

Deconstructing the  
**COMMERCIAL**  
**REAL ESTATE**  
**LEASE**

Written by,

**Gregory J. Laskody, CCIM**

*Principal*

Lee & Associates South Florida

305.235.1500 | [lee-associates.com](http://lee-associates.com) | [leesouthflorida.com](http://leesouthflorida.com)



COMMERCIAL REAL ESTATE SERVICES



**LEE & ASSOCIATES**  
COMMERCIAL REAL ESTATE SERVICES

The Author of this document and Lee & Associates do not make any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein. Lee & Associates has not been contracted to provide, legal, financial, or tax advice, and any such advice regarding any investment by the recipient of this document must be obtained from the recipients' attorney, accountant, or tax professional. Information contained herein is believed to be accurate, however, recipient should conduct their own due diligence

Lee & Associates South Florida  
7925 NW 12th St, Suite 301  
Miami, FL 33126

305.235.1500 | [lee-associates.com](http://lee-associates.com) | [leesouthflorida.com](http://leesouthflorida.com)



# Deconstructing the **COMMERCIAL REAL ESTATE LEASE**

There are a wide variety of commercial real estate (“CRE”) lease types and structures present in today’s marketplace, while the terminology and vernacular used to classify them can be extremely confusing. But, regardless of the lease types that will be subsequently presented, there are three things that all CRE lease structures have in common:

- 1 They are based on the property type, which also depends to some degree on;
- 2 The market or sub-market that a particular property is located within;
- 3 And **‘who’** pays for **‘what’** operating and ownership expenses associated with a particular property

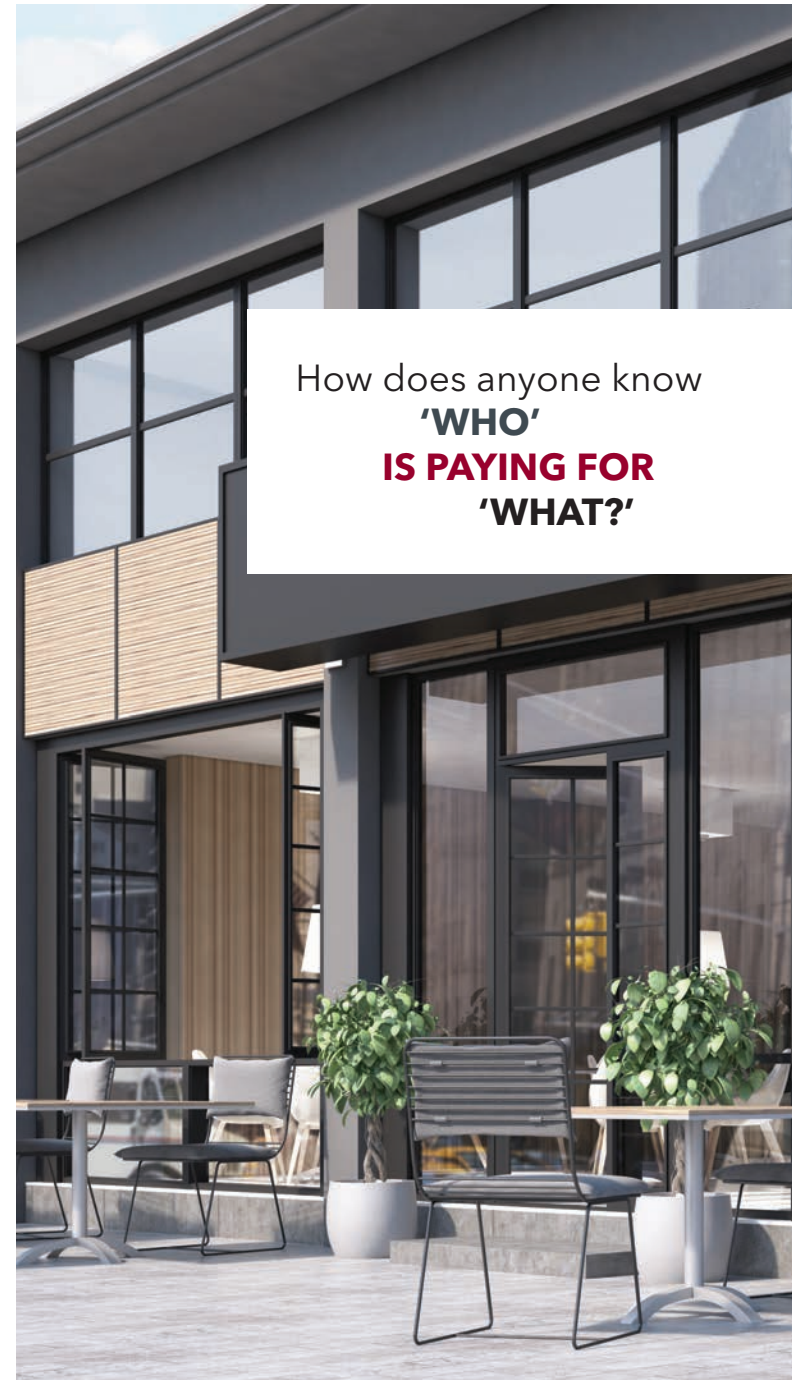
As will be provided in much greater detail below, the more ‘gross’ a lease is, the more that the operating and ownership expenses become the obligation and responsibility of the landlord; conversely, the more ‘net’ a lease is, the more that the operating and ownership expenses become the obligation and responsibility of the tenant. Said differently, in a ‘gross’ lease, a tenant will pay one flat rental rate to the landlord, with the landlord paying directly all operating and ownership expenses associated with the property; in a ‘net’ lease, the landlord receives a ‘base rent,’ with the tenant either paying some, or all, of the operating and ownership expense directly, or ‘reimbursing’ the landlord for these expenses (this ‘reimbursing’ the landlord also has its own terminology, such as: “Operating Expense Recoveries,” “Recoveries,” “Pass-Thru’s”, “CAMs” [for ‘Common Area Maintenance’ - which in itself is a misnomer], “Reimbursements,” and many others).

As a 30-year commercial real estate professional, a former MAI and state-certified general appraiser, and currently a CCIM member and an investment sales and capital markets advisor, I remain continuously amazed at not only how many professionals do not fully know or understand how to properly classify the various types of commercial real estate lease types, but more so that there is not one definitive, authoritative, and generally accepted source on this topic. Not that I am looking to establish such a reference - but, I do believe there should be greater consensus and clarification as it relates to commercial real estate lease structures.

Certain property types will contain rent and lease structures that can vary greatly, even if the properties are near each other, or even next door or across the street. For example, a “Class-A” multi-tenant office building located in a downtown urban core may be comprised entirely of “gross” leases, while a mixed-use lifestyle and entertainment center located immediately next door may have a “net” lease structure. Also, similar property types may have different lease structures, based on the characteristics in that given market or sub-market - which, in actuality are influenced by prevailing market trends. For example, retail leases have generally been structured as ‘net,’ while office leases have generally been structured as ‘gross.’ However, in certain office markets, this trend is (not so gradually) shifting from ‘gross’ to ‘net,’ as landlords and property owners attempt to own and operate their buildings more profitably, while at the same time transferring as much of the “uncontrollable” expense risk to their tenants as possible, i.e., ‘whatever the market will bear.’

The graphic presented below shows a spectrum of the CRE lease types available in the current commercial real estate landscape. The problem here is that one man’s ‘double-net’ is another man’s ‘modified-gross.’ Said differently, there is no generally accepted classification of these CRE lease structure types. This is because they all vary from market to market, property type to property type, broker to broker, landlord to landlord, market participant to market participant, and finally - source to source. For example, this can be hugely important for brokers that are quoting rental rates for available space; if there isn’t a consensus on what ‘modified gross,’ ‘double-net,’ ‘triple-net,’ or ‘absolute net’ is, then how does anyone really know ‘who’ is paying for ‘what’ when a rental rate is quoted?

And, if you don’t believe me on any of these categories, just open up your favorite browser and enter ‘types of commercial real estate leases’ into the search bar and see what comes up. I find it interesting that such well-reputed, nationally recognized commercial real estate sources - such as The Appraisal Institute (AI), National Association of Realtors (NAR), the Building Owners and Managers Association (BOMA), the National Association of Office and Industrial Properties (NAIOP), and many other highly respected commercial real estate sources along with these mentioned - do not seem to be in agreement on these lease classification types.

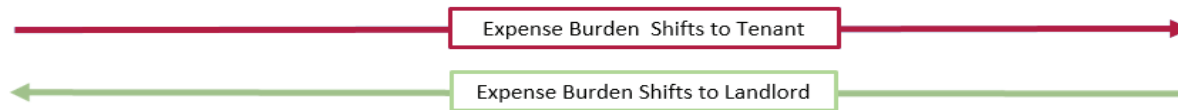




**But - what ALL of these have in common is only two simple things:**

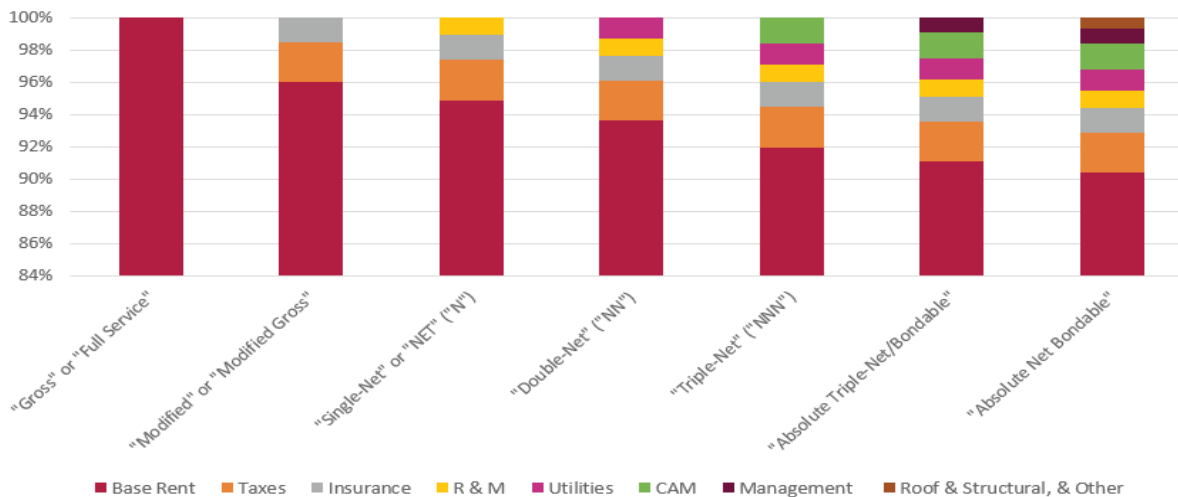
- 1 Which operating & ownership expense obligations belong to the landlord/property owner?
- 2 Which operating & ownership expense obligations belong to the tenant?

Take a look at the graphic below. This assumes that 'market rent' on a 'gross' basis is \$50.00 per square foot, or 100% of the rent paid that is paid to the landlord by the tenant. If the market is in equilibrium (which always happens, right?), 'gross' rents will always be equal to the 'net' rents plus all 'reimbursable' operating expense items on a pro-rate basis for each tenant. This graphic is intended to show how - within each lease structure - more operating expense burden shifts from the landlord to the tenant, depending upon this relationship between 'gross' and 'net'.



**Market Equilibrium = Gross Leases = Net Rents + All Pass-Through Items**

**COMMERCIAL REAL ESTATE LEASE TYPES**



The following pages offer a brief discussion on the most generally accepted CRE lease structures prevalent in the current marketplace. They are categorized starting with the landlord having most - if not all - of the operating and ownership (capital expenditures) expenses, with the categories gradually shifting that risk, such that more and more operating and ownership expenses are borne by the tenant. There may even be other monikers for these lease structures in a market located outside of my own, but almost all leases fall into the following general categories.



### **"Gross" or "Full-Service"**

Landlord directly pays all of the operational and ownership costs associated with the building. This would include not only the base rent for the space that a tenant occupies, but also all of the operating expenses, both fixed (controlled) expenses, such as property taxes and insurance, as well as variable (uncontrolled) expenses, such as management, repairs and maintenance, landscaping, trash removal, utilities, and other related expenses. In addition, the landlord is also fully responsible for all ownership items, or capital expenditures - such as parking lot resurfacing, replacement of the HVAC, electrical, and plumbing systems, as well as the roof, structural components, site improvements, drainage, landscaping, common area lighting... even the utility lines leading to, or are situated on, the property. In a gross or full-service lease, the tenant pays one amount to the landlord on a monthly basis that includes all of the items detailed above.

**A Gross/Full-Service lease structure is best for the tenant, because the tenant's 'all-in' rent cost is fixed, with no 'reimbursements' of any additional operating expenses or capital improvements.**

So, landlords with gross leases must absorb all tax and insurance increases, increases in the costs and repairs of both short- and long-lived items of their buildings, as well as capital expenditures, and over the entire term of that tenant's lease. It's easy to see how quickly this can work to the landlord's disadvantage, especially where longer lease terms are involved, and in rapidly expanding markets, where 'market' rent significantly outpaces 'contract' rent. Under a gross lease, the landlord cannot obtain any reimbursement for these items from the tenant.

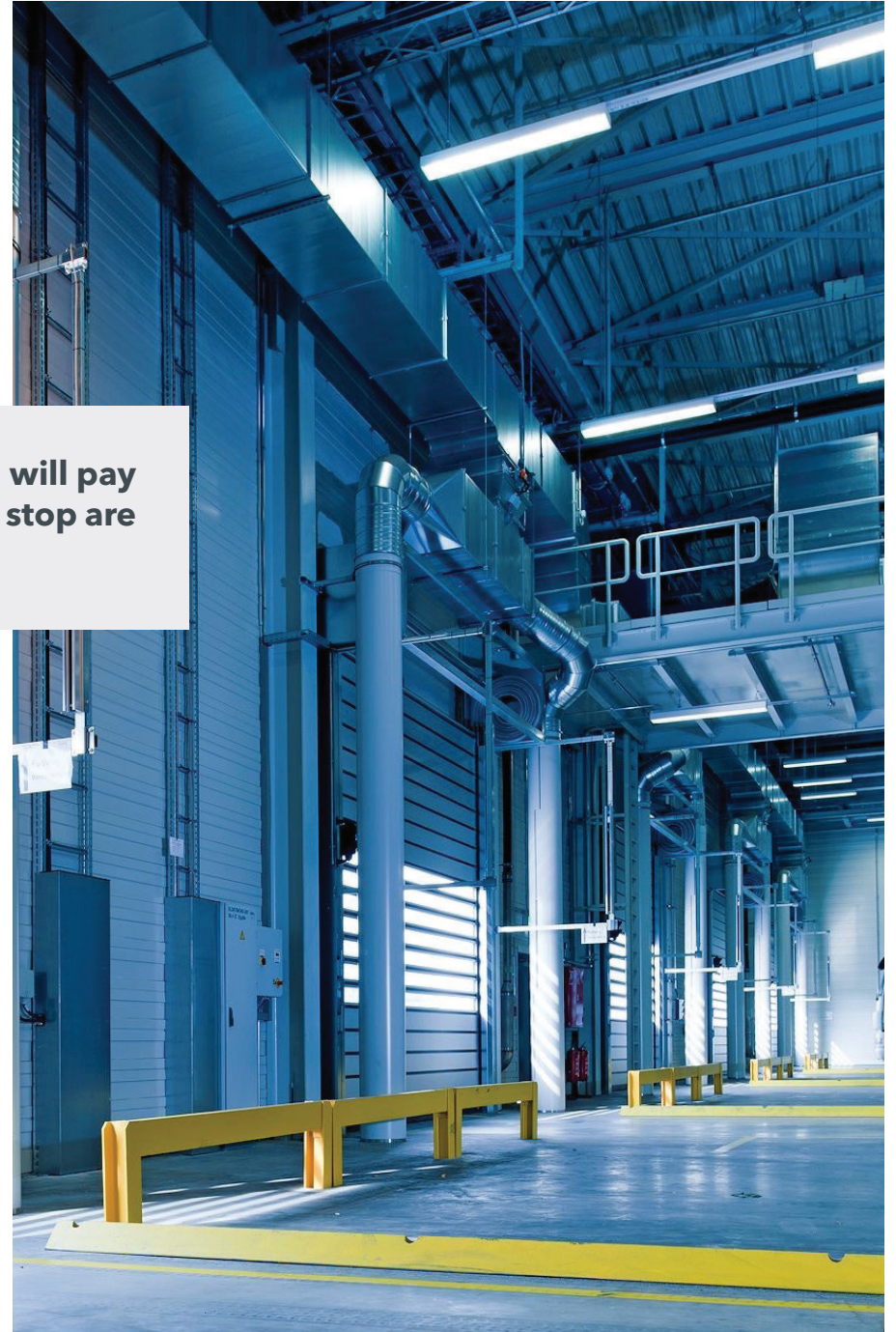


## **“Modified,” “Modified Gross,” and/or “Industrial Gross”**

The tenant and the landlord share in some, or all, of the operating expenses. This is done by the landlord instituting an ‘expense stop,’ which, according to the CCIM Institute, is:

**The level (or maximum amount) up to which the landlord will pay certain operating expenses. Amounts **above** the expense stop are the tenant’s responsibility.**

An expense stop is a tool used by landlords to limit their exposure to operating costs, and as such helps to maintain predictable operating expenses over the term of a lease. A modified structure may also prescribe that a tenant pays its pro rata share of taxes and insurance, with the landlord paying all other expenses. “Base year” expense stops are another common expense-sharing mechanism. With a base year expense stop the landlord pays all of the first-year operating expenses for a tenant, and then in subsequent years the tenant is responsible for any expenses in excess of the base year amount. The portion of expenses above the expense stop that are passed through to the tenant are commonly referred to as “Recaptured” or “Recovered” expenses. In some markets, “Modified” can also be referred to as “Single-Net” and/or “Double-Net.” Confused yet? Keep reading, it gets worse....





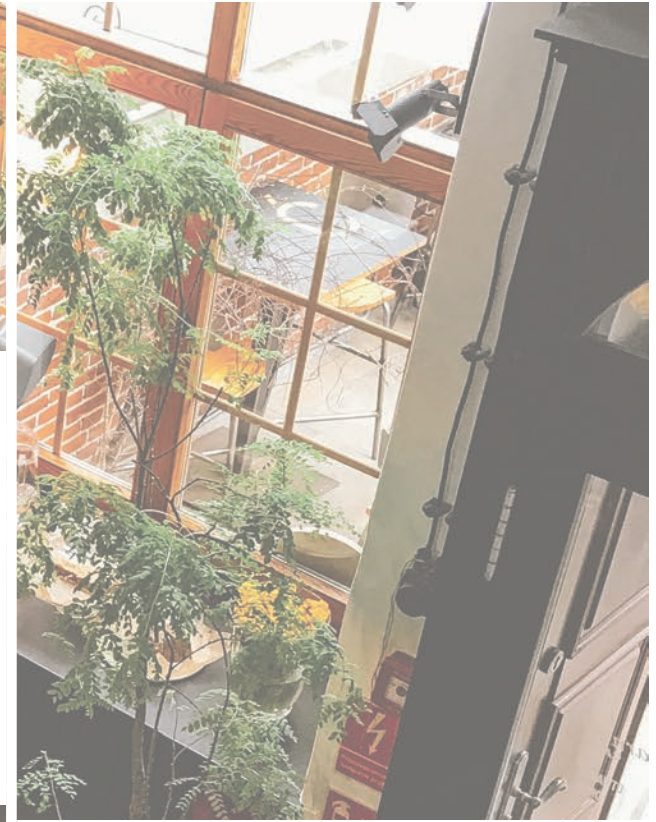
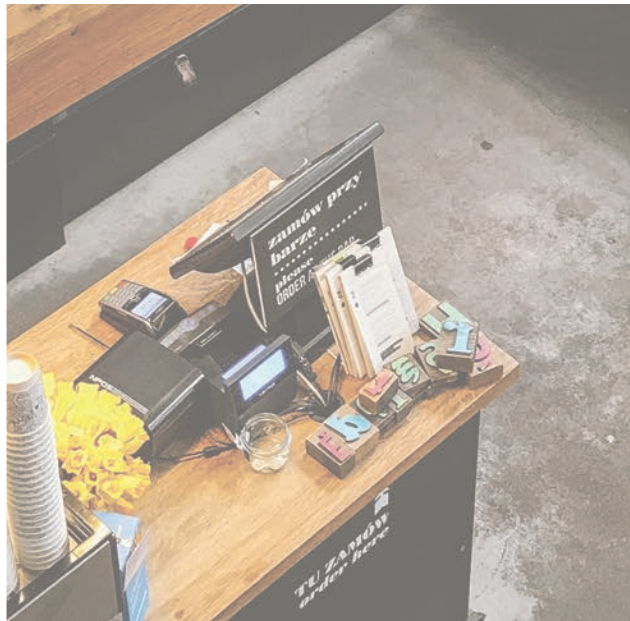
## "Single-Net" or "Net" ("N")

In addition to base rent, the tenant pays some or all of the property taxes, insurance, and/or maintenance. The 'single' comes from just one operating expense item being reimbursed, but this has varied over time and throughout different marketplaces.



## "Double-Net" ("NN")

Generally, a lease in which the tenant pays for property taxes and insurance, in addition to the base rent, and the landlord pays for maintenance, utilities, repairs, and capital expenditures ("Cap-X"). "Double-Net" is also referred to as a double-net lease, NN, and/or can also be referred to as a modified gross lease, which was previously addressed.



## "Triple-Net" ("NNN")

A lease under which the tenant assumes all expenses of operating a property, including both fixed and variable expenses and any common area maintenance that might apply, with this (sometimes) including HVAC, plumbing, and electric systems, depending on the use. However, the landlord remains responsible for structural repairs, utility lines to the property, and sometimes site improvements (parking, landscaping, site lighting, etc.). Can also be referred to as a triple net lease, NNN lease, and/or stated as a fully net lease.



## “Absolute Triple-Net/Bondable”

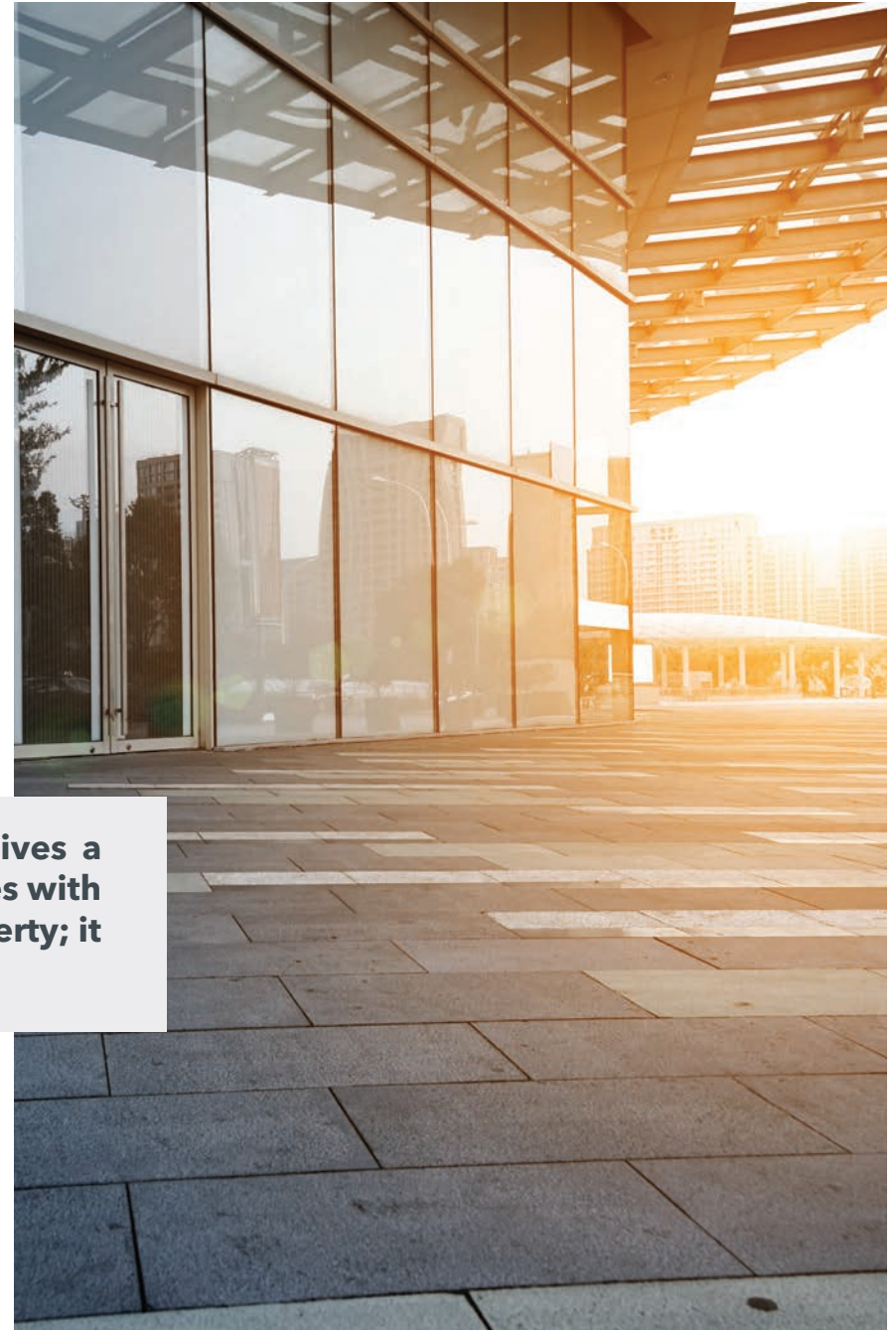
In a general sense, the landlord has no expense or capital responsibilities. Tenant is responsible for taxes, insurance, common area, and all repairs and maintenance items, even including the roof and the structure.

## “Absolute Net Bondable”

All operating expenses and capital improvement items for the property are the tenant’s responsibility, which includes casualty, condemnation, all utility lines, easements, and any other items affecting the property. It is called ‘net bondable lease’ because it is essentially a bond; there is nothing that the property owner – or, in this case, the ‘bondholder’ – has to worry about, except what day the rent check hits his/her bank account, and even that risk is negated thanks to direct deposit. This lease type is also favored by lenders, but only to the extent that a tenant is ‘credit-rated,’ or has a ‘shadow credit-rating’ to further eliminate risk. Many of these leases are accompanied by a corporate guarantee or a credit enhancement provided by the tenant to further insulate the property owner from any loss.

**This is best for the landlord, because the landlord receives a guaranteed base rent with no obligation or responsibilities with any expenses associated with owning or renting the property; it is an “all in,” “bottom-line” rent to the landlord.**

Note that there are other types of lease structures in certain markets and associated to certain property types – such as a “percentage” lease, which is typically seen with retail and entertainment uses. A percentage lease can be in lieu of, or addition to, a base rent, with that rent structure being either ‘gross,’ ‘modified,’ ‘net,’ or any variation thereof.





There is no arguing that this vernacular and jargon can be most confusing, even for the most seasoned CRE professionals, let alone a lay person ('tenant') that is not typically well-versed in CRE lease structures.

An easy rule-of-thumb is that the more **'net'** a lease is, the greater the operating expense and capital improvement costs will become the **responsibility of the tenant.**

The more **'gross'** a lease is, the greater the operating expense and capital improvement costs will remain the **responsibility of the landlord.**

The important thing to remember here, and whether one is:

securing space as a tenant-user;  
projecting revenue as an owner, asset manager or property manager, or  
as an interested third-party, such as a lender, broker, or appraiser,

...is that it is not really as important to be concerned about a particular classification of a lease structure or 'type,' but to instead focus on those two things that really matter under any and all scenarios:

**'who' is paying  
for 'what'  
operating expenses and capital items.**

These obligations - as well as how they change over time - should be adequately addressed in every lease, both for the protection of the landlord and the tenant.





## ABOUT **THE AUTHOR**

### **Gregory J. Laskody, CCIM**

**Gregory J. Laskody, CCIM**, has over 30 years of commercial real estate experience, with expertise in investment sales and realty capital brokerage, real estate investment banking, and valuation. Collectively he has been involved in over \$3.0 BB of commercial real estate transactions since graduating from the renowned and nationally ranked Real Estate program of the College of Business at The Florida State University. Throughout his career, he has held leadership and management positions with some of the most notable companies in commercial real estate, such as: Deloitte; Nomura Capital; Wells Fargo; Q10 Capital, Newmark Grubb Knight Frank, and Colliers International. He is also a former Member of the Appraisal Institute (MAI), and was a licensed mortgage broker, state-certified general real estate appraiser, and an appraiser instructor, all in the State of Florida, in addition to being an Adjunct Professor of Real Estate Studies at Miami Dade College.

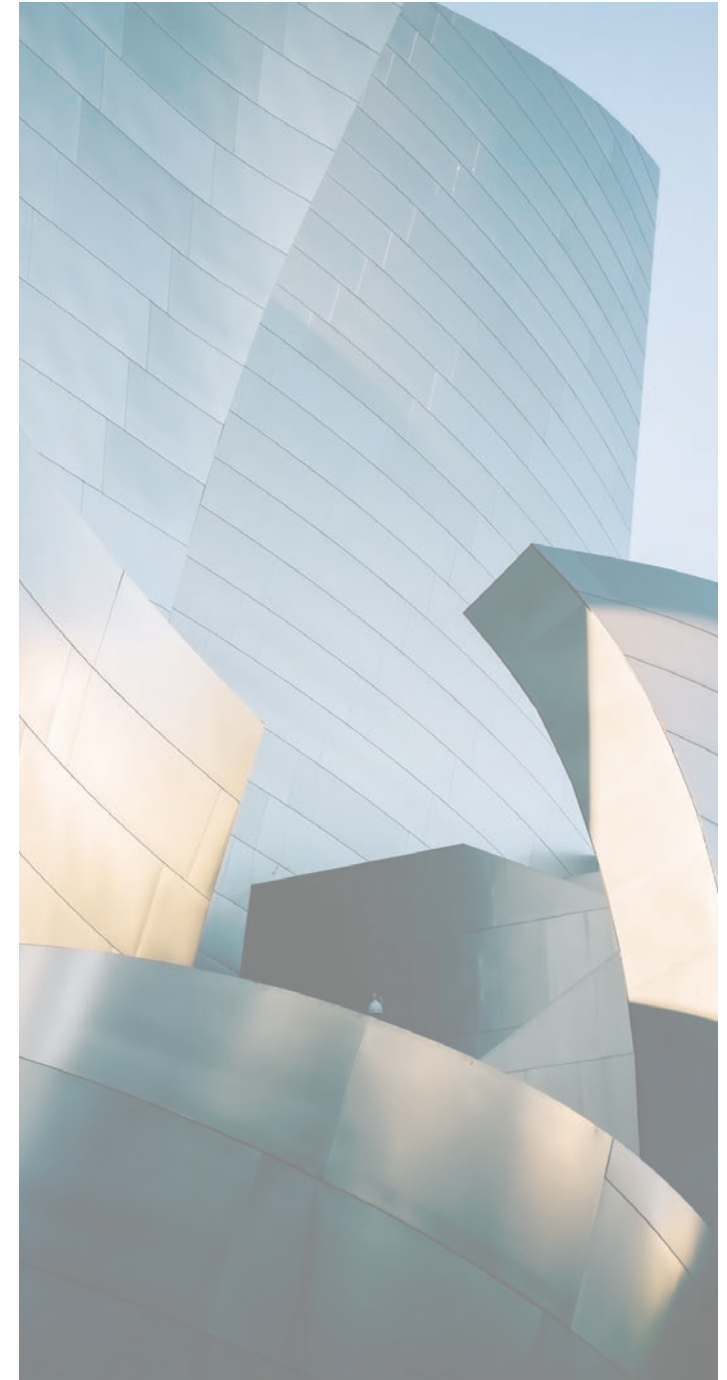
He is currently a Principal with Lee & Associates South Florida, where he specializes in commercial real estate investment sales and realty capital origination and placement.

#### **Gregory J. Laskody, CCIM**

*Principal*

305.490.8082

[glaskody@lee-associates.com](mailto:glaskody@lee-associates.com).





**LEE & ASSOCIATES**  
COMMERCIAL REAL ESTATE SERVICES

Lee & Associates South Florida  
7925 NW 12th St, Suite 301  
Miami, FL 33126

305.235.1500 | [lee-associates.com](http://lee-associates.com) | [leesouthflorida.com](http://leesouthflorida.com)