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The commercial classroom: Exploring commercial leases - Part 1

August 18, 2008 - Long Island

The leasing process ideally begins with a "wish" list from whomever the broker is representing. Landlords desire certain fees, commitments and conditions from their tenants; and the tenants have size, budget and terms they desire. Once all objectives have been defined by each party the terms of a lease may be negotiated, which usually results in some compromises by each side.

In this lesson we will start to examine some of the general types of leases:

In a Gross Lease the landlord collects rent from the tenants and from the money collected pays all the operating expenses of the building. In some cases, the landlord collects rent from the tenant and "passes through" to the tenant additional costs representative of certain of the building's expenses. In this case we would refer to the lease as a Modified Gross Lease, for example, the cost of power or utilities. The rent may be quoted as $30 per s/f base rent plus $2.50 per s/f for the cost of utilities.

The triple net (NNN) lease, is the other extreme, whereby the tenant pays rent to the landlord and the tenant pays all (or their proportionate share) of the building operating costs. Also, the triple net lease is sometimes written with a structural exclusion. A leaking roof repair may be the responsibility of the tenant, but if the entire roof needs replacement that would be the landlord's expense.

Net leases fall between gross and triple net leases in that the term means the landlord will pay some of the building operating expenses and the tenant will pay some of the operating costs. The lease will clearly define who is responsible for what and who will pay for what.

It is important, as we assign responsibility for payment of operating expenses, that this be fair and accountable. A landlord may pass through to a tenant their proportionate share of the electric or fuel costs; the tenant should have the right to review the actual bills for accuracy. The tenant pays additional rent of $2.50 per square foot for utilities; the lease should allow the tenant to review the basis of this cost and also allow the landlord to periodically adjust the cost based upon the actual expenses.

A flat lease means that the amount of rent will not increase during the term of the lease. As one might expect this would usually apply to a relatively short term lease. This is also known as a month-to-month lease. (Even if the term of a lease is short a written document detailing all the terms is appropriate). This type of lease may occur when someone is moving and their new space is not ready, necessitating a short term lease elsewhere; or for seasonal businesses.

A step-up or graduated lease establishes a base rent, but reduces the initial rent due for a period of time. For example the store's rent will be $2,000 per month, but to help the tenant get started (or build up a client base) the landlord agrees to $1,000 per month for the first three month, $1,500 per month for the next three months and then in the seventh month of the lease the full rent commences. Often child care facilities are new construction and they cannot get their state license until the building is completed and a Certificate of Occupancy is obtained. Consequently they cannot register any children until licensed. This type of lease gives them time to complete their enrollment, and develop their regular cash flow before the full rent is due.

More lease types and terms next month...

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