

# *KW Commercial Real Estate*

## **Presents**

### **Commercial Real Estate – Sales, Leases / Lease Terms**

**A general review of some common commercial real estate sales & leasing terms:**

**Tenant = Lessee                      Owner = Lessor**

**There are several major type leases in use today. These include:**

- \* Gross (Many variations)   \* Net                      \* Percentage                      \* Ground**
- \* Sub                      \* Assignment                      \* Turnkey                      \* Build-to-suit**
- \* Sale-leaseback**

The following definitions are generally accepted in the industry. There are nuances and exceptions in the interpretation and application of the terms relative to a specific lease/property.

**Abatement:**                      A reduction or decrease; usually applies to the forgiveness of rent or a decrease of assessed valuation of ad valorem taxes after the assessment and levy.

**Above Building Standard:**                      Specialized design and engineering services and all construction necessary to personalize tenant space.

**Absolute Net:**                      **Lease** requiring tenant to pay in addition to base rent all costs associated with the operation, repair and maintenance of the building, all real estate taxes, and utilities including repair and maintenance of the building's structure and roof. Often the tenant is directly responsible both for all such costs and for the active handling of the items themselves. Distinguished from Triple Net (see below) by tenant's responsibility for maintenance and repair of the building structure and roof.

**Absorbed Space:**                      Net change in leased space between two dates.

**Absorption:**                      (1) The rate at which land or buildings will be sold or leased in the marketplace during a predetermined period of time, usually a month or a year. (2) The filling of space such as the rental of units or sale of a tract. The time or rate must be estimated and considered as part of the owner's

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(usually the builder) costs.

**Absorption Period:** The number of months required to convert vacant space into leased space assuming there is no new delivered space. Computed by dividing the average monthly absorbed space during a recent period by the current vacant space.

**ADA:** Americans With Disabilities Act passed by Congress in 1994 with intent to provide persons with disabilities accommodations and access equal to or similar to that of the general public.

**Addendum:** Something Added. A list or document or other material added to a document, lease, contract, letter, etc. IE: Legal description; List of FF&E; Survey; Map; Improvements to be made; etc.

**Add-on Factor:** Considered a loss factor, the % of gross rentable square footage that is lost due to the tenant's physical occupancy.

**Ad Valorem:** (According to value) Used in reference to general property tax, which is usually based on the official valuation of property.

**Agent:** One who is authorized to act for or represent another (principal) usually in business matters. Authority may be express or implied.

**Air Rights:** The rights to use the air space over a piece of property.

**Alienation Clause:** A type of acceleration clause where a debt becomes due in its entirety upon the transfer of ownership of a secured property. See also "Due on Sales Clause" and "Acceleration Clause".

**Allowance:** A set dollar amount provided by the Landlord under a lease to be used by the Tenant for a specific purpose. Examples include allowances for tenant improvements; moving expenses design fees, etc. If the expense exceeds the allowance amount, such excess is the Tenant's responsibility. If the expense is less than the allowance, the savings are retained by the Landlord unless their agreement specifies otherwise.

**Allowance Over Building Shell:** One of three arrangements often used for financing tenant improvements (finishing out office space to accommodate a tenant such as walls, doors, carpeting, etc.). Often used in a yet-to-be-built building, this arrangement caps the landlord's expenditure at a fixed dollar amount over the negotiated price of the base building shell. This arrangement is most successful when both parties agree on a detailed definition of what construction is included and at what price. Tenants may ask for a

contingency in the event the actual build-out costs are less than the allowance, requiring the landlord to return the savings in the form of rent abatement or other concession.

- Amendment:** A document to reflect a change either to correct an error or alter a part of an agreement without changing the principal idea or essence.
- Amortization:** Payment of debt in regular, periodic installments of principal and interest, as opposed to interest only payments. May also be used in a lease where the landlord incurs costs for additional tenant improvements which are effectively treated as a debt and repaid by tenant over the term of the lease.
- Anchor Tenant:** The most reliable, and usually the largest, tenant in a shopping center (or could be an office building or industrial building) The strength of the anchor tenant greatly affects the availability of financing for the property. May dramatically affect the attraction to the property of other tenants.
- Anticipatory Breach:** Occurs when one party to a contract, prior to time of performance, informs the other of his or her intent not to perform. Example: The buyer informs the seller before the closing date of his or her intent not to buy.
- Appraisal:** The estimation and opinion of value placed upon a piece of land based upon a factual analysis by a qualified professional; the process of estimation and the report itself.
- Appreciation:** An increase in the value of property caused by an improvement or the elimination of negative factors.
- Arbitration Clause:** A clause in a lease calling for the decision of a 3<sup>rd</sup> party (arbiter) regarding disputes over future rents based on negotiation. Also used in construction contracts, disputes between brokers, etc.
- As Is:** As Is Condition – Premise accepted by buyer or tenant in the condition existing at the time of the sale or lease, including all physical defects.
- Asking Rent:** The dollar amount asked by landlords for direct available space (not sublease), expressed in dollars per square foot per year in most parts of the country and dollars per square foot per month in areas of California and selected other markets. Buildings will have an average asking rent for available space. Usually a point of departure for negotiations between landlords and tenants.
- Assessment:** (1) An estimate of property value for the purpose of imposing taxes. (2) A fee imposed on property, usually to pay for public improvements such as streets and sewers.

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<b>Asset Based Lender:</b>	A lender who loans money based primarily on the values of an asset - accounts receivable, inventory, a piece of equipment real estate – rather than on the financial strength of the business, which is the primary criterion for banks.
<b>Assignment:</b>	Under the terms of an assignment, a tenant transfers all interest in the leased property to another party. Generally all lease terms remain the same. To transfer interest in a property.
<b>Attachment:</b>	Legal procedure to add in the collection of a debt. Usually the court issues a writ to seize the property of a debtor and holds it pending the outcome of a lawsuit, keeping the property available for sale to pay any money judgment entered in such lawsuit.
<b>Attorn:</b>	To turn over or transfer to another money or goods. To agree to recognize a new owner of a property and to pay him rent. See also Letter of Attornment.
<b>Back Up Offer:</b>	A secondary offer to buy property. Used in case the first offer (primary) fails. A back up offer is especially useful when the primary offer contains difficult contingencies, time frames, finance issues, etc.
<b>Balloon Payment:</b>	A large payment due on a balloon note. Generally a balloon payment is required when regular monthly or quarterly payments have not covered both the increase due and the principal of the loan.
<b>Base Rent:</b>	A specific amount used either as a minimum rent in a lease (retail) which uses a percentage of sales or overage for additional rent or sets a base onto which is added expenses and taxes in a net lease or increases in those items in a fully serviced lease. May contain provisions to increase the base rent amount over the term of the lease to account for the time value of money.
<b>Base Year:</b>	The year upon which a direct expense calculation of rent is based. The 12 month period upon which a direct expense escalation of rent is based. Typically the calendar year the lease commences. AKA “dollar stop lease”.
<b>Below Grade:</b>	Any facility or part of a facility located underground or below the surface grade.
<b>Big Boxes:</b>	A retail real estate slang term for large square footage tenants such as Wal-Mart, a grocery store, a department store, a Home Depot or Lowes, etc.
<b>Breakpoint:</b>	A retail business term that specifies the point when a tenant would pay

additional rent based upon a % of sales.

**Breach of Warranty:** The failure of the seller of real property to pass title as either express or implied by law in the conveyancing document.

**Broker:** Common term used to refer to any commercial real estate licensee. In many states – denotes a level of license held – ie: Sales Agent vs. Broker.

**Buffer:** A strip or parcel of land established as a transition between parcels of land, such as a strip or parcel of land between an industrial and residential area. May contain natural or planted shrubs, walls or fencing, singly or in combination. Also known as Buffer Zone or Buffer Strip.

**Building Classifications:** Class A – Building has excellent location and access to attract the highest quality tenants. Building must be of superior construction and finish, relatively new or competitive with new buildings and providing professional on-site management. Class B- Building with good location, management, construction land tenancy. Can compete at low end of Class A. Class C – Generally an older building with growing functional and/or economic obsolescence. Class D – An older building in need of extensive renovation as a result of functional obsolescence or deterioration.

**Building Code:** Local, state, or regional ordinances that specify various methods and materials to be used to construct improvements to comply with requirements.

**Building Core:** The central or arterial part of a multistory building that integrates functions and service needs for established occupants. Such areas are normally composed of toilet facilities, elevator banks, janitorial closets, utilities, mechanical facilities, stairwells, etc. (See Core Factor)

**Build-out:** The cost of configuring and finishing new or relet space in accordance with a tenant's specifications.

**Building Standard:** A list of construction materials and finishes used in building out office space for a tenant that the landlord contributes as part of the tenant improvements. Examples of standard building items are doors, partitions, lights, floor covering, telephone outlets, etc. May also specify the quantity and quality of the materials to be used and often carries a dollar value.

**Build-To-Suit:** Under the terms of a build-to-suit option, a landlord agrees to develop or finish a property or space to the specifications of a tenant. Building costs are usually offset, in part, by increased rent paid by the tenant. This option is seen in the case of a general-purpose industrial building with special-use

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attributes.

**CAM:** Common area maintenance

**CAM Charges:** Common Area Maintenance charges. Those charges levied on or the expenses incurred in maintaining the common areas of a building.

**Cancellation Clause:** A provision in a lease that confers upon one or both of the parties to the lease the right to terminate the lease upon the occurrence of the condition or contingency set forth in the clause – terms negotiable.

**Capitalization:** A process of determining the value of real property in which project income is divided by a predetermined annual rate (capitalization rate). For example, a building with annual project income of \$100,000 is worth \$1,000,000 at a 10% Cap Rate ( $\$100,000 / 10\% = \$1,000,000$ )

**Cap Rate:** Cap Rate is a term used to calculate and thus indicate the value of a property. Probably the most common, and therefore effective, method to value an investment is through the use of a cap rate. Cap Rate is the rate of return used to determine the value of the property's income stream. Precisely defined, the cap rate is the net operating income of the property divided by its purchase price. It shows the expected percent annual return given a specific investment

### **The Capitalization Rate:**

The Cap Rate is calculated as follows:

Cap Rate = (Net Operating Income / Market Value) x 100

Cap Rate = (NOI / MV) x 100

### **Example:**

Net Operating Income (NOI): \$239,430

Market Value (MV): \$3,420,000

Cap Rate =  $(239,430 / \$3,420,000) \times 100$

Cap Rate = 7%

The Cap Rate of 7% represents the annual return before mortgage payments and income taxes on the total investment of \$3,420,000.

**Carrying Charges:** Various costs that are incidental to property ownership (taxes, insurance costs, maintenance expenses); Costs involved in keeping a property which is intended to produce income but has not done so as of yet.

## Cash on Cash Return:

Another measure of property value. Also called equity dividend return. This formula enables investors to determine the return on their equity in Leverages properties. Cash on Cash =before tax cash flow ( NOI minus Debt service) divided by initial cash outlay

Example: Assume initial cash investment to purchase a property was \$100,000 and your NOI this year after mortgage payments was \$25,000. Your return would be 25%.

The same formula can be used to calculate after-tax return. Just subtract both the mortgage payment and the estimated taxes from your NOI.

Divide cash flow after debt service by the total purchase price.

Cash-on-cash return = Annual Before Tax Cash Flow  
Divided by: Total Cash Invested

\$1,200,000 Apartment Complex Purchase Price  
300,000 Downpayment  
5,000 Monthly Cash Flow From Rentals Less Expenses  
60,000 Annual Cash Flow From Rentals Less Expenses

Cash on Cash = \$60,000 divided by \$300,000 = 0.20 = 20%

## Limitations

- Because the calculation is based solely on before-tax cash flow relative to the amount of cash invested, it cannot take into account an individual investor's tax situation, the particulars of which may influence the desirability of the investment. However the investor can usually deduct enough [Capital Cost Allowance](#) to defer the taxes for a long time.
- The formula does not take into account any [appreciation](#) or [depreciation](#). When some cash is a [return of capital](#) (ROC) it will falsely indicate a higher return, because ROC is not income.
- It does not account for other risks associated with the underlying property.
- It is essentially a [simple interest](#) calculation, and ignores the effect of compounding [interest](#). The implication for investors is that an investment with a lower nominal rate of compound interest may be superior, in the long run, to an investment with a higher cash-on-cash return.

It is possible to perform an after-tax Cash on Cash calculation, but accurate depictions of your adjusted taxable income are needed to correctly address how much tax payment is being saved through depreciation and other losses.

**Cash Flow:** The cash an owner has left after paying operating expenses and debt service.

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**Certificate of Insurance:** A certificate issued by an insurance company or its agent. It verifies that a certain insurance policy is in effect for stated amounts and coverage and names those insured. Coverage should be – at a minimal – that which is called for in the lease document.

### **Certificate of Occupancy:**

Many cities / municipalities require a new tenant to obtain a Certificate of Occupancy. The lease term should stipulate who is responsible for obtaining the C/O in order to permit legal occupancy of the property. If modifications are required to obtain a C/O - who is responsible for compliance.

**Change Order:** An order issued any time there is a change in the specification, price or time set forth in the building contract as authorized by the owner, architect or engineer. May incur an additional charge to accommodate same.

**Class:** Class is usually used in conjunction with an office property and refers to the quality of property. Class definitions fall with the following guidelines. **Class A+:** Landmark quality, high rise building with prime central business district location (the best of the Class A buildings). **Class A:** Generally 100,000 sf or larger (five or more floors), concrete and steel construction, built since 1980, business/support amenities, strong identifiable location/access. **Class B:** Renovated and in good locations. Newer building are smaller in size, wood frame construction, and/or in non-prime location. **Class C:** Older, un-renovated of any size in average to fair condition.

**Clear Span Facility:** A parking structure with vertical columns on the outside edges of the structure and a clear space between columns, making it unnecessary for vehicles to maneuver between columns.

**Client:** A buyer or seller who is represented by a real estate licensee. .

**Co-Brokerage Agreement:** Agreement between brokerage firms on how the commission will be shared and paid.

### **Commencement Date:**

The date on which a lease begins. This is typically but not always the day on which the tenant takes possession of the leased space, which usually occurs upon substantial completion of the tenant improvements. (See occupancy Date).

### **Common area factor:**

This is a term that defines commonly shared, public space within buildings (usually office buildings). This can include hallways,

Vestibules, rest rooms, lobbies and atriums. The factor is usually described as a percentage and should be accounted for in your space allocation. For example, you may be using 1,500 usable square feet, but if the common area factor is 15 percent, then your rentable square feet is 1,725 square feet. Other buildings may be different, so be careful when comparing your effective rental rate.

**Common Area Maintenance: (CAM)**

The cost of maintaining the exterior and/or the shared interior areas of a property may be passed through from the landlord to a tenant. These costs may include snowplowing, rubbish removal, parking lot lighting, cleaning of restrooms. Property management, taxes and other costs. It is important to identify the amount of these costs, which is included in the rent (also known as “stops”) which may increase or decrease over time

**Comparable:** A term used in real estate, often times appraisals, where a comparable property, recently sold or leased, that an appraiser or broker can use as a comparison to the one they are trying to value.

**Competition:** Restricts landlord's right to lease nearby space to businesses similar to those of the tenant's. This clause is usually found in leases of retail space. “No Compete” or tenant receives “exclusive right” to represent / provide a particular type of service / product in the property.

**Compliance With the Federal Americans with Disabilities Act (ADA):**

States that the building complies with the ADA . This is important because both the tenant and the landlord are responsible for making the property accessible to disabled persons. The tenant should make sure that the landlord makes this warranty based on an ADA survey or an audit performed by an engineer or architect. In many cases - as older properties become available - they will be required to be made to be in compliance with ADA standards. Some exceptions apply.

**Concessions:** Cash (or cash equivalents) expended by the landlord in the form of rent abatement, build-out allowance, moving expenses, or other payments to induce the tenant to sign a lease.

**Condemnation:** The process by which private property is taken by a governmental agency for public use without the consent of the owner, but only upon payment of just compensation. See also Eminent Domain.

**Conditional Contract:** A contract with conditions that must be met before a party has to perform.

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**Construction Management:** An arrangement for building construction whereby the owner engages a contractor to oversee the work of all building trades, each of which enters a separate construction contract with the owner. By contrast – see General Contractor.

**Consumer Price Index (CPI):** A federal government index that measures the change in the cost of a variety of goods and services. Used in loans, purchase agreements and leases as a measure by which to adjust future payments to reflect inflation. Also called “Cost of Living Index)

**Contiguous Space:** Adjoining office space. Multiple offices/retail spaces or blocks of spaces that can be combined and rented to a single tenant. Can also be on multiple floors in a highrise building.

**Contract Documents:** The design plans and specifications for construction of a facility. Working drawings that detail for the contractor the exact manner in which a project should be built.

**Contract Rent:** Rent paid under a lease. The actual rent as opposed to the market rental value of the property.

**Conveyance:** Most commonly refers to the transfer of title to land between parties. The term may also include most of the instruments by which an interest in real estate is created, mortgaged or assigned.

**CORE FACTOR:** A term used to denote an add on to the square footage of an office space to allow for the owner to recoup the costs associated with providing space in a building for hallways, stairwells, elevators, restrooms, break rooms, etc. If an office space is 500 SF with a core factor of 15% - the tenant pays based on a rental rate factor calculated on 575 SF.

**Cost Approach:** A method of appraising real property whereby the replacement cost of a structure is calculated using current costs of construction.

**Covenant:** A private, legal restriction on the use of land recorded in the land records.

**Covenant of Quiet Enjoyment:** Usually inserted in leases or conveyances whereby landlord or grantor promises that the tenant or grantee shall enjoy possession of the premises in peace and quiet without disturbance.

**CPM:** Certified Property Manager

**CRE:** Counselor of Real Estate

**Cumulative Discount Rate:** A discount factor applied to the rental rate that takes into effect all landlord lease concessions expressed as a % of base rent.

- CUP:** Conditional Use Permit – required to change the use of a property to something other than specified zoning.
- Dedicate:** Transfer of property from private to public ownership.
- Deed:** Generally, a conveyancing instrument given by the seller to pass fee title to property upon sale.
- Deed In Lieu of Foreclosure:** A deed given by an owner/borrower to a lender to prevent the lender from bringing foreclosure proceedings.
- Deed of Trust:** An instrument securing a loan that is used in many states in place of a mortgage. Property is transferred to a trustee by the borrower (trustor), in favor of the lender (beneficiary), and reconveyed to the borrower upon payment in full.
- Default:** The omission or failure to perform a legal or contractual duty or to pay an obligation when due. Some specific examples are: Failure to make a payment of principal or interest or other type of financial obligation when due; The breach or failure to perform any of the terms of a note or the covenants of a mortgage or deed of trust.
- Deficiency Judgment:** Commonly, the amount for which the borrower is personally liable on a note and mortgage if the foreclosure sale does not bring enough to cover the amount owed. Actually, the judgment is for the total amount of the obligation and not for the deficiency. Any recoveries from a foreclosure sale are deducted from the judgment. May also apply to debt due after repossession of personal property subject to a security interest.
- Delivered Buildings:** Buildings that have completed construction and are ready for tenant build-out. May or may not yet have a C of O.
- Demising Walls:** The boundaries that separate a tenant’s space from another tenant’s space and from a public corridor.
- Density:** Number of dwelling units divided by the gross acreage being developed. For an urban project, this term is also used to refer to the Floor Area Ratio.
- Design / Build:** A system in which a single entity is responsible for both the design and construction of a facility, often involving the fast-track method of construction; also referred to as a Design/Construct.
- Depreciation:** Decrease in the usefulness and therefore value, of real property improvements or other assets caused by deterioration or obsolescence; A loss in value as an accounting procedure to use as a deduction for income

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tax purposes; Spreading out the cost of a capital asset over its useful life.

### **Destruction or Condemnation:**

States if the landlord is required to rebuild if the property is destroyed. This clause will specify whether the rent will be abated and whether or not the tenant can terminate the lease if the building is totally or partially destroyed. It will also specify the rights of the parties if the property is taken by eminent domain.

### **Discounted Cash Flow:**

Discounted Cash Flows - also known as Net Present Value of Discounted Cash Flows is a valuation method which discounts future cash flows back to the present to estimate the attractiveness of an investment.

### **Distraint:**

The act of taking (legally or illegally) personal property and retaining control until the property owner performs an obligation. Commonly, a landlord takes possession of personal property of a tenant in default until the default is satisfied.

### **Distress Sale:**

The sale of property under less than favorable conditions. Usually, the seller is experiencing financial difficulties and is under extreme pressure to sell.

### **Dollar Stop:**

An agreed dollar amount of taxes and operating expense (expressed for the building as a whole or on a SF basis) over which the tenant will pay its prorated share of increases. May be applied to specific expenses (e.g., property taxes or insurance).

## **DOUBLE NET LEASE:**

Tenant pays property taxes and insurance.

### **Due Diligence:**

The process you perform prior to having your purchase contract go “hard”. It goes hard when you reach a point where you have something other than your time and inspection fees at risk – perhaps a deposit or a promise to close on the property without further inspections.

### **Earnest Money:**

A sum of money paid by a buyer at the time of entering a contract to indicate the intention and ability of the buyer to carry out the contract. Normally such earnest money is applied against the purchase price. The amount can be any amount agreed upon by the parties to the contract. Earnest money is NOT required to make a contract a valid contract.

**Easement:** A right to use the property of another created by grant, reservation agreement, prescription, or necessary implication. It is either for the benefit of land appurtenant, such as the right to cross A to get to B or in gross, such as a public utility easement.

**Economic Feasibility:** A project's feasibility in terms of costs and revenue with excess revenue establishing the degree of feasibility.

**Economic Rent:** Calculations or analysis to determine market rental value of a property at any given time, even though the actual rent may be different.

**Effective Rent:** The average per square foot rent paid by the tenant over the term of a lease. Takes into account only free rent and stepped rents. Does not include allowances, space pockets, free parking and other similar landlord concessions.

**Effective Useable Area:**

Excludes those areas within the Useable Space (see below) that the tenant pays rent on but effectively cannot use such as columns and sharply angled spaces.

**Efficiency Factor:** The number resulting from dividing the Usable Area by the Gross Building Area in an office building, providing a benchmark measurement for the economic efficiency of that building's use as an office building.

**Eminent Domain:** A right of the government to acquire private property for a public use by condemnation in return for just compensation. See also condemnation.

**Encroachment:** Generally, a structure that extends impermissibly over a property line, easement boundary, or building setback line.

**Encumbrance:** Any right to, or interest in, real property that may exist in one other than the owner but which will not prevent the transfer of fee title. A claim, lien, charge, or liability attached to and binding real property.

**Enforcement:** Specifies how the agreement is to be enforced and who pays attorney fees. Many businesses negotiate a clause into leases requiring the parties to resolve any disputes through either mediation or arbitration.

**Environmental Impact Report:**

A report generally prepared by an independent company detailing the probable environmental effect of a development on the surrounding area.

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**Equity:** The value of one's interest in a property consisting of its fair market value less any outstanding debt or other encumbrances.

**Equity Kicker:** Also called a participation loan. Under this kind of loan – often used by non-bank lenders with start-up businesses – the lender gets not only interest payments and principal repaid, but the right to buy equity (part ownership in the company) as well. Equity participation is generally required for riskier deals or in return for lower rates.

**Equity Participation:** The participation by a lender in the equity ownership of a project as one of the conditions for granting a loan. Used by financial institutions to partially offset the effects of inflation. Also called "Equity Kicker".

**Equity of Redemption:** Not the same as the redemption period after a foreclosure sale, which is a right established by payment of the principal, interest and costs due.

**Escalation Clause:** Provides for increases in rent over a specified period of time. Most commercial leases contain escalation clauses. Ascertain how the increase is determined. Is it keyed to actual increases in the landlord's operating costs or to some outside index?

**Escrow Agreement:** A written agreement (ie: contract) usually made between a buyer, seller and escrow agent (title company). The escrow agreement sets forth the basic obligations of the parties, describes the objects deposited in escrow and instructs the escrow agent concerning the disposition of the objects deposited.

**ESFR Sprinkler System:** Early Suppression Fast Response – New technology fire sprinkler system offering faster response time, higher volume of water, larger water droplets for greater efficiency in fire detection and suppression even though the system is in the ceiling structure.

**Estoppel Certificate:** An instrument which itself prevents individuals from later asserting facts different from those contained in the document. Often required by the buyer of an office building. The tenant and landlord both sign the Estoppel certificate, confirming the lease and pertinent facts thereto. Thereafter, neither party may make claims to the contrary.

**Expansion:** Gives the tenant the right to add adjacent space or to move into a larger vacant space in the building

**Expenses:** Leases in the DFW area generally assume that there are six (6) different types of expenses: Roof and Structure; Taxes; Insurance; Utilities; Janitorial (excluding outside trash removal); Common Areas (utilities and

general maintenance) and Electricity. Variables would be for water / sewer expenses.

- Expense Stop:** A fixed amount (typically per square foot) in a lease where the tenant is responsible for all building operating expenses and taxes in excess of said amount. May be applied to specific expense – taxes / insurance.
- Extension Option:** An agreed continuation of occupancy under the same conditions, as opposed to a renewal, which implies new terms or conditions. In a lease, it is a right granted by the landlord to the tenant whereby the tenant has the option to extend the lease for an ad.
- Face Rental Rate:** The “asking” or nominal rental rate published by the landlord.
- Fair Market Rent:** The rent which would be normally agreed upon by a willing landlord and tenant in an "arm's length transaction" for a specific property at a given time, even though the actual rent may be different. In a lease, the term "fair market rent" is defined in a number of different ways and is subject to extensive negotiation and interpretation.
- Feasibility Study:** An analysis of needs, costs of recommended improvements and anticipated revenue and costs; establishes the basis for the construction of an individual improvement or a complete system.
- Fee Simple:** An estate of real property that the owner has unrestricted powers to dispose of and which can be left by will or inherited. Commonly used as a synonym for ownership.
- First Generation Space:** Generally refers to new space that is currently available for lease and has never before been occupied by a tenant. Can also indicate the space has never been finished out.
- First Mortgage:** The senior mortgage which, by reason of its position, has priority over all junior encumbrances – or 2<sup>nd</sup> / 3<sup>rd</sup> liens or loans. The holder of the first or senior mortgage has a priority right to payment in the event of default.
- First Right of Refusal / Right of First Refusal: (Purchase)** A lease clause giving a tenant the first opportunity to buy a property at the same price and on the same terms and conditions as those contained in a 3<sup>rd</sup> party offer that the owner has expressed a willingness to accept. Can include a time limitation.
- First Right of Refusal / Right of First Refusal: (Lease)** A lease clause giving a tenant the first opportunity to lease additional space that might become available in a property at the same price and on the same terms and conditions as those contained in a third party offer that the owner has expressed a willingness

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to accept. This right is often restricted to specific areas of the building such as adjacent suites or other suites on the same floor. Can include a time limitation.

**Fixed Costs:** Costs, such as rent, which do not fluctuate in proportion to the level of sales or production.

**Fixed Expenses:** Operating costs that usually do not change as a result of occupancy such as property taxes, insurance and some forms of building maintenance.

**FF&E:** **Furniture, Fixtures & Equipment:** Term used to denote a list of any and all “FF&E” that the seller is offering to convey to a buyer or tenant as part of a transaction. If a sale – a “Bill of Sale” might be appropriate. Such a list should typically be fairly detailed and when / where appropriate should stipulate conditions and if Seller / Landlord is offering any sort of warranty or guarantee or maintenance after the closing of the sale – or the execution of the lease or else a buyer or tenant may find a problem / discrepancy with the FF&E and expect the Seller / Landlord to be responsible for same.

**Flat Lease:** A lease in which payments are made at set intervals in equal amounts throughout the life of the loan.

**FLEX:** A flex building is designated to be versatile and may be used for office, research and development and/or retail sales as well as manufacturing, warehousing and distributing. A typical flex building will be one or two stories tall with at least half of the rentable space used for offices (and/or retail). Ceiling heights are typically 16 feet or less. Most flex buildings also include some type of overhead door.

**Floor Area Ratio (FAR):** The ratio of the gross SF of a building to the land on which it is situated. Calculated by dividing the total SF in the building by the SF of land area.

**Force Majeure:** A force that cannot be controlled by the parties to a contract and prevents said parties from complying with the provisions of the contract. This includes acts of God such as a flood or a hurricane or, acts of man such as a strike, fire or war.

**Foreclosure:** A procedure by which the mortgagee (lender) either takes title to or forces the sale of the mortgagor’s (borrower) property in satisfaction of a debt.

**Free Rent:** A concession granted by a landlord to a tenant whereby the tenant is excused from paying rent for a stated period during the lease term.

**Full Service Lease:** A lease in which the stated rent includes the operating expenses and taxes for the building. Same as Gross Lease. Opposite of Net Lease. Tenant may still be held liable for any increases in operating expenses over a base year

amount if so specified and agreed upon.

**Full Service Rent:** An all-inclusive rental rate that includes operating expenses and real estate taxes. Can be for the first year or more or for the full term of the lease. The tenant is generally still responsible for any increase in operating expenses over the base year amount.

**FSG:** Full Service Gross - Landlord covers all base year expenses. A lease under which the tenant pays a fixed amount of rent and the owner pays all the other operational expenses related to the leased space and property including utilities. Generally for office space. May or may not include janitorial services for interior office areas.

**General Contractor:** The prime contractor who contracts for the construction of an entire building or project, rather than just a portion of the work. The GC hires subcontractors, coordinates all work and is responsible for payment to subcontractors.

**Graduated Rental Lease:**

A lease in which rent graduates (usually increases) periodically during a lease term based on changes specified in the lease. Also called step-up lease.

**Grant:** To bestow or transfer an interest in real property by deed or other instrument; either the fee or a lesser interest, such as an easement.

**Grantee:** One to whom a grant is made.

**Grantor:** The person making the grant.

**Grace Period:** Allows the parties a period of time in which to comply with the terms of the lease. This clause may specify the period of time in which the tenant must correct or "cure" a default in the rent.

**Gross Absorption:** A measure of the total SF leased over a specified period of time with no consideration given to space vacated in the same geographic area during the same time period.

**Gross:** Landlord covers roof and structure, taxes, insurance and common areas. Tenant covers janitorial, utilities and outside trash removal. Increases over base year are passed through to tenant.

**Gross Building Area:** The total floor area of the building measuring from the outer surface of exterior walls and windows and including all vertical penetrations (e.g. elevator shafts, etc.) and basement space.

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**Gross Lease:** A lease of property whereby the lessor is responsible for paying all property expenses, such as taxes, insurance, utilities and repairs. There can be a “modified” gross lease where there is an exception to the lessor paying for all of the previously mentioned items. Gross leases can also include provisions for expense increase pass-through provisions. See Expense Stop / Net Lease Note: A Gross Lease is also typically referred to as a Fixed, Flat or Full-Service Lease. It is most typically used for Office, Industrial and most apartment leases.

### **Gross Rent Multiplier:**

The GRM is an easy rule of thumb to forecast a value. Gross rent is the total rental income you could realize from a building if it were 100% leased. To calculate the GRM, divide the gross rent into the sale price. If your projected monthly rental income is \$15,000 and your sale price is \$175,000, your GRM is  $\$175,000 / \$15,000 = 11.667$ . You can also make this calculation using net income, which is total possible rental income less vacancies.

**Gross Up:** An adjustment made to operating expenses to account for the occupancy level in a building. When operating expenses are "grossed up", it means that the building's variable expenses have been adjusted upwards to the level that those expenses would be incurred if the building was fully occupied (typically 95%).

**Ground Lease:** A lease for the sole use / occupancy of land only. Often times - this might be for an extended period of time - up to 99 years in some cases - to allow for commercial development and amortization of the leasehold improvements. The improvements belong to the tenant. Typically used in an area that has a shortage of highly desirable land.

**Ground Rent:** Rent paid to the owner for use of land, normally on which to build a building. Generally the arrangement is that of a long-term lease (e.g. 99 years) with the lessor retaining title to the land.

**Guarantor:** One who makes a guaranty.

**Guaranty:** Agreement whereby the guarantor undertakes collaterally to assure satisfaction of the debt of another or perform the obligation of another if and when the debtor fails to do so. Differs from a surety agreement in that there is a separate and distinct contract rather than a joint undertaking with the principal.

**Hard Cost:** The cost of actually constructing the improvements (i.e. construction costs)

**Highest and Best Use:** The use of land or buildings which will bring the greatest economic return

over a given time which is physically possible, appropriately supported, financially feasible.

**High Rise:** In the Central Business District, this could mean a building higher than 25 stories above ground level but in suburban sub-markets, it generally refers to buildings higher than 7 or 8 stores.

**Hold Over Tenant:** A tenant retaining possession of the leased premises after the expiration of a lease.

**Hotelling:** An alternative workspace concept where rather than having an assigned exclusive workspace, an employee accesses one space, perhaps being one of many such spaces in common with others on an as needed basis, and otherwise works outside of the office.

**HVAC:** Heating, Ventilation, Air Conditioning. A general term encompassing any system designed to heat and cool a building in its entirety, as opposed to a space heater.

**Hybrid Leases:** Hybrid leases mix the features of Gross, Modified Gross leases and Net leases. In these, some expenses are passed on 100% to the tenants while others are included in the rent on a gross or modified gross basis. For example, utilities and cleaning may be charged to the tenants on a Net basis (fully charged to the tenant), while operating expenses and taxes are handled on a Modified Gross basis (base amount included in the rent, with a pass-through of increases).

**Improvements:** In the context of leasing, the term typically refers to the improvements made to or inside a building but may include any permanent structure or other development, such as a street, sidewalks, utilities, etc.

**Industrial.** Industrial space is usually in buildings / areas zoned for industrial uses.

**Industrial Gross:** A lease with the understanding that the tenant must perform its own building maintenance, do its own repairs and pay the building utilities.

**Internal Rate of Return (IRR):**

Often used in capital budgeting, it's the [interest rate](#) that makes net present value of all [cash flow](#) equal zero.

**Insurance and Liability:**

Specifies who is responsible for casualty and liability insurance and the

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coverage required.

**Inventory:** The total amount of rentable SF of existing and any forthcoming space (whether it be a tenant vacating space or new building coming on the market), in a given category, for example, all WHS space in a specified submarket. Inventory refers to all space within a certain proscribed market without regard to its availability or condition, and categories can include all types of leased space such as office, flex, retail and WHS space.

**Judgment:** The final decision of a court resolving a dispute and determining the rights and obligations of the parties. Money judgments, when recorded, become a lien on real property of the defendant.

**Judgment Lien:** An encumbrance that arises by law when a judgment for the recovery of money attaches to the debtor's real estate.

### **Landlord and Tenant (lessor and lessee):**

Identifies the parties by their full legal names, states of incorporation, and principal business addresses.

### **Landlord Improvements:**

Specifies which improvements the landlord is to make to the premises prior to the tenant's taking possession of the property.

### **Landlord's Solvency:**

Specifies tenant's rights if the landlord is in financial trouble and there is a foreclosure on the leased property.

**Lease:** A written contract between a building owner and a tenant transferring the right to occupy a specific property and setting forth the rights of both parties to a particular property or space within a property and specifying such as rental amount, terms, conditions, etc.

**Lease Interest:** A property interest that arises from the association of a lease with a property e. g., a leased fee estate or leasehold estate.

**Lease Term:** The specific period of time in which the Landlord grants to the tenant the right to possession of real estate.

**Leasehold:** The interest or estate on which a lessee (tenant) of real estate has a lease. A long term lease in this case could be used as collateral.

**Leasehold Estate:** An ownership interest in real estate held by a tenant during the term of a lease. The tenant is given the right to use and occupy a property for a time

and based on the restrictions contained in the lease.

**Lease with Option to Purchase:**

A lease that gives the lessee the right to purchase the property at an agreed upon price under certain conditions at a later point in time. Note: Due to many variances involving such - TREC does not recognize these and does not provide a form. The terms of such an agreement would need to be worked out by attorneys. As licensed agents - if we were to draft such an agreement - it would be practicing law - which we can't do as we'd be in violation of TREC Rules/Regs.

**Lease Rollover:** The re-leasing of a space with the same tenant, after the expiration of a previous lease on the same space.

**Leasehold Improvements:**

Improvements or additions made to a leased property by the lessee.

**Lessee (Tenant):** The party to whom a lease (the right to possession) is given in return for a consideration (rent).

**Lessor (Landlord):** The party (usually the owner) who gives the lease (right to possession) in return for a consideration (rent).

**Letter of Intent:** There are potentially multiple uses of this term. Generally a written statement that two parties to a prospective transaction (buyer/seller or lessor/lessee) intend to proceed to a final agreement in good faith on stated principal business terms of the deal to be entered into. This meaning applies when executed by both parties. Alternatively such a document may be signed only by one party and is then an indication of a willingness to enter into agreement on the stated terms and conditions. To avoid legal issues regarding offer and acceptance and thus formation of a binding contract, care should be taken to include a clause stating that there is not a specific offer and no intent to be a legally binding obligation. However, an obligation to continue to negotiate in good faith to conclusion can be created.

**LLC – Limited Liability Co.**

**Load Factor:** In a lease, the load factor is the multiplier to a tenant's useable space that accounts for the tenant's proportionate share of the common area (restrooms, elevator lobby, mechanical rooms, etc.). The load factor is usually expressed as a percentage and ranges from a low of 5% for a full tenant to as high as 15% for a multi-tenant floor. Subtracting one (1) from

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the quotient of the rentable area divided by the useable area yields the Load Factor. At times confused with the "loss factor" which is the total rentable area of the full floor less the useable area divided by the rentable area. (If a full floor broken up into multiple tenancies has a useable area of 18,000 . and a rentable area of 20,000 SF., the load factor is 11.1% and the loss factor is 10%.

### **Maintenance and Repairs:**

Specifies which party is responsible for the maintenance and repair of which portions of the property

**Master Lease:** The dominant lease in a building or development that contains a sublease.

### **Modified Gross Leases:**

This is a lease in which the rent includes building expenses like a Gross lease, but the landlord recaptures expense increases after the base year via a pass-through provision such as an operating expense, tax, or utility escalation. Some landlords use substitute escalation provisions, such as Porters' Wage escalations (NYC only) and CPI escalations. Modified Gross leases are most commonly found in multi-tenant office environments. Tenant maintenance obligations may vary greatly.

### **Mortgage Release Price:**

A specific amount of money that must be paid to a lender so that the lien specified by the mortgage on a particular property will be released.

**NAR:** National Association of REALTORS – a professional trade organization for those involved in the real estate sales and leasing business.

**Net:** Typically / generally - landlord covers roof and structure, taxes and insurance. Tenant covers utilities, janitorial and common areas.

### **Net and Gross Leases:**

Net and Gross refer to whether the base rent includes operating costs. When a lease is Net, it means that the base rent being paid does not include building taxes, insurance, utilities or other operating expenses. These must be paid for separately by the tenant. On the other hand, when a lease is a Gross lease, the tenant pays a lump sum each month, and all of these additional costs are included in the rent.

The terms Net and Gross are often incorrectly used to refer to who performs building services. This is because in many Net leases, the tenant performs its own building services. For example, it is common to see space

referred to as “Industrial NNN” with the understanding that the tenant must perform its own building maintenance, do its own repairs and pay the building taxes and utilities. But it is also common to find a multi-tenant office building in which the landlord performs building services and then passes 100% of the costs onto the tenants. This is a Net lease too.

**Net Lease:** A lease whereby, in addition to the rent stipulated, the lessee pays such expenses as taxes, insurance and maintenance. Net/Net/Net = Taxes / Insurance / Utilities & Repairs/Maintenance. There can be Net or Net-Net or Net-Net-Net leases. The term Net Lease applies to any and all leases under which a tenant pays a portion of the operating expenses. The base rent is considerably less than that for a full service lease due to the expenses that the tenant will be responsible for on an on-going basis. Commonly used for office and industrial properties.

**Net-Net-Net Lease:** A lease in which the tenant pays all the operating expenses including taxes, insurance and repairs/maintenance. NNN or Triple Net leases are sometimes also called Full Net Leases. Generally the NNN expenses will be estimated perhaps based on prior experience and the total annual amount will be divided into monthly installments based on the SF the tenant occupies and collected monthly along with the rent. After the end of the year - the owner will be responsible for providing a statement of income / expense for the NNN expenses and an adjustment may be in order based on actual experience.

**Net Leases:** A lease in which there is a provision for the tenant to pay, in addition to rent, certain costs associated with the operation of the property. These costs may include property taxes, insurance, repairs, utilities and maintenance.

\* **DOUBLE NET LEASE:** Tenant pays property taxes and insurance.

\* **TRIPLE NET LEASE:** Tenant pays property taxes, insurance and common area maintenance.

\* **QUADRUPLE NET LEASE:** Tenant pays property taxes, insurance, common area maintenance and all utilities.

**NOI – Net Operating Income:**

**NPV - Net Present Value:** An approach used in capital budgeting where the present value of inflow is subtracted from the present value of cash outflows.

**Office Space:** Is loosely classified based on the quality of construction, features and the status of location:

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**Class A.** Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence.

**Class B.** Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area and systems are adequate, but the building cannot compete with Class A at the same price.

**Class C.** Buildings competing for tenants requiring functional space at rents below the area average.

**Operating Expense:** The actual costs associated with operating a property such as maintenance, repairs, management, utilities, taxes and insurance. A landlord's definition of operating expenses is likely to be quite broad, covering most aspects of operating the building.

**Pass Throughs:** Refers to the tenant's pro-rata share of operating expenses (ie: taxes, utilities, repairs) paid in addition to the base rent.

**Percentage Lease:** Under the terms of a percentage lease, rent is based on a percentage of gross sales generated on the leased site (retail tenants). The percentage charged takes various forms:

- \* Straight percentage, with no minimum amount
- \* Minimum plus percentage
- \* Minimum or percentage, whichever is greater
- \* Minimum plus percentage, with a ceiling on the total amount

**Plus E:** E = Electricity - In whatever type of lease - the tenant is responsible for their own electricity expense.

**Plus U:** Plus utilities - may include electric, water, gas, etc. typically individually metered to the property or particular space.

**Procurring Cause:** The proximate cause; the cause originating a series of events which, without break in their continuity, result in the accomplishment of the prime object.

**Property:** Gives a full description of the property being leased. This description should include the suite number, street address, city, state, and zip code. It should also include the number of square feet in the space.

**Proprietary Lease:** In a multi-unit building, the lease a corporation provides to the stockholders which allows them to use a specific unit under the conditions specified.

**Purchase option:** Gives the tenant an option to purchase the facility at the end of the lease term. This provision should specify not only the option price but also when and how the option must be exercised.

**QUADRUPLE NET LEASE:**

Tenant pays property taxes, insurance, common area maintenance and all utilities.

**RADIUS CLAUSE:** A clause in a lease whereby a tenant would be prohibited from moving and opening another store within a certain distance of the current location.

**RCA:** REALTORS Commercial Alliance - a division of the NAR denoting a REALTOR practices commercial real estate.

**REIT:** **Real Estate Investment Trust** – a means of ownership of real estate.

**Rent:** States the amount of rent and when and how the rent is to be paid. In this clause, the manner in which the rent is computed should be stated, e.g., flat rent, net-rent, percentage rent, etc.

**Renewal option:** States whether the tenant has the option to renew the lease when it expires, the term of the option, and the amount of rent to be paid during the renewal term.

**Revaluation Lease:** A lease in which rent is adjusted periodically according to the revaluation of the real estate.

**Right of entry:** Gives the landlord the right to enter the premises on an as-needed basis.

**RLI:** REALTORS Land Institute - a trade organization for those specializing in land – sales and development.

**RPA:** Real Property Administrator – a designation from BOMA

**Sale-Leaseback:** A financing technique by which the owner sells a property to an investor and subsequently rents it from the buyer for continued use. Serves to free up the capital that the original owner has invested in the property.

**Second Generation Space:** Space that has previously been finished out for a prior tenant. Depending on length of tenancy, use, etc. space may be in various conditions and configurations that could be suitable for lease to a new tenant with minor to major remodeling required to suit new tenant needs.

**Security Deposit:** States the amount of the security deposit. This provision should also state

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what the security deposit will be used for, where it will be held, and whether it will earn interest.

**Shell Space:** Shell space is space that has never been finished out – ie: new construction – office, retail, etc. Space would typically have slab, all 4 walls and ceiling. All improvements and finish out of the interior would have to be negotiated and installed to suit tenant.

**SIOR:** Society of Industrial and Office REALTORS

**Step Up Lease:** A lease in which rent graduates (usually increases) periodically during a lease term based on changes specified in the lease. See Graduated lease. Also known as Stair Step lease. Helps reduce the rent rate on the front end of a lease but increases it over the term to achieve an average rent yield that is acceptable to the landlord.

**Straight Lease (Flat Lease):** A lease specifying a fixed amount of rent that is to be paid during the entire term of the lease, usually in monthly installments.

**Sub-leasehold Estate:** The property interest associated with a sublease. The value of the Sub-leasehold can be estimated as the present value of the difference between the market rent and the sublease rent.

**Sub-Lease:** Under the terms of a sublease, a tenant leases some portion of a premises to another tenant, while remaining liable to the landlord for the rent.

### **Subletting or assignment:**

Gives the tenant the right to sublease or assign the property if the tenant cannot fill out the term of the lease or wants to rent part of its space to someone else. This clause will specify under what conditions the tenant can avail itself of this right. Under a sublet, the original tenant is still responsible for honoring the provisions in the lease. In an assignment, the original tenant is out of the picture and has no further liability under the lease.

**Taxes:** Specifies whether landlord or tenant is responsible for the property taxes.

**Tenancy At Will:** Agreement between landlord and tenant wherein the landlord agrees that the tenant may stay in possession of the leased space after the expiration of the lease and pay rent for the time the space is occupied until landlord or tenant elects to terminate the lease. Any and all terms of the tenancy at will are entirely negotiable between the two parties involved.

### **Tenant Improvements:**

Indicates whether the tenant has the right to make improvements to the property and the extent to which the landlord will allow such

improvements.

**Tenant Improvement Allowance:**

An amount negotiated to allow for improvements to a particular space. The improvement allowance can be given lump sum or on periodic draws until completion of the improvements. Improvements can be performed by the tenant and/or the landlord. Whatever is negotiated and agreed upon by all parties.

**Termination:** Imposes an obligation on the tenant to return the property in a certain condition at the end of the lease.

**Termination date of lease:**

Specifies the lease's ending date.

**Term of the lease:** Identifies in months or years the duration of the lease. It should also state when the tenant is entitled to possession.

**Triple Net Lease:** A net-net-net lease, where in addition to the stipulated rent, the lessee assumes payment of all operating expenses of the property and the landlord receives a net rent. This includes both fixed expenses, such as taxes and insurance, and all operating expenses, including costs of maintenance and repair. In some cases, the NNN tenant even pays the interest payments on the lessor's mortgage on the property lease.

**TRIPLE NET LEASE:**

Tenant pays property taxes, insurance and common area maintenance for their portion of the property.

**Turnkey Lease:** Under the terms of a turnkey lease, a landlord agrees to turn the premises over to the tenant in a ready to use condition based on specifics negotiated as to any maintenance, repairs or improvements.

**ULI:** Urban Land Institute – a trade organization

**Use of Premises:** Specifies any restrictions on the use of the premises.

**Utilities and Services:**

Specifies what utilities and services each party is responsible for and the

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days and hours provided. Water, trash, sewer, waste water, electricity, gas, CATV, telephone, etc.

**Variable Expenses:** Costs, such as janitorial, that may vary within a building's occupancy and by decisions made in the management of the building (Also known as Controllable Expenses)

**Warranty:** Statement by the landlord that the premises are in compliance with applicable laws.

**Zoning:** States the zoning laws or other restrictions that apply to the facility.

**Conclusion:** Because of the many different variations on these lease structures, it is highly recommended that practitioners refrain from using the terms "Gross" and "Net" in lease language. (For that matter, you should not use the terms "Double-Net" or "Triple-Net" either.) These terms can have different meanings to different people, and may be understood in one area differently from another area and there is no accepted standard as to which "Net" refers to which expense. As a rule, it is always better to spell out the actual obligations of the parties.

For assistance or more information - contact your real estate professional. Make sure he / she is a Commercial REALTOR.

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