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## Commercial Leasing Issues: Understanding Net versus Gross Leases



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**THE QUESTION MAY ARISE** as to which party pays for the operating costs in a commercial lease. Generally speaking, “Net” leases are those leases in which the operating costs are not included in the base rent and “Gross” leases are those leases in which the operating costs are included in the base rent.

- **Retail Leases** –Most retail leases are triple net (“NNN”) leases which means that the costs of taxes, insurance and common area maintenance (CAM) of the shopping center are not included in the tenant’s base rent. The costs for these expenses are billed separately to the tenant on a monthly basis and then reviewed on an annual basis at year’s end. A description of what is included in each of the categories is included in the lease document. Typically, if there is a discrepancy of more or less than five percent (5%) in the total amount billed to the tenant in a calendar year, then the tenant will either be refunded or billed for the difference. In certain situations, the percentage of discrepancy can be negotiated.
- Sometimes a lease is a “Gross” lease which means that all operating costs as previously delineated as “NNN” are included in the base rent. Rarely will you find a situation in a retail leasing situation where a lease is net “N” or net net (also known as double net) “NN” which means that only one or two of the operating expenses categories mentioned above is billed separately, while the others are included in the base rent.
- **Office Leases** –In office leases, there is a wider variation of operating expense structures and sometimes there is a misunderstanding about who performs building services.



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- **Office Leases (cont.)** – While a space might be listed as NNN, the tenant might be expected to perform its own building maintenance, pay for taxes and utilities and perform its own repairs without landlord performance of these responsibilities. However, in most multi-tenant office buildings with NNN leases (also known as Net leases), the landlord will perform all of the building services and pass the entire cost onto the tenant.

Gross leases are also found in office leases as well as a third type of lease, known as the Modified Gross lease. In a Modified Gross lease, the operating costs are included in the base rent as in a Gross lease, but there is also an escalation (e.g. CPI) that is included in a pass-through provision for tax, utility or other maintenance costs in order for the landlord to recapture any increase in those expenses.

There can also be an operating expense structure that incorporates the NNN, Gross lease and Modified Gross lease structures. Some expenses might be passed on entirely to the tenant as in a NNN lease (e.g. taxes), others might be included in the base rent as in a Gross lease (e.g. utilities), while some might be included in the base rent with a pass-through provision for escalations as in a Modified Gross lease (e.g. cleaning).

**Final Thoughts** – Regardless of what terms are used to identify the lease expense structure, it is very important to determine which party is responsible for specific operating costs in order to prevent any unexpected expenses associated with leasing a space.



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