

Quoted Rental Rates Aren't Always What They Seem

Friday, September 10, 2010 | San Diego Metro Magazine | David Marino

Is a \$1.50 rent less than \$2? The answer would be an obvious “yes.” But you probably guessed this is a trick question, and there are a lot of tricks in the business of commercial real estate. The biggest trick in the book is to confuse the commercial real estate tenant — the ultimate consumer of the space. While it probably wasn't designed to be this way, “rent” is quoted in so many different ways, it bewilders the customers. The real question to ask is what is included and excluded in the “rent” being charged?

The most basic way to quote rent is on a “triple net” (NNN) basis. The evolution of NNN rents stems primarily from industrial real estate, where tenants with different uses require different building services. Typically, such tenants pay their own electricity bills, contract for janitorial or self-serve with their own employees, and maintain the heating, ventilation and air conditioning (HVAC) units and other features of the space. Thus, the cost and intensity of these different services caused landlords to have a hands-off approach with the real estate and charge just a base rent, or NNN rent, thereby allowing the tenant to effectively manage the space. However, there are additional “operating expenses” when the landlord pays the tax bill, pays the damage and destruction insurance and provides common area maintenance for the outside areas of the building, and bills all of the tenants their prorata share of these costs. Industrial NNN rents in the region vary widely depending on location, level of improvements and the nature of the space. NNN rents for warehouse space in Miramar might be \$.65, but for electronics lab space in Sorrento Mesa rents could be \$1.10, and for wet lab space in Torrey Pines they might be \$2. The operating expenses vary widely too, based on the tax basis of the real estate, the insurance for replacement cost of the building if it burns down or falls down and the elegance or sterility of the common areas. These operating expenses can be from \$.25 for that warehouse space in Miramar, \$.45 for that electronics lab space in Sorrento Mesa and \$1.25 for wet lab space in Torrey Pines.

Tenants in office space get the luxury of having to learn yet a new language of “net of electricity” and “full service gross” rents. What that includes in both structures is the NNN rent, the operating expenses and janitorial services. The landlord also maintains all of the HVAC units, services and stocks the restrooms and replaces light bulbs in the tenant's space. In a “net of electricity” lease, the only other costs is for separately metered electricity, which typically is another \$.20-per-square-foot per month expense for most office tenants. Most space in suburban two- to three-story office buildings in the San Diego region costs \$1.50-\$1.85-per-square-foot per month net of electricity, but there is a great range of pricing in the market today, as Del Mar Heights is running \$2.25-\$3 net of electricity.

For Class A office tenants in UTC and Downtown, rents are quoted on a “full service gross” basis, whereby the face rate also includes the costs of electricity. When these high-rise buildings were constructed, utility costs were still relatively cheap and it was deemed impractical and unnecessary for a landlord to give every tenant in a high rise office building their own electricity meter. As a result, the landlord now pays the electricity bill for the entire building, and the cost is imbedded in the full service gross rent. Thus, a tenant can pay a \$2 to \$2.40 full service gross rent in UTC or Downtown and be better off than tenants paying the same rents, but paying for their own electricity. Some landlord brokers out there are quoting rents as “full service gross, net of electricity,” which is inherently contradictory. They are making it sound like its full service gross, but then adding that the tenant still has to pay for electricity. I don't know if it's professional laziness or deception, but brokers can't make things up like this.

Occasionally, we have a client looking at an office space where the landlord is quoting the rent on a NNN basis, and on the surface \$1.20 NNN per-square-foot per month looks cheap. But when you add in another \$.60 for

Hughes Marino

Because Where You Do Business Matters™

operating expenses and janitorial costs, and another \$.20 for electricity, that office space in a cheap industrial park is often more expensive than much higher quality spaces in traditional office buildings with net of electricity and full service gross leases.

So next time you are at a dinner party or at the gym and someone brags about getting a great lease rate, you now know what questions to ask. The office tenant that pays \$1.50 for space may very well be paying a lot more than \$2.

David Marino is Executive Vice President of [Hughes Marino](#), a San Diego commercial real estate company specializing in San Diego tenant representation and building purchases. Contact David at (619) 238-2111 or david@hughesmarino.com to learn more.