HOW ARE COMMERCIAL RENTS CALCULATED?

I am frequently asked the question on how monthly commercial rents are calculated. Residential rentals are very simple in the sense that the monthly amount quoted is more or less what a tenant pays +/- some stipulated inclusions or exclusions.

Commercial rentals are most commonly offered on an annual per square foot basis. For example, a 1,000 square foot space may be offered at $12.00 per square foot.

$12.00 psf x 1,000 sf = $12,000 per annum or $1,000 per month before GST

Per square foot rent is most frequently offered as two components that are advertised separately:

Net Rent (or Base Rent) + Triple Net (sometimes referred to as Additional Rent)

$8.00 base rent + $4.00 Triple Net = $12.00 Gross Rent

Net Rent is typically the going market rate for a given type of commercial space. Triple Net is comprised of the Insurance + Property Taxes + Operating Costs (sometimes referred to as CAM or common area maintenance) of a subject property. These annual amounts for a property are totaled and charged back to a tenant based on their percentage of total square footage in a given building. For example if the total triple net for a 10,000 sf building was $40,000 and a tenant rented 1,000 square feet, their annual triple net cost would be:

$40,000 x 1,000/10,000 = $4,000 $4,000/1,000 sf = $4.00 per square foot.

Most typically, triple net is an annual estimate that is charged to a tenant on a monthly basis. At the end of the year if these costs are higher, than the tenant is frequently responsible for the difference is cash or their annual estimate for the next year will recover the differential. If triple net comes in less the difference is frequently to the credit of the tenant's account. This type of lease is referred to as a **NET LEASE**. In this type of lease the tenant bears the risks and rewards of the triple net costs increasing or decreasing. As a tenant it is important to have an understanding of the factors in their local market that can cause triple net to increase.

It is very important for a tenant to understand how their rentable square footage is being calculated. For example, if there is a shared hallway, foyer or washroom for a tenant to have their pro rata portion of such common area included in their "leasable square footage" in their lease agreement because they share the benefit and therefore the cost of such space. The result is the leasable square footage will be the subject space square footage plus the reasonable allocation of the common area.

In some instances a Landlord will offer their space as a **"GROSS LEASE"**, typically as a gross rental rate per square foot. This implies that the Landlord will offer the subject space for a set annual or monthly amount and assume the risk and rewards of cost fluctuations. Although this seems simpler to administer from a tenant perspective it is important to understand that in a gross lease the landlord is motivated to keep costs as low as possible which is not always the best thing for a tenant's business. In a triple net lease the tenants may request and negotiate additional work or standards for a building that are beneficial to their business. It is easier to convince a landlord to add costs that benefit a tenant if they are being recovered over time through the triple net recovery.

The **MOST IMPORTANT** thing to understand is that unlike residential rentals, commercial leasing does not have the same level of consumer protection for any lack of understanding of the rules and trade practices and it is crucial to understand the terms that you are negotiating in an Offer to Lease and to have a lawyer review a final lease agreement with a Landlord prior to sign-off.

The above information is comprised of generalizations to assist in understanding commercial rentals and there are many exceptions to the basic scenarios presented above.