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The commercial classroom: Exploring commercial leases

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

Percentage Leases apply only to retail businesses. In this case part of the rent paid to the landlord is a percentage of the sales of the retailer. A break even or threshold dollar amount is determined and the percentage is negotiated. After sales reach the break even point the tenant pays as additional rent the agreed percentage of all sales thereafter.

Ground or Land Leases As it sounds the tenant is renting the land and the tenant is responsible to make any desired improvements (like constructing a building) at their expense. Since the tenant is doing the improvement they want a long lease to get the benefits of their construction and amortize their cost. Hence land leases today are generally written for a 49 year term (in the past many were written for a 99 year term.

These types of leases are generally "triple net" whereby the tenant pays all the expenses, real estate taxes, insurance, etc. The rent is increased, but usually in five year increments.
Build-to-Suit In this case there is generally a developer who finds a property (vacant or with a building on it that may be demolished) they think would be good for a national company. They approach the national company with a proposal that they will construct a building per their plans and specifications on the site. In exchange they expect a long term lease to be signed (20 years or more). The rent and escalations are negotiated and the lease is signed. The developer builds-to-suit the building and the tenant moves in. Then the developer sells the entire project to an investor and looks to do the same type of project again for someone else.

Turnkey Lease This is very similar to the build-to-suit, but goes a step further. Tenants who seek these leases want the developer to do everything in terms of finishing the space. This could include painting, wallpapering, building fixtures, providing furnishings so that on the date of occupancy the tenant could literally turn the key in the door and go to work. Obviously this extra work is going to cost more and the rent will be higher.

Sale-Leaseback A successful business owner may need cash for expansion, another facility or other investment. They own the building their business operates out of generally without debt. To raise capital they sell their building to an investor becoming the tenant. The deal may be something like this. If you buy my building for $1 million; I will become the tenant and offer you an 8% return on your investment. This would be accomplished with a 20 year, Triple Net lease with a base rent of $80,000. The seller gets their capital and the investor gets a stable tenant with a good return on their investment. This is quite popular in the industrial manufacturing sector.

Sublease This begins as a clause in the original lease that would allow the tenant to rent out part or all of their space. The clause would require the landlord's consent and approval. When this is done a second lease is constructed between the Tenant, now referred to as the Master Tenant and the Sub-Tenant. There is no direct contractual relationship between the Sub-Tenant and the Landlord. The Sub-Tenant pays their rent to the Master Tenant who in turn pays the Landlord. The original Tenant is liable under the lease for all rent due.

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