



News from StarGroup

Triple Net Leases

Accurate property condition information is a necessity for both property owners and businesses.

The triple net lease is very popular in commercial building leasing because it reduces the owner's need to spend time and money monitoring property conditions and providing maintenance, repairs, and/or replacement of roofing, HVAC, and other major property components. This kind of lease works especially well for the owner who wishes to create an "armchair investment" situation. A sometimes confusing variety of names is used for the various parties in a lease arrangement, including building owners and occupants, lessors and lessees, landlords and tenants.

The basic idea of a *net-net-net* lease is for the lessee to assume responsibility for all the property's expenses, both fixed and operating. While there are many versions, triple net typically includes **Taxes**, **Insurance**, and **Maintenance**, or **TIM** (think "Timothy").

Most triple net leases require the lessee or tenant to cover costs to maintain the roofing, heating and air conditioning (HVAC) systems, exterior parking surfaces (typically asphalt), interior and exterior painting, landscaping, carpeting – practically anything related to the building that can wear out or be damaged during the lease period. A modified net (or modified gross) lease is a variation of the **NNN** lease in which the tenants pay their own utilities, interior maintenance and repairs, and insurance. The landlord pays everything else, including real estate property taxes.

At StarGroup, our primary goal is to provide an accurate evaluation of the third **N** or **Maintenance**.



What Can Go Wrong?

All parties in a triple net lease arrangement need protection against surprise expenses that can occur as the facility ages and components wear, requiring maintenance and eventual replacement.

The two building components most likely to require substantial expenditures are the roofing and HVAC, or heating and cooling system. The design life for these components is typically in the 15- to 25-year range, depending primarily on climate, usage, and quality of maintenance. Other building components, such as asphalt surfaces, painting, loading dock walls, vehicle barriers, and fencing, among others, are also likely to need attention within this time frame.

For Example

Within a ten year period, a 100,000 square foot, 20-year old, concrete tilt-up building, including an assembly plant, warehouse, and office spaces, could easily require a new roof (\$300,000 to \$600,000), new HVAC equipment (\$100,000 to \$500,000), and new asphalt parking surfaces, creating

a total potential ten-year maintenance budget in the \$500,000 to \$1,400,000 range, not counting restroom fixtures and surfaces (\$100,000 to \$300,000), interior carpeting and paint, and exterior paint, landscaping, and other maintenance items.

Protection for Owner and Lessee Alike

StarGroup is frequently retained by building owners to determine the projected maintenance and replacement costs for building components. We have also been retained by owners to determine if a lessee or tenant has failed to provide adequate building maintenance according to contract. Tenants retain StarGroup to determine remaining useful life spans, and projected maintenance and repair costs over the lease period.

As in any business, it's the assumptions that get us into trouble. If we assume the roof will last another ten years and it fails in five, someone is going to be facing a substantial and unexpected expense. Whatever the situation, a StarGroup inspection serves everyone's interests by providing impartial, accurate, and useful information on property conditions.

Owner and Lessee Exposure

Tenants leaving a ten-year lease may consider the building to be in good shape and believe they have no obligation to pay for the diminished value represented in the aging roof and components that lose value with age. The armchair investor-owner may not realize that several of the major systems are likely to fail within the next five years and that succeeding tenants may not wish to assume the expenses generated by pre-existing wear and tear. These expenses may then fall to the building owner. *(continued on page 2)*

Exposure

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Such risks become more complex to manage when the same facility has multiple tenants with varying lease periods. For example, which tenant is responsible for replacing how much of the roof when it fails?



The Reserve Fund Solution

Some building owners reduce their risk by establishing a reserve fund into which each tenant makes regular payments. The owner then covers property maintenance costs as needed from this fund. As tenants come and go, the maintenance fund is constantly replenished—with no surprise burdens for a single tenant or for the owner.

Independent Information

It is very important for both owners and tenants to know the actual conditions of the building's systems. This information should be provided by a neutral third party who can provide objective building maintenance cost projections. The tenants, of course, need to know these costs have not been inflated. Periodic inspections should also be made to enable all parties to make good maintenance decisions and to adjust the contributions made to the fund as needed. Building owners can make a mistake by relying on contractors to tell them how long a system will last, often the same contractor who installed or who has been maintaining the system. Contractors, however, are in the business of selling new systems, which may interfere with their ability to provide accurate independent information. Contractors with current maintenance contracts on the property may be reluctant to report on poor maintenance. Outside contractors may be overly critical in an effort to gain business by discrediting those who have been taking care of the systems.

At StarGroup we believe all interests are best served by regular inspections performed by independent professionals with extensive experience and expertise in evaluating and reporting on building conditions.

Our Basic Evaluation provides valuable information on:

- Roofing
- HVAC or Cooling and Heating
- Structures, Exteriors, Interiors
- Plumbing, Mechanical, Electrical

We can also provide:

- Repair Cost Estimates
- 5-Year Cost Projections
- Fire Sprinkler Inspections
- Elevator Inspections
- Phase One Environmental
- Life Safety Review
- Floor Plans
- Rentable Area Determinations
- ADA - Accessibility Review
- Project Management
- Other services designed to meet your needs

Learn more about us at
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Leaders in property condition analysis services.

Providing commercial, environmental, and residential inspections since 1979.