



## COMMERCIAL REAL ESTATE TERMINOLOGY & DEFINITIONS

### Office Buildings

Office buildings range from small, owner-occupied properties to multi-building office parks. Below is the industry's classification of office property.

Class "A" - A building with excellent location, high quality tenancy and superior maintenance. Building must be superior construction and finish, relatively new or competitive with new buildings, and providing professional on-site management. These properties are within the top percentage of the overall market desirability.

Class "B" - Building with average to above average location and tenancy quality. Minor functional obsolescence. Can compete with low end of Class A.

Class "C" - Building with average to poor location, management, design and tenancy quality. Generally an older building with growing functional land, economic obsolescence and/or deterioration.

### Industrial Properties

There are several different classifications of industrial properties. Such uses are: manufacturing, processing, storage, distribution, research and development. Warehousing is included in the industrial classifications and most have a small percentage of offices in the building. Office/Warehouse properties are typically flexible, general purpose buildings that can be changed to a small user needs. Below are the categories for industrial uses.

1. The Heavy Industrial segment is made up of manufacturing properties. Typical users would be the auto industry, textiles, steel and chemicals. Office space is usually zero to five percent of the building.
2. The Light Industrial/Assembly facility usually has production lines that assemble components. Office space is usually 10 percent or less.
3. Warehouse/Distribution is the least intense industrial use. Comparable to light industrial/assembly property, office use is limited to management task for the distribution or warehouse facility, or about 15 percent of total space.
4. Office/Warehouse or Research & Development broadly define the wide variations in markets throughout the country. Research & development or office/warehouse properties could have lab facilities, offices, warehouse facilities, or personal services such as carpentry or machine repair. There will be a different percentage of office use based upon the individual needs of the user.

### Retail

Retail Properties can range from a single, one-tenant building to over a million square feet of assorted shops that display goods or sell services to the public. There are three general categories of Retail properties:

1. Shopping Centers- A group of stores catering to a trade area, which offers a variety of goods and/or services and on-site parking (the tenant "mix"):

a. A "super regional center" has three or more major department stores, is often enclosed (mall), is 750,000 to one million square feet, and draws from a large trade area of 12 miles or more.

b. A "major mall" is an enclosed retail center which equals or exceeds 500,000 square feet of leasable area. Tenant mix typically features department store anchors with additional smaller specialty shops.

c. A "regional center" has one or two department stores, a variety of smaller stores, and is larger than 300,000 square feet. It will draw from an eight mile radius or more.

d. A "power center" is a retail center featuring a majority of oversized tenants. Design is usually open, featuring a tenant mixture of discount, big box, club warehouse and/or single category discount retail operations (a.k.a. "category killers"). Size ranges from 250,000 square feet & up.

e. A "community center" usually has a supermarket, junior department store, and a variety store, is larger than 100,000 square feet, and draws from a three to five mile radius.

f. A "big box store" is an oversized discount retail store with large open floor plan. Frequently freestanding but can also be part of a large power center. Sizes range from 50,000 square feet to 125,000 square feet.

g. A "neighborhood center" is built around a supermarket and/or drugstore, provides convenience goods and services to a neighborhood, is between 30,000-100,000 square feet, and draws from a one to three mile radius.

h. "Strip centers" are retail centers & plazas that have a minimum of 10,000 square feet. Design is typically open with larger anchor store(s) which can be freestanding or accompanied by smaller "satellite" stores.

i. A "convenience center" is a small cluster of stores along a street, 5,000-40,000 square feet; trade area is immediate neighborhood. May have a convenience market, laundromat, dry cleaner, etc.

j. A "specialty center" often has a theme, usually has no anchor tenant, and generally is local in impact. Examples might be home improvement centers, gift shops, or auto service and sales.

2. Free Standing Store - One commercial building meant to be occupied by a single user. It is typically found near major shopping centers on major routes, and fills a specific need in the area.

3. Strip Commercial - A string of stores in a commercial area with no central leasing, management, or theme.

### **Commercial Rents**

Commercial properties for lease are typically quoted on an annual rent per square foot. That is, the total rent per year per square foot. For example, if you lease 1,000 square feet of commercial space and the rent is quoted at \$12 per square foot, the total annual rent would be \$12 x 1,000 square feet = \$12,000. On a monthly basis this would be \$1,000 per month.

### **Types Of Leases For Office And Industrial Users**

The first step in analyzing market rents is to compare all leases on an equal basis. A tenant that leases at \$12 per square foot NNN (Triple Net) would pay more rent than if the same tenant were leasing on a gross basis. With a 'Net Lease' the tenant would pay a share of the operating expenses plus the \$12 per square foot. With a 'Gross

Lease' the tenant will pay \$12 per square foot and no operating expenses. In comparing rents it is imperative that the type of lease is known and understood.

### **Types Of Commercial Leases**

Full Service Lease - Everything is included in rent. All operating expenses and utilities are paid by the landlord.

Gross Lease- Lease which includes all building operating expenses, common area maintenance (CAM - is used primary in retail leases), building insurance, building maintenance, real estate tax charges. Think in terms of "TIM" Taxes, Insurance and Maintenance. Landlord pays for building operating expenses, and the tenant pays for all utilities.

Absolute Gross Lease - The same as Gross Lease, however, the rent includes utilities.

Net Lease - A lease which the tenant pays expenses such as taxes, insurance, and maintenance.

NNN Lease (Triple Net Lease) - In addition to base rent, tenant pays all proportionate share of utilities, insurance, maintenance, real estate taxes, and common area maintenance (CAM). Several centers feature separate additional promotional fees.

Other issues for commercial leases:

- A lease that specifies that the landlord is responsible for the payment of all operating expenses.
- The lease, however, may contain pass-through provisions which would increase the rent each year over the term of the lease. This is also known as a full service lease.

### **Rent Payments**

The key business decision to be made by the parties to a commercial lease concerns the payment of rent. To the landlord, rent is the return on his investment in the real estate. To the tenant, rent is an important cost of doing business. The major change in the form of commercial rent payments in the past quarter century has been substitution of adjustable rents for the traditional fixed rents over the term of the lease. The cause has been inflation, which not only increases the landlord's operating expenses in dollar terms but also reduces the purchasing power of the dollars he receives in profit. Consequently, while fixed rentals still are fairly common, tenants must anticipate the likelihood that the landlord will request some form of adjustment when the lease is being negotiated. Most leases contain a rent clause that falls into one of the following four categories:

1. Flat rental: fixed rental for the term of the lease
2. Step-up: fixed rental with fixed increases or decreases
3. Escalation rental: fixed rental adjusted for real estate taxes, operating expenses, or both
4. Cost-of-living rental: fixed rental adjusted for changes in cost of living

It is not unusual for a lease to include a combination of these rental categories.

### **Flat Rental**

The traditional and least complex method of setting the rent is to provide that the rent will be a fixed number of dollars per annum, payable monthly in advance. Tenants prefer this type of provision since they know exactly what their rent obligations will be for the term of the lease; in addition, with the likelihood of continuing inflation, a fixed rental in effect is a diminishing rental over a period of time.

Landlords naturally take the opposite view and try to avoid fixed rentals, since they make the landlord the victim of inflation. At the very least, the landlord wishes to be able to pass on increased operating expenses or real estate taxes incurred by him during the lease term. In addition, the landlord wants his cash flow to maintain the same purchasing power over the lease term. As a result, landlords are now requiring some form of escalation even in short-term leases (i.e., one to three years).

### **Step-Up Provision**

Rental provisions providing for additional increments at specific dates during the lease term have the great advantage of being simple. There is no need for an elaborate set of definitions or for detailed procedures. The lease merely states in a schedule the applicable period and the rent to be paid during such period.

Tenants very often are willing to accept such fixed "step-ups" because they recognize the inevitable upward trend of costs. The loss of precision in matching the increases to changes in the cost-of-living or operating costs is believed to be more than offset by the simplicity of the clause.

### **Escalation Rental**

Adjustment for Increased Real Estate Taxes - A common form of commercial lease rental arrangement is the fixed rental with a provision for the tenant to pay his share of increased real estate taxes. This protects the landlord's dollar profit from the most significant type of increased cost. At the same time, the tenant is afforded considerable security against substantial increases, since the adjustment is limited to a well-defined standard and increased real estate taxes usually are only a small percentage of total rental cost.

Tax-adjustment clauses (also known as "tax-escalation clauses" and "tax-stop clauses") typically are based on the real estate taxes paid by the landlord during the initial year of the lease. If real estate taxes increase in subsequent years, the tenant is required to pay the proportionate share of the increase (or the entire increase, if the tenant occupies the entire building). It should be noted that in some leases, the tenant is required to pay all real estate taxes in addition to the fixed rental. This is usually, but not necessarily, limited to a "net lease" situation where the tenant occupies the entire premises, pays all operating expenses, and remits a net rental to the landlord each month.

### **Measuring Commercial Space**

To determine the annual rent of a tenant, the space must be measured. There are three basic ways to measure a commercial building. If done incorrectly, the error could cost you thousands of dollars over the term of the lease. The three methods are:

Gross Building Area (GBA) - The total floor area of a building measured in square feet from the external walls, excluding unenclosed areas. Gross building area does not include basement area. This method is typically used with a single tenant building.

Usable Area - Total floor area computed by measuring the inside finished surface of the corridors and other permanent walls, to the center of the partitions that separates the adjoining usable areas. (The space that is occupied by the tenant.)

Leasable or Rentable Area - Is the same as Usable with additional prorated square footage of the common areas.