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A Full Service Commercial Real Estate Company

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Commercial Real Estate Investment Newsletter

It's Easier To Keep Tenants Than Find New Ones

A property manager may spend quite a large amount of money advertising to fill vacancies in a building. Once the tenants are in, everything within reason is done to keep them happy and paying the rent. It is difficult when one of these tenants is enticed to move to another location.

Leases can stretch the length of time a tenant will stay with you. Six-month, nine-month and one-year leases are common in apartments, much longer in commercial buildings.

The Anti-Raid Clause In A Commercial Lease

An anti-raid clause in a commercial lease can make a tenant think twice about vacating the space occupied in a building to move to another building. When such a clause is in the lease, the landlord can treat the move of the tenant as a breach of the contract and cause all of the rent due under the lease to become immediately due and payable.

The landlord may want this clause and any lease where the presence of that tenant in the building is deemed to be important to the success of the building. If the building is devoted to a certain type of business and the tenant is a leader in the field, the landlord might expect raids from rival building owners who might also have buildings devoted to that kind of tenants.

The anti-raid clause gives the landlord the right to an injunction prohibiting the tenant from moving from the leased space. However, there is no record of a court ever having enforced such a provision.

Any building owner is entitled to run his business in his own self interest. Therefore, another building owner whose tenant is being "raided" cannot recover damages against the raiding building owner for inducing a breach of lease. This rule can change if the raiding owner makes false claims such as that the tenant's present quarters are located in a building that is in dangerous condition or is slated for condemnation or demolition.

What Makes Apartment Tenants Happy

When landlords, architects and builders design apartments, none of them have lived in an apartment for years. They assume they know what tenants want.

Apartment living is a lifestyle decision for many tenants. One landlord, together with his management company polled tenants in a survey. ➟

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This publication is not a solicitation but is an information service from this office.

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They were surprised by the results.

They found that apartment tenants would rather have more car wash areas, longer pool hours, and a bigger club or recreation room on the premises instead of lower rent. The survey found that tenants preferred that the landlord provide more and better amenities rather than making any changes in the rental arrangements.

What They Really Want

Before the survey the landlord and management firm expected to see that tenants would be concerned with rent levels, money rather than amenities. Rent levels were well down on the list.

In addition to the three most frequently mentioned amenities (car wash, pool hours, and rec room)–which the manager noted are the easiest for a landlord to give tenants–tenants also said they would appreciate having designated parking spaces, a barbecue or picnic area, tenant gardening, and permission to hold yard sales. ❏

Fix Problems In Income Properties For Profit

There are always problem properties in any community. Some are only troubled or problem properties because the current owner does not know how to fix them (or will not). The present owner may have failed to do fairly simple things that can solve the problems. This can be an opportunity for someone who can do the work. Buying a property and solving problems that plague it is a profit-making business.

Location is the most important thing in real estate. Even if you spend a great deal of money refurbishing a structure in a questionable location, it will always be in that location. Stay away from bad locations – locations cannot be fixed. The successful turn-around property is a property that can be improved to attract more tenants at higher rents, a building that can be changed to another use, or a building that can be torn down and successfully rebuilt for a better use.

Examine all properties on the market. Look for some of these signs that the present owner may have given up on the property:

- Run down (uncared for) landscaping.
- Partially vacant rentals.
- Collection problems of rents.
- Rental units in poor condition.
- Obvious mismanagement of property.

How to follow up on such a find

Begin with the neighborhood. Compare rent levels in buildings like the target property (in the condition like it will be after you do a makeover). Make a list of the needed repairs that your property will need and get bids. Add a generous percentage to the resulting figures since bids are usually low.

Interview current tenants. Describe what you intend to do with the building. See if any will stay when the property is improved. Check the existing rental agreements or leases. Make sure that current tenants are paying amounts listed in the agreements.

Plan to create amenities that make the property a better place to live or work.

Older apartment units, the usual target for a turnaround, need to be upgraded to stay competitive. Modernize, installing dishwashers, microwave ovens, disposals, and new and more electrical service. Today's tenants have so many electrically powered gadgets, i.e. computers, TV's, DVDs, Electronic games, hair dryers etc. that even in small units you should consider supplying 100 amps of power and in larger units 200 amps.

There Are Risks

Knowledgeable property developers and managers (especially those familiar with empty or near-empty office, hotel, and apartment buildings) caution that buying troubled property requires taking a risk.

The profits can come from any one or a combination of circumstances.

- A market turnaround caused by a boom in the local and/or national economy.
- An improved system for promoting and operating the property. Some syndicates are being formed solely to manage the troubled property with an option to buy when and if it hits a specified profit level.
- Purchase of the property at a bargain price, often combined with imaginative and untraditional financing techniques. Some lenders are asked to share the financial risks by accepting a low initial interest rate in return for a big share of the profits later on. Sometimes the seller of the troubled property is asked to retain a financial stake in the property and to help turn it around. The seller's experience and involve ➟

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ment in the project from the start can be valuable.

• Including the troubled property in a larger development plan. An office building that sits empty might become part of a new industrial park with hotels, conference facilities, and residential apartments, all of which are successful.

Take another look at troubled properties in your area. With fresh new ideas and a re-structuring of the mortgages, the troubles may go away, leaving a profitable investment for you.

What is the upside in a turn-around project? It is in the form of increased rents, lower vacancy rates, happier tenants, and a project you can sell easily because most buyers of investment property want to have "Pride of Ownership" investments. ❑

Advantages And Risks Of STPs

Around 25% to 35% of the value of commercial properties are *single-tenant properties* (STPs). This large percentage means that institutional investors such as pension funds, as well as smaller investment groups must consider this type of investment. There are many uses ranging from office to industrial to retail. They can include office buildings, warehouses, department stores, supermarkets and other retail use. There are advantages and disadvantages in this type of ownership compared to multi-tenant properties.

Types of STPs

• **Corporate sale-leasebacks.** Most of the STP properties are corporate properties that have been sold to third parties and simultaneously leased back by the corporate seller, often for a long term. The usual reason for the seller was to raise additional cash.

• **Build-to-suit.** Build-to-suit (BTS) generally refers to office, industrial, or warehouse facilities constructed for a single user and designed specifically for its particular needs. In an over-supplied market, BTS eliminates the rent-up risk for developers. The completed building is either held by the developer or is sold to a third party who simultaneously enters into a long-term lease with the user.

• **Existing STPs**. The third form includes multi-tenant buildings that ultimately are occupied by a single tenant that expands space plus the two preceding types that are leased to third parties after the original user vacates. Since all in this group are "second generation" tenants, buildings in this category are often older than other STPs.

Convertibility To Other Use

The major consideration to an investor is whether the building can be converted to related uses at a low cost. This rules out special use properties such as refineries or manufacturing facilities. It may also rule out some corporate headquarters or institutional office buildings, constructed to meet business objectives of the original user. Often these were built without regard to capital outlays or ease of maintenance.

Warehouse and distribution facilities might be easily subdivided provided that the original design did not include a central access. They can be obsolete quickly if transportation patterns change.

Retail properties may require considerable alteration to create suitable individual stores. Service and customer access must be available for each unit. Parking may not be adequate with a larger number of tenants.

Advantages Of STPs

The major advantage of the STP is the absence of any short-term re-leasing risk plus a known cash flow for the term of a long lease. Another consideration is the minimal management requirement on the investor since the properties are usually leased under net leases.

Risks Of STPs

The obvious risk is when a tenant does not renew the lease or the business fails. The vacancy rate immediately jumps to 100%. Time to find a new tenant or to renovate the property can be very costly.

A STP may not be any riskier than a multi-tenant building, providing the lease is long and the tenant is a high quality company. Risks can be minimized by requiring tenants to have high credit ratings and by providing in the lease that rental payments must continue under all circumstances except possible destruction or condemnation of the building (in which case, insurance proceeds or the condemnation award should reimburse the owner's capital investment.)

A STP that fits all of the qualifications for a good investment can be a worthwhile acquisition for the institutional or individual investor. ❑

The Right Investment At The Right Time

The recession has affected real estate more than economic turndowns in recent decades. The government reports that this economy is now showing signs of a turnaround. If it is improving, now may be the time to start thinking of the next real estate investment.

Recovery from recessions in the past have taken less time than the months or years than it took to reach the bottom. If the public feels the economy is improving, the spending starts and improvement accelerates. Instead of years, the recovery in real estate may take only a few months. If investors wait, the bargains can be snapped up by others.

You must pick the right property for you. Sometimes, even the best thought out plans do not work out. Investments in real estate can turn out badly even in the best of times. Investors may then blame the loss on the "real estate cycle" when there were mistakes that could have been avoided by better planning and analysis.

Based on data obtained through interviews with more than 200 real estate practitioners, several costly mistakes were identified and discussed. Here are three of them:

Misjudging demand. Developers have faced costly setbacks by assuming that customers existed without undertaking adequate market analysis. For example, a retail development designed to attract shoppers from executive ranks in the adjoining commercial center failed to realize that high-income executives have demanding work schedules and tend to shop during their leisure hours near their suburban homes. Clerical workers, who might shop during lunch or break periods, cannot afford up-scale store prices.

Faulty property analysis. Investors invite catastrophe by failing to thoroughly examine all physical aspects of property improvements, including size, structural stability, and mechanical systems. Some investors have suffered losses by relying on ballpark estimates of rehabilitation costs or by purchasing multi-unit buildings after seeing only representative sample units carefully selected by sellers.

The investment fallacy. Too many people have equated real estate investment with a more passive "buy low, sell high" investment in assets such as stocks, gold, and stamps. They have failed to recognize that time, talent, and work must go into maintaining and enhancing a property's value. They have failed to understand that income properties and "investment" properties are largely the fruits of imaginative and capable management. ❑

Real Estate Investment Consultants

When you need professional advice and help in commercial real estate you must come to our office. We are experts in values and knowledge of the entire market in this area. If you have been looking for a certain type of property we probably have the full information on several like it already.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated. As your professional commercial real estate advisors, we are in the position to represent you in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate

More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of information, planning is better and there is less chance for error.

Real estate investing is not just the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

We can be your consultants. ❑

As commercial brokers, we are part of your professional team. It is our job to create the real estate transactions that will be needed to enhance your estate.