Operating Costs and other Additional Rents in a Commercial Lease from a Tenant's Perspective.[1]

Tenants usually understand the terms "minimum rent" and "percentage rent". They also understand that in a typical commercial lease there is an obligation to pay an assortment of additional costs (usually termed "additional rent"), including: the utilities consumed in their premises; the realty taxes applicable to their premises and the development; business taxes if levied on the business being conducted from their premises; promotion and advertising charges; heating, ventilating and air conditioning ("HVAC") charges; and a contribution to common area costs ("CAM Costs"). It is, however, the extent of charges within additional rent, primarily CAM Costs, which can catch the unwary tenant and cause a significant increase in the tenant's additional rent.

Landlords use broad, generic language in their offers to lease to describe CAM Costs, with the devil being found in the detail of the lease. To the tenant's detriment, once the offer is signed by both parties, it is legally committed. From a business perspective, (since there is now both a legal and psychological commitment to the deal), there could be little latitude or fortitude to negotiate. Some landlords invoke a 'no lease no keys' policy denying the tenant occupancy until the lease is executed, even though the time periods in the lease (the fixturing period for example) continue to run. This adds to the pressure for the tenant to sign the lease and possibly to back off on requested lease amendments. A tenant may only have the opportunity to obtain amendments that are germane to its interests at the offer stage; therefore the tenant should take the time to thoroughly review and negotiate the offer to lease.

However, if the offer is signed and a lease is presented which contains additional terms unfavourable to the tenant's interest, case law provides some assistance. For example, in ***R. Denninger Ltd. v. Metro International General Partner Canada Inc. and Lehndorff Property Management Ltd.***, 8 O.R. (3d) 720, the landlord did not specify in the offer to lease that there was a fifteen percent administration fee attributable to CAM Costs. The tenant refused to sign the lease with such an administration fee. The landlord relied on the "net net" lease clause from the offer to justify the administration fee inclusion. The court found that such a charge was not part of the net net concept and was not exigible. In ***Dylex Ltd. v. Premium Properties Ltd.*** [1996] O. J. No 2165, the tenant successfully rejected an attempt by the landlord to include capital taxes in the lease when they were not referenced in the offer.

A carefully crafted offer will state that the tenant is obligated to pay its proportionate share of the landlord's costs and expenses; "attributable to the ownership, administration, operation, management, maintenance, improvement, insuring, cleaning, policing, supervision, rebuilding, replacement and repair of the development and realty taxes on the development, plus an

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[1] by David V. Westwood, David V. Westwood (Commercial Lease Law) Professional Corporation.

administration fee equal to fifteen percent (15%) of such costs and expenses".[2] For a prudent tenant, this general wording should raise the following questions:

i. What should be excluded from this basket of costs?
ii. What is the tenant's proportionate share?
iii. What substantiating documentation must the landlord provide to confirm these costs?

EXCLUSIONS FROM CAM COSTS

The following is my list of exclusions from CAM Costs, followed by a comment on how this request is received.

EXCLUSION:

- Any ground rent, mortgage or other finance charge payable by the landlord.

COMMENT: Usually accepted, though a landlord may except interest charges on depreciation.

EXCLUSION:

- Any management fee charged for the management of the development.

COMMENT: Where the landlord is also charging the fifteen percent (15%) administration fee on CAM Costs, the inclusion of management fees is a 'double dip'. The purpose of the fifteen percent (15%) administration fee is to compensate the landlord for the unquantifiable costs associated with administering the development. When a landlord retains the services of a management company to perform the administration of the development and recharges that cost to its tenants, the imposition of the 15% administration is a duplication of this cost. A landlord will usually accept this exclusion.

EXCLUSION:

- Any cost or expense incurred by the landlord in discharging its obligations with respect to other tenant/occupants of the development.

COMMENT: This is a cost arising from the landlord's administration of the development and should be covered by either the administration fee or the management fee.

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[2] See Appendix 1 to see how the landlord expands upon this language in the commercial lease.

EXCLUSION:

- Any cost incurred by the landlord or any other tenant/occupant of the development as a result of a breach by the landlord or any tenant of its respective obligations contained in its lease/license.

COMMENT: If the landlord is in breach, why should the tenant pay for the consequences of such breach? If another tenant has breached, the landlord can recover these costs from that tenant. Regardless, this is another cost arising from the landlord's administration of the development and should be covered by either the administration fee or the management fee.

EXCLUSION:

- Any amount payable by the landlord as a result of a breach by the landlord, or those in law for whom it is responsible, of this offer to lease and/or lease, or another tenant's/occupant's lease/license, or arising as a result of the negligence of the landlord and/or those in law for whom it is responsible[3].

COMMENT: See comment above.

EXCLUSION:

- Leasing and marketing costs/fees, agents/brokers commissions or charges, any tenant allowance or inducement in leasing, or marketing the development, and fees or charges incurred in negotiations with prospective tenants/occupants of the development.

COMMENT: These costs are not applicable to the day to day operation of the development.

EXCLUSION:

- Any amount for which proceeds of insurance are available to the landlord or would have been available had the landlord taken out the required insurance.

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[3] Though it is not within the parameters of this paper, a tenant should know that where the negligence of a landlord causes damage to the tenant, certain landlords will only accept responsibility for its negligence where; (a) the Landlord receives proceeds of insurance from its insurers and (2) the tenant does not have insurance that would compensate the tenant for such damage. I have difficulty with this position for certain reasons; (i) the general concept of a party being negligent yet refusing to be responsible for its own action, (ii) the tenant has paid for the landlord's insurance through the inclusion of insurance premiums in CAM Costs, (iii) the landlord has the ability to take out such insurance as it requires and to pass that premium onto the tenants, and (iv) if the tenant must look to its insurance, its loss ratio is adversely affected resulting in a possible premium increase.

COMMENT: As the tenant contributes to the landlord's insurance premiums, the landlord should look to its insurance where appropriate. A landlord should restrict this to proceeds with regard to items that would otherwise be included in CAM Costs. This should be accepted by a landlord.

EXCLUSION:

- Any cost covered by a warranty or indemnity.

COMMENT: If restricted to proceeds that would otherwise be included in CAM Costs, a landlord should accept this amendment.

EXCLUSION:

- The capital cost of initial construction and development of the development or any redevelopment or renovation of the development, as well as the depreciation of such cost.

COMMENT: A landlord should not be able to recharge its initial construction/development costs. This cost is reimbursed through the minimum rent the landlord receives. A landlord should accept this amendment.

EXCLUSION:

- Any repair or replacement to the base building, including the structural components, the roof, foundations, mechanical/electrical/heating/ventilating/ plumbing systems, as well as the depreciation of such cost.

COMMENT: This is an area of considerable negotiation. From a tenant's perspective it is reasonable for the landlord to recharge maintenance of the structure of the development and its base building services. However, conflict arises whether the landlord can recharge the cost of repairs and replacements thereto, for example, with regard to roof repairs, structural repairs and parking lot/parkade repairs. A landlord will argue that these costs are required to maintain the development in a good condition, which then benefits all tenants by maintaining an attractive development. A tenant will argue that these costs are tantamount to the original construction cost and should not be included in CAM Costs. A landlord could respond by agreeing to not recharge replacement costs but to recharge repair costs.

The difficulty then arises as to when a repair morphs into a replacement. A suggestion is to rely on generally accepted accounting principles ("GAAP") and the concept of a 'betterment'[4]. If the cost is a betterment, it has enhanced or increased the life of that asset[5]. For example, if a parking lot is extensively repaired such that its natural life is increased, this would constitute a betterment. As such it is similar to the original construction cost and should be borne solely by the Landlord. If it is not a betterment but is still of a capital nature then that cost is amortized over its useful life, with the annual amortized amount, with a reasonable interest component thereon, being included in the annual CAM Costs. The tenant may want to amend the lease to reference the CICA handbook noted in footnote 4 below for the definition of GAAP. With regard to roof repairs or replacement, a prudent tenant would want the exclusion to include not just the structural roof, but its membrane, granular and insulation.

EXCLUSION:

- Any tax on the income of the landlord, or the large corporations tax or the minimum corporate tax of Ontario if any, or any capital tax.

COMMENT: While these taxes do not have any applicability to the development itself, as it is based on the capital structure of the tenant, this charge is appearing more frequently in commercial leases. A landlord has yet to properly justify its inclusion to me, other than the self serving 'its our policy'.

EXCLUSION:

- Any administrative wage and/or salary of head office personnel of the landlord.

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4 See CICA Accounting Handbook, Specific Items Section 3061 'property, plant and equipment, § .26, .27 and .28. Point .26 states:

> "The cost incurred to enhance the service potential of an item of property, plant and equipment is a betterment. Service potential may be enhanced where there is an increase in the previously assessed physical output or service capacity, associated operating costs are lowered, the life or useful life is extended, or the quality of output improved. The cost incurred in the maintenance of the service potential of an item of property, plant and equipment is a repair, not a betterment. If a cost has the attributes of both a repair and a betterment, the portion considered to be a betterment is included in the cost of the asset".

Note that starting in 2011 GAAP will be changing to the International Financial Reporting Standards ("IFRS") as issued by the IFRS Board for certain companies. However, it is my understanding that the treatment of capital costs will not be affected by this change.

5 Do not confuse the term 'betterment' used in GAAP with that used in ***Stellarbridge Management Inc. v. Magna International (Canada) Inc*.** [trial decision is at [2002] O.J. No. 1008, (Ontario Superior Court) , and the appeal decision is at 71 O.R. (3d) 263, (Ontario C. A.) where the term 'betterment' referred to the tenant's repair obligations at the end of the Term.

COMMENT: Arguably another 'double dip' if the landlord is charging the fifteen percent (15%) administration fee on CAM Cost.

EXCLUSION:

- Any goods and service tax exigible upon any cost included in operating costs, such that there will not be any duplication of the GST;

COMMENT: A landlord should accept this.

EXCLUSION:

- Any cost resulting from any hazardous or toxic substance being found in the development.

COMMENT: A tenant should not be responsible for hazardous or toxic substances that are on or in the development. The landlord should have done its due diligence when it purchased the development, including environmental assessments. If there were hazardous substances, then the landlord should have discounted its purchase price by the remediation cost, or insisted on remediation as a condition of closing. If another tenant caused the hazardous substance to be present in the development, the landlord has its remedies against that tenant. However, where a third party or parties unknown deposit such waste onto the development, the landlord should be able to recharge that clean up cost as part of CAM Costs, provided the landlord uses its commercial efforts to find and take the appropriate action against the perpetrator.

EXCLUSION:

- Any penalty or interest charge exigible against the landlord.

COMMENT: A landlord should accept this provided the charge did not arise from the default, negligence, act or omission of a tenant or those in law for whom the tenant is responsible.

EXCLUSION:

- Any severance pay or termination pay arising from any business restructuring or reorganization or changes of property management or ownership.

COMMENT: In my opinion the landlord would be compensated for this cost by the fifteen percent administration fee.

OTHER CAM COST COMMENTS

- When acting for a tenant, I request that CAM Costs are charged 'without duplication or profit to the landlord'.

- The landlord should covenant that all contracts entered into for such costs be with arm's length companies and at competitive markets rates.

- The norm for the administration fee is fifteen (15%) per cent. Some landlords have raised this to twenty (20%) percent.

The success of the tenant in obtaining all or some of these exclusions depends on the bargaining strength of the respective parties. In 'A' and "B' malls, where there is significant demand for smaller premises, landlords know their bargaining strength and are loath to provide amendments. The landlord would demand its offer be signed in the form presented on the basis that there are other tenants willing to take the space with minimal or no amendment. The tenant then must decide whether this is a bluff or not. Tenants taking larger premises may have more success in such negotiations.

A reason cited by landlords for rejecting these amendments is that it can create an accounting incubus. Imagine a development with several hundred tenants each with its own unique exclusions from CAM Costs. The administration costs would be considerable. Therefore, the landlord may accept only certain amendments, in effect, standardizing exclusions. Alternatively, some landlords are now specifying a fixed amount for the first year CAM Cost contribution, with subsequent year's increases being based upon a formula, such as the Consumer Price Index of Statistics Canada ("CPI"). This saves both parties the time and expense of reviewing and fighting over annual recharges. An exception to this formula is the exclusion of costs which have had dramatic escalations beyond the control of the landlord, such as insurance premiums and snow removal. It is reasonable for these to be excluded from this formula with the tenant paying its proportionate share of the annual actual increase.

If the Landlord is charging the fifteen percent administration fee, a tenant should attempt to amend the lease to the effect that:

- The administration fee is not applied to insurance, realty taxes, capital costs and depreciation.

- In determining the administration fee, it should be calculated after the landlord has deducted from the CAM Costs the contributions thereto from tenants whose premises are excluded from the proportionate share denominator.

HVAC COSTS:

HVAC costs are included in CAM Costs where the tenant's premises are served from a central plant, which is common in an enclosed shopping centre. However, in strip plazas, power centres and some enclosed malls, the tenant has its own roof mounted HVAC system, with wording in the lease requiring the tenant to maintain, repair and replace the HVAC unit and system serving its premises. The tenant must be careful of these provisions, otherwise the tenant could be in for an exceptional cost, the cost of replacing the system or paying the cost of a major repair. By the typical wording of a lease, the tenant is responsible for the repair or replacement cost of such unit at any time during the Term. From the tenant's perspective the responsibility to replace should not arise unless the cause of the HVAC repair or replacement was the negligent act of the tenant. However, it is appropriate that the tenant take out or contribute to the cost of a biannual/quad annual HVAC maintenance contract.

Assuming such a maintenance contract is in place and there is no negligence by the tenant, then the tenant should only be responsible for a specified portion of HVAC repair and replacement costs per annum (i.e. $2,000.00), with any cost in excess of such amount being borne by the landlord. The landlord would not want to pay this entire cost, arguing that the tenant is receiving the benefit of the repaired or replaced unit. A compromise is to amortize the repair or replacement cost over the useful life of the HVAC unit, (and I specify this useful life at fifteen years to avoid future argument), with either the landlord or tenant undertaking the initial repair or replacement then seeking reimbursement from the other. Thus, if on the first day of the last year of a term the HVAC unit was replaced, the tenant would be responsible to pay only 1/15th of the replacement cost.

The prudent landlord would:

i. Want to attach an escalator to the $2,000.00 threshold amount, such that there would be annual increases to reflect inflation. An escalation based on the CPI is reasonable.

ii. Reduce the amortization period. Ten years is a possible compromise.

iii. If the Tenant subsequently renews the lease or extends its term, then the Tenant should reimburse the landlord for the amortized portion of the cost applicable to the renewal or extension term.

You may want to consider the following wording:

> "In the event the HVAC system or a major component requires repair or replacement, and provided:

(a) The cost of such repair or replacement (the “Repair Cost”) is in excess of two thousand dollars, (exclusive of GST);

(b) The repair was not occasioned by the wilful act, omission and/or negligence of the Tenant and/or those in law for whom the Tenant is responsible, and the Tenant has maintained its annual HVAC maintenance servicing contract;

(c) The Tenant provides to the Landlord a copy of the invoice substantiating the Repair Cost, and the Tenant is not then in default of any of its obligations as contained in the Lease; and

(d) The Tenant has assigned, (or will assign upon receipt of payment from the Landlord as provided below) to the benefit of the Landlord any warranty arising as a result of such repair;

then the Landlord agrees to reimburse the Tenant within thirty days of receipt of the aforesaid invoice, an amount equal to the unamortized portion of the Repair Cost as of the last day of the Term, which unamortized portion shall be determined by amortizing such Repair Cost over a fifteen year period commencing on the date of the completion of such repair. In the event that such amount is not paid when due, then the Tenant may set off against Rent such amount. By way of example only, if a Repair Cost of $10,000.00 was completed on June 30th during the penultimate year of the Term, then the Landlord would reimburse the Tenant the sum calculated as follows:

1. Number of days remaining in the Term = 547.

2. 15 year amortization period = 5,478, [15 x 365] + 3 (3 being the number of leap years).

3. Amortized amount attributable to Tenant = [$10,000.00 x 547/5478] = $998.54.

4. Amount payable to Tenant = [$10,000.00 - $998.54] = $9,001.46.

If however, the Tenant has a right of extension or renewal remaining and exercises such right, the Tenant shall repay with its exercising such right the thirty-three percent (33%) of the Repair Price, [based on the fact that the extension/renewal term is for five years and the amortization period is for fifteen

> years]. If the Tenant exercises its second right of extension, then the Tenant would repay the balance of the Repair Price previously paid to the Tenant."

PROPORTIONATE SHARE RATIO

Most landlords use some form of weighted ratio to determine the tenant's proportionate share. For example a tenant leasing 2,000 square feet in a 400,000 square foot plaza may think that its proportionate share is 2000/400,000 or 1/200th. This tenant would think that it is therefore only responsible for 1/200th of all CAM Costs. Practically, this is seldom the case. The landlord will try to exclude from the 400,000 square foot denominator some or all of the following:

> (a) kiosks; (b) storage areas; (c) free-standing buildings; (d) premises with an area of more than 10,000 square feet; (e) space used or intended for use as theatres or cinemas; (f) offices that are not at or near the level of a mall and do not have direct enclosed pedestrian access to and frontage on a mall; (g) bowling lanes and space used or intended for use as recreational, sports or health facilities; (h) space used or intended for use by governmental or public offices, agencies or services or charitable organizations; and (i) mezzanine areas inside rentable premises.

From the tenant's perspective, the first item of concern in this list is paragraph (d), premises with areas in excess of 10,000 square feet, (and for the purpose of this paper such tenants are hereinafter called "Major Tenants"). The landlord's argument for justifying this exclusion is that Major Tenants act as a draw for the general public to the centre, that Major Tenants understand this, and therefore, the landlord must offer reduced rents to attract Major Tenants. This seems reasonable where the threshold is 30,000 or more for a supermarket, or 60,000 square feet for a department store, but not for stores with an area in excess of 10,000 square feet. (I have seen this threshold as low as 6,500 square feet).

If the landlord wants to rely on this argument, the corollary should be a co-tenancy clause, such that if a Major Tenant ceases to carry on business in the centre, then the tenants who have subsidized that Major Tenant through their contributions to CAM Costs, should have an abatement in their rent (or a right of termination) if the premises occupied by the Major Tenant become vacant and are not replaced by a similar tenant within a specified period of time. I would also recommend that the area specified in (d) be qualified to refer only to ground floor area, (save if in a multi level development, where this area can be over several floors, provided there is direct access to such store from the common mall).

The lease will likely provide that, before calculating the tenant's contribution to CAM Costs, the landlord will deduct therefrom the Major Tenants' contribution to CAM Costs. A smart landlord will allocate a preponderance of the total rent it wants to charge a Major Tenant to the Major Tenant's minimum rent, and reduce or 'cap' the Major Tenant's contribution to CAM Costs. The shortfall in the Major Tenant's CAM Costs contribution would be payable by the other tenants of the centre. This also has the benefit of increasing the landlord's income for the development.

There is no justification for (a) kiosks and (b) storage areas. Both occupants of these premises benefit from the operating costs of the development, but do not provide any benefit to the tenant. Items (e) theatres or cinemas, and (g) bowling lanes, are not necessary as they are included under (d). From (h) a tenant would want to exclude liquor stores, beer stores, and government agencies such as Motor Vehicle registration offices, as these occupants are probably paying full rent.

Note as well that landlord's use defined terms that can further reduce the denominator. For example, the landlord will state that the proportionate share denominator is; "the area of all 'Retail Tenants' in the development", before specifying the exclusions thereform. Carefully review the "Retail Tenant" definition (or such other defined term), as it probably is limited to those tenants who sell merchandise at retail, and therefor could exclude service oriented tenants such as medical/dental offices, law offices, chiropractic and massage. All of the premises carrying on these latter uses should be included in the denominator. Therefore this defined term must either be amended such that 'all tenants or occupants' are included.

Gross up of the Tenant's area

Note that landlord's also gross up the area of the tenant's premises (as is done with office leases) to pick up a proportion of the common areas, such as utility rooms, garbage rooms and administration offices. This is justified on the basis that if the tenant had to include that area within its premises, it would be paying full rent on that space. While the gross up is now standard in commercial retail leases, the tenant should insist that the gross up factor be specified and not fluctuate in order for the tenant to accurately determine its future rent costs.

Some landlords want to attribute a minimum rent to these areas as well. This should be deleted as the landlord cannot operate its development without these areas, and therefore such areas could never be leased as an income producing area.

Increase in Minimum Rent for Major Tenants

Certain landlords will try and increase a tenant's minimum rent by one ($1.00) or two dollars ($2.00) per square foot for each Major Tenant in the development. For example; assume that a tenant is paying a minimum rent of $25.00 psf/pa for the term and the offer contains a right to increase the minimum rent by $1.00 per square foot for each Major Tenant. If the landlord subsequently secures a 7,000 square foot dollar store and then a 20,000 square foot sporting goods store, the tenant's minimum rent would increase to $26.00 psf/pa and then to $27.00 psf/pa. This is unreasonable and should be rejected by the tenant. Such an increase in minimum rent skews the tenant's budget. Further, the landlord's argument that such Major Tenants induce greater traffic to the tenant's premises thereby resulting in higher sales, is in the writer's opinion, specious. This provision is especially onerous where the square foot threshold for a 'Major Tenant' is low, [the previously recited 6,500 square foot threshold].

SUBSTANTIATING DOCUMENTATION

Most leases require the landlord to provide the tenant with an annual statement of CAM Costs, which statement is a reconciliation of the previous year's CAM Costs. What is lacking is the detail. Usually the lease provides only for a statement signed by an officer of the landlord or a statement signed by the landlord's auditor, without backup. A prudent tenant should:

i. Require the landlord to provide substantiating documentation;

ii. Require the opportunity to review or audit the landlord's books (which right is identical to the landlord's right to audit the tenant's books for determining gross sales in calculating percentage rent);

iii. Require the landlord to provide this statement within a reasonable period from the end of each fiscal year. Some landlords fail to provide a reconciliation for years, yet each year they increase the estimated additional rent. The Tenant should require a time frame for the production of such statements, failing which the tenant should not have its CAM Costs increased until such reconciliation is received; and

iv. Try to cap CAM Costs for the first year, and thereafter pay increases based upon a formula (i.e. increases in CPI). Even with a new development, a landlord has a good idea of what its CAM Costs will be.

v. Landlords usually grant themselves an indefinite period of time to review the tenant's books for the gross sales calculation. I try and tie the tenant's right to audit or inspect the landord's books to the same time line. This way the tenant can limit the period during which the landlord can review its books [i.e. one year after receipt of the tenant's annual statement of gross revenue], with the same limitation on the period during which the tenant can review the landlord's books.

REALTY TAXES

A tenant should ask for the following exclusions from realty taxes.

- The landlord's income taxes and other taxes personal to the landlord.

- Capital taxes, [as previously discussed].

- Penalties relating to the late, partial and/or non payment by the landlord of realty taxes which are not the result of any late, partial and/or non payment by the tenant of its share of realty taxes.

- Any levy, impost fee, development fee, and or local improvement charge (collectively a "Development Fee") arising from the site plan agreement and or building permit for the development and such costs shall be paid by the landlord without recharge to the Tenant, and for greater certainty if such development fee is included in taxes or improvement charges the tenant is not obligated to pay such portion of the realty taxes or local improvement charges applicable to the Development Fee and the landlord shall pay such portion.

  COMMENT: Municipalities may require infrastructure improvements as a condition of approving a development, such as a signalized intersection with dedicated turning lanes. In lieu of incurring this cost directly, a landlord could elect to have the municipality incur this cost and include this cost in the taxes exigible against the development. A landlord will argue that this improvement was required for the development. A tenant would respond that this is part of the initial cost is constructing the development and therefore would be included in the Minimum Rent.

- Any amount that the landlord or others (other than the tenant) may elect to pay in support of any educational facility other than the public school system.

  COMMENT: In some jurisdictions a party can elect to contribute an additional amount on account of a religious preference. A landlord should not be able to impose its beliefs on a tenant.

Where a tenant has a strong negotiating position, a landlord may be prepared to cap realty taxes in some manner. For example, a landlord may be prepared to cap or waive the first year realty taxes; however, as the landlord has no control over realty tax escalations, it should not cap subsequent annual increases.

Realty taxes are paid to the taxing authority by either the tenant or landlord. Where a landlord has the responsibility to pay realty taxes to the appropriate authority and a tenant has obtained a realty tax cap, the tenant must ensure that if at some future point the taxing authority requires the tenant to pay taxes directly to it, the lease permits the tenant to deduct an amount equal to the cap from Rent. Otherwise the tenant has lost the benefit of the cap.

CONCLUSION

The reality is that leases are drafted by landlords for their benefit. Therefore, a prudent tenant should review its documentation carefully and understand all of its obligations and costs before signing on the dotted line. At least then, even if the landlord refuses to amend its document, the tenant has entered into the agreement with its eyes wide open. A prudent solicitor should advise its tenant client of these potential pitfalls.

APPENDIX 1

ARTICLE I – OPERATING COSTS - [LANDLORD FORM]

“**Operating Costs**” means the aggregate of all charges, impositions, expenses and costs of every kind for each fiscal period designated by Landlord, accrued, paid, payable, attributable, incurred by or on behalf of Landlord with respect to the operation, maintenance, repair, replacement (including repairs and replacements of a capital nature) and management of the Common Area Facilities, and all insurance placed by Landlord relating to the Development. Without in any way limiting the generality of the foregoing, Operating Costs shall include, without limitation, all costs in respect of the following:

(a) all remuneration, including wages and fringe benefits, of employees engaged in the operation, maintenance, repair and replacement and management of the Common Area Facilities, including contributions and premiums towards fringe benefits, unemployment and Workers Compensation insurance, pension plan contributions and similar premiums and contributions;

(b) all repairs (including major repairs) and replacements to and maintenance and operation of the Common Area Facilities and the systems, facilities and equipment within or serving the Common Area Facilities;

(c) all utilities supplied to the Common Area Facilities including, without limitation, water, gas, electricity and sewer charges, excluding those charged directly to tenants of the Development;

(d) landscaping and maintenance of the Common Area Facilities, including snow and ice clearing and removal and salting of sidewalks, driveways and parking areas;

(e) pest control and pest extermination in relation to the Common Area Facilities;

(f) equipment, machinery, systems and facilities constructed or installed in or used in connection with the Common Area Facilities;

(g) depreciation or amortization of all capital costs of such items including existing and future structures, improvements, furnishings, fixtures, equipment machinery, facilities, systems and property which is part of or installed in or used in connection with the Common Area Facilities which, by their nature, require periodic or substantial repair or replacement, or which are installed or used primarily to reduce the cost or consumption of other items included in Operating Costs (whether or not such costs in respect of the same are in fact reduced), amortized on a straight line basis over Landlord’s reasonable estimate of the economic life thereof, in accordance with generally acceptable accounting principles ("GAAP");

(h) all insurance of the Development which Landlord obtains and the cost of any deductible amounts payable by Landlord in respect of any insured risk or claim relating thereto;

(i) policing, supervision, security and traffic control of the Common Area Facilities;

(j) Development office expenses including telephone, stationery and supplies, and a reasonable Minimum Rent attributable to any on-site office;

(k) all costs in the nature of Operating Costs in respect of areas, services and facilities outside the Development relating to the Common Area Facilities and for the benefit of the tenants, such as sidewalks and boulevards, off-site utilities, parking areas and other service connections;

(l) engineering, accounting, legal and other consulting and professional services relating to the Common Area Facilities;

(m) the purchase, maintenance, repair and replacement of holiday or other special decorations for the benefit of the tenants of the Development;

(n) signs including, without limitation, pylon signs, parking signs, directional signs and the cost of all repairs, maintenance and rental charges in respect thereof (except where specifically charged back to tenants;

(o) costs and expenses of environmental site reviews and investigations, removal and/or clean-up of Hazardous Substances; and

(p) an administration fee of fifteen percent (15%) on all of the above costs.

Operating Costs, however, shall exclude the following:

(a) proceeds of insurance and damages actually recovered by Landlord from third parties to the extent of costs otherwise included in Operating Costs;

(b) contributions, if any, in respect of Operating Costs, from parties other than tenants of the Development, such as contributions made by parties for sharing the use of Common Area Facilities; and

(c) any contributions received in respect of Operating Costs from occupants of any areas excluded from the denominator when calculating Tenant's Proportionate Share.