CRAVEY REAL ESTATE SERVICES, INC.

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Leased Property - Sometimes Big Profits

There are real estate investors who specialize in making profits, sometimes big profits from properties that they lease and do not own.

This cash flow from a lease can be extremely interesting. Often the lessee making a huge profit has a relatively small cash investment in the property.

The Usual Lessee

Take the position of the person acquiring property for use in a retail business or profession. For this person, the fundamental advantage of leasing over purchasing is the fact that the entire amount expended for leasing is currently deductible. On the other hand, if the property were owned, the owner would not be able to deduct any part of the purchase price. His entire cost would have to be capitalized, and could only be recovered through depreciation of the cost of the improvements over their life. The remainder would only be recovered on the disposition of the property.

An Estate for Years

A lease is defined as a contract between the owner of the land or building (landlord or lessor) and a tenant (lessee) in which the lessee agrees to pay a stipulated sum (rent) for the use and enjoyment of the property for a specified period of time. This is, for the lessee, very much like an ownership, and is also called an Estate for years.

Complicated Legal Contract

A lease is a complicated legal contract and it should not be entered into by either the lessor or lessee without professional assistance. All leases are different and so we cannot cover all of the possible combinations of items in a lease in this publication.

We can cover just the elements that can result from negotiating leases and subleases for profit.

The Original Lease

The original lessee may lease a property for a certain specified monthly rental amount. This lease is with the owner of the property.

As an example, what if a commercial building is leased for $10,000.00 a month? If the lessee could sub-lease the same property to another renter-user for a rent of $11,300.00 per month, then the original lessee would have a cash flow of $1,300.00 from this situation that is often called a “sandwich” lease. The original lessee is “sandwiched” between the owner and the user of the property.

This original lessee still pays the original specified monthly rental of $10,000.00 to the owner, but since he is collecting $11,300.00 from the sub-lessee under a separate contract, the difference of $1,300.00 is a monthly profit for him.

The Right to Sublease

As we pointed out, you need professional assistance to prepare the lease. If a “sandwich” situation is contemplated, a provision giving the tenant the right to sublease space is an absolute necessity in the lease agreement.

It is customary, in landlord prepared “form” leases, to preclude assignment and subletting. The ideal position for an active landlord who intends to provide competent continuing management to his real estate is to maintain this clause intact throughout the lease negotiation and thereby provide himself complete control of all assignments and sublettings, since none can be accomplished without his prior approval.

The usual original reason for the lessee to place the provision to sublet into the contract is the question about the future amount of space that the original tenant will need. If a tenant believes that he will need less space in the future, a sublease clause can be provided to solve the problem. The owner will usually agree in this situation, since the alternate provision might be for a cancellation of the lease.

A good counter-offer from the owner in this situation might be a “right of approval” of a sub-tenant. There might be other things that the owner wants into the lease regarding the use, etc., of a sub-lease tenant. All must be negotiated.

The Profits

- Our example of the commercial space leased for $10,000.00 and sublet for $11,300 showed a $1,300 a month cash flow.
- One speculator, when looking through an area for a commercial property, noticed a well-located house with an owner’s “for rent” sign. He inquired and leased the house for his own use. A few months later, he moved from the property, but was able to sub-lease the house for a $500 a month profit.

(Note: This is getting into a dangerous area. The original lessee would probably be liable for any damages to the home. Take care!)

- A retail store operator leased a 30,000 square foot retail location, knowing that it was too large for

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him. By negotiating for the entire space, he was able to get an excellent price per square foot - a wholesale price based on his financial strength and ability to lease the large space.

The retailer used 15,000 square feet, as originally planned. The balance of 15,000 square feet was remodeled (by the retailer at his expense) and sub-leased to a number of smaller retail operators, who paid a premium price for their store area.

The original lessee ended up with enough income from the sub-leased space to pay all of the rent on the building. He had negotiated a situation where he had free rent for himself in an excellent downtown location.

not, or would not have the time to do himself.

- One lessee leased a commercial building that had been used entirely by the offices of an insurance company as a regional location. By taking the entire building, he was able to work out the same rental rate that the insurance company had paid – also on the entire property

With very little in changes, the lessee then leased each room or suite of the building separately to various professionals - attorneys, insurance agents, real estate agents, etc. His cash flow from the "sandwich" lease situation amounted to a profit of $13,000.00 per month - for leasing and managing a property that was not owned, and in which he had little cash investment.

Making these profits may take a little ingenuity on the part of the lessee. He may have the imagination to see the uses of a property that the owner does not, or would not have the time to do himself

Real Estate Investment Advisors

Today's investor in real estate must be aware 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 advisors 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.

Please give us a call. We can be your real estate investment advisors.

Leverage With An Option

Leverage is the use of borrowed money to control something of value. Real estate investments for many years have afforded the investor some extreme leverage situations. Let's examine leverage. If double-digit inflation returns, controlling the maximum amount of real estate may be extremely desirable. One way to do that is with an option.

High leverage is an excellent benefit. Remember though, that with an option there is a problem. Options have an expiration date. If you haven't gotten the desired increase in value by the time the option expires, you must make the choice - buy the property and wait longer, or let the option expire.

An option is simply a contract that gives the purchaser a right to buy a certain property at a certain price for a certain period of time. Sometimes a seller will sell an option to purchase his property because the amount of money paid will solve an immediate problem, and it really does make him feel that the property is sold or will be sold.

Always ask yourself a few questions before buying an option.

- Will you have enough money to exercise the option at the expiration date if no loans are available?

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- Do you think the property will increase substantially in value during the option period?
- Will the profit be large enough to chance the loss of a small investment in the option on the property?

Suppose you buy an option to purchase a property during a period of the next three years. You have set the option price at today's market value and put up only about 10% of the ultimate purchase price. You wait three years and find that you guessed right! The property has increased in value by $100,000. You can now make some choices on the next move:

- **Exercise the option.** You can buy the property. Maybe you can borrow the amount of the purchase price on the land and buy for no money down. To sell at a long-term gain, you must now hold it for six months, or longer.
- **Sell the option**. You might sell the option for the $100,000 cash to someone who wants the land. This would be an immediate long-term gain since the option has been owned for more than the minimum time period.
- **Settle the option.** The profit is yours because the present value is higher. What if the original owner who sold the option to you now sees more future value in the property and would like to continue owning it. The original owner might buy the option from you or settle it with you in some other way. Perhaps a joint ownership could be arranged, with both of you taking a further holding position for more profits in the future.

The Risk

Remember, the market tends to reward those who take risks. When you minimize risk too much, play it too safe, you may give up the chance for larger profits.

See Us For Investments

Serious real estate investors may want to own real estate for cash flow, tax shelter and reasonable growth. Maybe you would also like to invest something for a long-term growth, such as land speculation. Come in and see us. Perhaps we can help you with choices and do some of the research for you.

Managing The Commercial Condominium Complex

One of the functions of real estate asset managers is handling some of the commercial condominium complexes nationwide.

Association Challenges

The associations face several important challenges. They set rules, for example, as to what constitutes an unacceptable deviation from the development's uniform architectural and esthetic standards. They decide questions about the window coverings and signage. They determine parking lot rules. They decide questions about shrubs, landscaping and any plants in the interior of the common areas. They set rules governing use of any outside areas, such as the lighting for both the inside and outside of the buildings.

The Money Concern

One of the most troublesome problems facing these associations is how to finance the major repairs that will eventually be needed. How much money should be assessed property owners now to be able to pay for a new roof on the development 15 or 20 years in the future? How will the streets and parking areas within the development be repaved in the next 5 or 10 years unless some money is assessed for that purpose now?

Value Counts

What individual condo owners really care about is maintaining the value of their businesses. The upkeep of the buildings and the common areas must be maintained to perfection.

Developing A Master Plan For Land Acquisition

The acquisition and improvement of land is a large-scale operation and requires large amounts of capital. This has created methods of land acquisition that gives the developer access to and control over a large enough tract to make development economical without requiring an initial outlay of all of the capital necessary to acquire such a tract.

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From the point of view of the landowner, the disposal of a large tract at a good price may require a formula that will encourage the developer to commit improvement and development money for part of the tract that will build future value into the entire tract.

This may be accomplished by the following:

- The developer sets up a master plan that sets forth the general scheme of development and submits it for the approval of the owner.
- The developer and owner enter into an agreement setting forth the acreage prices for the entire property.
- Owner and developer agree on the number of years over which the full development is to be completed.
- To protect the owner against freezing of his property, the developer firmly commits to buy a predetermined number of acres each year.
- If the developer fails to meet this schedule, the owner is released from his commitment.

A Development Agreement

Another way of handling the problem is for the developer to share the net profits from the land development with the landowner. This can be done by a "land development agreement" in which the developer agrees to perform the platting, the laying out, the installation of lot improvements, and the promotion of the. subdivision. The landowner agrees to accept a percentage of the sales price of each lot, with a fixed minimum lot price guaranteed.

With this kind of arrangement, it is important to protect the landowner from finding his land cluttered up with liens left by a subdivider who became insolvent. The landowner should consider confining the developer or subdivider to a small tract of land at a time and give him "rolling options" to acquire additional parcels at intervals over a period of time. Failure to keep up with this purchase program results in loss of future options. The land that has been optioned but not purchased is not subject to liens against the developer.

A Liability for Not Proceeding With Development. In one case, a jury found that a village breached its contract with a real estate developer calling for the village to acquire property and convey it to the developer for construction of apartment houses and a shopping center, all conditioned on obtaining financing from HUD. The village repudiated its explicit undertakings, to acquire and convey property to the developers. HUD had granted the main application and was in the process of considering the other grants involved, so the village could not back out of its promise. **[Heritage Commons Partners v. Village of Summit, 730 FSupp 821, (ND Ill. 1990)]**

Cravey Real Estate Services, Inc.

A Full Service Commercial Real Estate Company

5541 Bear Lane, Suite 240 | Corpus Christi, TX 78405| 361-289-5168

cravey@craveyrealestate.com | craveyrealestate.com

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About Cravey Real Estate Services, Inc.

Cravey Real Estate Services is a full service commercial and industrial real estate company based in Corpus Christi, Texas. We sell, lease and manage Commercial, Industrial, Warehouse, Office, Retail, Shopping Centers, Land and Investment Properties in Texas.

Established in 1975, we provide the most innovative and cost-effective real estate solutions for our clients on local, regional, national and international assignments. Our brokers at Cravey Real Estate Services have a reputation for reliability and prudence, providing clients with real estate leasing and sales, investment counseling, asset and property management and real estate marketing services.

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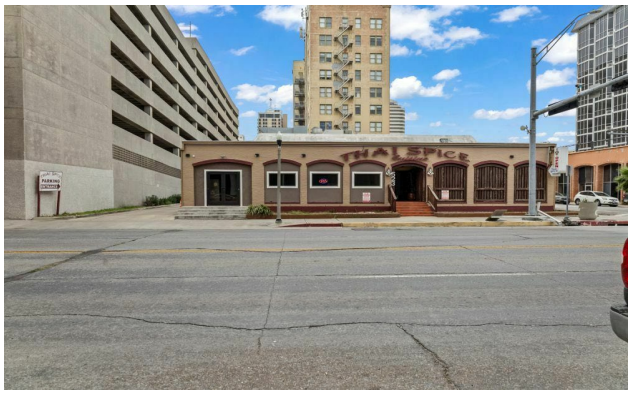
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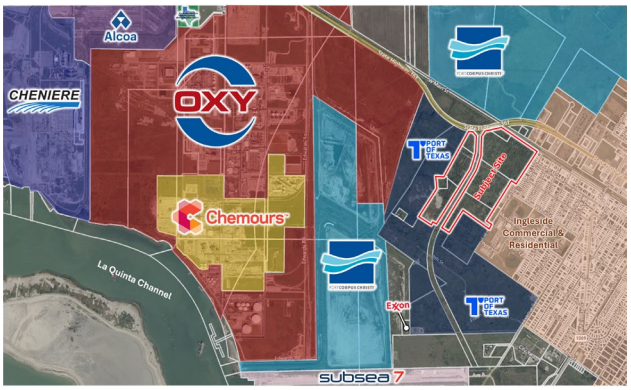
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