Real Estate 631 S. Malpezzi: Common Lease Terms
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Leasing has its own weird terminology, with which you must become familiar. I've never found a decent glossary of leasing terms, and those I have found often contradict each other. Here's the jargon you need to follow along in class.

General sources of information include many publications of the Urban Land Institute (ULI) and of the International Council of Shopping Centers (ICSC).

Dale Vanderlaan, of RealLogic, has the best advice possible regarding these terms: *always ask*. If someone says "gross lease" to you, ask "what exactly do you mean by that?" Be a pest.

Anchor/Major Tenant

A large tenant, such as a department store, which generates lots of traffic for other tenants. In economic terminology, a "major" is a source of *agglomeration economies* or *externalities*. As a consequence, majors usually have very favorable lease terms.

In-Line Tenant

A nonanchor tenant.

Gross Leasable Area

All space leasable to tenants (including storage, etc.).[1] Called "Property Size" in Argus.

Inflation

Common usage uses "CPI" for general inflation. Actually there are several candidate measures, which should be very carefully specified in the lease.

> CPI, All Urban Consumers (CPI-U) is calculated by the Bureau of Labor Statistics. The national figures are widely available, but they are also broken out (1) by type of good,

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[1] One ICSC publication states that GLA does not include space leased by the anchor tenants, but generally according to everyone I've talked to it does. Possible exception: when a major tenant is simply assigned some area (a "pad") and builds and operates their own store largely independently of the center.

and (2) by region and size of place in BLS's *CPI Detailed Report*. Also, be careful, are you using (e.g.) annual averages, or (say) December-to-December changes? In the long run these differences tend to iron out, but be specific in a contract to avoid misunderstandings!

CPI, Urban Wage Earners (CPI-W) is similar but different: it's based on a slightly different bundle (wage earners are a subset of all consumers). Less commonly used for real estate contracts.

CPIs for a number of specific large MSAs are available from *CPI Detailed Report*.

GNP Implicit Price Deflator: from the national income accounts, an index that is more broadly based and probably a better choice conceptually than the CPI; but rarely used in leases. These are available from the Department of Commerce's Bureau of Economic Analysis. A convenient quick source of historical data is the *Economic Report of the President*.

New “Chained” Price Indexes: for the national income accounts, weights now change every year, instead of periodically.

Note in Argus, specific inflation categories override the “general” inflation factor, and "hard-coded" inflation factors override specifice inflation categories and general inflation.

Budget Account Codes

Accounting codes associated with property level cash flows, which permit analysis by type of expense, etc.

Credit Loss

Allowance for bad debts from nonpayment of rent.

Capital Expense

Major building improvements and expenses, usually "lumpy," such as a new roof or a new boiler. These are usually incurred by the landlord, and not passed through to tenants.

Recoveries/Reimbursable Expenses/Bill-Backs/Pass Through Expenses

Property level expenses which are recovered or reimbursed by tenants, usually on some sort of prorated basis. Often include common area maintenance, property taxes, utilities, insurance, etc. Related terms:

> **Stops**: Landlord agrees to pay one or more specified expenses (e.g. property taxes) up to a certain amount per square foot. Tenants pay that expense over the specified amount. The stop is the ceiling on the landlord's responsibility for expenses, thus the tenant's floor (where his/her responsibility begins).
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> **Increase Over a Base Year/Base Stop**: Applied to one or more specified expenses, such as property taxes. Tenant pays no tax in the first year, and that establishes a "base." In future years landlords pay the base and tenants pay any tax over the base. In other words, a particular way of establishing a stop.

The most common basis over which reimbursements are calculated is the tenants's pro rata share of gross leasable area. However, be aware that if major tenants negotiate a reduction in their reimbursement payments, (1) the major's (smaller) contribution will first be subtracted from the pool, then (2) other tenant's shares will be calculated on the basis of GLA *less* the space occupied by the majors.

Nonreimbursable Expenses

Expenses which can’t be recovered from tenants. Management fees often fit this category, i.e. the management fee is deducted from gross income to arrive at NOI (whereas reimbursable expenses are deducted once as incurred, then added back in as "recoveries," hence they are a wash when calculating NOI).

Informational Expenses

A Pro-Ject definition. Expenses of major tenants that are collected into a CAM (Common Area Maintenance) pool, and possibly massaged (e.g. CAM plus 15%). Now, to get NOI we (1) subtract actual expenses from gross revenue, and (2) add back in recoveries. In Pro-Ject, we create a pool by creating another expense. If we set up an expense pool we've already deducted the expense once from gross revenue, as a line item (e.g. property taxes, or insurance). Thus, to avoid double counting and double subtraction, we label the CAM pool as an informational expense, which is *not* subtracted from gross revenue.

Then we add back in the recovery based on the informational expense.

Natural

A natural pro-rata share is based on the tenant's GLA, as a share of total GLA (less major tenants excluded from recovery calculations). This is in contrast to an explicit percentage of recoveries. Also, note that "natural" in this context has a different meaning from "natural breakpoint," see below.

Common Area Maintenance (CAM)

Charges tenants pay for maintenance of shared areas, including common area utilities, insurance, security, cleaning, parking lot maintenance, snow removal, etc. In a well executed lease these will be carefully specified. By convention there are certain common maintenance expenses which are *not* included in CAM, such as repairs to the roof. Property taxes are *not* generally included in CAM. The lease should also clarify if majors are exempt from CAM, how often the CAM pool[2] is calculated, and how often payments are made.[3]

Rent Roll

Basic data for each tenant, e.g. start and end of lease, GLA, rent, reimbursements, leasing costs, etc.

Rent Abatement

Such a deal we have for you! Reductions in rents, or other "goodies," at the beginning of the leasing period.

Gross Lease

Landlords pay all taxes, insurance, common maintenance, etc. out of rent. Common in apartments and industrial, rare in office and retail.

Some in the industry use "gross" to refer to leases with a base stop. This is more correctly termed a **Modified Gross Lease**.

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[2] The pool is the amount that gets divvied up by tenants paying CAM.

[3] For example, the CAM pool could be recalculated on an annual basis, and payments made monthly on the basis of last year's charges, with a refund or assessment at the end of the year to adjust for differences between actual and forecast expenses.

Net Lease

Rent net of expenses such as taxes, maintenance, insurance, etc. These expenses are passed through to tenants. A **Triple Net Lease** means (1) taxes (2) maintenance and (3) utilities are (i.e. all major recurring common expenses) are passed through to tenants.[4] The net lease is the standard in office and retail.

Minimum Rent/Fixed Minimum Rent/Base Rent

Basic rent in $ per square foot per year.

Percentage Rent

Rent as percent of sales. Related concepts include:

> **Breakpoints**: A preset level of sales, after which percentage rent kicks in. A **natural breakpoint** is that which sets the breakpoint at the level of minimum or base rent. That would be the minimum rent divided by the overage percentage. E.G. if base rent is $20, and percentage rent is 6% of sales, then the natural breakpoint is $300 per square foot (pretty darn good sales). Breakpoints can be set somewhere else than the "natural" level by negotiation, of course.
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> **Overage Rent/Percentage Rent**: Rent paid as percent of sales. Overage rent is usually used more or less synonomously with "percentage rent."[5] Usually calculated with respect to a breakpoint (see above). For example, suppose we have a base rent of $10, and percentage rent of 5% of sales *with a natural breakpoint*. Suppose sales are $50. Since .05*50 < 10, we're below the breakpoint of $200, and the percentage rent doesn't "kick

[4] A few sources have different definitions but this is the most common. Ask, and clarify.

[5] According to ICSC there's a difference between overage and percentage rent, but I have never met anyone who uses the ICSC definition. For the record, they describe it as a percentage rent calculated "*without regard to base rent*." For example, if base rent is $10, and overage rent is 2%, and sales are $50, then by ICSC's definition, overage rent is .02*50=1.00, and total rent is $11. ICSC's definition is equivalent to percentage rent with a zero breakpoint.

The moral of this story is, when someone you work with uses the term "overage rent," ask what they mean. If I ask you on an exam, and don't specify, use the "usual" definition in the body of this note, not ICSC's definition. But be able to explain both definitions if I ask you.

in." Total rent is $10. If sales were $300, we're above the breakpoint of $200, and so we owe another .05*100=$5 in addition to the base rent.

Straight Percentage Lease: percentage rent, no breakpoint.

You will have noticed that percentage/overage rent with a breakpoint is basically a guarantee of a minimum rent to the landlord, and when sales exceed the breakpoint it's equivalent to a straight percentage of sales.

Multiple Percentage Rent: Lease in which the percentage applied to sales varies with the level of sales.

Step Down Rent: Two possible definitions (ask!): (1) When the percentage applied to sales falls as sales increase. (2) Also refers to case when rent decreases at specified dates, according to the lease.

Step Up Rent: Two possible definitions (ask!): (1) Percentage applied to sales increase with sales (unusual). (2) Also refers to case when rent increases at specified dates, according to the lease.

Recapture/Recovery from Overage: Major tenants may be permitted to deduct specified recoveries (e.g. their property tax or CAM charges) from percentage rents owed. Don't confuse with "Recapture Privilege" of landlords.

Effective Rent

Minimum rent plus percentage rent. Everything called "rent," but does not include recoveries.

Recapture Privilege

Agreement that if sales (and hence percentage rent) don't reach a preset level by a certain date, the landlord has an option to terminate the lease, unless tenant agrees to pay an equivalently higher rent.

Porter's Wage

An indexed wage charged to the tenant. Darned if I've ever seen or heard a really clear discussion of this one. It's common in New York City, and (as far as I know) nowhere else.

Tenant Improvements

Improvements designed to customize space for the tenant, usually paid for at least partly by the landlord, and generally incurred as tenant moves in or upon renewal of a lease. Usually costed out on a per square foot basis.

In recent years, with a down market, TI has been commonly paid by landlords. As market returns to "normal," don't be surprised to see more TI split between landlord and tenant. Sometimes the landlord finances the tenant's share, i.e. the landlord pays up front and the tenant pays over the lease or some negotiated period, at a negotiated rate of interest.

Speculative Renewal/Market Renewal

Estimate of what market terms will be when the current lease expires (unknown, since this event occurs in the future).

"Blended Rate" for Renewals

Weighted average of estimated costs, rents, etc. for a new tenant at lease expiration, and for a renewal of the existing tenant. The weights are the subjective probability that a new tenant will be sought, and that the existing tenant will renew.

Space Absorption

Space which is initially vacant but leased up over time (or so we hope!)