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NNN Leases Explained

Many of you have heard the term “Triple Net Lease” but I’ve found a lot of people don’t fully understand what that means. First of all many of you have owned and managed your own rental properties, mostly apartments and rental homes. In that market you have short term leases, higher turnover and you as the landowner pay most of the expenses related to your property. For example you have to pay for the property taxes, insurance, maintenance costs, improvements, fix-up related to getting the property or units fit for the next tenant when somebody moves out, utilities, etc. This is totally common in the multi-family rental market.

In the commercial market, very often you have long term leases, 5-10 or even 20 years. Also, many times there are tenant improvements that are particular to your tenant, such as a build-out for kitchens, etc., as in a restaurant. There could be special provisions for coolers for a grocery store, loading bays for a retail store or extra plumbing and build-outs for a kidney dialysis or medical clinic. In most of these situations you’ll have your tenant sign a “triple net” lease, which is very common in these situations. A triple net (NNN) lease is defined according to Wikipedia as:

“In United States real estate business, “Net Lease” is a term used to signify a lease structure in which the tenant or lessee is responsible for paying a portion of or all of the common expenses related to real estate ownership, in addition to base rent. Real estate related expenses associated with ownership are divided into three categories referred to as the three nets which are property taxes, insurance, and maintenance. The rent collected under a net lease is net of expenses. It therefore tends to be lower than, for instance, rent charged under a gross lease. Net lease types include single net, double net, triple net and even bondable triple net leases. The term “net lease” is often used as a shorthand expression when referring to NNN leases.

An NNN Lease is a net lease, structured as a turnkey investment property in which the tenant is responsible for paying the three major expenses associated with commercial real estate ownership. “NNN” stands for “Net-Net-Net”, is pronounced “Triple Net” and represents the three most common, consequential real estate related expenses:

*N - Property Tax
N - Insurance
N - Maintenance*

The rent the landlord receives from the tenant is in effect net of expenses.”

Again, most apartment owners have trouble getting their arms around this arrangement, but in the commercial real estate market this is very common.

So with a NNN arrangement, the tenant will pay pretty much all of the expenses related to the property they are renting. If the air conditioning malfunctions, the tenant pays for it. If the driveway needs to be redone, the tenant pays for it. New signage, roof leaks, property taxes, insurance payments, landscaping, etc. are all cost that are borne by the tenant.

For a property owner that wants a long term, low maintenance situation, often with a nationally known tenant, NNN leases are the way to go. In the real estate world, your lowest risk income property is a NNN lease with a “credit tenant” (A credit tenant is usually an organization with a national footprint, a large regional tenant, or a local tenant with excellent credit that may be better than their national competitors. Only larger companies are called credit tenants.)

With these properties there are some downsides as well. Often with a large high credit tenant, they will be very harsh negotiators and throw their weight around. This means they want as low a rent as they can get and very few increases in their leases. With the lower risk of these types of tenants, you are going to have lower income. This could be a problem if and when interest rates go up and the NNN lease you have doesn't go up with the increase in interest. This can impact the appreciation long term. On the other hand if and when there's a softening in the economy, the vast majority of these types of tenants held up very well and didn't have a problem paying their rents when others couldn't. That's not to say there wasn't any problems with NNN lease tenants, but they were less than other types such as office buildings or apartments.

For a savvy investor with a portfolio of properties, a NNN lease is a great anchor to your portfolio. For more information about NNN leases, or for a personal, private consultation, give me a call at (626) 588-1520.

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