

OPERATING COSTS WITHOUT A FUTURE! A FUTURE WITHOUT OPERATING COSTS?



AUSTRIAN THOUGHTS ON A LEASE MODEL WITHOUT OPERATING COSTS

Due to the significant rise in energy and property management costs in recent years, the expenditure associated with operating a shopping center poses a financial challenge for both shopping center operators and retailers. The following article deals with the question of whether the traditional allocation of "operating costs" is still appropriate and offers food for thought on charging ancillary costs on a lump sum basis.

WHAT EXACTLY DOES THE TERM OPERATING COSTS MEAN AND WHO BEARS THEM?

Operating costs generally refer to the landlord's expenses for renting and leasing residential and commercial spaces of all kinds, rather than expenses associated with maintaining the building (MietSlg 45.312). Costs incurred here are regularly passed on to the tenants.

Generally speaking, operating costs include expenses for

- Electricity
- Maintenance of technical installations including repairs
- Building maintenance staff
- Water, sewer
- Waste disposal, pest control
- Cleaning, property maintenance, and surveillance
- Insurance and public charges, fees and duties
- Center management

These ancillary costs can become considerably high, depending on the size and type of equipment installed in the center, the technology level, the scope of the mall, glass, and green areas, as well as

the number of retailers. As a matter of fact, the industry often refers to such costs as a "second rent".

In recent years the Supreme Court ruled that tenancy relationships in shopping centers meeting certain requirements are considered a lease of business to which the regulations of the Austrian Rent Act (MRG) do not apply. Therefore, as long as the parties have validity entered into a lease of business relationship, there is no legal restriction regarding passing on operating costs to the tenant. Even in the case where the tenancy agreement in a shopping center falls under the partial scope of the MRG, this would not affect the calculation of operating costs or the possibility of transferring them. The situation is different for a shopping center where tenancy agreements are subject to the MRG in their entirety. In these cases, the possibility of putting operating costs on the tenants is very much restricted by the provisions set forth in the MRG. Consequently, the admissibility of transferring all operating costs to the tenant is basically undisputed, provided that the shopping center was constructed with a building permit issued after June 30, 1953^[1] or the tenancy relationship is considered a lease of business. In such cases, the parties are free to determine who shall bear the operating costs, as long as the general civil-law barriers, such as unconscionability or usury, are not violated.

CHARGING OPERATING COSTS ON A LUMP SUM BASIS

In practice, operating costs are charged according to what has actually been accrued. Usually, the shopping center

operator determines monthly fixed payments with an annual settlement of accounts; a possible positive or negative balance is then cleared accordingly, and the new payment on account is calculated based on this.

However, on grounds of the current laws and legislation, the parties to a tenancy agreement would also be allowed to agree on settling the operating and ancillary costs by way of a lump sum. Even a complete waiver with respect of charging operating costs on the basis of an individual amount would also be possible, merely stipulating a fixed amount including rent and operating costs for the retailer. The calculation of such a fixed amount is referred to as a lump sum rent (whereas VAT is to be charged on top naturally). In view of that, lump sum rent agreements like this are permitted according to the prevailing opinion; however, the landlord bears the risk of increases in operating and ancillary costs. Incidentally, the lump sum rent model also corresponds with the vision of the historical legislator, which outlined in § 1099 of the Austrian Civil Code that basically all ancillary costs are to be borne by the landlord, thereby being implicitly in line with a lump sum rent.

MAIN ARGUMENT FOR A LUMP SUM MODEL

The main argument for changing the system to a lump sum model is a concept initially borrowed from energy contracting. The shopping center operator invests in the energy efficiency of his center in order to reduce energy costs and thus operating costs, raising the long-term savings potential.

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In this case the provisions of the MRG are only applicable in part.



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However, these investments only make business sense for the operator if the cost benefits resulting from the investments remain with the operator and do not have to be passed on to the retailer. This would be the case if the operating costs continued to be calculated according to what has been actually accrued. In this particular case, the operator misses out; from a business perspective, his expenses would be "frustrated". Introducing a lump sum model in preparation for investments in energy efficiency is, therefore, fundamental.

If a shopping center operator is able to shift the calculation of operating costs to a lump sum model at the forefront, he will be in a position to gain the cost benefits resulting from higher energy efficiency. In the long run, this could turn into an additional

"source of income" for the operator. As a matter of fact, shopping center operators should be well advised considering investments in energy efficiency to be closely linked to a change in calculating their operating costs. Otherwise, operators in Austria could suffer the same fate as landlords of so called "old buildings", whose energy investments can only be divided among the tenants to a limited degree. Although the typical shopping center operator is not subject to those legal barriers, he has to take into account contractual obligations with his retailers. Therefore, it is recommended that shopping center operators take precautionary steps and provide for a linear calculation of operating costs in their tenancy agreements.

FURTHER ADVANTAGES

In addition to the aforementioned advantage,

another benefit can be reaped from a lump sum calculation. The lengthy catalog of operating costs often included in tenancy agreements can ideally be omitted or at least replaced by a simple figure, namely the lump sum operating costs premium. This factor not only simplifies the agreement, but also leads to a faster conclusion of the contract. Furthermore, both parties spare themselves considerable administrative work. The substantial accounting work is eliminated for shopping center operators; retailers are spared the need to review the calculated operating costs. The elimination of individually charged operating costs also rules out errors and doubts about the accuracy of these costs, thus consistently preventing conflicts between the parties.

Moreover, a lump sum calculation of operating costs or even a lump sum rent can, in our opinion, also provide a competitive advantage, as the costs for (future) business partners are transparent and thus calculable from the very beginning. If nothing else, this model can generate environmental advantages through energy saving measures, which, aside from a "green conscience," can also contribute to improving the company's image.

RISKS

With all of the cost benefits and competitive advantages, the possible risks associated with a lump sum calculation of operating costs should be weighed carefully. Is there a plan B if the planned reduction of operating costs cannot be achieved or the costs even rise drastically due to external influences? Well, the shopping center operator could

counter this risk by providing himself a right to change the system. However, it remains to be seen whether this fallback solution will be accepted by the business partners and whether such right for the landlord would be legally binding on the side of the tenant. In any case, the risk of cost increases should be moderated by indexing the lump sum rate (or the lump sum rent). What also should be kept in mind is that when deciding on a lump sum rent system the usual forms of turnover rent are to be reconsidered and adjusted.

In practice, the greatest challenge for the shopping center operator will be converting all the retailers to the new system, as parts of the savings fall away when running two different accounting systems parallel. In order to sway the contractual partners to a change in the agreement, it is particularly important with long running agreements to allow your business partner to share potential benefits.

CONCLUSION

If extensive investments in a shopping center's energy efficiency are planned in the near future, it is imperative to change the operating costs system in order to guarantee the predicted cost benefits for the center operator. A lump sum model is the only way to protect the operator from the risk that savings are passed on to a third party. In addition to the benefits of a lump sum model such as simplified administration, transparency and increased competitive advantage, the associated risks must be considered, which however should be seen as a sporty challenge to all parties involved. ❖



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