

Development of an Effective Rent (Lease) Index for the Chicago Suburb

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This paper estimates changes in effective rental rates for the period 1985 to 1995 for office space in the Chicago suburb using information from individual leases provided by Allegis Realty Investors, Heitman JMB and LaSalle Advisors. This is the first study to use detailed lease-level data to estimate a price index for changes in *effective rents* for a suburban area.

Effective rents are estimated from the perspective of the property owners and are defined as the annual-equivalent cash flows of the present value of *all* cash flows that are explicitly identified in the lease contracts including the contract rental rate, graduations in the contract rate, tenant improvements, moving allowances, buyout allowances, expense stops, broker commissions, and any other conditions of the lease that generate specific dollar receipts or expenditures for the owner.

Although effective rents for both the CBD and suburbs generally declined over the 1985 to 1992 time period, the two rent series do not appear to be perfectly correlated. Assuming property values follow changes in effective rents, this suggests that property values for office buildings in the CBD are not perfectly correlated with property values for office buildings in the suburbs. Thus, there may be diversification benefits associated with having office buildings from both the CBD and

suburbs in an investment portfolio.

Effective rents for both the suburban and CBD office markets declined considerably from 1985 to 1992. Effective rents in the suburbs appear to have started recovering after 1993. Further research is needed to confirm this recovery in subsequent periods and to determine if the CBD is also recovering.