3 Different Types of Commercial Real Estate Leases

There are three basic types of commercial real estate leases. These leases are organized around two rent calculation methods: "net" and "gross." The gross lease typically means a tenant pays one lump sum for rent, from which the landlord pays his expenses. The net lease has a smaller base rent, with other expenses paid for by the tenant. The modified gross lease is a happy marriage between the two. While terms vary widely building by building, this basic overview will help businesses shop for the best deal possible.

Gross Lease or Full Service Lease

In a gross lease, the rent is all-inclusive. The landlord pays all or most expenses associated with the property, including taxes, insurance, and maintenance out of the rents received from tenants. Utilities and janitorial services are included within one easy, tenant-friendly rent payment.

When negotiating a gross lease, the tenant should ask which janitorial services are provided, and how often they are offered. Excess utility consumption beyond building standards is sometimes charged back to tenant; so if the tenant is a big consumer of electricity, this point should be clarified in the lease as well. The tenant pays his own property insurance and taxes.

A benefit of this type of lease is that it is supremely easy for the tenant, which can forecast expenses without worrying about an unexpected lobby maintenance charge, for example. The landlord assumes all responsibility for the building, while tenants concentrate on growing their businesses.

Net Lease

In a net lease, the landlord charges a lower base rent for the commercial space, plus some or all of "usual costs," which are expenses associated with operations, maintenance, and use that the landlord pays. These can include real estate taxes; property insurance; and common area maintenance items (CAMS), which include janitorial services, property management fees, sewer, water, trash collection, landscaping, parking lots, fire sprinklers, and any commonly shared area or service.

There are several types of net leases:

Single Net Lease (N Lease)

In this lease, the tenant pays base rent plus a pro-rata share of the building's property tax (meaning a portion of the total bill based on the proportion of total building space leased by the tenant); the landlord covers all other building expenses. The tenant also pays utilities and janitorial services.

Double Net Lease (NN Lease)

The tenant is responsible for base rent plus a pro-rata share of property taxes and property insurance. The landlord covers expenses for structural repairs and common area maintenance. The tenant once again is responsible for their own janitorial and utility expenses.

Triple Net Lease (NNN Lease)

This is the most popular type of net lease for commercial freestanding buildings and retail space. It is known as the net net net lease, or NNN lease, where the tenant pays all or part of the three "nets"--property taxes, insurance, and CAMS--on top of a base monthly rent. Common area utilities and operating expenses are usually lumped in as well; for example, the cost for staffing a lobby attendant would be part of the NNN fees. Of course, tenants also pay the costs of their own occupancy, including janitorial services, utilities, and their own insurance and taxes.

Landlords typically estimate expenses and charge tenants a portion of these expenses based on their proportionate, or pro-rata share. A tenant who leases 1,000 square feet of a 10,000 square foot building would be expected to pay 10% of the building's taxes, insurance, and CAMS, for example.

Triple net leases tend to be more landlord-friendly, and tenants should carefully review NNN fees and negotiate caps on the amounts they can be raised annually. An NNN lease can also fluctuate from month to month and year to year as operating expenses increase or decrease, making the company's expense forecasting tricky and sometimes frustrating.

There are tenant benefits in the NNN leases, however. Transparency is an excellent perk, since tenants can see business operating expenses in relation to what they are charged. Cost savings in operating expenses are passed on to the tenant rather to the landlord. In addition, the monthly rent in a NNN lease is potentially lower than in a gross lease, as tenants have a higher level of responsibility for the building.

Absolute Triple Net Lease

This is a less common option that is more rigid and binding than the NNN lease, where tenants carry every imaginable real estate risk, for example, being responsible for construction expenses to rebuild after a catastrophe, or for continuing to pay rent even after the building has been condemned. Aptly called the "hell-or-high-water lease," tenants have ultimate responsibility for the building no matter what.

Modified Gross Lease

As the gross lease is more tenant-friendly, and the net lease tends to be more landlord-friendly, there exists a compromise lease for the convenience of both parties. The modified gross lease (sometimes called the modified net lease) is similar to a gross lease in that the rent is requested in one lump sum, which can include any or all of the "nets"--property taxes, insurance, and CAMS. Utilities and janitorial services are typically excluded from the rent, and covered by the tenant. Tenants and landlords negotiate which "nets" are included in the base rental rate.

The modified gross lease is more popular with tenants, because its flexibility translates into an easier agreement between tenant and landlord. Unlike the NNN lease, if insurance, taxes or CAM charges increase, the lease rate would not change. Of course, if those expenses decrease, the cost savings is passed on to the landlord. As janitorial service and electricity are not covered, tenants can better control how much they spend compared to a gross lease.

Summary of NNN Lease, Modified gross, or Full Service Commercial Leases

When evaluating options for office space lease, it is important to compare the different lease options with an eye toward all expenses, and not just the base rental rates. NNN base rental rates tend to be much lower, with additional expenses added for the real monthly rate.

Market forces will tend to even out rental rates for comparable properties, regardless of type of lease. Tenants should expect to pay roughly the same amount with an NNN, modified gross, or full service lease for similar quality office spaces in the same area.

The most important rule of commercial leases is for tenants to read their leases carefully, and clarify exactly what expenses they have responsibility for. Circumstances under which additional charges will occur should be identified and caps negotiated.