PRINT CLOSE

NEW HAMPSHIRE BUSINESS REVIEW

Navigating tangled maze of commercial lease jargon

Thursday, August 23, 2001

By Bradley Vear

Why must commercial leasing terms be so confusing? If you are in the market for office space and try to compare the rental rates of various buildings it is apples and oranges.

What is the difference between a triple net rate and gross rate? What about modified gross? What do useable vs. rentable figures have to do with rent? What's the difference between "tenant electric" and plain electric? TIs, NNN, CAM, CAF, CPI – what's it all about and who cares?

It sounds confusing because it is confusing. There is no simple and easy way to directly compare rental rates of various buildings. You have to gather all of the cost variables and then try to calculate what I call an "effective rate per square foot." When we represent a tenant in a site search for space, we prepare a property matrix to try and accomplish this "apples to apples" comparison. For each property we list the quoted rate, the common area factor (CAF), expenses that are not included in the rate such as common area maintenance (CAM), utilities estimates, parking, etc., and then calculate an effective rate per square foot.

This then should be summed up over the number of years of the lease term with any annual increases or "bumps" included and discounted back so that the net present value (NPV) of the total lease cost is determined.

I know, it sounds like calculus.

If you are looking for commercial space, some basic terms and practices should be understood. First, in this part of the country, rental rates are quoted in terms of annual cost. That is, if the quoted rate is $12 psf it means that the tenant pays $1 per square foot per month ($12/12 months). Other regions like California quote rates as monthly figures.

Second, you need to know if it is an NNN (triple net) rate, a gross rate or something in between, such as modified gross. Most multi-tenant office buildings quote as "gross" rates. Flex space or office/warehouse space is generally an NNN rate. If you look at the "one liners" that advertise commercial space in this paper, you can see examples of this. The problem is that one landlord's "gross" rate is not necessarily the same as another landlord's "gross" rate. For example, cleaning or electricity may be totally included under one gross rate, yet another gross rate may bill the tenant extra for these items, i.e., a "modified gross rate."

An NNN rate is like a la carte rent — it does not include the tenant's share of real estate taxes, common area maintenance (CAM) and insurance. Nor does it usually include utilities. Obviously, these extras, or "pass-thru's," are significant and can add up to as much as one-third or more of the NNN rate that is quoted. When estimating utility expenses, remember to determine how the space is heated. Is it a central boiler system that becomes part of the CAM or is it electric heat pumps that are metered to the tenant directly?

The obscure CAF

One of the most obscure variables that can amount to a 10 percent to 20 percent variation in the effective rental rate is the CAF. If you want to impress your real estate broker (or more likely stump them), ask what the common area factor is for a particular building. Sometimes referred to as a "load factor," the CAF indicates how much of the building's space is devoted to common areas, like hallways, bathrooms, elevators, the lobby, etc. There are guidelines on how to correctly measure space, developed by BOMA (Building Owners Management Association). I have seen the CAF vary from 8 percent to 22 percent.

The actual usable square footage of the tenant's premises is then increased by the CAF to arrive at the rentable square-footage. It is the rentable square-footage that is multiplied by the rental rate to arrive at the total rent. If one building has a CAF of 10 percent and another's is at 18 percent, then the tenant with the lower CAF saves approximately 8 percent for the same amount of usable space.

So why are there so many variables and variations in the commercial leasing environment? Probably because of the way different product types have evolved and what was commonly accepted by different tenant categories. It may have been impractical for large multi-tenant office buildings to separately meter utilities to individual tenants, while the single story multi-tenant flex building could be more easily divided.

In any case, those of us in the commercial real estate business are left with an assortment of rates and terms that need to be distilled in order to properly compare the true cost of leased space.

Bradley Vear is principal of Vear Commercial Properties Inc., Nashua. He has represented tenants and landlords throughout southern NH since 1986. For more information, call 882-6000 or e-mail, btv@TeamVear.com.