

# *Principles of Commercial Real Estate Finance*

## **Module 3: Fundamentals of Commercial Leases**

### Associated Reading

**Linneman Text:**

Ch. 3: The Fundamentals of Commercial Leases



*Office Buildings in Singapore*



# Fundamentals of Commercial Leases

- How many of you have read your apartment lease word for word?



- The devil is in the details – even more so in commercial leases
- As a commercial landlord, what is the most important clause in a lease other than rent?

# Fundamentals of Commercial Leases

- Rental Rate Components
  - Base Rent
  - Escalations – specify how the rent changes during the lease
    - By percentage(s) based on a schedule
    - By \$ amounts based on a schedule
  - Percentage Rent, aka Overage (unique to retail – Why?)
    - e.g., 2% of Gross Revenues over \$75 per SF

# Fundamentals of Commercial Leases

- Lease Length (term), Extension and Expansion Options
- Taxes, Utilities, and Insurance
  - Types of “Net Rent” e.g., NNN
- HVAC
- Security – level, hours
- Property Maintenance – standards kept
- Tenant Improvements – critical negotiation point
- Free Rent (if any)
- Capital Costs – who’s responsible?
- Parking
- Recourse and Security Deposit

# Retail Leases

- Retail-specific clauses:
  - Signage
  - Going Dark
  - Hours and Days of Operation
  - Usage of the space
  - Location assignment
  - Tenant Mix – radius restrictions/tenant inclusions

# Comparative Lease Analysis

- Tenants almost always have multiple options from which to choose
- How do they know which is the most attractive option for their needs?

[Go To Excel – Comparative Lease Analysis tab >>](#)

# Connection Between Capital and Physical Markets

- The “Gordon” Model for simplified DCF analysis
  - The value of a perpetuity stream of **stabilized** cash flows growing at **constant** rate “g” and a **constant** discount rate of “r”

$$V = CF / (r-g) \text{ (IOWs, } r - g = \text{the cap rate)}$$

Examples:

$$V = \$50,000 / (.08 - .03), \text{ which equals } \$1,000,000$$

$$V = \$75,000 / (.08 - .03), \text{ which equals } \$1,500,000.$$