

What Spa Tenants Need to Know About Operating Costs

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Operating Costs (also known as Common Area Maintenance/CAM) can be a confusing issue for spa tenants. As explained in our new book, *Negotiating Commercial Leases & Renewals FOR DUMMIES*, most commercial real estate professionals may tell you that operating costs are not negotiable; however, this is not completely true. There are aspects of the operating costs that can be changed to the spa tenant's favour.

First, spa tenants should know and understand that operating costs include maintenance, repairs, property taxes, insurance, utilities and any other additional costs associated with the operation and management of a building. Operating costs refer to expenses for the benefit of *all tenants*, rather than *just one*. Therefore, removing of garbage would classify as a justifiable operating expense while painting an individual commercial unit would not. The landlord wants to ensure that the tenants pay for all the operating costs for the property. There is nothing unusual about that. But when we do operating cost audits for groups of tenants in a building, we frequently find that the tenants are subsidizing capital improvements that the landlord is using to enhance or increase the building's value.

If a formal lease agreement uses sufficient detail to define an operating cost, then the spa tenant has a fighting chance to at least examine, question and negotiate each item. We remember one Florida landlord who charged an annual fee to all tenants so to have a pool of money to cover hurricane damage not fully covered by insurance. Upon further inspection, we noticed there was no end to this billing or reserve fund, Tenants were required to pay it forever. If a tenant moved out at the end of their lease term, they did not get any of the money back they had paid, even if there had been no hurricane damage. The landlord simply created a slush fund that they could use as they pleased.

Look at what you're paying for: The majority of commercial lease agreements may stipulate the specific or key components of the operating costs that the tenants need to pay for. Almost every lease agreement has an operating cost clause that typically defines common area maintenance charges in a short- or long-form manner.

Why proportionate share counts: If a spa tenant occupies 7 percent of a commercial property, they can typically be required to pay their proportionate share – 7 percent – of the operating costs as additional rent. But not all tenants use or consume operating costs proportionately. For example, would a hair salon or a bookstore use more water? Have your proportionate share of CAM (as a percentage number) actually stated in the lease agreement and don't be afraid to question this amount.

Capping the operating costs: You've heard the old cliché that nothing's certain except death and taxes. Well, you can add ever-rising operating costs to that short list too. Rarely do operating costs go down, and will most certainly rise over time. Many spa tenants fall victim to landlords who abuse the operating cost budget and use the spa tenant's money to polish their jewel – the property. In some cases, a slothful or cash-strapped landlord may have skimmed on regular maintenance, but after the property is sold to a more reasonable landlord, several years' worth of deferred maintenance has to be caught up on at the expense of the present tenants. If you're trying to budget annual costs and your overhead rents are important to you, you may want to negotiate a 5 – 10 percent cap on your operating costs so that annually the landlord can only raise them that amount at a maximum.

For a copy of our free CD, *Leasing Do's & Don'ts for Commercial Tenants*, please e-mail your request to DaleWillerton@TheLeaseCoach.com.

*Dale Willerton and Jeff Grandfield - The Lease Coach are Commercial Lease Consultants who work exclusively for tenants. Dale and Jeff are professional speakers and co-authors of *Negotiating Commercial Leases & Renewals For Dummies* (Wiley, 2013). Got a leasing question? Need help with your new lease or renewal? Call 1-800-738-9202, e-mail DaleWillerton@TheLeaseCoach.com or visit www.TheLeaseCoach.com.*