Considering Triple Net-Leased Investments?
by Christopher Miller, MBA

"Triple Net Leased" is a term that is thrown around a lot in the real estate world. This article will define this term, and discuss the benefits of owning such properties. **First, I will need to define some real estate lingo.**

Many commercial leasing terms exist to describe who pays the property's expenses. Who pays which, and how much, of those expenses is all spelled out in a tenant's lease agreement. Three ways to describe commercial leases are:

- Gross lease
- Modified Gross (or Net) Lease and
- Triple Net (or NNN) Lease

A gross lease is the easiest to understand. Under this lease, a tenant pays rent only, and the landlord pays for all utility bills, insurance, and property taxes. A modified gross, (sometimes called a "Net") lease is one where a tenant will pay some expenses. For example, an apartment building that has electricity separately metered to the units is charging modified gross rents. Tenants pay their electricity bills, while the landlord pays everything else. (Water, gas, sewage, garbage, maintenance, and insurance – to name a few.) Triple Net describes leases where the tenant pays all of the expenses previously mentioned. In fact, the name "triple net" is an abbreviation for the term "Net taxes, Net insurance, Net maintenance." Note that the term "double net" is sometimes used to describe leases. This means that the landlord, not the tenant, is paying one of these bills.

I could write an entire article on the differences between commercial leases, but this article focuses on *properties that are triple net leased to credit tenants*, so I will focus on that topic. The previous summary will have to do for now.

Benefits of Triple Net Leases
With Triple Net Leased properties, the tenant is responsible for paying expenses; so the landlord's income will not vary month to month due to operating costs. Every rental property owner knows the frustration of collecting rents on a 100% occupied building, but seeing that month's net income drop due to property taxes or an unexpected water bill. With triple net leased properties, the tenant pays expenses along with his rent; leaving the investor a stable income stream.

The Triple Net Leases That I Prefer
I prefer Triple Net Leases that are backed by a credit tenant. For example, most fast food stores are owned by franchisees, rather than by their corporate namesakes. If a restaurant goes out of business, its landlord likely won't be receiving checks anymore – if that lease was guaranteed by a franchisee, rather than a major corporation.

For this reason, I prefer Triple Net Leased properties featuring leases backed by major corporations. Major corporations have higher credit ratings than smaller companies, so they are

a better *credit risk;* although nothing is ever guaranteed, a larger company is more likely to pay their rent than a smaller one. These leases can be found in assets such as bank buildings, drug stores or office buildings. Let's examine each of these asset types.

Bank Buildings

Think about your local bank branch. Chances are that it is free-standing (not attached to another business), is in a great location on a corner lot, and has been operating as a bank for over a decade. Sure, banks have received a good share of negative press with all the recent bank failures. What happens when a bank fails, though? A stronger bank buys its assets, and assumes all its' leases. For example, when Washington Mutual recently failed, J.P. Morgan Chase took over all the company's assets. That is bad news for Washington Mutual stockholders, but good news for the company's landlords. WaMu branches were simply replaced with Chase banks. When a landlord gets a tenant with stronger credit, the value of his property goes up – so buildings occupied by Washington Mutual have potentially seen their value *increase* since Chase has taken over. This is why, as one real estate executive once told me, "banks are the only tenant that fail up." When a bank is absorbed by another, 10-15% of locations in urban settings are shuttered. (Less in the suburbs). If this happens, the owner needs to re-lease a property that is on a corner lot in a high-traffic area. This space is easier to re-lease than one without these attributes.

Drug Stores

Free-standing drug stores have become a hot asset in recent years, boasting long-term leases and credit tenants. Good deals are harder to find in this segment, however, as many properties feature leases that are strongly biased towards the tenant. I have seen properties where the drug store's lease is for 75 years, with no rent increases. Such a lease's value is actually declining every year as inflation grows. The equivalent of $120,000 today is $7,300 in 1933. (75 years ago.) A landlord may have been satisfied with $7,300 of annual income back then – but he (and his children and grandchildren) would not have stayed happy. For these reasons, contracted rent increases are very important when evaluating triple net leased properties.

Office Buildings – Sale-Leasebacks

Triple net leases can often be found in office properties through a sale-leaseback transaction. Under such an arrangement, a company that wishes to raise money will sell its real estate, and sign a lease to occupy that real estate for many years. When a company owns the real estate it occupies, this can indicate a long-term commitment to a given location. These companies tend to spend money – much more than normal tenants do – retrofitting buildings for their unique needs. However, many companies are in business to seek a higher return on equity than real estate provides – that is their motivation to spend all that energy manufacturing and marketing products. If their goal is a 20% or higher return on investment, that company may want to sell their real estate to re-invest in their business. For instance; they could buy more machines to make more widgets, and potentially earn more income.

Investors can find great deals with sale-leasebacks, and often can find an excellent, well-maintained property, leased to a credit tenant under good terms for a long duration.

Of course, buying triple net leased properties contains all of the risks involved with buying any kind of real estate. Sticking to excellent locations, with credit teants and long term leases can possibly decrease these risks.

Of the many ways to invest in triple net leased properties, I offer several options starting at $50,000 of equity. Perhaps triple net leased properties could compliment your existing real estate portfolio – it is certainly worth investigating.

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