once every set number of years. The same tenants may also push back on paying roof repairs and such atypical insurance items as earthquake or terrorism coverage, he adds.

"For the most part, tenants are just trying to control their gross-occupancy costs and budget accordingly," said Spencer Bomar, principal of Avison Young's national retail advisory services group. "But while retailers want to take out some of that risk, landlords can't always absorb the extra costs."

Bomar said mall CAM budgets are rising faster than industry average at the hot "A" properties, as landlords try to bring centers up to modern standards by making them more experiential. "It costs money to create experience," he said.

Sometimes, simplified CAM-fee structures are the answer. "Many malls have moved to fixed CAM charges with set annual increases to ameliorate the issues that retailers have with what is or isn't included in CAM," said Jim Greenfield, a mall asset manager with Dallas-based Cencor Realty Services. "It's then incumbent upon the developer or landlord to keep costs within that fixed range, which saves accounting time and gives retailers a fixed number." The out-and-out capping of CAM charges is a growing trend as well. "We're seeing re-

Landlords must walk a delicate line with CAM fees: Too little can devalue the center itself, while too much can cause tenants to fail

quests for CAM caps on a regular basis, and seeing tenants that are balking on management fees to a point we've had to actually list the management-fee percentage in the lease that [landlords] are not to exceed," said Karen Waring, director of asset and property management for Cencor.

Retail REITs are more inclined to have fixed CAM costs than smaller independent owners, says Karen Raquet, director of national property services for JLL Retail. "As for tenants, the CVSs and the GAPs and the other large retail companies have been pretty consistent in questioning CAM costs and auditing landlords."

Tenants that have successfully persuaded landlords to cap controllable CAM-charge increases are doing so at about three to five percent annually "and they really want to pull out those administrative and management fees," Bomar said. "They want to take the guesswork out of it and know their occupancy costs in advance; they don't want surprises." Sometimes, tenants are just seeking caps on controllable expenses, excluding such things as snow removal, utilities, taxes and insurance, he said.

In turn, some landlords who have forked out more on maintenance than the CAM pools allow in a given year are asking to recoup those past costs from CAM in years when their outlays come under budget, Brooks added.

Typically, energy charges are no longer included in CAM fees because most centers' tenants are individually metered, says Cencor's Greenfield. Water is mostly sub-metered but is sometimes pro-rated using a formula based on tenant type. "For example, a gym or a restaurant would use more water than a dress shop, and the system needs to be fair based on usage," Greenfield said. When energy or water charges are in CAM, it's usually for common area uses like lighting or sprinklers, he says.

Landlord-tenant CAM reconciliation is important to retail real estate investors when they're evaluating a property, Brooks says. Such investors are reliant on a prospect's net operating income (NOI) to establish a market-based cap rate, he says. "As a result, 'slippage,' or the inability to recover expenses from tenants, is a critical issue to them."

JLL's Raquet says one center her company has worked with perennially shorted itself on tenant CAM charges. That made it difficult for the property to remain viable and was a turn-off to potential buyers, who realized they'd have to raise CAM rates significantly or pay much less for the property to make the deal work. "It's a careful balance," she said. "If you as a landlord, on the other hand, are blowing the retailers' costs out of the water with CAM fees, they aren't going to be successful or profitable either."

The mixed-use projects out there with intertwined uses can be an enormous challenge in accurately apportioning CAM costs, Raquet say. "You have to ask yourself who's using the hallways. Is it office or retail or residential, or all three? Who uses the elevator? And who uses the parking?" she posited. "Our accounting groups aren't too fond of mixed use." One solution: create strong and definitive cost allocations even before a center comes out of the ground, she says.

Some CAM exclusion requests are offshoots of the recession, when a handful of landlords tried to pass through inappropriate charges to keep their centers going, Brooks says. "But the overwhelming number of items on these [exclusion] lists are things that no landlord would even think of passing through to the tenant anyway, such as the landlord's mortgage payment or the landlord's cost of refinancing a project," he said.

For the most part, tenants and landlords realize they're partners but are trying to make sure they're not being shorted in their individual effort to make their projects successful, Bomar says. "More and more, tenants just want to know what their model is going to be and how they can eliminate the variables." ■