

# Medical Office Leasing

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A Guide for Doctors





# Commonly Used Terms

- Base Rent
- Operating Expenses
- Base Year / Expense Stop
- Tenant Improvement Allowance (TI)
- Escalations (CPI, Steps, etc.)
- CPI – Consumer Price Index
- CAM – Common Area Maintenance
- CAF – Common Area Factor (also called load factor)
- RSF – Rentable Square Feet
- USF – Usable Square Feet
- CPI – Consumer Price Index
- FMV – Fair Market Value

## Occupancy Cost

This is the sum total outlay of cash that a practice spends on its real estate. This should include Base Rent and Operating Costs that are attributed to the occupancy by the practice.

**Base Rent + Operating Costs =  
Occupancy Cost**

## OCCUPANCY COST ANALYSIS

### Typical Expense Data

Taxes	\$3.00	/SF
Insurance	\$0.30	/SF
Utilities	\$2.50	/SF
Cleaning	\$1.00	/SF
Repairs & Maintenance	\$0.65	/SF
Roads & Grounds	\$0.30	/SF
Security	\$0.50	/SF
Mgmt Fees	\$1.25	/SF
<b>Total Operating Expenses</b>	<b>\$9.50</b>	<b>/SF</b>

# Lease Types

## 1

### GROSS LEASE

- Tenant is quoted a rental rate that is inclusive of all costs. Landlord pays for everything
- Operating Expenses are not passed through to the tenant
- Typically initial rent is very high as Landlord must insure that they are recouping every expenditure.
- Higher rent but can be budgeted for with absolute certainty.
- Extremely Rare for Class "A" & "B" office space.

**Rent = Occupancy Cost**

## 2

### MODIFIED GROSS LEASE

- Tenant is quoted a base rental rate that includes some, but not all of the operating expenses.
- Tenant may pay directly for such expenses as security, janitorial, electric and utilities, what is typically considered uncontrollable expenses.
- Operating expenses are passed through to the tenant as either an estimate paid per month and/or at the end as a reconciliation over the Base Year or Expense Stop

**Base Rent + Uncontrollable Expenses = Occupancy Cost YR 1**

**Base Rent + BY overage + Uncntr. Exp. = Occupancy Cost YR 2**

## 3

### FULL SERVICE LEASE

- Tenant is quoted a base rental rate that includes all of the operating expenses for the first year.
- Landlord pays for everything up front but operating expenses are passed through to the tenant as either an estimate paid per month and/or at the end of the year as a reconciliation over the Base Year or Expense Stop
- No expense exposure for the first year but overall rent can be slightly higher over term.
- Escalations (Rent Steps) are applied to the total base rent and base year expenses.

**Base Rent = Occupancy Cost in Year 1**

**Base Rent + Operating Cost Increase over BY = Occupancy Cost in Years 2+**

## 4

### NNN (TRIPLE NET)

- Tenant is quoted a base rent exclusive of operating costs.
- Appears to be lower Rental Rate as Operating Expenses are not included in the quoted rental rate.
- No base year or expense stop, as Tenant pays all other operating expenses on a pro rata basis or directly (common area maintenance, building insurance, real estate taxes, utilities, water, electric, and janitorial).
- The operating costs "are what they are" and the same for each tenant.
- Escalations (Rent Steps) are applicable only to the base rent.

**Base Rent + Operating Expenses = Occupancy Cost**

# The Math: Lease Analysis

## BREAKDOWN YEAR 1

	Quoted Base Rent		Yr 1 Base Year Exp.	Yr 1 Expenses	Total Rent
NNN	\$15.00	+	\$0.00	\$9.50	\$24.50/SF
Modified Gross	\$21.00	+	\$6.00	\$3.50	\$24.50/SF
Full Service	\$24.50	+	\$9.50	\$0.00	\$24.50/SF
Gross	\$26.00	+	\$0.00	\$0.00	\$26.00/SF

## BREAKDOWN YEAR 2

(Base rent and estimated expense increase due to inflation at 3%)

	Base Rent			Base Rent Increase		Yr 1 Expenses			Yr 2 BY Increase	Yr 2 Expenses Due	Overall Increase	Total Rent
NNN	\$15.00	X	3%	\$15.45	+	\$9.50	X	3%	\$0.00	\$9.79	\$0.29	\$25.24/SF
Modified Gross	\$21.00	X	3%	\$21.63	+	\$3.50	X	3%	\$0.18	\$3.61	\$0.29	\$25.42/SF
Full Service	\$24.50	X	3%	\$25.24	+	\$0.00	X	3%	\$0.29	\$0.00	\$0.29	\$25.52/SF
Gross	\$26.00	X	0%	\$26.00	+	\$0.00	X	0%	\$0.00	\$0.00	\$0.00	\$26.00/SF

## BREAKDOWN YEAR 3

(Base rent and estimated expense increase due to inflation at 3%)

	Base Rent			Base Rent Increase		Yr 1 Expenses			Yr 3 BY Increase	Yr 3 Expenses Due	Overall Increase	Total Rent
NNN	\$15.00	X	6%	\$15.90	+	\$9.50	X	6%	\$0.00	\$10.07	\$0.57	\$25.97/SF
Modified Gross	\$21.00	X	6%	\$22.26	+	\$3.50	X	6%	\$0.36	\$3.71	\$0.57	\$26.33/SF
Full Service	\$24.50	X	6%	\$25.97	+	\$0.00	X	6%	\$0.57	\$0.00	\$0.57	\$26.54/SF
Gross	\$26.00	X	0%	\$26.00	+	\$0.00	X	0%	\$0.00	\$0.00	\$0.00	\$26.00/SF

