BREAKWATER
1031

# *Investing in Triple Net Properties*

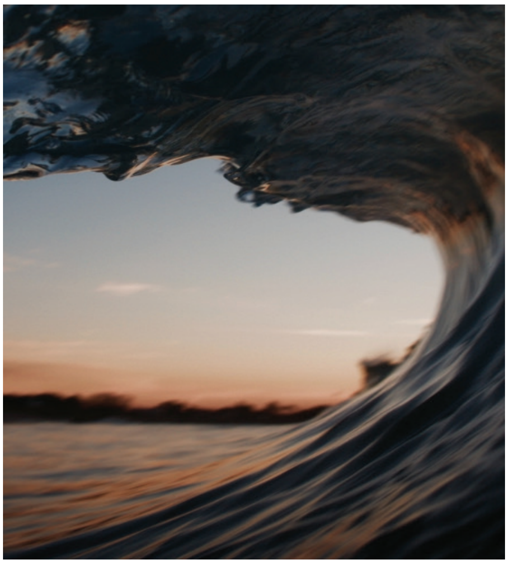
A NNN property is a property for which the lease agreement specifies that the tenant must pay all of the property's expenses, including real estate taxes, insurance, and maintenance. The term "triple-net lease" comes from the fact that the lease on a NNN property requires the tenant to pay those three property expenses. The tenant in a triple-net lease must also pay standard rent and utilities. In simplified lease agreements, the landlord is responsible for paying some or all of the above property expenses. NNN leases are common with commercial properties like retail spaces, offices, and industrial buildings.

## *How A NNN Lease Works*

A NNN lease works by shifting more responsibility to tenants than in other lease agreement structures. A net lease in commercial real estate is an agreement where the tenant will pay some or all of the property's maintenance costs, taxes, and fees. Different kinds of net leases divide the property's costs between the tenant and property owner differently.

NNN leased investment properties place the burden of paying insurance, real estate taxes, and property maintenance costs squarely on the tenant for the lease's term. By agreeing to pay for these expenses, tenants assume more financial responsibility for the property's upkeep and gain more control over the maintenance and operational responsibilities of the property.

Triple-net investment properties can also enable tenants to avoid being overcharged for utilities, taxes, or building insurance, which the landlord might tack on to their rent. Because the landlord is free of the obligation to pay these property upkeep costs, they typically lower the rental payments for tenants.



## *What Are The Responsibilities Under A NNN Lease?*

Each party's responsibilities in a NNN lease commercial investment are rigidly defined. Each party must meet its obligations as outlined in the lease agreement or face potential consequences like legal action. Here is a brief overview of the responsibilities described in a triple-net lease:

### LANDLORD

Landlords have fewer responsibilities in a NNN lease agreement, making triple-net investment properties potentially attractive to investors. Property owners must handle the following obligations for a NNN lease commercial investment:

- **Collecting rent:** While tenants pay utilities, insurance, and property taxes directly to the appropriate parties, they still owe rent payments to the property owner. Landlords are responsible for collecting rent from tenants on time each month.

- **Mortgage payments:** Property owners must pay the mortgage payments throughout the lease, which rental income will help offset.



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## LANDLORD (cont.)

• **Inspecting the property for proper maintenance:** Landlords want to ensure their properties are in good condition, including the structure and heating, air conditioning, and plumbing systems. Landlords may inspect their buildings periodically to see whether the tenant follows the maintenance contract.

• **Creating a maintenance contract:** Landlords may include a maintenance contract in the lease agreement to define the maintenance tasks the tenant must perform, the maintenance timeline, and other expectations.

• **Structural issues:** A landlord may still be responsible for covering any structural issues the property experiences, which include capital improvements such as replumbing a building or replacing an entire roof. ese expectations should be outlined in the lease agreement. A net lease that places responsibility for the property's structure on the tenant is called an absolute net lease.

## TENANT

Tenants bear a greater share of the financial responsibilities for a property under a NNN lease, including:

• **Rent:** Tenants must pay rent by the agreed-upon date each month. Since landlords don't have to cover the property's taxes, insurance, and maintenance expenses, rent payments are usually lower.

• **Utilities:** Building utilities like electric, gas, and water all fall under the tenant's list of obligations in a NNN lease. e tenant pays the expenses to their local utility departments.

• **Building insurance:** Tenants may also pay for liability insurance if someone is injured on the property. The tenant may also list the property owner on their insurance policy, protecting the owner in case someone is injured.

• **Property taxes:** Tenants must pay real estate taxes for the property. If these taxes increase over the lease term, the tenant is still responsible for paying them. However, landlords and tenants may agree to a cap that transfers the additional tax burden to the landlord if it reaches a certain threshold.

• **Maintenance costs:** It's also the tenant's responsibility to maintain the property by paying for upgrades, renovations, and repairs over the lease term. Maintenance tasks may include landscaping, maintaining the parking lot, and repairing plumbing or HVAC issues.

## *Factors to Consider*

ABSOLUTE TRIPLE NET

DURATION OF LEASE

LOCATION

DEMOGRAPHICS

CORPORATE GUARANTEE
VS. FRANCHISEE

TENANT CREDIT RATING

UNDERLYING NATURE OF TENANT BUSINESS

## *Due Diligence Process*

### Over the last 15 years, Breakwater Capital has Developed a Comprehensive Due Diligence Procedure

The process includes a thorough look at the operator, property, and market to establish a valuation and terms that are executed in a marketable lease.

### TENANT

Each potential tenant goes through a rigorous due diligence process where financials and operating history are reviewed and approved.

### PROPERTY

Each property is run through a checklist of requirements that include but are not limited to a Phase I, Phase II (if needed) and a property condition report.

### MARKET

In reviewing the market, we are looking to run a full competitive analysis as well as pull a list of all relative sales comps to underwrite a likely exit cap rate.

### LEASE

All the boxes have been checked and the NNN lease is finalized with long-term lease, proper tenant requirements, rent escalations, and a 1st year rent number that is sustainable for the tenant to operate

## GENERAL DISCLOSURE

Not an offer to buy, nor a solicitation to sell securities. Information herein is provided for information purposes only, and should not be relied upon to make an investment decision.

All investing involves risk of loss of some or all principal invested. Past performance is not indicative of future results. Speak to your finance and/or tax professional prior to investing.

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## 1031 RISK DISCLOSURE

- There is no guarantee that any strategy will be successful or achieve investment objectives;
- Potential for property value loss – All real estate investments have the potential to lose value during the life of the investments;
- Change of tax status – The income stream and depreciation schedule for any investment property may affect the property owner's income bracket and/or tax status. An unfavorable tax ruling may cancel deferral of capital gains and result in immediate tax liabilities;
- Potential for foreclosure – All financed real estate investments have potential for foreclosure;
- Illiquidity – Because 1031 exchanges are commonly offered through private placement offerings and are illiquid securities. There is no secondary market for these investments.
- Reduction or Elimination of Monthly Cash Flow Distributions – Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is potential for suspension of cash flow distributions; Impact of fees/expenses
- Costs associated with the transaction may impact investors' returns and may outweigh the tax benefits