



Breaking down triple net (NNN) properties: A look at the advantages and risks involved

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There is much talk around and demand for triple net (NNN) lease properties. At first glance these properties may appear to be a no-brainer investment. However, there seems to be a large grey area when we find ourselves asking the following questions: What exactly are they? How much risk is actually involved? Are they really the "perfect investment?" In this article we will breakdown and discuss what these investment properties actually consist of, things to consider when looking to invest in one of these properties, as well as the advantages and risks involved.

The Breakdown

Triple Net Investing, (NNN) stands for "Net-Net-Net" and represents the three most common real estate expense nets: property tax, insurance, and maintenance. NNN investing involves buying free-standing buildings that are leased to credit-worthy tenants. Tenants can be everything from a CVS Pharmacy to a McDonald's to a Chase Bank, as the tenant or lessee spectrum is very wide. NNN properties are typically leased to tenants for a 10 to 25-year term; however, each lease agreement does vary greatly. Furthermore, in these lease agreements the tenant or lessee is responsible for paying a portion of or all of the common expenses related to real estate ownership in addition to the base rent. With NNN leasing, there are five different types of leases, which vary depending on management responsibilities.

Bond lease: Tenant is fully responsible for operating expenses, maintenance, repairs and replacements for the entire building and site, without limitation.

NNN lease: This lease follows the bond lease definition except that capital expenditures are limited, usually in the final months of the lease. The lessee is liable for all of the property's expenses, both fixed and operating.

NN lease: This lease follows the NNN, except the landlord is responsible for structural components, such as the roof and foundation.

Modified net lease: The tenant pays its own utilities, interior maintenance and repairs, and insurance. The landlord pays everything else, including real estate property taxes.

Gross lease: The tenant pays one set cost for their rent and the landlord pays everything else including real estate property taxes, insurance, repairs and interior maintenance.

Things to Consider

As with any investment, there are many things that need to be considered prior to investing. Being certain that you've done your due diligence will allow you to be more confident in your decision making. The three main things to consider when investing in a NNN property are as follows: evaluate the lease, consider the quality of the tenant, and research the strength of property location demographics.

Evaluate the lease: It is incredibly important for a detailed and complete review of an existing lease

when looking to invest in a NNN property as this document is the source that outlines your gross income. Things specifically to explore are: clear and consistent language which eliminates ambiguity, type and frequency of rent increases, and inflated rent analysis.

Consider the quality of the tenant: At American Investment Properties, we believe that half of the value of a NNN property is the tenant; therefore it is an absolute must that the tenant is thoroughly researched. Specifically, the tenant's business model and financial strength, number of stores, debt to equity ratios, operating margins, stability of management, and the outlook for their industry sector. Most importantly, the tenant's credit rating/grade will also dictate the quality of the tenant. This rating also dictates the cap rate - the higher quality rated the tenant, the lower the cap rate will be.

Research the strength of property location demographics: As we mentioned above that half of the value of a NNN property is the tenant, we also believe that the other half of the value is driven by the location of the real estate. Demographics are always important to research when looking to invest in any real estate; however, with a NNN property it is extremely important. Specifically, employment rate, median income, population density, and nearby traffic.

Advantages and Risks

There are clear advantages in owning a NNN property, which have fueled a tremendous growth in demand from investors on every level. These properties fulfill objectives that may not be met by typical real estate investments as they appeal to part-time investors looking for guaranteed income with no or little management responsibility, and they provide an attractive exit strategy for those with mature real estate portfolios. NNN properties are attractive to investors who look to benefit from a stream of income without the day-to-day management responsibilities for the property.

However, NNN properties can also be the most challenging type of real estate investment as these property types are actually considered to be highly risk-averse investments. The fine print of the lease document may detail some of these risks such as: casualty or natural disaster repairs and rebuilding, property condemn decisions, or fluctuations in property taxes. Because of these many details, NNN leases require high levels of oversight and a tremendous amount of due diligence, and much more understanding is required than that of a more typical real estate investment. In addition to the lease, it is also imperative to thoroughly research the tenant further than their credit or quality rating. Just because a tenant has a good rating, does not mean that the investment is secure. The outside factors of location demographics, local market conditions, building size, quality, and use all must be considered.

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