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Small bays for big boys (and girls) part 2: What to expect - by David Skinner

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If you have been keeping up with the industrial updates lately here at the New England Real Estate Journal, you might notice that this article is a continuation of the last article where we jumped into the discussion about small bay industrial properties. Last time, we discussed five key characteristics that drive value for small bay industrial, which we defined as an industrial building with unit sizes of 2,000-10,000 s/f. The five key drivers are: 1) Appropriate garage door size, 2) Flexible zoning, 3) Extra land included in the parcel, 4) Oil/water separators installed in the floor, and 5) Good highway access.

Today, we will discuss four more elements to small bay industrial that are important to keep in mind about tenancy and lease types, answering four common questions: 1) What type of tenant should I expect? 2) Will I be able to impress my bank with the credit rating of my tenant? 3) What type of tenant businesses should I expect? 4) How should I negotiate leases with these types of tenants?

1. Typical business type. Small bay industrial properties attract a wide variety of business uses, in far more variety than a standard industrial property. For example, if the small bay property in question has loading that is designed with a tailboard loading dock rather than drive-in, grade-level door, there could be anywhere from a research and development firm or small manufacturing concern to a local contractor. Often times, a larger company in the local area will need overflow storage and a 2,000-10,000 s/f industrial unit will serve that use well. There are also non-traditional uses that oftentimes express interest, regardless of loading type. A few examples would be the following: fitness center, church or other faith-based institution, donation processing center, or the ubiquitously popular doggy day care.

2. Tenant credit expectations. Because these spaces are affordable by many local small businesses due to their size, many of the prospects will not have strong financial backing, nor will they likely have strong balance sheets. On occasion, a larger company may have a requirement; one such example would be a national construction office that needs an outpost for a few years for a long-term construction project. Another example would be a national utility contractor or equipment company. However, it is more common to lease to a local business without sizable backing.

3. How to negotiate a lease. Many of the aforementioned are non-traditional in nature. Because of this, they tend to be motivated differently than a traditional storage or manufacturing company. In exchange for a long lease term and bankable credit, the benefits to landlords are often that the leases themselves are landlord-favored. Most of these tenants typically do not have many property options, and so the terms of the lease can be driven by the landlords. This is particularly true of local, non-institutional landlords who do not have covenants or regulations about what kind of tenant can occupy the property. These items would be those such as landlord termination rights, relocation clauses, landlord-favored subleasing clauses, to name a few. Pricing power is also on the landlord's side, with many small bay buildings commanding what might be considered "above market" lease rates compared with similar industrial spaces of larger size.

4. Common lease structures. In Greater Boston and throughout New England, industrial property is

typically leased on a triple net basis. Triple net leases are most typically structured with the tenant being responsible for the base rent, their proportionate share of taxes and property insurance, and the separately metered utilities. However, a significant percentage of small bay industrial properties are set up on a modified gross structure. A gross lease would have all expenses wrapped up into one payment, and modified gross would include all expenses except separately metered utilities. Many times, multi-tenant properties will be billed on this modified gross basis with the tenants putting the utilities in their own name. With many tenants and shorter-term leases, billing the triple net charges separately can be much more time consuming, this is often done for simplicity of property management.

Small bay industrial is a great place to look to invest, and there are many creative ways to maximize returns with properties like this in the right areas and at the right price.

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