# INSIDE COMMERCIAL REAL ESTATE

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## Modernize Older Buildings For Profits

When you look around a community, you will usually find a number of properties that need to be upgraded. Some existing owners do not recognize the increased return that they could get with a remodel or they do not want to make the necessary upgrades on the investment. Often these buildings can be acquired at a price that reflects the return based on the current condition and income.

When you set out to modernize an older building, you will encounter physical deterioration, which starts immediately after the building is completed and continues throughout its entire life, unless it is handled along the way with proper maintenance and repair. Functional obsolescence then happens when the property loses its usefulness as a result of changes in styles or in the needs of tenants. Economic obsolescence is a change in value that is caused by circumstances that are not directly related to the property. Often this is a change in the area from residential to commercial or industrial. When a building is quite old, structural changes may be needed for safety reasons. Before you purchase the building, a professional engineer should make an inspection.

The building can be partially redesigned with architectural changes during the modernization. If a building has very distinctive architectural features these might make the building more desirable and be retained.

Functional changes and mechanical replacements can reduce costs in an old building and increase efficiency. Wiring will usually need to be replaced to provide safety for modern electrical and computer equipment. Old heating systems will usually be inefficient and cause high maintenance costs, and should be replaced.

Aesthetic improvements are the sprucing up of the property and can usually be done at a relatively little cost. When an investor is looking for a quick resale, this type of improvement may be done rather than some of the others. Cleaning up the property, inside and outside, installing new lighting and repainting the building can be enough sometimes to make a quick, small profit.

### Modernize For Profit

When an investor is looking for the proper investment, older apartment or commercial buildings in good neighborhoods often look better for a long-term commitment than new construction. When a property is upgraded, rents can be raised substantially and, if the work can be done without disturbing the existing tenants, the investor will not have the expense of carrying the property as he would in new construction. The investor would also hope that most of the existing tenants would stay and pay the increased rents, so the costs related to acquiring new tenants, as would be needed with a new construction, would be avoided.

Finally, the overall costs may be less. Although the price of the property may be high in relation to the current rents, the final cost after modernization may be far less than the cost of new construction. With this lower cost, the investor may be able

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to charge lower rents than new buildings nearby, putting him into a very competitive position.

### Converting To New Use

Unproductive properties can present opportunities for big profits. When a building is bringing in little or no income because obsolescence or because of changes in the neighborhood that have made the location unsuitable for the original use of the building, converting to a new use can make a new profitable income stream.

Don't overlook properties that are still productive, but may have a much greater potential after a conversion. A chocolate factory was converted to a shopping center on the west coast. Movie theatres have been converted to supermarkets. Garages have been converted to condominium parking buildings. Seeing potential profits in older buildings takes imagination.

Give our office a call if you see a building that has potential for another use. ❏

## The Need For Both Asset And Property Managers

When owners of large portfolios of investment properties need to make strategic business decisions involving management of these properties, they will usually call on asset managers. Areas of concern are overall leasing strategy involving rental rates and tenant concessions, in addition to repositioning or redevelopment, tenant mix, managing bulk service contracts.

### The Asset Manager

There will be owner oversight to the manager's actions, but the asset manager usually controls such matters as contracts, leases, and capital improvements for portfolio properties and is directly involved in implementing strategies involving financing and tax or litigation-related issues. The asset manager will also be responsible for maintaining communication with lenders and equity partners with respect to financial reporting, debt negotiations, and significant operational issues.

The asset manager also can be expected to provide basic administrative services, including information systems support, in-house legal counsel, financial accounting, coordination of required appraisal, and preparation of annual operating budgets. The asset manager also may plan and coordinate exit strategies–sale and disposition of real estate. Finally, the asset manager will be responsible for overseeing property management personnel.

### The Property Manager

Property management responsibilities differ from those of the asset manager. The property manager has a more tactical focus, dealing with the day-to-day operation of individual properties. These responsibilities include: overseeing repairs and maintenance, security, and cleaning operations.

Finance-related responsibilities of the property manager include tenant billings and collections at individual properties; lease negotiations; vendor contracts; cost control for property operations; and maintaining appropriate insurance coverage. They also handle tenant relations and deal with on-site issues such as space and leasing requirements. Finally, the property manager maintains accounting records and performs necessary inspections.

Property managers also may be called on to handle legal matters relating to building and tenant interests and to ensure compliance with local laws and ordinances. Finally, the property manager is the conduit by which information about each property and its operations passes to the asset manager. ❏

## Communication Between Management And Owner

For success in achieving the owner's objectives, there must be open communication between the owner and the management company. The process must be continuing from the onset of the management plan based on the owner's objectives to the dissemination of monthly and annual financial reports for the owner's records.

Meetings between the owner and the management company should be set up on a regular basis. In these meetings, topics such as major repairs, personnel problems and rent collection can be reviewed. In-between meeting, managers must communicate serious problems with the owner immediately, so they can be addressed in a timely and cost-effective manner. Constant communication is essential to the process of management. ❏

# Contingencies Between Buyer and Seller

### The Buyer

You have found the investment property that you have been looking for. It's time to make an offer.

To buy a piece of property or any other real estate without all of your homework completed means that you must have a way to cancel if something unusual and unexpected comes up. Waiting for all inspections, financing, etc. before making a purchase offer is a good way to lose that property to another buyer. Maybe another buyer knows about contingencies.

A contingency gives the buyer a way to cancel a purchase contract and getting any cash deposit back if some future event fails to materialize. Even though the sellers have accepted the offer, the well-written contract should contain these extremely important escape clauses.

The buyer's partner may not be available until the weekend. A contingency for the inspection within a few days will usually be accepted. Normally, the seller will refuse no reasonable contingency. They know that any other buyer will also request reasonable escape clauses.

Typically, the following two contingencies are written into nearly every offer on a property:

• **Financing.** You can get out of the transaction if the loan specified in your contract is not approved.

If it is a business, the buyers are allowed to take a look at the property's financial records. The income and expense records are very necessary for a better evaluation of the overall cash flow. Also check out the property's vendor records and operating invoices to better calculate the property's financial health and whether it is turning an actual profit or not.

• **Property Inspections.** You can cancel the transaction if you don't approve the inspection reports or cannot reach an agreement with the seller about how to handle necessary repairs.

Before you invest in any real estate property, it is important to you to ensure that both the building and land are safe and suitable

When you place an inspection contingency on your proposal, you ensure that you get a chance to inspect and examine the condition of the building and the land that it is built on.

Some other things to check include:

* The safety of construction,

• The conditions of the amenities of the building and need for improvement (if any).

• Verify the square footage and whether you can afford to invest in the deal or not.

### Zoning contingency

It is necessary to be sure that you can do whatever you wish with the property. It is possible that the zoning laws set in the area or locality can forbid you from using the commercial property for what you plan for it.

Other standard contingencies can give the buyer the right to review and approve such things as a condominium's master deed, bylaws, and budget as well as a property's title report. You might want to make the contract contingent upon your lawyer's approval of the contract or your partner's inspection of the property.

What good is an accepted offer that has several escape clauses in it? An accepted offer with contingencies ties up the property for a short period of time. This gives the buyer time to check out the property, the traffic, the parking and any other things that affect the property. The buyer does not worry about the owner selling the property to someone else while he is spending time and money inspecting it and getting all of his questions answered.

### The Seller's Side

On the other side, the seller must protect himself. He or she must limit the time of the contingencies in a counter-offer if those time limits seem unreasonable. The seller does not want the property taken off the sales market for weeks just waiting for a simple walk-through inspection.

Inspections by partners or approval of existing deeds, bylaws, easements, etc. should not take more than two or three days. Financing may take a few days longer, but most loans can be approved very quickly. The seller's real estate agent can give guidance on the typical time limits for various types of contingencies. The shorter the better for everyone!

By making strict time limits on removal in writing of all of the buyer's contingencies, the seller can get the property back on the market within days if the buyer cannot perform.

Contact your experienced commercial real estate agent to ensure that you get the best out of the deal. They will help you negotiate the terms and get the best offer for the property that you are looking at. ❏

# Good Management Increases Market Value

Investors purchase residential and commercial income producing real estate to make money. There are two obvious ways of making money from a property. First, the owner takes a share of the annual operating profit generated by the investment, and Second, profits from increasing the market value of the investment beyond what it would be because of inflation alone.

Increasing the market value of rental units does require know-how, absolute understanding of the market values of this type of property and excellent management.

### Management and Income

Good management has always been the most important point in increasing or maintaining annual operating profits. Being a skillful manager requires intelligent handling of the functions of buying and selling properties, rent collections, maintenance, leasing, controlling expenses, refurbishing, management accounting and more. All of this requires long "hands-on" experience in the field with plenty of assistance from the latest in administrative hardware and software.

### Increasing Market Value

Since the value of a rental property is based directly on the cash return, adding value means increasing cash flow.

When small investors set out to increase real estate values, the steps are in upgrading and enhancing the cash flow, therefore increasing equity when the property is sold.

When thinking of buying larger commercial properties, there are two major actions:

- Be aware of the things that have the potential of adding value, taking advantage of this knowledge and moving quickly before another buyer can purchase or option the property.
- Do the required homework on the property. A feasibility analysis can measure the ability to add value. There may be many other measures that must be taken, such as market analyses, applications for new zoning, design and construction planning and a plan for marketing.

Professional property managers should be contacted before an investment property is purchased as they will do a much better job than most owners and will more than cover their fees. ❏

# 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. ❏


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