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Friday, September 27, 2002

# Companies increase options using industrial flex space

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Industrial flex space is the chameleon of commercial real estate. Typically found in industrial and business parks, but also tucked in among more traditional business structures, IFS can be office space. It can be a warehouse. It can be light industrial and it can be all three at once.

According to John Nelley, managing director of Duke Realty, the exact definition of IFS drifts with customer need and market demand.

"We define it as a single story, industrial-type building that's generally 25-100 percent office space. Ceiling heights are 14 to 16 feet and the parking ratio is usually four to one, in case the building goes 100 percent office. In general, the depth is somewhere between 70 and 120 feet," he says.

The roof can accommodate the weight of extra air-conditioning units and the building is designed to handle power demands that may be greater than the typical warehouse, says Nelley. At the front door is likely to be traditional street-style landscaping. Around the back, there could be loading docks, a pedestrian door

or windows looking in on more office space. It all depends on the tenant's need.

And IFS tenants vary. Before the bottom fell out of the Internet market, flex space was popular with Internet companies. That's because it's relatively cheap and the companies didn't worry about impressing customers with flashy offices. These days, flex space is popular with telecommunications firms such as Sprint, Cricket and others because fiber-optic capabilities and other related infrastructure are usually available, says Nelley.

Union Planters Bank has back-office operations in IFS in the 440 Business Center. Medical laboratories such as Quest Diagnostics, with offices in MetroCenter, like it for the easy access it provides couriers, says Nelley. For many IFS tenants, access to the area's three major interstate highways is important, though it doesn't necessarily have to be the same immediate accessibility many true distribution centers demand.

Secure Pharmacy Plus, a supplier of pharmaceuticals to prisons and jails nationwide, is an example of a tenant for whom IFS has been a good choice.

"We have about 40,000 square feet off Seaboard Lane in the Cool Springs area. Of that, 8,000 is front office and the balance is pharmacy and office space where pharmacists and data entry staff work," says Grant Bryson, Secure Pharmacy's president. The company, a subsidiary of Brentwood-based America Service Group Inc., fills 18,000 prescriptions daily and ships them out via Federal Express to 400 corrections facilities.

"Security is a big issue for us," says Bryson. "An area like this allows us to be anonymous while also accommodating our need for loading dock space."

For ADT Security Services, IFS works well on many levels. "It's allowed us to have an all-in-one environment," says Ed Pedersen, ADT regional general manager. "We have a nice professional space that includes administration and sales. It's a place where customers can come to see demonstrations. But we also have a place for operations and for technicians. Essentially, (this location) allows the right hand to know what the left hand is doing."

Also located in the 440 Business Center, ADT leases 26,000 square feet housing about 120

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**A Matter of Money**

Relative cost is another of IFS' selling points.

"In Nashville, IFS is about \$70 to \$100 per square foot to build versus \$115 to \$150 for typical office space," says **Duke's Nelley**. "Rent, of course, is driven by the amount of space a tenant wants but typically, IFS runs \$8 to \$12 net, depending upon the amount and quality of space. In a normal real estate market, Class A space is \$14 to 16."

Nelley estimates Duke is the largest holder of flex space in Middle Tennessee, with about 1.3 million feet.

According to Pat Emery of Crescent Resources LLC, the Charlotte, N.C. developer of Centre Pointe Distribution Center in La Vergne, IFS construction costs in that location run between \$40 and \$75 per square foot. Spaces lease for between \$3.75 and \$6.50 per square foot net. Crescent has about 268,000 square feet of IFS in La Vergne.

Both Emery and Nelley agree that a generally depressed commercial real estate market such as the one Middle Tennessee is experiencing shrinks the rent gap between pricier Class A and B office space and IFS. This reduces the demand for new construction and provides tenants with more choices.

Emery says IFS is just a half step below traditional office space but a full step above rear or front-loading dock-style warehouse facilities. It's a subtle position upon which developers in Rutherford County are trying to capitalize. "The county has said it wants to move more toward construction of office space," says Emery. "With IFS, we're trying to straddle that fence."

Emery is optimistic about his company's flex space near the Interchange City area and in Middle Tennessee in several respects. Future office development, he says, will follow IFS projects as companies that initially opt for flex space because of price and location switch to pure office space as they grow and mature.

"Someone will figure out that it's actually office space those customers need and they'll build it," says Emery.

*Mardy Fones is a Nashville-area freelance writer.*

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# **NAIOP Terms & Definitions: U.S. Office and Industrial Market**

**Prepared for  
The National Association  
of Industrial and Office Properties  
Research Foundation**

**2005**

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# About NAIOP

NAIOP is a national association with 52 chapters and more than 13,000 members, representing the interests of developers and owners of industrial, office and related commercial real estate throughout North America. NAIOP provides communications, networking and business opportunities for all real estate related professionals; provides a forum for continuing education; and promotes effective public policy, through its grassroots network, to create, protect and enhance property values.

## The NAIOP Research Foundation

The purpose of the NAIOP Research Foundation is to support individuals and organizations engaged in real estate development, investment and operations. The Foundation strives to make available the very best research information regarding how real properties, especially office, industrial and related properties, impact and benefit communities throughout North America. The NAIOP Research Foundation was established in 2000.

## Disclaimer

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## Caveat

NAIOP has taken extreme care and imposed high procedural standards in developing this glossary, *NAIOP Terms and Definitions: U.S. Office and Industrial Market* and offers it as a useful service to its general membership and the public. However, the contents are presented with no warranty either expressed or implied as to its validity and NAIOP assumes no legal responsibility for the accuracy of the presentations, comments or other information contained herein. Neither does it assume any responsibility for the outcome of decisions, contracts, commitments, nor obligations made on the basis of this information.

## Special Thanks To:

The NAIOP Research Foundation for funding this project and the members of the Task Force who so freely gave their time and talents to this project and for their willingness to embrace these definitions as a standard for the real estate industry.

# NAIOP Terms and Definitions: U.S. Office and Industrial Market

The NAIOP Research Foundation funded a standardization project that would define selected office and industrial real estate terms commonly used by owners, brokers, developers and others in their day-to-day business operations. To accomplish this task, NAIOP assembled a Task Force consisting of representatives from a cross-section of NAIOP's membership including developers, investors, financiers, and brokerage and research organizations. A Project Team, spearheaded by Deloitte Consulting LLC, and also consisting of members of NAIOP's senior management and industry consultants, gathered and constructed definitions and solicited comments and recommendations from the Task Force.

Definitions for selected commonly used office and industrial terms were gathered from real estate associations, research organizations, developers and technology providers. For certain terms, existing definitions provided from these groups were incorporated as-is, with attribution. For other terms, new definitions were constructed.

The standardized terminology documents are available on the NAIOP Web site at [www.naiop.org/foundation/completedresearch.cfm](http://www.naiop.org/foundation/completedresearch.cfm).

Yours truly,  
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# Preface

The purpose of a standard is to provide clear and understandable communication of information and facilitate consistent measurement and aggregation of results. Standards for the commercial real estate industry continue to evolve as the industry strives for transparency. The definitions contained herein were developed with the primary goals of transparency, effective communication and a narrowing of the practice in the forefront.

The definitions are grouped into various clusters to facilitate an understanding of the interrelationships among the terms. In addition, within each cluster, the definitions are listed in an order which the Task Force believed was most relevant. For example, definitions within Development Status Terminology are listed in the order of the life cycle of a development project. For reference purposes we have also provided an alphabetical Index of Terms, which is located in the back of the document.

NAIOP urges all its members and others in the office and industrial building industries to adopt the definitions in this document as standard. Furthermore, in circumstances when local custom or individual transactions differ from the standard definitions, we encourage the industry to embrace the recommendations to disclose these differences in the interest of clear communication and transparency of information.

# Development Status Terminology

The following chart illustrates the key definition components within the selected Development Status terms. See following definitions for further explanation and clarification.

## Development Status Terminology Timeline

	<b>Proposed/ Planned</b>	<b>Construction Starts</b>	<b>Under Construction</b>	<b>Delivered</b>	<b>Becomes Inventory</b>
	Development announced	Construction initiated	Groundbreaking; Site Excavation; Foundation Work	Construction completed	(See measurement terms)
	Construction not started	Groundbreaking	Ongoing construction	COO issued	
	Subjective criteria		Major renovation  No certificate of occupancy (COO)		

**The following statement must be true:**

Beginning balance of Under Construction  
 + Construction Starts during the period  
 + Properties commencing Conversion to office during the period  
 – Deliveries for the period  
 \_\_\_\_\_  
 = Under Construction at the end of the period

**Bold** indicates term defined in this glossary

**Proposed/Planned** The status of a building that has been announced for future development but not yet started construction. The probability of successfully completing any individual development is difficult to determine at this stage. Criteria for inclusion in this data set are somewhat subjective.

**Construction Starts**<sup>1</sup> The total number of buildings or square feet where construction has been initiated as defined by the actual ground breaking. (See **Under Construction**.)

**Under Construction** Buildings where either: a) actual ground breaking has occurred (site excavation or foundation work) and construction is ongoing (not abandoned or discontinued) but for which a certificate of occupancy (COO or CO) has not yet been issued; or b.) properties undergoing **conversion** to office from another use; or c) properties undergoing a major **renovation** where 75 percent or more of the building is not available for lease and the building generally requires a certificate of occupancy (COO or CO) to be made available for lease.



**Delivered** Total square footage and/or number of buildings that have completed construction (status changing from **under construction to inventory**) and received a certificate of occupancy (COO or CO) during a stated period. Once a certificate of occupancy has been issued, the property will be considered delivered whether or not tenants have occupied the space. (*Synonyms:* Completion; New Supply)

**Conversion** A general term applied to the change in usage of space. Space being converted is removed from current **inventory** and included in the **under construction** statistics for its planned use. (Example: An office building being converted to an apartment will be removed from current office **inventory** and included in the total of apartment space **under construction**.)

**Renovation** A general term applied to the process of upgrading an existing improvement. Renovations are included in **under construction** if the renovation is major, that is, where 75 percent or more of the building is not available for lease and the building generally requires a certificate of occupancy (COO or CO) to be made available for lease. Conversely, if less than 75 percent of the building is undergoing renovation, the building remains in **total inventory**.

## Measurement Terminology

**Total Inventory** Total inventory is the total square footage of **gross rentable area** in a specific market. It includes the **gross rentable area** in buildings that have received a certificate of occupancy (COO or CO). (See **delivered**.) Total inventory increases when a new building is delivered and decreases when an existing building is destroyed, demolished or its use changes. Total inventory includes office properties under **renovation** when the renovation is not major and excludes office properties undergoing **conversion**.

Market analysts often create statistical subsets of inventory. Inventory analysis in certain markets may exclude selected building types or attributes such as minimum size thresholds, government, medical, single-tenant or owner occupied buildings. Disclosure of the elements of a competitive inventory subset including market boundaries is required. (*Synonym:* Stock)

**Government Office Building** A building which is owned and/or at least 90 percent leased by public sector agencies.

**Medical Office Building<sup>2</sup>** A building which consists of 90 percent or greater medical tenancy.

**Multi-tenant Office Building** A building for which there are multiple lease obligations and less than 90 percent of which may be owner occupied.



**Owner Occupied Office Building** A building which is at least 90 percent occupied by its owner.

**Single-tenant Office Building** A building for which there is a single lease obligation or is 100 percent owner occupied.

**Rentable Area** (Synonym: Gross Rentable Area)

**Net Rentable Area**

**Usable Area**

**SEE “STANDARD METHOD FOR MEASURING FLOOR AREA IN OFFICE BUILDINGS” (An American National Standard)** Approved June 7, 1996, by American National Standards Institute, Inc. **Secretariat** Building Owners and Managers Association International REF: ANSI/BOMA Z65.1- 1996). The document is available for sale on both the ANSI ([www.ansi.org](http://www.ansi.org)) and BOMA ([www.boma.org](http://www.boma.org)) Web sites.

## Space Use Terminology

**Office Building** A property providing environments conducive to the performance of management and administrative activities, accounting, marketing, information processing, consulting, human resources management, financial and insurance services, educational and medical services and other professional services.<sup>3</sup> At least 90 percent of the interior space is designed and finished to accommodate office usage but the space may include other usage.

### Office Building Types:

**Low-rise:** fewer than seven stories above ground level.

**Mid-rise:** Between seven and 25 stories above ground level.

**High-rise:** Higher than 25 stories above ground level.<sup>4</sup>

Disclosure of the number of stories in the building is recommended.



# Typical Industrial Building Characteristics

The following matrix illustrates the primary considerations for determining the appropriate classification of an **Industrial Building** as **Manufacturing**, **Warehouse** or **Flex**.

Primary Type	Building Type					
	Manufacturing	Warehouse			Flex	
Sub-type/ Special Purpose	General Purpose	General Purpose Warehouse	General Purpose Distribution	Truck Terminal	General Purpose Flex	Service Center/ Showroom
Size (sf)	Any	50k+	50k+	20k+	20k+	<150k
Clear Height (ft)	10+	16+	16+	12-16	10-18	15-25
Loading Docks	Yes	Yes	Yes	Cross-dock	Yes	Yes
Door-to-Square-Foot Ratio	Varies	1:5k-15k	1:3k-10k	1:500-5k	1:5k-15k+	1:10k
Office Percentage	<20%	<15%	<20%	<10%	25-100%	30-40%
Divisibility (Smallest suite – sf)	Varies	15k+	50k+	10k+	5k+	2k+
Curb Appeal	Low	Low	Low	Low	High	High
Automobile Parking Ratio	Varies	Low	Low	Varies	High	High
Primary Use	Manufacturing	Storage, Distribution	Distribution	Truck Trans- shipment	R&D, Storage, Office, Lab, Retail, Light Manufacturing	Showroom, Storage, Light Manufacturing
Sub-Sets	Heavy, Light Manufacturing	Bulk Warehouse, Cold/Refrigerator Storage, Freezer Storage, High- Cube, Self Storage, Bonded	Overnight Delivery Services, Air Cargo		Garden Office, Incubator, Tech	Shallow-Bay

Note: This matrix is intended to be an aid in classifying properties between the principal Industrial Building types, subject to the following considerations:

- These are intended to be TYPICAL characteristics of different properties, but actual characteristics may vary.
- In classifying properties, the user should select the classification which most closely fits a given property.
- The most important characteristics of each type are highlighted. While these characteristics are not “acid tests,” they should guide the user in most instances.

**Industrial Building** A facility in which the space is used primarily for research, development, service, production, storage or distribution of goods and which may also include some office space. Industrial buildings are further divided into three primary classifications: **manufacturing**, **warehouse** and **flex** buildings. Typical characteristics of the different types of Industrial Buildings are shown in the matrix. Buildings must exhibit more than one of the characteristics but need not exhibit *all* characteristics to be considered under a specific classification.

**Manufacturing Building**<sup>5</sup> A facility used for the conversion, fabrication and/or assembly of raw or partly wrought materials into products/goods. Typical characteristics are shown in the matrix.



**Warehouse** A facility primarily used for the storage and/or distribution of materials, goods, and merchandise. Typical characteristics are shown in the matrix.

**Distribution Building** A type of **warehouse** facility designed to accommodate efficient movement of goods. Typical characteristics are shown in the matrix.

**Truck Terminal**<sup>6</sup> A specialized **distribution building** for redistributing goods from one truck to another as an intermediate transfer point. These facilities are primarily used for staging loads (rather than long-term storage) and possess very little if any storage area. Typical characteristics are shown in the matrix.

**Flex Facility** As its name suggests, an **industrial building** designed to allow its occupants flexibility of alternative uses of the space, usually in an industrial park setting. Specialized flex buildings include **service center/showroom** properties. Typical characteristics are shown in the matrix.

**Service Center/Showroom** A type of **flex** facility characterized by a substantial showroom area, usually fronting a freeway or major road. Typical characteristics are shown in the matrix.

## Space Availability Terminology

**Pre-leased Space**<sup>7</sup> The amount of space in a building that has been leased prior to its construction completion date, or certificate of occupancy (COO or CO) date. Disclosure of whether **proposed/planned** projects are included in any data statistic of pre-leased space is recommended.

**Available Space**<sup>8</sup> The total amount of space that is currently being marketed as available for lease in a given time period. It includes space that is available, regardless of whether the space is **vacant, occupied, available for sublease, or available at a future date.** Available Space excludes **shadow space.** If sub-tenant space is excluded from the calculation, the term Direct Available Space is recommended.

**Leased Space** Leased space includes all space under contract, regardless of whether the space is currently **occupied** by a tenant. Leased space need not be physically **occupied**; it also includes space being offered for **sublease.** If sub-tenant space is excluded from the calculation, the term Direct Leased Space is recommended.

**Occupied Space** Space that is occupied by a tenant, sub-tenant or owner. The total amount of occupied space is calculated by subtracting the amount of **vacant space** from the amount of **inventory.** If sub-tenant space is excluded from the calculation, the term Direct Occupied Space is recommended. Disclosure of whether **owner occupied buildings** are included in any data statistic of occupied space is recommended. (Synonym: Total Occupied Space)



**Shadow Space** That portion of **leased space** which is **vacant** but not **available space**. Shadow space is difficult to measure. (Synonym: *Phantom Space*)

**Sublease Space**<sup>9</sup> Space that is controlled by a lease executed by a tenant (the “Sub-Lessor”) to another lessee (the “Sub-Lessee”) for a term equal to or shorter than that held by the tenant under its original lease with the landlord.

**Vacant Space Inventory** that is not currently **occupied**. If sub-tenant space is excluded from the calculation, the term Direct Vacant Space is recommended. (Synonym: *Total Vacant Space*)

**Vacancy Rate** A measurement expressed as a percentage of the total amount of **vacant space** divided by the total amount of **inventory**. This measurement can be applied to either an individual building or an aggregation. If sub-tenant space is excluded from the calculation, the term Direct Vacancy Rate is recommended. (Synonym: *Total Vacancy Rate*)

## Building Materials

**Brick**<sup>10</sup> A small solid masonry unit of clay or shale formed into a rectangle and burned or fired in a kiln.

**Concrete Block** A small modular structural component of a building made of pre-cast concrete. (Synonyms: *Cinder Block*, *Concrete Masonry Unit (CMU)*)

**Split-Face Block** A **concrete block** molded with two units face-to-face and subsequently split apart. This process allows a more finished appearance on the exposed surface.

**Brick & Block** A building with the exterior facade made of a combination of **brick** and **concrete block**.

**Brick & Glass** A building with the exterior facade made of a combination of **brick** and glass.

**Metal Building** A building with an exterior facade primarily made of metal (typically steel or aluminum).

**Pre-Cast Construction** A construction technique in which concrete panels are manufactured off-site and transported to the site for assembly into a building.

**Tilt-Up Construction** A construction technique in which concrete panels for structural support for the building are cast at the site and hoisted, or tilted, upright into vertical position. Although it is possible that a **pre-cast** panel would be similarly tilted into position, the term **tilt-up** is reserved for panels cast on site.

**Masonry Construction** A construction technique in which materials, usually **brick** or **concrete block**, are stacked and grouted together to form walls that bear the weight of the structure.





# Industrial Building Characteristics

## Exterior Building Characteristics

**Loading Dock** An elevated platform at the shipping or delivery door of a building; usually at the same height as the floor of a motor truck or railroad car to facilitate loading or unloading. These doors can be exposed on the outside wall of the building or covered with a canopy or other construction to cover or protect the loading area.

**Cross Dock** A **loading dock** situated along two walls of the same building where goods are transferred from vehicle to vehicle for further distribution.

**Side-Loading Dock** A **loading dock** configuration designed to facilitate the loading and unloading of a vehicle through its side.

**Dock-High Door** An elevated **loading dock** door which usually opens at a height of four feet from the **truck court** level (the standard tractor trailer height). Some doors called **semi-dock** or **half dock** are constructed at a two-foot height to accommodate smaller-sized delivery trucks.

**Drive-In Door** A door through which trucks, forklifts, and other machinery or vehicles can enter and exit without a change in elevation.

**Ramp Door** A **dock-high door** that has been converted to a **drive-in door** by creating a ramp from ground level to dock level.

**Rail Door** A door, generally side-loading, with access to railroad tracks, that facilitate the loading or unloading of railroad cars directly to or from the building.

**Door-to-Square-Foot Ratio** The ratio of the total number of **loading docks** and **drive-in doors** to building square feet.

**Truck Court**<sup>11</sup> An area adjacent to a building's **loading docks** comprising the loading and truck maneuvering areas. The most important measure of the truck court is the depth from the building to the end of the truck court, as this will impact truck maneuverability.

**Apron** The area, within the **truck court**, where trucks are parked for loading and unloading. This area will be paved with more durable material than the rest of the truck court (e.g. concrete or other structural reinforcement vs. asphalt) to withstand the heavy loads being parked there.

**Automobile Parking Ratio** Ratio of available standard parking spaces to the gross leaseable area of a property. Varies by property use with labor-intensive operations needing higher parking ratios.



## Interior Building Characteristics

**Bay** The interior building space between columns.

**Bay Depth** The distance from the front of the **bay** to the back of the **bay**.

**Bay Width** The distance from one side of the **bay** to the other.

**Column Spacing**<sup>12</sup> The distance between posts or vertical supporting beams in the warehouse section of an **industrial building**. Column spacing defines the size of the **bay** and is usually expressed as width x depth.

**Clear Height** Distance from the floor to the lowest hanging ceiling member or hanging objects, beams, joists or truss work descending down into a substantial portion of the industrial work area. This is the most important measure of the interior height of an industrial building because it defines the minimum height of usable space within the structure. (Synonyms: *Clear Headway, Clearance*)

**Ceiling Height** Distance from the floor to the inside overhead upper surface of the room. This measure will be higher than any hanging objects, beams, joists or truss work, unless there is a dropped ceiling.

**Truss** A framework of beams forming a rigid structure (as a roof truss).

**Truss Height** Distance from the floor to the bottom edge of any **truss** used to support the ceiling or roof of a building. If there are hanging objects, beams or joists below the **truss**, the **clear height** will be lower than the truss height.

**Super Flat Floors** Concrete floors with minimal variations in elevation from point to point. These floors are primarily found in automated **warehouses** where picking machinery and closely spaced racks mandate the need for level flooring to insure proper operation of the warehousing machinery. Super Flat Floors are specified according to the "F-Number System" which is governed by **The American Concrete Institute** (# 117) and **Canadian Standards Association** (# A23.1) standards for the specification and measurement of concrete floor flatness and levelness.

**Office Percentage** The percentage of an industrial property that is built out for office use. When **mezzanine office** is built above space that would otherwise be an industrial work area, this additional square footage is not counted in the total square footage of the building.

**Mezzanine Office** An office build-out on an intermediate floor that is smaller than the main floor. When mezzanine office is built above space that would otherwise be an industrial work area, this additional square footage is not counted in the total square footage of the building.



# Transaction Terminology

**Gross Absorption<sup>13</sup>** Expressed in total square footage, gross absorption is the total change in **occupied space** over a given period of time, counting space that is **occupied** but not space that is **vacated** by tenants. The inclusion (Total Gross Absorption) or exclusion (Direct Gross Absorption) of **sublease space** must be disclosed. Gross absorption differs from **leasing activity**, which is the sum of all **space leased** over a certain period of time.

**Net Absorption** The net change in **occupied space** in a given market between the current measurement period and the last measurement period. Net absorption can be either positive or negative and must include decreases as well as increases in **inventory** levels. It is recommended to disclose the inclusion (Total Net Absorption) or exclusion (Direct Net Absorption) of **sublease space** in any calculation of net absorption.

**Leasing Activity** Leasing activity is the sum total of the square footage of space that is committed to and signed under a lease obligation for a specified building or market in a given period of time, without regard to actual occupancy status. It includes direct leases, **subleases**, renewals, and expansions of existing leases. If sub-tenant space is excluded from the calculation, the term Direct Leasing Activity is recommended. Leasing activity also includes any **preleasing** activity in **under construction**, **planned** buildings or under **renovation** buildings.

# Lease and Rental Rate Terminology

**Asking Rental Rate** As stated by the broker or property owner, the rate per square foot for a particular space being marketed for lease. Disclosure of the basis for the asking rental rate is required (i.e., gross, modified net, etc.). (*Synonyms: Quoted Rental Rate; Face Rate*)

**Gross Lease<sup>14</sup>** A lease in which the landlord receives stipulated rent and is obligated to pay all or most of the property's operating expenses and real estate taxes. Disclosure of the specified costs of operation is required. (*Synonym: Full Service Lease*)

**Modified Lease<sup>15</sup>** A lease in which the landlord receives a stipulated rent and the payment of the property's operating expenses are divided between the lessor and lessee via specified terms in the lease; also called Modified Gross, Net-Net (Double Net), Net-Net-Net (Triple Net), etc., depending on the degree to which the tenant or landlord are responsible for operating costs.



## Lease and Rental Rate Terminology

*continued*

**Net Lease<sup>16</sup>** A lease in which the tenant pays all property operating expenses in addition to the stipulated rent. Disclosure of the specific expenses to be paid directly by the tenant is required.

**Effective Rental Rate<sup>17</sup>** Adapted from IREM (IREM 010201RASM604/LES6): A financial analysis tool for comparing alternative leasing transactions. Generally, the effective rental rate is the equivalent constant rent per period that equals the present value of the net cash flows over the lease term. The present value is typically discounted at a cost of capital rate or a property discount rate. The calculation of an effective rental rate will vary depending on whether it is based on the tenant's or landlord's perspective. Effective rental rate differs from net rental rate as it is not limited to expenses and incorporates cash flows related to capital items such as tenant improvements and leasing commissions.



# Office Building Classifications

A subjective classification system that divides buildings into three categories: Class A, Class B and Class C. Building Classifications differentiate among buildings within a relevant market area and are primarily based on quoted rents, building systems and services, tenant and building finish and location. Buildings must exhibit more than one of the characteristics but need not exhibit all of the characteristics to be considered under a specific classification.

The following matrix illustrates the primary considerations for determining classification of office buildings as either Class A, B or C.

	<b>Class A</b>	<b>Class B</b>	<b>Class C</b>
Rents	Asking gross rents are based on a specified range between the top 30-40 percent of the office rents in the marketplace.	Asking gross rents are based on a specified range between the Asking Gross Rents for Class A and Class C space.	Asking gross rents are based on a specified range between the bottom 10-20 percent of the office rents marketplace.
Location	Excellent, well located.	Average to good location.	Less desirable location. Depend chiefly on lower price to attract tenants.
Building Systems	The mechanical, elevator, HVAC and utility systems have capacities to deliver services that meet both current tenant requirements and anticipated future tenant needs.	The mechanical, elevator, HVAC and utility systems have adequate capacities to deliver services currently required by tenants.	The mechanical, elevator, HVAC and utility systems have capacities that may not meet current tenant needs.
Building Finish	High quality design and materials. Buildings must continue to remain competitive with new construction.	Average to good quality design and materials.	Dated appearance.
Tenant Finish	Efficient layouts, best quality trim and interior finish.	Good to fair quality trim and interior finish.	Functional, no frills tenant improvements.
Building Services	Above average maintenance, management and upkeep.	Average to good maintenance, management and upkeep.	Below average maintenance, management and upkeep.

Note: This Matrix is intended as a guide for those evaluating buildings and determining their classifications with the following caveats:

- The final designation of Class A, B or C is always relative to the local market or sub-market being analyzed. (For example, attributes of class may be different in a CBD versus Suburban market.)
- The primary considerations for determining class are listed in the matrix; however, other variables worthy of consideration may include: age, amenities, parking, construction materials and architecture.
- Buildings must exhibit more than one but not all of these characteristics to be considered under a specific classification.



## Office Building Classifications

*continued*

**Class A Buildings** A classification used to describe an office building with **asking gross rents** based on a specified range between the top 30-40 percent of the office rents in the marketplace. Class A buildings are well located relative to the needs of major tenant sectors in the marketplace. Building systems (mechanical, HVAC, elevator and utility) have capacities that meet both current tenant requirements as well as anticipated future needs. The building finishes have high quality design and materials and the building must continue to remain competitive with new construction. Tenant finishes are characterized by efficient layouts and the best quality trim and interior finish. Building services are characterized by above average maintenance, management and upkeep. Buildings must exhibit more than one of the characteristics but need not exhibit all of the characteristics to be considered Class A. Because property characteristics in different markets vary dramatically, property class definitions will remain subjective.

**Class B Buildings** A classification used to describe an office building with **asking gross rents** based on a specified range between the **asking gross rents** for Class A and Class C space. Class B buildings are in average to good locations relative to the needs of major tenant sectors in the marketplace. Building systems (mechanical, HVAC, elevator and utility) have adequate capacities to deliver services currently required by tenants. The building finishes have average to good quality design and materials. Tenant finishes are characterized by fair to good quality trim and interior finish. Building services are characterized by average to good maintenance, management and upkeep. Buildings must exhibit more than one of the characteristics but need not exhibit all of the characteristics to be considered Class B. Because property characteristics in different markets vary dramatically, property class definitions will remain somewhat subjective.

**Class C Buildings** A classification used to describe an office building with **asking gross rents** based on a specified range between the bottom 10 percent to 20 percent of office rents in the marketplace. Class C buildings are in less desirable locations relative to the needs of major tenant sectors in the marketplace. Building systems (mechanical, HVAC, elevator and utility) have capacities that may not meet current tenant needs. The building finishes are dated. Tenant finishes are functional with no frills. Building services are characterized by the existence of below average maintenance, management and upkeep. These buildings generally depend chiefly on a lower price to attract tenants. Buildings must exhibit more than one of the characteristics but need not exhibit all of the characteristics to be considered Class C. Because property characteristics in different markets vary dramatically, property class definitions will remain somewhat subjective.

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COVER STORY, APRIL 2005

**THE JOY OF FLEX**

**Flex space no longer is considered to be simply a less expensive option to leasing office or industrial space.**

Gregg Metcalf

As the old saying goes, "You've come a long way, baby." Flex started out as a low-cost alternative to office or industrial space, allowing startups and small entrepreneurial firms to collocate regional offices with distribution or light assembly operations. Today, flex space routinely features fully air-conditioned spaces, 22-foot clear ceiling heights in the warehouse areas, ESFR sprinkler systems, fiber optics and masonry construction as well as tilt wall.



Metcalf

So what is the official definition of flex? According to CoStar, it is "a type of building designed to be versatile, which may be used in combination with office (corporate headquarters), research and development, quasi-retail sales, and including but not limited to industrial, warehouse, and distribution uses. A typical flex building will be one or even two stories with at least half of the rentable area being used as office space, have ceiling heights of 16 feet or less, and have some type of drive-in door, even though the door may be glassed or sealed off."

Because of their lease rates (\$3 to \$4 cheaper than single-story office space), flex buildings used to be considered budget space only for budget-conscious companies, but now companies increasingly are utilizing their comparative benefits to address specialized needs.



One of the flex buildings at The Alter Group's 106-acre Chattahoochee Corners, located on Peachtree Industrial Boulevard in Duluth, Georgia. The park's first three phases have 627,291 square feet of office and service-center space. The completion of Phase IV will give Chattahoochee Corners more than 1 million square feet of quality flex/office space.

Looking at the national picture, flex vacancy was at 15.9 percent at year-end 2004. Asking rents in 2004 dropped to \$9.71 per square foot, down from \$10 in 2003. Since 2001, national rental rates for flex consistently have gone down as vacancies have trended up. (The only exception is between the third and fourth quarter of 2004 where vacancies improved from 16.2 to 15.9 percent). In the Southeast, vacancies stand at 16 percent with rents averaging \$8.14. Compared to pure office product and pure industrial product, these numbers are not pretty; a big part of the anemic flex market might be due to the fact that technology users account for a high percentage of flex space and were also the hardest hit by the recession. In addition, some flex tenants took advantage of the market to trade up to Class A office space, which was at a

steep discount. As we continue to recover, we eventually will see stabilization and rent growth in the flex market once again, with a slow climb beginning in the fourth quarter of 2005. Vacancies will improve similarly.

With the exodus of money from Wall Street into real estate (I'm guessing Donald Trump and "The Apprentice" have played a part in whetting people's appetites for real estate as an investment), all product types relatively are hot compared to years past. In the office, industrial and flex arena, all of the fundamentals converge regarding cap rates. Single-tenant, high-credit deals with long-term leases remain the holy grail of investors, and they draw big spenders from the institutional and

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REIT worlds. Interestingly, among smaller industrial buildings that mostly fall in the flex category, cap rates are in the 8.13 to 8.57 range.

The joy of flex is its versatility. If a company has an office use, it can build out the space with a 9-foot dropped ceiling. If it wants a retail component, it can create a showroom with a mezzanine. On the other hand, if it needs a distribution house for parts, it can use the 18- to 22-foot ceilings to stack inventory as much as three pallets high. Other advantages over more traditional office buildings include:

1. Tenants control HVAC and hours of operation.
2. Tenants have direct access to space without going through a common area.
3. Tenants control security of space;
  - this is an advantage for both
  - personal security and corporate
  - security. Limited access points
  - make it easier to record all ingress
  - and egress to the building.
4. Tenants can mix office and
  - distribution functions at one
  - location eliminating redundancy
  - in office support services.
5. Flex space is much less expensive
  - than traditional office space.

In Fort Lauderdale, U.S. Imaging Solutions just moved into a new flex building. The company had expanded at one point and separated its executive and sales offices from its warehouse operations. U.S. Imaging Solutions CEO Sean Guerin commented that certain business synergies were lost, and to consolidate all operations in the future was imperative.

In Atlanta, Simmons (the mattress company) currently has both warehouse space and separate Class A office space. The company may follow the lead of U.S. Imaging Solutions and many other national companies, as rumors suggest that Simmons is looking to consolidate both uses into a flex building.

Another recent transaction in metro Atlanta that affirms the versatility and value of flex space was MedEx's recent expansion from 25,000 to 45,000 square feet at The Alter Group's Chattahoochee Corners business park in Duluth, Georgia. MedEx occupies a dock-high building, which maintains a prestigious office building appearance from the front but still offers the versatility of distribution space. Once again, image, combined with practical features, is the allure.

Flex space no longer is considered just less expensive than the office space option. Nor is flex space considered only a more expensive "image" warehouse. Corporate America has proven that the benefits of flex space go well beyond being cheap and pretty. Versatility and value much more accurately define flex.

*Gregg Metcalf is vice president of national development for The Alter Group. He directs The Alter Group's build-to-suit activity and property development initiatives throughout the Southeastern United States.*

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