

Cravey

Real Estate Services, Inc.



A Full Service Commercial Real Estate Company

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Commercial Real Estate Investment Newsletter

Real Estate Managers Enhance Value

The professional investor can usually spot the low-priced and currently unprofitable income property that can be purchased, then upgraded with little expense so that it becomes a cash flow property. That property can then be added to the investor's real estate portfolio or quickly sold for a profit.

All owners want their properties to have increased income and so increase in value during their period of ownership. The first-rate property will command the highest price when it is sold. To achieve these goals, income property must be properly managed. The major error that can be made by an income property owner is saving money by self-management. The professional investors know that enhanced value usually comes from professional management.

Since professional management teams have experience and training in the field, they will usually increase revenues and cut costs. Since the value of a building is based on the condition of the property and the cash flow, this management should increase the value and keep it at its highest potential. The difference is the professional's ability to define and execute management duties.

The key management duties are: tenant relations; finances; maintenance; and protection of the investment. To handle

these duties, the professional management company will do the following:

1. Plan the rent schedules.
2. Find the tenants who can meet this rent schedule.
3. Qualify these tenants by a thorough credit investigation.
4. Prepare the lease or rental agreement and have it executed.
5. Prepare specifications for decorating, securing estimates, awarding the contract, and supervising the work.
6. Purchase all supplies needed for the operation of the building.
7. Audit and handle payment of bills.
8. Advertise and publicize vacant space through the proper media and in cooperation with other brokers.
9. Plan alterations and modernizing programs.
10. Inspect vacant space in the property.
11. Keep abreast of competitive market conditions so rent schedules will be correct at all times.
12. Maintain a complete system of



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

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

(continued)

records available for immediate reference.

13. Prepare accurate and periodic financial statements and a complete accounting of funds handled.

14. Pay insurance premiums and taxes and recommend tax appeals when warranted.

To put this into its simplest terms, real estate management means someone's efforts to maximize income and value by:

A. Preserving the physical desirability of the property (checking for ways to prevent physical deterioration; studying and anticipating functional obsolescence; being alert to interior and exterior maintenance needs); and

B. Maintaining high standards of service to tenants (being conscious of tenant and public goodwill; valuing the reputation and appearance of the building; being alert to extending services that will attract reliable tenants).

Standard Procedures

Professional property management companies will use a written Standard Operating Procedures Manual to cover every aspect of operating and maintaining the property. It is used by the manager's employees daily, and a copy is usually given to the owner.

How a property manager carries out duties will vary, depending on the type of property involved and on the kind of manager hired. In addition to the basic duties, a manager at a newly developed retirement community might consider safety and security systems his top priority item. In an old office building, this same

manager might be much more concerned with physical aspects (heat, electricity, plumbing, painting) and with energy conservation measures (water use, non-centralized air conditioning, weather-stripping windows and doors). All properties will be examined in depth to solve particular problems inherent to that location and use.

Each property has its own set of problems and challenges for the professional management company. Each will be analyzed when the management contract is executed. The management company then sets up the procedures and goals necessary to increase the income from the property. By doing so, its value is enhanced in the most efficient way.

Computers have taken a larger role in the maintenance of properties, including the record-keeping aspects for budgets, income statements and rental statements. On-site managers must be better educated and trained. This can be handled better by the professional company with a trained staff managing a number of large properties.

Many owners of a number of large complexes always use a professional management company to manage all of their investment properties. The manager usually works on a commission basis, frequently a percentage of the gross income. The experience and know-how that a good manager brings to the table usually makes up for the cost of his services.

Like hiring any other professional in commercial real estate for acquisition, sales or exchanges, professional management is not a cost that will not be returned. It makes money for the property owner. □

Pre-Leasing To Secure Construction Financing

Banks will be making some loans on real estate during this year. The borrower will have to have documentation on everything. The loan application must be perfect.

Whether it's a new office building, industrial warehouse, retail shopping center, or high-rise residential apartment building, investors and lenders increasingly demand to see a substantial portion pre-leased before they are willing to put up construction money.

Purely speculative construction projects are rare in today's real estate market. "With vacancy rates as high as they are, people are reluctant to invest in buildings that haven't got good strong prospects for leasing," said one builder. Another developer was saying virtually the same thing: "The old days when developers and inves-

tors would go in and spec a building really are gone. Now developers and investors expect to have a tenant going in and taking away some of the risk." The trend away from speculative building without pre-leasing is having a profound impact.

Build-To-Suit Projects

The decline (and in some section of the U.S., the demise) of speculative building is being replaced by an increase (and in some sections of the U.S., a surge) in build-to-suit projects. That's because build-to-suit is a process in which the owner (or main tenant) is going to get exactly what he needs in the most expeditious manner. One design/build firm said "Built-to-suit has become more popular because of its cost-effectiveness." □

Controlling Overdue Rents

A critical indicator of a management company's success is their effectiveness in controlling overdue rents. A well-run property should not have chronically delinquent tenants. However, when delinquency does occur, immediate action must be taken. A list of all delinquent rents must be prepared showing all tenants who have not paid, or for those who have partially paid rents and other monies due. In addition, a delinquency report recording the manner and date of all collection attempts should be prepared.

When initial notification of the delinquency does not help, the property manager should review the lease's termination rights and consider possible legal action against the tenant. Should a delinquent tenant suddenly vacate the premises, late charges and legal fees should be deducted from the security deposit.

Finally, if repeated notices and personal visits by the property manager fail to remedy the delinquency, the manager should contact legal counsel, research relevant state and local laws,

and prepare to file eviction proceedings for nonpayment of rent.

The Legal Action

Each month, the property manager should review the delinquency report outlining all telephone calls, personal visits, notices, and other actions taken in an effort to collect the rent. This report, along with the tenant ledger, will help determine what legal action, if any, should be taken against each delinquent tenant.

Tenants who generally pay rent on time should be granted an extended grace period in which to pay. In many cases, the initiation of legal action will induce habitual late payers to remit rent monies owed; however, eviction procedures should begin immediately for tenants who are suspected of moving, as well as for those who continue to refuse to pay. Copies of the tenant's lease and the tenant ledger should be forwarded to the attorney, who can then begin legal action. □

Making A Tax-Free Exchange Of Partnership Property

There are many limited partnerships that own rental property. Suppose a real estate limited partnership plans to sell rental property of the partnership to a third party and one or more of the partners wants to defer tax through a tax-free exchange (rather than receiving cash for their partnership interests). It is important that the proper procedure be followed so that an actual exchange takes place between the partners seeking a tax-free exchange and the third party. The partners desiring the exchange will have to follow these rules:

- Each partner seeking a tax-free exchange receives a distribution from the partnership by way of a deed of an undivided interest in the partnership property.
- The partner then identifies property he wishes to receive in exchange, and the property is purchased by the third party.
- The third party then exchanges this property for an undivided interest of the partner seeking

the exchange.

In a 1989 Tax court decision, a tax-free exchange was lost because Chase (the partner seeking the exchange) failed to observe a few simple requirements. (Chase, 92 TC 874 (1989).

The requirements were as follows:

- The deed to Chase from the partnership of his undivided interest was not recorded.
- Since the partnership agreement barred distribution of property other than cash to the limited partners, this provision had to be waived by the partnership. However, no evidence was presented of such waiver.
- There was no evidence that Chase negotiated on his own behalf.
- During the time that Chase supposedly was the owner of the undivided interest in the partnership property, he received no rental income or credit from the partnership for rental income it received on his behalf. □

Investing In Industrial Properties

If you haven't considered industrial properties as an investment vehicle, it may be time to take a look. Warehouse and distribution (W&D) properties are of interest because their standard layout suits a wide range of users, in contrast to specialized manufacturing facilities. Industrial properties look good for the following reasons:

- The market for industrial property is doing well with vacancy rates nationwide below those of other commercial buildings.
- There is a shift in the location and nature of demand, caused by changing technology and trade patterns, that will present investment opportunities.
- Institutional investors who have portfolios that are light in industrial assets are acquiring W&D properties for diversification.

With any kind of investment, of course, there are always risks. The most significant is the potential for rapid functional or geographic obsolescence. Because of this, investors must carefully analyze factors such as location, construction, ceiling height, and the number and location of docks, as well as other factors.

The Healthy Property

The turndown in real estate did not affect industrial property as much as other properties because this property did not encourage speculative building; as much as 30% of the cost of W&D properties is in nondepreciable land, so they held limited appeal for tax-motivated investors. Foreign investors have largely avoided the W&D sector because it lacks the "trophy quality" that makes offices, hotels, and resorts attractive. As a result,

warehouse development was driven more by demand than by capital seeking an outlet. Also the size of the properties discouraged many institutional investors who prefer to invest in larger properties than the typical \$1 million to \$10 million W&D property.

Choosing The Investment

Choosing the right property may be a little more difficult. Certain factors may be driving the W&D market toward greater efficiency, changing how and where business will be done:

- **Inventory control systems.** Computerization and techniques such as bar coding can insure faster and more reliable deliveries from shipper to destination. Combined with just-in-time systems, it reduces inventory and space requirements.
- **Automated space.** Using robots in W&D facilities will grow over time, encouraging more efficient use of space.
- **Regulations.** With the trend toward deregulation during the past decades, there has been a reduction in delivery costs by trucks and planes, causing a shift away from rail and water. This widens the possible locations for W&D facilities and encourages the construction of fewer and larger facilities. Since trucks and planes speed deliveries, the amount of inventory stored and the space needed can be reduced.

Investment in W&D facilities must be very carefully thought out because of the conflicting needs for greater demand for space while using existing space more efficiently. □

Your Real Estate Investment

Knowing what you can do in some investment situations can be the difference between an annual profit or loss in your currently owned commercial property or the one you intend to acquire. How you acquire it can be important.

The professional commercial real estate broker is in the position to represent a client in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate. This real estate practitioner stays aware of current tax laws and court decisions in order to structure transactions, but does not give legal or tax advice (unless he/she is also an attorney or a certified public accountant). In any complex transaction that might result in changes in any

owner's legal or tax situation, the other members of the "consulting team" should be the owner's attorney and/or tax advisor. We always recommend consulting with these professionals during the planning and closing of major real estate transactions. All can affect taxes and estate planning.

We are the heart of your professional team, creating the real estate transactions that will be needed to expand your estate. Let's get together to evaluate your present portfolio of properties, or review your plans for future acquisition.

Starting with your present position and your goals for the future, we can set out moving directly toward achieving those goals. □

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.