



TURNING PRO AS A PROFESSIONAL REAL ESTATE INVESTOR

The Tools and Strategies To Make It Possible

Over the last 25 plus years Darin Garman has seen a lot when it comes to apartment and commercial real estate investing and has documented for investors that want to turn "PRO" profitable ways to earn significant returns and income from their commercial property purchases using state of the art information, systems and strategies.

As a former bank owner and board of director member as well as a manager and part owner of over \$40,000,000 in investment real estate properties and partnerships Darin, or as some call him "The Paranoid Banker" has seen about every type or kind of investment a person can participate in. Though many apartments and commercial investment properties come and go Darin still comes back to the strategies and systems that have served him best and that is what you will find in this book!

As the U.S. economy, global financial markets and political landscapes continue to be unpredictable roller coaster rides investors are finding conventional investing emotionally and financially draining. Many conventional market based investments continue to be influenced by national and global events that in many cases have nothing to do with the investment frustrating investors even more.

Over the years Darin has written about apartment and commercial real estate investing as one of the last investment refuges for investors seeking a more predictable return, income and investment. Turning "PRO" as an apartment and commercial investment real estate owner and investor is not only smart in today's economic and political landscape but in many cases one of the few ways to grow and protect your income and wealth more predictably and profitably. Over the years Darin has been a guide for many investors that were tired of what the conventional markets offer by way of investment benefits and finally decided they want to turn "PRO" in commercial investment real estate investing and ownership.

Now in this easy to read and understand book passive or active real estate investors can profit and get the kinds of investment returns and benefits they deserve as Darin brings his best apartment and commercial real estate investment analysis, systems and methods under one book!

Turning Pro As A Professional Real Estate Investor

Darin R. Garman

TURNING PRO AS A PROFESSIONAL REAL ESTATE INVESTOR



DARIN R. GARMAN

Darin Garman's Real World Guide to

**Turning Pro As a
Professional
Real Estate Investor**

The Tools and Strategies To Make It Possible

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This book is not intended to give legal and/or accounting advice, but rather demonstrate the power of real estate investments and how it can grow your wealth. The user of this book will also realize that they will also have to do the necessary research and educate themselves on the specific real estate and/or rental rules, laws, and regulations in their individual states and in their individual market places. Darin Garman takes no responsibility for the outcome of any real estate investments, good or bad, and urges the user of this book to use competent legal and professional advice whenever necessary.

Introduction

When I mention to people that they can become a professional real estate investor I most always get a look of skepticism and believe me, I understand!

Most people's dealings over the years with making money in real estate has been the late night infomercial experience. For years the late night TV and the traveling seminar business was all about "NO MONEY DOWN!", "BUYING FORECLOSURES CHEAP!" of course all of this was always done with "OTHER PEOPLE'S MONEY". There was a new "guru" about every month with a new "CREATIVE" way to make millions in real estate all of course in 6 months or less and almost always with "NO MONEY." The testimonials about the person living on the street one day and having a \$5,000.00 per month cash flow within 30 days was all the norm.

For years these marketers made tens of millions of dollars off of selling this information with the majority of it actually being accurate information but leaving one important thing out: One out of every 1,000 people that bought their courses or seminars were successful. Why? Because the promoters of these products never told their customers just how hard it was to make their "systems" work. They were selling this information in a way that had the undertone of these customers getting the huge payoff with little or no money and little or no risk. You buy our course and/or attend our seminar and pay \$10,000 to do it and you will make millions from real estate. Hmm. \$10,000 course gets me millions? Where do I sign up?

Many people spent but few profited. It was almost like gambling. Put your \$10,000 on red (in our course) spin the roulette wheel (do the three simple steps) and have \$100,000+ in your bank account in a few months (finally the big cash pay day!)

This was the case for years and years. I personally know three of these gurus that made millions every year with their traveling seminars selling their courses and coaching and infomercial products.

Then the real estate crash came starting in 2008.

Almost overnight these gurus businesses evaporated. Why? Because everyone was scared to buy any real estate. Millions were losing their homes, real estate values were plummeting by the month and with this going on there were not many people looking to get rich in real estate because real estate was making everyone poor!

In a way this was the perfect way to cleanse the world of investment real estate sales pitches, tactics and unrealistic expectations. Purging the bad information and sales tactics that were all about selling a product, course or coaching no matter the cost. Today, many if not all of these gurus are no longer in the real estate investment business.

Which brings me to you, now and this book.

Over the last 25 years I have been involved in the sale and acquisition of over \$500,000,000 in apartments and commercial investment properties. I have made my living in the world of investment real estate and continue to do so today. You can say that I am a professional real estate owner, investor and broker. I am doing this every single day and doing this conventionally like a business owner would. Simply put I walk the talk, have had skin in the game and you could even say I have my soul in the game. Every day.

I did not start out my real estate career with the goal of being a professional real estate owner / investor. After 25 years it just worked out that way.

Many people have contacted me over the years wanting to know if I can pass on my 25 plus years of experience to them. Most of these people just want to make a few good property investments while others want to make real estate ownership a career.

Like any business every day has not been hugely profitable. I have made some great investments over the years but I have also made some huge mistakes and had some real losers too. I have learned more from my mistakes than from my successes and much of what

you will find in this book is designed for you to learn from my mistakes and hopefully not make them yourself.

What you will find in this book is real world information, strategies and tips to help you be a profitable investor no matter how large you want your real estate empire to be. Whether you want to make one or two smart property investments or want to seriously look at making investment real estate a professional career.

You have in your hands the necessary tools to get your real estate investing started and a resource you can refer to over and over again. No late night infomercials, no outlandish claims.

I am in hopes this book is the start of you getting what you want from real estate and real estate ownership in general and helps avoid the common mistakes made. Who knows, you may like it so much that like me you may find yourself years down the road doing this real estate investing thing full time.

Here is to turning pro!

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Chapter 1

Buying Systems

Of course, the act of owning investment real estate needs to take into account the need, desire, or goal of building as much cash flow and wealth as possible from the properties. What many don't realize though is that you can actually do this when you buy real estate. In other words, make money when you buy.

So, in this part of the book, we are going to look into ways that we can make money when we buy the real estate and how we can do this by using tried and true systems that many don't know of or many don't talk about. In other words, we want to assure ourselves that we make as much money from a commercial investment property when we buy versus hoping that we make money on it when we sell, because if we can make money both when we buy and when we sell, of course it will increase our profits and our cash flow exponentially.

So, with this in mind, let's find out what we actually do to find the right type of commercial investment property that will give us these kinds of profits when we purchase and talk about these strategies, techniques, and mindset that we need to use when we do buy.

But Don't Bank On Traditional Ways Of Getting The Good Deals In Commercial Real Estate

Many investors think that their best deals are lying in one of three places #1. Foreclosures #2. Bank Repos or REO Property and/or #3. Sheriff Sales or Auctions. After giving this some thought, those three answers do make some sense, because in all three of those situations, there is a good chance that the buyer would have a shot at buying the property at a discounted price in order to help the motivation of either the current owner or the lender. **But, if all you do is look here you will be leaving money on the table!**

Now, don't get me wrong. There are SOME good deals in bank repossessions, foreclosures, bankruptcies, etc., and of course, someone interested in investing in commercial investment real estate (being its apartments, office buildings, shopping centers, etc.,) can find these deals if they look hard enough.

However, there are a few problems with this:

Problem #1: They just don't occur very often. That's correct. In proportion to the number of what I would call motivated sellers, there are hardly any motivated sellers in the commercial real estate world. It does not happen very often. For example, in my marketplace, where I actually live, which is about an overall population of about 200,000, what you will find is maybe once per year where a commercial real estate property is in that kind of “desperate seller” situation where you could potentially make a sizable profit.

Problem #2: Price. In most situations what is owed on the property is in excess of how much the property is really worth. So, many times you will find, say, a \$200,000 apartment property BUT there is \$197,000 owed on it. You cannot make much money buying from the owner in foreclosure or buying at a Sheriff Sale or auction when you pay close to the appraised value for it—why even buy the property at the auction or Sheriff sale in the first place?

Problem #3: Lack of Good Product. OK let's say you find what looks like a great commercial investment property, let's say an apartment building and you think you can get it for a decent price from your motivated seller source. Now for the \$64,000 question. WHERE IS IT LOCATED??

You see, many of the deals in the foreclosure/repo world are in foreclosure because of a problem and that problem many times is location. It does you no good to pick up a supposed “deal” if the tenants are selling guns out of the apartments or using the hallways as their motorcycle repair shop.

So, despite the hype it receives when it comes to foreclosures, bank repos, etc. in the world of commercial investment real estate the numbers aren't on your side.

So what I would tell you on the outset is if you're one of these kind of investors that is looking for the foreclosure, the bank repossession, the bankruptcy kind of property as it relates to commercial investment real estate, do not spend most of your time looking in that area for the great deals because at the end of the day they will be few and far between.

However, there's good news. There is an area I'm going to tell you about right now where you can find very good deals that in most cases will get you instant cash flow, instant equity, and a fantastic rate of return on your dollar and the nice thing is they are right out there today, waiting for you to find them.

Here they are:

Source #1: Dumb Real Estate Agents.

Source #2: Dumb Owners.

Source #3: Lazy Owners and Lazy Property Managers.

First, let's talk about dumb Real Estate Agents.

For the majority of people that sell their commercial investment real estate properties they are going to do it through real estate agents and frequently what will happen is someone will use a real estate agent that has no idea what they're doing and the owners also have no idea what they're doing and what they should be expecting in terms of a selling price for their property. It happens much more than you would think.

I'll go ahead and illustrate what I'm telling you with a story: (Everything that I tell you in this book and throughout this system are related to actual transactions I've been involved.)

One day I'm sitting in my office and my secretary brings me the new "on the market" apartment listings for the day. I take a look at

the listings and I find that there is a seven-unit property for sale for \$130,000. After making a quick calculation, it comes out to less than \$20,000 per apartment unit. Now, in my marketplace, which is in Cedar Rapids, Iowa, that sounds like a pretty good deal. So, my skepticism starts to kick in. I started thinking that it's probably a property that needed a lot of work, or it was probably an old converted property that was built in 1850 and needed a substantial amount of money put into it to bring it up to date, etc. However, I did have an appointment on the side of town this property was located later that morning, so I decided to drive by.

When I drove by, I was shocked and surprised. I got out of my car, walked around the property, and walked through the property. What did I find? A nice seven-unit apartment building built as a seven-unit apartment building that was probably 15-20 years old. Everything on the exterior and in the common area hallways looked to be in good condition. So, I started to get a little excited, thinking, hmm, could this be an opportunity? But, why in the world is it priced at only \$130,000? There has to be something I am missing.

So, I go back to my office and I make a phone call to the real estate agent that has the property listed. (Note: Please make sure that you go through the Seven Mistakes To Avoid When You Sell Your Commercial Investment Property in another area of this section to avoid happening to you what I'm going to tell you happened to this owner.) Based on the information that she gave me the property was worth about \$150,000 - \$160,000 easy. But, on the market for \$130,000. Long story short the property was purchased for \$129,000—A property that was worth \$150,000 easy. The seller left \$20,000+ on the closing table. \$20,000 that went into the buyers pocket at closing. The lesson here is to look for these kinds of opportunities (we will discuss how to later) and never have a real estate agent work with you that has no idea what they are doing.

Dumb Owners

Once again, these are the people that don't really have an idea what they're doing, do not really know the conditions of the current marketplace, or are so busy and overwhelmed with a whole bunch of

other things, that the real estate that they own or manage has taken a small priority and they are not up to date on what they should be doing.

Years ago I was contacted by an owner of an apartment property. 20 years prior, he inherited this property from his mother, who had passed away. During that time, that owner had only raised the rent one time; that's correct, he raised the rent one time in a 20+-year period. Suffice to say, the current tenants in this apartment property were basically stealing legally from the owner. When I asked him why he did not raise rent in all this time he said, "I got the property free and clear, I don't have any debt, the income stream coming from it was good for me and my family, so why rock the boat? I've got no motivation to do so, so that's why I decided not to raise the rent".

Once again, bad for him, good for us.

Well, he ended up selling the property for over \$25,000 less than he could have if he would have simply just kept his rents at market levels. Of course as the buyer you made over \$20,000+ at closing and you knew you could **REALISTICALLY** raise the rents to market levels and capture that hidden profit!

As, I've said before, this kind of thing happens quite often; the deals like this come from areas you don't really expect, if you know what to look for and how to look for it.

Lazy Owners and Lazy Managers.

This is just a corollary of the dumb owner or dumb manager, only in this situation the owner or manager knows that his or her rent should be raised, expenses should be looked at and controlled, tenants screened better, etc. but is just too lazy to do it. These are the owners that always say, "My apartments (or office, retail space, etc.) should be renting higher, but, I just have not gotten around to doing it yet." Once again opportunity for you to take advantage of.

And that is what it is really about. Taking advantage. Not in

some mean spirited way of course but one person's problem, one person's laziness, one person's lack of knowledge can and will be your advantage and profit in the world of commercial investment real estate. This is where the opportunities lie. Think about this. There are much more of these people and these situations existing in your marketplace today, than say foreclosures or bank repos. These three areas should be the areas you focus on from here on out.

Now that you know what to spend most of your time looking for let's take some time to talk about mistakes to avoid then doing so:

The Seven Mistakes To Avoid When You Purchase a Commercial Investment Property

These are the seven mistakes you must absolutely avoid when you purchase an apartment property, office building, shopping center, commercial property, etc. Making any one of these mistakes will cost you literally thousands of dollars at the closing table when you buy. Here they are:

Mistake #1: Not putting yourself in the buyer's shoes 5, 10, 15, or even 20 years down the road when you buy your commercial investment property. You almost want to buy the property over again in your mind say 10 years down the road and ask yourself the following question: "Based on the future of the location and condition of the property, will a buyer find this property attractive?" If you hesitate on saying yes, you must definitely do more analysis as to the salability of the property and the area.

Mistake #2: Not inspecting the entire property prior to closing. To make an offer on the property, of course you have to do an inspection. Well, many apartment and commercial investment property owners do not want to bother ALL of their tenants with an inspection every single time someone has an interest in buying their property. So, what usually happens is, you end up looking at part of the property, not the entire property, before making an offer. (If you were looking at a 48-unit apartment property, you'd probably look at say 6-12 units first and make an offer "subject to" inspecting the rest

of the units.) This is the way it's typically done; however, one big caution to you, make sure you inspect the entire property prior to closing.

This is for two reasons.

1. Damage. It's amazing what can get damaged between the days that you look at the property and the day that you actually close. Sometimes it can be 30, 60, or even 90 days between the time that you initially look at the property and the time you close. Many, many things can happen between that period of time and most of them detrimental to your cash flow and to your profits.

2: Hidden surprises: Many times when you go through the property the first or even the second time, you could miss something; something of vital importance and something that if caught early, could save you thousands of dollars. For example, I recently went through a 56-unit property with some clients and we totally missed that one of the roofs on one of the buildings needed to be repaired. Actually after we took note of it later on, we actually noticed that more than one roof needed to be repaired soon. The total cost? \$32,000. We got the seller to share in half of that cost with us before we took over the property. Now, if we wouldn't have noticed it, wouldn't have gone through all of the units and looked at all of the buildings, we would've left \$32,000 on the table.

Mistake #3: Work only with an experienced commercial investment or apartment property lender. Save yourself a ton of time and money by working with a banker that truly understands apartments and/or commercial investment property. This almost more than anything can make or break a good deal for you. Work with a lender with no real experience at your own risk.

Mistake #4: Do not buy on the assumption that you will raise rents—only under special circumstances. Whatever you do, do not buy on the word of a broker or owner that all you have to do is raise the rents a little bit and the property will work wonderfully. Make sure you do your homework and analysis as to the validity of this claim. Almost ALL owners say that their rent is too low. It's typical; you'll

hear it from every one of them. Before you buy into it make sure you do the analysis necessary to make sure that this is not a blue-sky claim. There is nothing worse than purchasing a property with rents at the top of the market that can't go any higher and all of a sudden you have vacancies. If that happens, it will drastically affect your cash flow.

Mistake #5: Only work with an experienced broker to find a property that will work, make you profits, and they will protect your interests at the same time. The best brokers to work with specialize in commercial investment real estate. Be it apartment properties, office buildings, shopping centers, or maybe all of the above. You have to look hard and look long to find these brokers. Probably one of the biggest mistakes that I've noticed is investors that have invested tons of time and tons of money into investment courses, investment know-how and knowledge, pick the worst possible person to work with, which is usually a residential real estate agent. Why on earth would you work with someone who has an open house on a Sunday and you want him or her to help you buy a \$2,000,000 commercial investment shopping center on a Monday? Big mistake.

The best kind of brokers have designations such as: CCIM, which means Certified Commercial Investment Member or SIOR, which means Society of Industrial and Office Realtors. These folks that have these designations have taken the time and invested in their careers to take the necessary course work and the transaction volume to substantiate getting these designations. In other words, these designations are comparable to a PH D in commercial real estate. You want to seek out these folks that have these designations or at the very least find out the market specialist who specializes in apartment and investment real estate in your area. Doing anything other than that can actually cost you thousands of dollars at the closing table, not only during negotiation, but also mistakes that would not be caught or observed by a broker without this kind of experience. **One more note:** These kinds of brokers that actually know what they're doing and understand what they're doing can help you tremendously when it comes to the analysis of a property. In other words, they can give you a shortcut and let you know if a property does indeed have the merits of being a profitable one,

especially if you're new and don't know your way around the market very well.

Mistake #6: Not examining income and expenses closely. Before you actually say yes to a property, ask to see the seller's last two years of Schedule E and/or partnership or corporation tax returns for the property. This, more than anything will give you an accurate reading as to the performance of the property. Compare this to the income and expense figures that the owner or broker originally gave you. As long as they're close and there are no large deviations, you should be fine. However, if there are large deviations between the figures you were presented and the tax returns, red flags definitely need to go up and you need to start asking questions. Make sure that you are comfortable with the answers to these questions. If you're not, this may be a deal you may want to walk away from. Know this, owners are widely known to exaggerate income and reducing expenses—especially for tax purposes. Only by looking at their tax returns can you get a good idea of the validity of their numbers.

Now, one other note: Make sure you understand that their numbers don't have to be the same. So, if I spent \$3,542 in repair and maintenance costs on my tax return, but on my income and expense information I have shows it was \$2,975, don't sweat it, it's no big deal. But if the cost was \$10,644 on the tax return, but the income and expense information reported was \$2,900, then you need to start asking questions.

Mistake #7: Not factoring in enough vacancy and reserves. Make no mistake that during your ownership, you will manage the building, have empty space, have empty apartments, they will need capital improvements, leasing help, etc. Make sure you factor in these costs into your operating statements to give you a TRUE idea of how the property will cash flow. The lenders and appraisers will also do this. You should do this as well.

Make sure you factor in:

A: Enough vacancies.

B: Enough reserves to fix and repair things that go wrong; roofs need to be replaced, appliances need to be replaced, things get

broken over time with normal wear and tear, make sure you factor in reserves and vacancy to take care of these items so that you will not be surprised.

Chapter 2

Looking Past the Surface - Your Key to Wealth

As I briefly mentioned in Chapter 1 you're going to find the profitable properties in areas you don't expect and part of the analysis of these properties is to make sure they are going to be a profitable is going to be the ability to look behind the surface.

This is best illustrated by sharing with you a property that my partnership purchased some time ago. I was contacted by the owner of a 100 unit apartment property. After doing an analysis of the rental income and expenses that the property was producing it looked to be an average property with average return and average income. Nothing bad but nothing to get real excited about either – on the surface anyway.

This is where most investors would stop. Most investors would do this same kind of simple income and expense analysis, see the income and profits being generated by this property and see it as average and most would probably then pass on this opportunity.

However, after take the important second step of **LOOKING UNDER THE SURFACE** of the property here is what I discovered:

1. I could reduce the property taxes by over \$60,000 per year.
2. I could reduce the labor costs over \$45,000 per year.
3. I could realistically increase the rental income about 3.5% within 12 months.

There were other items I could improve but these were the biggies.

And here is the big key to this: I would not have to do any improvements or put any money into the property first in order to get these improvements. I just had to go through some asset

management processes in order to make these changes, and some others, a reality.

So, after looking under the surface I found that I could realistically add an additional \$100,000+ to the bottom line of this property's performance. Let's just say that this took the property from an average property to a fantastic one. That's exactly what happened with this property.

The moral to this story is: We bought this property for \$4,100,000, a year later; the property appraised for \$5,275,000 and our income from the property was substantial!

The main reason I got this large boost of equity and cash flow was I looked under the surface. How do you look behind the surface?

Whenever you look at a property here are some questions that you need to ask yourself:

1. Are the rents at market levels?
2. Are the expenses in line? In other words, is the owner spending too much money and doesn't even know it?
3. Are there any ways that I can add additional income to the property?
4. Are there small improvements that I can do to the property that could substantially increase the value and/or increase the rents that I could be receiving?
5. Are there specific management strategies that I could use to increase the rent substantially in a short period of time?

You see, it's all what you find underneath the surface. Most investors will look at a property on the surface and then move on, discounting it because they don't think it has any real possibility. Don't make that mistake, especially if you have a gut feeling about the property.

Look past the income and the expense information that you were provided. Answer the questions that I just went over with you. Once you do that, many times you'll find it's probably an average

property that you may want to pass on anyway, but there will be times that you'll find out that it has huge potential in areas that you did not foresee on the surface. So, look under the surface.

Chapter 3

GRM, CAP RATE, NOI

Technical terms to know before you jump into the commercial investment real estate world.

GRM or Gross Rent Multiplier.

What you'll find in your marketplace when it comes to analyzing apartments is you can use a quick rule of thumb method of analyzing a property to give you an idea of whether you think of it may or may not be worth pursuing. That is the gross rent multiplier. How do you get the gross rent multiplier and what is it? The gross rent multiplier is simply the asking price of a property divided by the annual gross rents. For example, if I have an apartment property where the owner is asking \$300,000 and my annual gross rental income is \$60,000, I would take \$300,000 divided by \$60,000 and I would get five. So, my gross rent multiplier would be five.

After you've taken a look at quite a few apartment properties, you'll get a good feel of what a good gross rent multiplier would be and what a profitable gross rent multiplier would be. For example, when I'm working with apartment property investors, I encourage them to look for gross rent multipliers in the four, five and six ranges. Anything over the six ranges sends out a red flag and tells me that we need to look at this really hard because there could be some possibilities; however, it also could be overpriced.

Shortcut: Ask around and find out who the top apartment property appraisers are in your marketplace. Give them a call. Tell them you're going to invest in some apartment properties and were wondering if they could spend one minute talking to you about gross rent multipliers. Talk to them about what the typical gross rent multipliers is with a property with various ages: five, 10, 15, and 20

years or more. Ask them what they see the gross rent multipliers being with properties, apartment properties, built as apartment properties, versus those that have been converted into apartment properties over time. This will save you a lot of time and a lot of hassle.

Strategy: If you work with a broker that understands the marketplace and understands these things, this will also be a huge shortcut for you.

CAP RATE:

CAP RATE is short for capitalization rate. What the capitalization rate represents is how apartment properties are valued and actually how all investment property is valued. **Bottom line, investment real estate is valued by the cash flow or the income stream the property produces.** So, unlike single-family homes where they compare a three-bedroom ranch that's 1,100 square feet to the 3-bedroom that's 1,050 square feet that sold across the street, income property and apartment properties are different. You compare income streams, not specifically properties.

So, what is the capitalization rate?

It is simply the net operating income the property produces (before any mortgage payments are made), divided by the price.

For example, if I have a \$300,000 property and my gross yearly rents are \$60,000 and all of my expenses (taxes, insurance, maintenance, etc.) are \$30,000. That leaves me with a net income end of year of \$30,000.

So, \$30,000 of net operating income divided by a \$300,000 asking price is 10%. So, the capitalization rate on this particular apartment property would be 10%.

Another way to look at it would be to think of yourself as buying a business. Think of it as if you are paying all cash for this business

and you are getting no loans. In my previous example, if I pay \$300,000 of cash to buy this apartment building (business) and it gave me \$30,000 of income after expenses that would be a 10% return on my \$300,000 cash. Remember, capitalization rates are the way that properties are valued and the benchmark that appraisers and investors need to use to gauge the value of a property.

Strategy: Use your appraiser and broker strategies in the gross rent multiplier section to find out the same information (from the appraisers) with capitalization rates as well. In a nutshell, the higher the capitalization rate is the higher your return and cash flow is. The lower your capitalization rate is, the lower your return in cash flow is. For example, if you have a capitalization rate of 7%, you will have less cash flow than if you have a capitalization rate of 12%. So, in a nutshell, the goal is to find a property that has the highest capitalization rate as possible.

Caveat: If the capitalization rate on a property is high (uncommonly high) and gets you really, really excited, before you go too far, take a quick look. It could mean trouble. It could mean either: 1) The owner isn't being upfront with his income and expense information or is leaving something out. 2) There's a problem with the property, or 3) You have very bad tenants that are occupying that property and you should stay away from that property.

NOI:

NOI stands for **Net Operating Income**. Out of all of the numbers you see on an apartment or commercial property, this is by far the most important number. This is where the rubber meets the road. This is where you are going to decide whether this is a profitable or non-profitable property, by the net operating income.

Not only does this give you a barometer for value, but also gives you a barometer of cash flow and a barometer of how high you can make that cash flow become over the next 1, 2, 3 to 5 years. In other words, the value of the property is mainly tied to the net operating

income that the property produces.

The goal, as a buyer should be to find a property with a high net operating income and be able to increase that net operating income as quickly as you possibly can.

So, let's review these three terms one more time. **GRM:** Gross rent multiplier. You find the gross rent multiplier by simply taking the price of the property and divide it by the annual gross income. **CAP RATE:** The CAP RATE is the net operating income (not the gross) before any mortgage payments (or sometimes called debt service) divided by the price of the property. **NOI:** NOI is the net operating income that the apartment property produces and is the most important number that you will find associated with an apartment building.

HOW APARTMENT PROPERTIES ARE VALUED

As I've said previously, apartment properties are valued much differently than single-family homes. What appraisers do is compare income streams that properties produce versus comparing bricks, mortar, wood, etc.

They do use three kinds of methods to value property: The comparable approach, the cost approach and the income approach.

Keep in mind with apartment buildings and other investment real estate, appraisers will rely 80-90% on the income approach to value.

So, let's say you're looking at a 12-plex that's about 20 years old. This is the fourth or fifth 12-plex you've seen over the last few months that is of this age, location, condition, etc. After you've analyzed the other four or five 12-plexes, you've noticed that they're consistently being offered at a 10% capitalization rate (Net Income Divided By Purchase Price) So, what that tells you is in the market right now, a 10% "cap" rate is pretty much what the properties are selling for.

So, back to our 12 plex in question. After you've analyzed this

particular 12-plex, you find that this is being offered at an 11.5% cap rate. HMMM. This could mean opportunity.

Remember, the higher the cap rate, the more profit you're going to have and if comparable apartment properties are being offered at a 10% cap while this one is being offered at a 11.5% cap, what that means is you could potentially have a very nice profit. It also means you need to look carefully to make sure the owners aren't leaving any financial information out, but it could be worth pursuing.

On the other hand, let's say the 12-plex in question had a 7% cap rate, while similar ones had a 10% capitalization rate. Right away, you know that the property may be overpriced (because the comparables are at 10% cap rates) With that low of a cap rate, that means they're asking much higher for the property than what comparable properties are being offered for. However, it's worth looking at the property (remember the section on looking beneath the surface), to see if it's worth pursuing. But, with the thought in mind, it may be overpriced in the first place.

Remember, if you get nothing else out of this book at all, please keep in mind it's all about the income stream the properties produce, capitalization rates, and then operating income. Of course, it's about the cash flow you'll get and the equity you'll build as well and we'll talk more about that. But, from a value standpoint, this is basically what investors, appraisers, and lenders will use to value income real estate.

Confused? Don't worry; it really isn't that big of a deal. Once you've looked two or three deals, sat down and talked with an experienced broker/appraiser and had an experienced broker represent you in the marketplace, it'll come across and you'll catch on in a snap. It won't be difficult at all.

CHAPTER 4

CAREFULLY REVIEW THE INCOME AND EXPENSES USING AN ANNUAL PROPERTY OPERATIONS SHEET

Make no mistake; it's not difficult putting income and expenses together for an apartment or commercial property. I mean, after all, it's not that difficult to figure out what the income is and what the expenses are like taxes, insurance and utilities since these items will be provided to you by the owner. So you may be wondering, why do I even need a worksheet in the first place? Well, the main reason you need this particular worksheet is to make sure you have an accurate analysis of the property mainly from an expense standpoint.

Earlier in this course, I hinted that owners are notorious for understating their expenses and sometimes leaving them out. Now, don't get me wrong, 99.9% of the owners don't do this on purpose and aren't trying to cheat you, lie, etc., But we want the most accurate picture of how the property is performing financially don't we? That's why we use the annual property operating data form to make sure we are accounting for all of the expenses.

The income side is pretty easy I mean the rents are the rents. We know what the apartments rent for, so to calculate what the apartments rent for, laundry income, any other miscellaneous income, really isn't too big of a deal.

However, when it comes to expenses, that's a whole different ball game. For example, some owners who may own and manage the property themselves don't account for repair and maintenance costs. They figure since they are the ones doing the repair and maintenance that it really isn't costing anything to take care of the apartment property. However, please be advised, that's not the way to look at

it. Your time is worth money if you do it, or if you have it hired done of course you have to pay for those services.

Make sure you do a good job of analyzing expenses and income using the annual property operations form, making sure nothing is to be left out. If you have a question regarding any of the expenses, ask the broker or the owner to provide them for you and to provide accurate expenses. Worst case scenario, do some sleuthing and investigating on your own. Call the assessor's office and the treasurer's office to find out what the property taxes are. Call your insurance agent to find out how much insurance coverage would be if you purchased this property. Call the utility companies to find out what the gas, electric, and water bills are to make sure what you are being told is right on. Call the trash haulers to find out what it would cost to haul trash from the property. Snow removal, lawn care, etc.

Here is an example of an Annual Property Operations Form.

Yearly Property Operations Form Example. Gershwin Apartments

ALL FIGURES YEARLY	\$/unit	
1 ACTUAL RENTAL INCOME		\$107,255
2 Less: Vacancy & Cr Losses	(5%) of	\$5,363
3 EFFECTIVE RENTAL INCOME		\$101,892
4 Plus: Other Income		\$4,808
5 GROSS OPERATING INCOME		\$106,700
OPERATING EXPENSES:		
6 Real Estate Taxes	\$9500	
7 Personal Property Taxes		
8 Property Insurance	\$2,048	
9 Off-site Management	\$5,335	
10 Payroll - Onsite Management		
11 Expenses Benefits		
12 Taxes Workers' Comp		
13 Repairs and Maintenance	\$6,382	
Utilities		
14 Electric	\$1,987	
15 Gas	\$7361	
16 Water & Garbage	\$2,952	
17 Trash	\$2,236	
18 Accounting and Legal		
19 RE Leasing Commissions		
20 Advertising/Licenses/Permits	\$527	
21 Supplies		
22 Miscellaneous	\$1899	
Contract Services:		
23 Lawn & Snow	\$2,122	
24		
25		
26		
27		
28		
29 TOTAL OPERATING EXPENSES		\$42,399
30 NET OPERATING INCOME		\$64,301
31 Less Annual Debt Service		(\$38,696,81)
32 Less Funded Reserves		
33 Less: Leasing Commissions		
34 Less: Capital Addition		
35 CASH FLOW BEFORE TAXES		\$25,604

Please keep in mind that you'll want to do a good job verifying these expenses on a tax return and you may as well start that process with your annual property operations form. I've included sample copy in the book as well as one example that's been filled out for you to take a look out and use as you feel necessary.

CHAPTER 5

WHERE RATIOS SHOULD BE.

In this section, I want to give you ballpark figures to help with your analysis of apartment properties. By ratios, I mean expense ratios. Because, after you've looked at enough apartment properties, you'll know by the expense ratio whether or not the owner is telling you the whole story or whether you're being provided the whole story regarding the income and expenses that are being produced by the apartment building you're looking at.

So, when you analyze apartment properties, some things to keep in mind that can help your analysis:

Apartments where the owner pays the heat, common area electricity, and water for the buildings.

When you look at some apartment properties, you're going to find some where the owners actually supply the heat, common area electricity, and water for the building and for the tenants to use, with the tenants being responsible for their own individual electrical costs. If this is the case, make sure you budget between 39-50% for expenses on the property. That's typically where your expenses should be. Anything less than that should send up a red flag, which means just more investigation. Anything more than that, should also send up a red flag, which also means more investigation.

Apartment properties where the tenants pay all their own utilities except water.

Many buildings you'll find that tenants pay their own heat and electric, but the owner's responsible for water and common area electricity. When you find this to be the case, your expense ratio will be between 35-45%. Once again, if your expense ratio on these properties is less than 35%, more investigation is needed and more than 45%, more investigation is needed. If it's within that ballpark,

you can have a certain level of comfort that the expenses that are being reported are probably pretty accurate.

Properties where tenants pay all their own utilities.

Once in a while you'll find apartment buildings where the tenants will pay their heat, electric, and water - all utility costs. The owner doesn't have any utility costs whatsoever. If this is the case, your expense ratios will be between 34-44%. If it's less than 34%, once again, more investigation is needed. If more than 44%, more investigation is needed. If it's within the ballpark, you'll have some confidence that what you're being told is fairly accurate.

After you've looked at enough apartment properties, you'll get an idea of whether you're being told everything upfront. It's amazing how many apartment properties I analyze for myself or for my clients that I just look at that expense ratio and know if I'm being told the whole story. Many times after looking at that ratio and asking more questions, we uncover more expenses that we need to add. Failure to do that and failure to have this knowledge would literally cost thousands of dollars.

CHAPTER 6

SMART DOWN PAYMENT STRATEGIES FOR APARTMENT PROPERTIES.

There is a section later on in this system about financing, so I will not go into too much detail right now. However, I do want to share with you three quick strategies for you to keep in mind when it comes to minimizing the amount of cash you'll have to come up with at the closing table.

Credits and reserves. Many times you'll be able to get a tax and/or repair or maintenance credit at closing from the seller of the apartment property. For example, in Iowa, if you buy a property at a certain period of time, you could get up to one year of property tax credited to you at the closing table - a large savings! Also, in the event that there's repair and maintenance costs that need to be done, you can have that credited to you at closing as well, further reducing your down payment. Think of it this way, you could use the combination of tax credits and repair credit to reduce your down payment substantially.

For example, let's say you've got to put \$50,000 down payment on an apartment property. After looking through all of the units, you notice that you're going to need about \$5,000 of repair and maintenance that'll be needed right away. You talk to the seller. The seller agrees to credit you the \$5,000 at closing. After you talk with your broker or your closing and/or escrow person, you find out that you will also be getting a tax credit at closing of \$7,200. So, when it comes to closing, when it looked like you would have to come up with \$50,000, now it's reduced \$5,000 by a repair credit and another \$7,000+ by a tax credit. So, now you're going to come to closing with \$38,000, versus \$50,000.

Rent pro rations. You'll always want to time your closings to happen the first three days of the month. The first, second, or third.

Why? Two reasons:

A: No or little prepaid interest. Many people don't know this, but when you make a mortgage payment, you're paying the interest from the month before. So, when you make March's mortgage payment, you're paying February's interest, when you make July's mortgage payment, you're paying June's interest, etc. So, when you take over at the beginning of the month, you will not have any interest that you need to pay; however if you take over at the end of the month, lenders will charge you interest for the entire month. Smart strategy.

B: Take over the first, second, or third day of the month and get all of the rents **WITHOUT** making a mortgage payment.

Also, an even bigger benefit is you will get credit for all of the rents that are to be received for that month.

For example, let's say you're taking over a 12-plex and the monthly rent from the 12-plex is \$5,000. Wouldn't it be nice to have that \$5,000 credited to you at closing? In other words, the current owner can receive the rents from the tenants, but give you a credit for the rents he is to receive, or worst case scenario, you take over on the second of the month, all the tenants pay you once you take over, so you still have your \$5,000 in rent; however, you don't have to make a payment on your financing until the following month, which means you get all the rent for that month without having to make any kind of payment to a financing company, bank, etc. Nice cash flow and if used wisely, could be a nice credit to you at closing.

Tax pro rations. As I said, many states pay taxes in arrears, so at closing you can get tax prorations that will be do in the future, but not yet payable. Use these pro rations wisely. One caution: Make sure you budget enough money to pay the taxes once they become due. I have had more than one investor who has gotten large credits

at closing from tax pro rations, but forgot to start saving and putting money away month after month to pay that tax bill once it comes due. Make sure you don't do this.

By using just these three strategies, you can save yourself tens of thousands of dollars.

CHAPTER 7

GOING TO CONTRACT - THE DOS AND THE DON'TS.

Of course, there will come a time when you are going to want to make an offer on a property. Remember, this is where a good broker is worth their weight in gold in how they can direct you as far as price, how to structure the offer, terms, etc. This of course is very, very important. However right now we are going to specifically deal with apartment properties so I'm going to give you some do's and don'ts when it comes to preparing the offer that you may want to keep in mind.

Of course, we could have a 1,000+ page volume of information relating to contracts and contract law, etc., but my point in this is going to give you some quick tips that can save you from making mistakes when it comes to drafting your contract on an apartment property

So, lets get started with the Do's

1: Arm yourself with contingencies.

Now, whatever you do, you don't need to put 45 contingencies in the offer. Just use enough contingencies to make sure you're protected in the event you find out things aren't going to be working out. Here are the top contingencies you will want in any offer you make on an apartment property:

A: Subject to inspection and acceptance of all of the apartment units.

B: Subject to inspection and acceptance by buyer of last two year's tax returns.

C: Subject to inspection and acceptance of current rent roll.

D: Subject to inspection and acceptance of all leases.

E: Subject to financing being satisfactory to buyer within _____ days of offer acceptance.

F: Owner not to change, renew, or modify any existing and/or new lease agreements without express permission by buyer between days of offer acceptance and closing.

G: Subject to buyer completing and facilitating a 1031 tax deferred exchange. The subject property will be replacement property to fulfill section 1031 requirements. (You use this when you are buying a replacement property for a tax deferred exchange.)

Most any offer you're going to want most, if not all, of the above contingencies. They will make sure you are protected in the event things don't work out, you find out the information you've been given is wrong, you find out that the financing won't work, etc. Be sure you give yourself plenty of time to work through the contingencies and make sure that you make the offer in such a way that you have to release the contingencies and that the contingencies don't expire on their own. In some offers, it is written that if you do not address any of the contingencies within a certain time period, they are released automatically. You don't want that to be the case.

Don'ts

A: Don't come to the table with too little earnest money. That's right, you read correctly. Don't come to the table in your offer with too little earnest money. You want to be taken seriously and you want the seller to work with you. Of course, conventional wisdom tells you that the least amount of earnest money as possible means little risk for you, it also means that you're small potatoes, bush league, small time. You don't want to come across that way. You don't want \$400,000 in earnest money either unless you are buying a \$20,000,000 property so don't get me wrong. Use a fair amount of earnest money. In my opinion, you should use 1-2% of the offering price as earnest money. Don't worry; as long as you have the proper contingencies in place, if something goes wrong, you'll get your earnest money back. This way, you'll be taken as a serious buyer, someone that has a sincere interest in the property and someone that is worth the seller's time in working with, no matter what the motivations of what the seller are.

Think of it this way, let's say you have two competing offers.

Let's say you submit an offer and another investor does. All things being equal, if the other investor has \$5,000 more earnest money down on the table, whom do you think the seller is going to be more cooperative with? That's right, the guy with the most earnest money.

B: Don't give yourself small timeframes to complete contingencies and close the deal.

Let's face it, in real estate, hardly any transaction goes exactly as it's supposed to, there are delays, glitches, small problems that come up here and there, that's the world of real estate. So, whatever you do, don't use too short of timeframes in your contingencies and in your closing period. You want as much time to take care of any surprises that come up as possible.

C: Don't overload the offer with contingencies.

If you overload the offer with too many contingencies, what that means is you're not really serious about buying the property. Sellers can sense this and if you have too many contingencies in the offer, they'll think you're just doing this for practice and you're not really serious. Use the contingencies that I have given you previously.

D: Don't accept work with verbal offers.

In some states, verbal offers are binding; however, in some states, they are not. Whatever you do, make sure you get everything down in writing. If the seller says he/she will sell at a certain price with certain terms, get it in writing as quickly as possible - don't dawdle, you never know when something else may come up that may change the seller's mind before you get it to contract or before you get it in writing, so whatever you do, get it in writing as soon as you possibly can.

E: Don't get emotionally involved with the property.

When making the offer, don't get too emotionally involved. Later on in this manual, I'm going to talk about negotiation; however, it bears mentioning right now that you don't want to get too emotionally involved in a property. If it's a good opportunity, you'll want to try to take as advantage of it as aggressively as you can, but not go overboard. Remember, opportunities will continue to present

themselves; this will not be the last property that you will ever be able to purchase. Keep that in mind.

F: Don't buy just to buy.

It's worth mentioning that you shouldn't make an offer just to make an offer on a property. Many times many investors get caught up with the thought of "I've got to buy an apartment building". Many times these same investors don't pay attention to all of the analysis that needs to be done in order to make a smart decision. So, what do they do? They take shortcuts...just to make sure they buy an apartment property. Don't you do this; don't buy just for the sake of buying, those that do, end up wishing they never got involved in the property in the first place.

G: Don't sign the contract until you've read over every single sentence.

It goes without saying that you don't have to be an attorney to figure out a contract; however, you want to make sure you understand everything involved. At least on your first two transactions, make sure you take the time to read through the contract and take the time to go through it sentence by sentence, most of it isn't going to mean a darn thing to you with legalities, however, there will be some things you'll want to take note of and make mention of to your broker / attorney.

H: Don't purchase a property "by owner" without an attorney representing you.

You'll want to get a good real estate attorney on your team anyway and it's necessary you do have a good real estate attorney and not just an attorney that will learn through you how the real world of real estate transactions work. So, make sure you have representation if you're doing something "by owner". Most of the problems that are encountered by investors when they purchase a property are doing it by owner, and not having good representation.

They end up in a situation that they never would want to be in the first place and unfortunately find this out when it's too late.

If another offer comes in while you have made an offer on an apartment property.

Once in a while what'll happen is you'll make an offer on an apartment property, then be told right after you made the offer one, two, six, 12 hours later, whatever the case, that there's another offer on the table. This other offer has been made to the owner before the owner has gotten back to you with either an acceptance of your offer or a counteroffer. Of course, at that time, you're going to be told by the broker or you may even think to yourself, "If you really want to buy the property, you should pay the owner's asking price."

Hold on, back up and stop.

What should you do if you're competing with another person to buy a property? Simple. Don't deviate from your strategy in buying the property. In other words, stay the course. If you have a plan on how you're going to buy the property, at what price, what terms, etc., don't deviate from that. Here's why: 90% of all other offers that come in on a property that compete with yours will not work; they'll either be too low, the terms won't be good enough, or there will be something else in the offer that will make it less appealing than yours.

So, just because another offer comes in on the property it doesn't mean it's a better one. The majority of the time (at least 90% of the time) the offer will not be as good as yours. So, whatever you do, don't let that influence the way you purchase the property, stay the course, and make sure you buy the way that you want to buy the property.

Don't be influenced by another offer coming in on the property, because as I've said the majority of the time that other offer will not be as competitive as yours and will not work out. Time and time again I've seen this tactic used and most of the time it's been sincere. Most of the time when there's multiple offers on the properties, there really are multiple offers, with more than one investor interested. Once in a while I've seen it done in a shady way. I've seen offers

being generated that had no hopes in going through, with the only intent of these so called “offers” being to get another investor's price up. This is obviously wrong and is against the law. Unfortunately it is done once in a while.

So, whatever you do, make sure you stay the course and don't be influenced by the other offer, keep negotiating, and working on it, etc., just as you originally thought you would, because the majority of the time, what you originally plan will work out even if there is another offer on the table.

Apartment Building Closing Items

Make sure before closing you verify the amount of deposits, insurance, review leases, etc. I've talked about these in previous steps; however, it's worth mentioning again. Make sure you do the following:

1. Verify deposit amounts and leases.
2. Verify rents.
3. Make sure there are no "side agreements" between the owner and a tenant. Many times what you'll find is a tenant's able to lease a space for say, \$600 per month; however, once you dig a little bit, what you'll find is that the tenant is really only paying \$300 a month, but is also in charge of cleaning the hallways, common areas, etc. That's not uncommon; however, you'll want to make sure you understand all of the agreements that are in place like that before you purchase a profit versus afterward.
4. Make sure you have insurance in place. You'd be surprised how many people forget this at the closing table.
5. Make sure you have management in place if you are hiring a management company.
6. Make sure you have down payment ready and lender is ready to close.
7. Make sure you have all keys to the property.
8. Make sure you have clear title free of liens or other issues.

One final note. Make sure that all parties agree upon two

important things. One is a rent proration amount. Rent proration happens if you happen to close on a date other than the 1st or the 30th (or 31st) of the month. For example. Let's say you are going to close on the 15th of the month. If that is the case the owner should have already collected all of the rent for the month, however, since you are closing on the 15th you should get credit for 15 days of rent since you are going to be the owner effective the 15th. Another example. Let's say that you are going to close on the 20th. The owner should have gotten the rent already for the month and should be crediting you 10 days of rent.

Just keep in mind that if you close on a date other than the 1st or 31st there will be a rent proration. Just make sure you and seller agree on what that is PRIOR to closing.

Lastly, rental deposits. Make sure that if there are rental deposits that you verify that amount with the seller PRIOR to closing. The seller should be issuing you a check for the total deposit amounts of the tenants.

When not discussed prior to closing these two items can be a problem for you because there you are, at the closing, 99.9% of the way there and you are finding out then that the rent proration amount is not correct nor are the deposits. The time to find this information out and get it taken care of is before the closing not during the closing.

CHAPTER 8

WHO SHOULD YOU HAVE REPRESENT YOU?

As you noticed previously, when I went over my seven mistakes to avoid one of the big mistakes most investors make is whom they choose to represent them as buyers in the marketplace.

It is worth repeating and it's worth delving into further because I've seen this mistake over and over again and it's cost investors literally tens of thousands of dollars and the sad part of it is, most don't even know it. You see what happens is investors like yourself invest in courses, knowledge, etc. to get a better idea of how to purchase investment real estate, in this case, commercial investment real estate: apartments, shopping centers, etc. Then, when it comes to actually finding the property all they do is simply call up a friend of a friend, a buddy, look online, etc., to get a hold of a just any real estate agent. These well meaning investors think as long as they have a "real estate agent" their needs will be taken care of.

Far from it.

Please pay attention.

Whatever you do, you need to work with someone who has track record in specializing in apartment properties, have a documented track record and are known in the marketplace as the specialists.

How do you find them?

You simply ask around. Talk to other apartment property owners, appraisers, talk to people at the local landlord's association, talk with other brokers, call commercial real estate offices and basically ask, "Who in your office specializes in selling apartment buildings?" 99% of the time there will be one or two names that come across most of the time. Those will be the one or two people

that you will want to work with and build a relationship with.

You see forging a bond with those people will make you more money faster versus using someone that doesn't know what they're doing.

Your job is not to educate realtors that have no idea how to analyze and assist you in building your wealth.

Let's think about it, you're really hiring these people to help you make money, you're hiring these people to work for you to build your net worth, to give you cash flow, to give you peace of mind. You've got to think very hard and seriously about this. These people, if chosen right, can help you build it much quicker and bottom line, help you avoid the mistakes that so many people make.

Put it this way, the marketplace is littered with people that have made mistakes and think commercial investment real estate sucks. It sucks because it never worked, it didn't work out for them, they had a bad experience, etc. But you know what? 95% of the reason it didn't work out for them can be traced back to the people they worked with originally to buy the property. If they would've worked with the right person, I guarantee the majority of the time they would love commercial investment real estate and it would be a large part of their lives. So whatever you do, do not make this mistake.

Chapter 9

Investment In Office Buildings.

No matter where you go, whether it's small towns or large cities, more than likely you're going to run into office buildings; both small and large. Most people's experience with office buildings is doing business there. For example, going there to transact business with someone in some way, whether it's your insurance person, financial planner, doctor, etc., they're all housed in office buildings. So, most people are familiar with office buildings at least from the standpoint of going there for some reason or some need.

There are others that are familiar with office buildings because they are either a tenant or they own a building. Many people in America run their businesses out of office buildings and from that standpoint are familiar with them as well.

Then, there are the investors. The people that own the office buildings and is either a tenant that actually owns the building as well or plain investors who own the building but do not have a business located in the building.

So, whether or not you plan on actually being a tenant in your own office building or just possibly own an office building for your own investment purposes, the following information will prove helpful in not only buying the right property, but making sure that you don't make the mistakes that could cost you thousands.

Important point: You will find from now and throughout the rest of the book find many similarities between the types of investment properties and apartments as far as where profits are found, how to locate them, etc. In many ways, any property that produces income, cash flow, and builds equity are similar. However, there are certain nuances with each kind of property that you must pay particular

attention to. So, even though there may be some similarities between say office buildings, apartments, shopping centers, etc., there are some very important differences as well. So, please make sure you don't skip over any of the sections from now moving forward especially if you plan on investing in one of these types of properties.

Where Office Profits Are Found.

Just like apartment buildings, office building profits are found in pretty much the same way. In a nut shell locating an undervalued income stream, via either rents are too low, expenses too high, bad management, lazy owners, bad real estate agents, etc., and taking advantage of that .

The Seven Mistakes to Avoid When Purchasing an Office Building

Mistake #1: Not putting yourself in the buyer's shoes five, 10 to 20 years from the date that you buy the property. Similar to what you'd find when you buy an apartment building, location and the area is just as important with office buildings. You want to make sure that you buy that property again over in your mind 10, 15, 20 years down the road. Based on what you see, based on the area, location, condition, etc., you need to be able to tell yourself, "If I wanted to buy this in 10 years, would I look at buying it?" If the answer based on what you've done is yes, then it's probably good to take the next step. However, if there's hesitation in this answer, you need to take a closer look at the property.

Mistake #2: Not inspection the entire property prior to closing. Many people when they look at an office building don't even consider looking at the whole building in and of itself. Why? Because many people feel that office-building tenants take much better care of the spaces that they occupy versus say people that occupy apartments. Nothing could be further than the truth. Make sure that you inspect the entire property at least one time before closing, preferably twice. Many times between the dates that you

make an offer on the property and the date that it closes is usually 90-120 days or more. You want to make sure nothing has changed in those 90-120 days. I would encourage you to not only inspect prior to closing, but to inspect the whole property prior to closing.

Mistake #3: Not working with an experienced office property lender. Once again there are lenders you want to work with for commercial investment real estate and lenders that you don't. Don't waste your time and don't provide training for some loan officer or bank that really has never done this before and has no real business being involved in this kind of investment. Make sure you ask around and find out who the top lenders are for office buildings in your market and that's whom you'd want to go talk to.

Mistake #4: Buying a property with few tenants. One of the things you need to consider when buying a property is how many tenants are in the property. In other words, diversification. Let me put it to you this way: If you had a 10,000 square foot office building with 15 tenants, if one, two, or even three of those tenants moves out, it's probably not going to affect you that much. However, if you have the same size of building with one tenant and that one tenant moved out, it could affect you drastically. So, looking for office buildings with multiple tenants is more than likely the most advantageous way to go because it definitely lowers your risk.

Mistake #5: Not working with an experienced office or investment property broker to help you find a property that meets your financial criteria but also can save you time. I've talked about this in other sections and will continue to do so. You've got to work with someone who knows what they're doing. CCIM and SIOR are good people to call and talk to. However, you want to make sure you ask around in your marketplace, make plenty of phone calls, do plenty of inquiries as far as asking, "Who would be the go-to guy in the marketplace for working with me to buy an office building?" You will get an answer and the name that you hear more than one time over and over again will tell you that would be the person you need to contact.

Mistake #6: Not examining the income and expense information

closely. Before you say yes to an office building, ask the sellers to see the last two years of Schedule E, Partnership or Corporate tax returns for the property. This, more than anything else would give you an accurate reading as to the performance of the property. You want to compare these figures to the figures the owner or the broker gave you to make sure that they are at least close. If there are large discrepancies, the red flag needs to go up and you need to do further investigation.

Mistake #7: Not factoring in enough vacancy and reserves for tenant improvements. Let me ask you a question. When you have a tenant move out of your office building and you have some space for lease do you think the new tenant coming in will want the space exactly as it looks? More than likely the tenant will not. The tenant may ask you to put in new carpet, do some painting, add a wall, take out a wall, provide doors, etc. In other words, the tenant may want you to make some improvements to the space. Depending on your market, the tenant may be able to pay for that, but usually if the tenant pays for that, they're going to want some kind of a discount in rent. More than likely though, what the tenant will want will be for you to take care of that improvement expense. Of course, you will want to make sure you build this cost into the rent once you rent the space to them. However, you will want to take into account that every time you have a turnover, more than likely some tenants are going to want you to spend some money to improve or change the space. Make sure you have enough in your reserves set aside for that. A good amount is usually 3% of the annual gross income that the property produces.

Chapter 10

Looking Past the Surface In Office Properties - Your Key to Wealth

As I said earlier in this section, you're going to find the profitable properties in areas you don't expect. Part of the analysis of these properties is to make sure they are going to be a profitable and that means you are going to have to look under the surface. Office buildings are no exception.

How do you look under the surface?

As with apartments, please make a mental note that whenever you look at a property to look at it more than just face value. Look beneath the figures. Here are some questions that you need to ask yourself:

1. Are the office rents at market levels?
2. Are the expenses in line? In other words, is the owner spending too much money and doesn't even know it?
3. Are there any ways that I can add additional income to the property?
4. Are there small improvements that I can do to the property that could substantially increase the value and/or increase the rents that I could be receiving?
5. Are there specific management strategies that I could use to increase the rent substantially in a short period of time? (I will also share with you high-profit management strategies in a later in the book.)

Office Terms You Need To Know

Gross lease - A gross lease is a lease in which you as the owner pay most or all of the expenses. In a gross lease, you are responsible for

paying the property taxes, insurance, and the maintenance of the building. That is your responsibility. It's similar to a lease you would have with an apartment property. Usually when you own an apartment building, when the tenant pays you rent, you take a part of that rent to pay your share of taxes, insurance, maintenance, etc. The same would apply under a gross lease scenario with an office building. The tenant just pays you a monthly amount of rent and you go ahead and you take that amount and you pay your pro rated share of taxes, insurance, maintenance, etc.

Net lease – A net lease is an interesting situation inasmuch as the tenant pays most of the expenses. In other words, in a net lease the rent is discounted and because the rent is discounted the tenant does pay all the other expenses. For example, the tenant pays property taxes, insurance, maintenance, lawn, snow, etc. based on their proportionate share of the building. In other words, if you had a 10,000 square foot office building with two tenants and you had net leases in place, each tenant would pay 50% of the property taxes, insurance, maintenance, etc. They would pay all of those costs and you would pay none. However, keep in mind, under a net lease, the lease amount that the tenant pays is discounted compared to a gross lease. For example, in a similar building, the gross lease would be \$20 a square foot with you the owner paying all of the expenses. Under a net lease situation the lease rate may be \$10 a square foot, however the tenant pays all of those expenses.

Price per square foot. Or you could think of this as rental amount per square foot. When a property is offered for rent, typically it's offered on a per-square-foot basis, \$7, \$8, \$10, \$15, \$20 per square foot, etc. Many times people don't understand what this means and how to calculate what you tenants would actually pay in rent per month. It's real easy. This number represents an annual amount per square foot that the tenant will pay you in rent.

For example, let's say you have a 10,000 square foot office building. In that 10,000 square foot office building, you have a tenant that indicated to you that they want to take the whole building and would like to pay you \$10 per square foot. So, with our calculations, 10,000 square feet times \$10 per square foot is

\$100,000 in rent. This figure represents the annual or yearly rent that you would receive from the tenant. \$100,000 divided by 12 is \$8,333.33 or what the tenant would pay you in rent monthly.

Keep in mind in most marketplaces the price per square foot is quoted on an annual basis not a monthly basis.

Let's use another example. Let's say you have a 5,000 square foot office building with four tenants. Each tenant takes up 1,250 square feet. You have a vacancy. However, you just got a call from a prospective tenant that wants to lease that 1,250 square feet. You've quoted them a rental rate of \$15 per square foot. How much money would you actually receive? Let's figure it out.

You take your 1,250 square feet and multiply that \$15 per square foot. Your answer would be \$18,750 in rent. Remember, this is what you would get annually from a tenant. Typically, tenants are going to want to pay you monthly, so you divide that \$18,750 divided by 12 and you would get \$1,562.50 of rent that the tenant would pay you monthly.

CAM - CAM stands for common area maintenance. When you own an office building, one of two scenarios will happen. The first is that you will take care of the hallways, the exterior of the building, parking lot, and lawns clean the hallways, bathrooms, etc., or the tenant will be responsible for that. In either case, this is called common area maintenance or CAM. Usually under a gross lease scenario, the owner is responsible for setting up the work on the common areas and the CAM charges. In other words, the owner will pay for and arrange for the lawn care, snow removal, hallway cleaning, etc.

However, usually under a net lease situation, the tenant is responsible for the costs. So, the Tenant picks up the charges of the parking lot, lawn, snow, hallway cleaning, etc.

Always remember, the CAM is charged on a pro-rated basis, usually based on the square feet the tenant occupies.

So, let's say I have a 10,000 square foot building with two tenants, one tenant taking 6,000 square feet, the other tenant taking 4,000 square feet. The tenant taking 6,000 square feet would pay the CAM charges based on their square footage or would have 60% of the charges. The tenant with the 4,000 square feet would pay 40% of the charges.

Options and option periods. Office building leases many times have options. The options are for the good of the tenant. It is not uncommon for leases to be drafted with the tenants securing an option for an additional period of time to lease the building after the primary term of the lease expires. For example you may have a tenant that wants to lease your space for two years and also have an option to lease for another two years. What you are doing is you're basically giving the tenant permission or an option on that space for an additional two years or four years total.

Usually, the options are negotiated ahead of time versus that the time the option could be exercised. What this does for the tenant is that they know they literally have control over the space (in this last example) for four years. They rent it for two years but they can also rent it for an additional two years if they so choose to do so.

Options can run as long as whatever as negotiated between you and the tenant: one, three, five, 10, years, whatever the case is. Realize that the tenants usually will want an option, but probably 50% of the time will not exercise the option. Many times they just want to make sure they have control over the space and as their business needs change, they may decide to stay there, or if they are undergoing substantial changes either positive or negative, they may want to get out of that lease when it expires.

Important point: Make sure you negotiate options and their rental pricing up front. Waiting 30, 60, or 90 days prior to the option being exercised will cost you thousands of dollars at the closing table, specifically if there are changes in the tenant's business.

Quick example. I work with a couple of owners of office buildings who did not do this; who decided to give the tenant two or

three year options once the lease expired with the rental rate and other miscellaneous items to be negotiated at the time of the option. Once the lease was signed, during the primary term of the lease the businesses changed or ownership changed. All of a sudden what was pretty much thought to be agreed upon with a "handshake" when the lease was originally signed now changes because of these changes which usually means the tenant now wants to pay you less rent. Or even better they'll go ahead and pay a fair amount when they exercise their option to lease but now they want you to put \$50,000 of improvements into the space in order for them to do that, etc. You want to make sure you get these things agreed upon up front versus waiting. Waiting could be a big detriment to your cash flow.

CHAPTER 11

HOW OFFICE BUILDINGS ARE VALUED

As I've said in a previous section investment real estate values really come down to the income stream a property produces and office buildings are no exception. What appraisers do is compare income streams that properties produce versus comparing bricks, mortar, wood, etc.

They do use three kinds of methods to value property: the comparable approach, the cost approach, and the income approach.

Keep in mind with office buildings and other investment real estate, appraisers will rely 80-90% on the income approach to value. So, let's say you're looking at a 5,000 square foot office building that's about 20 years old. This is the fourth or fifth office building you've seen over the last few months that is of this age, location, condition, etc. After you've analyzed the other four or five office buildings, you've noticed that they're consistently being offered at a 10% capitalization rate (Net Income Divided By Asking Price) So, what that tells you is in the market right now, a 10% "cap" rate is pretty much what the properties are selling for.

So, back to our other office building in question. After you've analyzed this particular office building, you find that this is being offered at an 11.5% cap. That could mean opportunity.

Remember, the higher the cap rate, the more profit you're going to have and if comparable office buildings are being offered at a 10% cap while this one is being offered at a 11.5% cap, what that means is you could potentially have a profit. It also means you need to look carefully to make sure the owners aren't leaving any financial information out, but it could be worth pursuing.

On the other hand, let's say the office building in question had a 7% cap, while similar ones had a 10% capitalization rate. Right

away, you know that the property may be overpriced (because the comparables are at 10% cap rates) With that low of a cap rate, that means they're asking much higher for the property than what comparable properties are being offered for. However, it's worth looking at the property (remember the section on looking beneath the surface), to see if it's worth pursuing. But, with the thought in mind, it may be overpriced in the first place.

Remember, if you get nothing else out of this course at all, please keep in mind it's all about the income stream the properties produce, capitalization rates, and then operating income. Of course, it's about the cash flow you'll get and the equity you'll build as well and we'll talk more about that. But, from a value standpoint, this is basically what investors, appraisers, and lenders will use to value income real estate.

CHAPTER 12

ANALYZE YOUR OFFICE BUILDING

The good news is when it comes to analyzing an office building you go through the same set of processes as you would apartments. So, nothing new.

If you paid close attention to this section in the previous apartment section in this book you can skip the rest of this chapter.

However, if you did not pay close attention you will want to continue reading.

Make no mistake; it's not difficult putting income and expenses together for a commercial property. I mean, after all, it's not that difficult to figure out what the income is and what the expenses are. So you may be wondering, why do I even need this worksheet in the first place? Well, the main reason you need the worksheet is to make sure you have an accurate analysis of the property mainly from an expense standpoint.

Earlier in this course, I hinted that owners are notorious for understating their expenses and sometimes leaving them out. Now, don't get me wrong, 99.9% of the owners don't do this on purpose, aren't trying to cheat you, lie, etc., many of them manage their own properties and don't know that they need to be including some of these expenses. So, that's the main reason why we do our income and expense analysis. It is to make sure we are accounting for all of the expenses.

The income side is pretty easy — the rents are the rents. We know what the office space is renting for per square foot, so to calculate what the income is really isn't too big of a deal.

However, when it comes to expenses, that's a whole different ball game. For example, some owners who may own and manage the

property themselves don't account for repair and maintenance costs. They figure since they are the ones doing the repair and maintenance that it really isn't costing anything to take care of the apartment property.

However, please be advised, that's not the way to look at it. Your time is worth money if you do it, or if you have it hired done; of course you have to pay for those services.

Make sure you do a good job of analyzing expenses and income using the annual property operating operations sheet making sure nothing is to be left out. If you have a question regarding any of the expenses, ask the broker or the owner to provide them for you and to provide accurate expenses. Worst case scenario, do some sleuthing and investigating on your own. Call the assessor's office and the treasurer's office to find out what the property taxes are. Call your insurance agent to find out how much insurance coverage would be if you purchased this property. Call the utility companies to find out what the gas, electric, and water bills are to make sure what you are being told is right on. Call the trash haulers to find out what it would cost to haul trash from the property. Snow removal, lawn care, etc.

SPREADING THE RISK WITH OFFICE BUILDINGS

As I mentioned before one of the things you'll want to consider is the type of office building you purchase. You'll find single-tenant buildings all the way up to multi-tenanted buildings.

Always keep in mind that multi-tenanted buildings are less risky simply because the more tenants that you have, the less risk that you'll incur if vacancy does happen. Currently, in my marketplace right now, vacancy is almost 15-20%. People with single-tenant or one-two tenant properties are having problems filling their space. Of course, lenders don't care; they want to be paid every single month no matter if the rent is coming in or not. So, how would you rather have it? No money coming in from a vacant one tenant property or if you had 10 tenants with four tenants vacant with only six total spaces left occupied, would you rather have those people paying you rent? Obviously the latter.

Keep that in mind when you're looking for properties. Not that single properties are bad (I'll get into more detail on how to profitable invest in them later), but you'll want to definitely consider this to lower your level of risk.

CHAPTER 13

GOING TO CONTRACT WITH OFFICE BUILDINGS- THE DOS AND THE DON'TS.

This section will also be very similar to the apartment section so you will find many things repeated, however, there are a few different items to make note of so please read this carefully.

Of course, there will come a time when you are going to want to make an offer on a property. Remember, this is where a good broker that works on office buildings and investment property is worth their weight in gold. However, we are going to specifically deal with office buildings so I'm going to give you some do's and don'ts when it comes to preparing the offer that you may want to keep in mind.

Of course, we could have a 1,000+ page volume of information relating to contracts and contract law, etc., but my point in this is going to give you some quick tips that can save you from making mistakes when it comes to drafting your contract on an office building.

So, lets get started with the. Do's

1: Arm yourself with contingencies.

Now, just like apartment properties you don't need to put 45 contingencies in the offer. Just use enough contingencies to make sure you're protected. Here are the top contingencies you will want in any offer you make on an office building:

A: Subject to inspection and acceptance of all of the office space or suites.

B: Subject to inspection and acceptance by buyer of last two year's tax returns.

C: Subject to inspection and acceptance of current rent roll.

D: Subject to inspection and acceptance of all leases.

E: Subject to financing being satisfactory to buyer within _____ days of offer acceptance.

F: Owner not to change, renew, or modify any existing and/or new lease agreements without express permission by buyer between days of offer acceptance and closing.

G: Subject to buyer completing and facilitating a 1031 tax deferred exchange. The subject property will be replacement property to fulfill section 1031 requirements. (You use this when you are buying a replacement property for a tax deferred exchange.

H: Verify Rents and Deposits Using An Estoppel Certificate or Estoppel Letter. All this really entails is that you get a letter from the tenant that verifies they are indeed paying the rent and have the same lease term that is being reported as well as having the correct deposit amount on hand that was being reported

In most offers you will want most, if not all, the above contingencies. They will make sure you are protected in the event things don't work out, you find out the information you've been given is wrong, or you find out that the financing won't work, etc. Be sure you give yourself plenty of time to work through the contingencies and make sure that you make the offer in such a way that you have to release the contingencies that the contingencies don't expire on their own. In some offers, it is written that if you do not address any of the contingencies within a certain time period, they are released automatically. You don't want that to be the case.

Office Building Don'ts

The following information is the same Don'ts as what was in the apartment section. If you have read that section thoroughly you can skip A – H. If you have not read that section thoroughly please read through this information.

A: Don't come to the table with too little earnest money. That's right, you read correctly. Don't come to the table in your offer with too little earnest money. You want to be taken seriously and you want the seller to work with you. Of course, conventional wisdom tells you that the little amount of earnest money as possible means little risk for you, it also means that you're small potatoes, bush league, and small time. You don't want to come across that way.

You don't want \$400,000 in earnest money either unless you are buying a \$25,000,000 property. Use a fair amount of earnest money. In my opinion, you should use 1-2% of the offering price as earnest money. Don't worry; as long as you have the proper contingencies in place, if something goes wrong, you'll get your earnest money back. This way, you'll be taken as a serious buyer, someone that has a sincere interest in the property, and someone that is worth the seller's time in working with, no matter what the motivations of what the seller are.

Think of it this way, let's say you have two competing offers. All things being equal, if you have \$5,000 earnest money and the other investor has \$15,000 earnest money down on the table, whom do you think the seller is going to be more cooperative with? That's right, the guy with the most earnest money.

B: Don't give yourself small timeframes to complete contingencies and close the deal.

Let's face it, in real estate, hardly any transaction goes exactly as it's supposed to, there are delays, glitches, small problems that come up here and there, that's the world of real estate. So, whatever you do, don't use too short of timeframes in your contingencies and in your closing period. You want as much time to take care of any surprises that come up as possible.

C: Don't overload the offer with contingencies.

If you overload the offer with too many contingencies, what that means is you're not really serious about buying the property. Sellers can sense this and if you have too many contingencies in the offer, they'll think you're just doing this for practice and you're not really serious. Use the contingencies that I have given you previously.

D: Don't accept work with verbal offers.

In some states, verbal offers are binding; however, in some states, they are not. Whatever you do, make sure you get everything down in writing. If the seller says he/she will sell at a certain price with certain terms, get it in writing as quickly as possible - don't dawdle, you never know when something else may come up that may change the seller's mind before you get it to contract or before you get it in

writing, so whatever you do, get it in writing as soon as you possibly can.

E: Don't get emotionally involved with the property.

When making the offer, don't get too emotionally involved. Later on in this book, I'm going to talk about negotiation; however, it bears mentioning right now that you don't want to get too emotionally involved in a property. If it's a good opportunity, you'll want to try to take as advantage of it as aggressively as you can, but not go overboard. Remember, opportunities will continue to present themselves; this will not be the last property that you will ever be able to purchase. Keep that in mind.

F: Don't buy just to buy.

It's worth mentioning that you shouldn't make an offer just to make an offer on a property. Many times many investors get caught up with the thought of "I've got to buy an office building". And many times, they don't pay attention to all of the analysis that needs to be done in order to make a smart decision. So, what do they do? They take shortcuts...just to make sure they buy an office building. Don't you do this; don't buy just for the sake of buying, those that do, end up wishing they never got involved in the first place.

G: Don't sign the contract until you've read over every single sentence.

It goes without saying that you don't have to be an attorney to figure out a contract; however, you want to make sure you understand everything involved. At least on your first two transactions, make sure you take the time to read through the contract and take the time to go through it sentence by sentence, most of it isn't going to mean a darn thing to you with legalities; however, there will be some things you'll want to take note of and make mention of to your broker or to the person you're working with in buying their property.

H: Don't purchase a property "by owner" without an attorney representing you.

You'll want to get a good real estate attorney on your team anyway and it's necessary you do have a good real estate attorney, not just an attorney that will learn through you how the real estate transactions work. And, you'll have them represent you especially if you're doing something "by owner". Most of the problems that are encountered by investors when they purchase a property are doing it by owner and not having good representation.

These investors end up in a situation that they never would want to be in the first place and unfortunately find out when it's too late.

If another offer comes in while you have made an offer on an office building

If you have read this section in the apartment property investing section you can skip this section and go to the end of the chapter.

Once in a while what'll happen is you'll make an offer on an office building, then be told right after you made the offer one, two, six, 12 hours later, whatever the case, that there's another offer on the table. This other offer has been made to the owner before the owner has gotten back to you with either an acceptance of your offer or a counteroffer. Of course, at that time, you're going to be told, "If you really want to buy the property, you should pay the owner's asking price."

Hold on, back up, and stop.

What should you do if you're competing with another person to buy a property? Simple. Don't deviate from your strategy in buying the property. In other words, stay the course. If you have a plan on how you're going to buy the property, at what price, what terms, etc., don't deviate from that.

Here's why:

90% of all other offers that come in on a property that compete with yours will not work; they'll either be too low, the terms won't be good enough, etc.

So, just because another comes in on the property, it doesn't mean it's a better one. The majority of the time - at least 90% of the time - the offer will not be as good as yours. So, whatever you do, don't let that influence the way you purchase the property, stay the course, and make sure you buy the way that you want to buy the property.

Don't be influenced by another offer coming in on the property, because as I've said the majority of the time, that other offer for whatever reason will not be as competitive as yours and will not work out. Time and time again I've seen this tactic used and most of the time it's been sincere. Most of the time when there's multiple offers on the properties, there really are multiple offers, with more than one investor interested. Once in a while I've seen it done in a shady way. I've seen offers being generated that had no hopes in going through, which is the intent of getting another investor's price up. This is wrong and is against the law. Unfortunately it is done once in a while.

So, whatever you do, make sure you stay the course and don't be influenced by the other offer, keep negotiating, and working on it, etc., just as you originally thought you would, because the majority of the time, it won't work out.

Practicing Buying Office Buildings

I recommend for those who do not have experience in office buildings to go and look at a minimum of 6-12 properties and go through the process of analyzing them first just to get comfortable with the marketplace, the cash flow, risks and rewards, etc. Believe me, office buildings are a very good investment if they're bought correctly, they can provide you very, very good cash flow with very little management as well, that appeals to many people, as I'm sure it probably does for you. However, not going through the proper steps can cause you a lot of headaches, management problems, and negative cash flow, something you don't want to do.

So, practice; that's right, I said practice. Go out into the marketplace, take a look at 6-12 properties and analyze these properties, not really with the intention of buying them, but with the intention of looking and seeing what works and what doesn't work in the marketplace. By doing this, once you do decide you're ready to jump in, you will be ready to go and will be in a good position to make good decisions as to whether or not the profit of the office building will make good financial sense for the short and long term haul.

Office Building Closing Items

You can skip this section if you read the similar section regarding apartments.

Whatever you do, make sure before closing you verify the amount of deposits, insurance, review leases, etc. I've talked about these in previous steps; however, it's worth mentioning again. Make sure you do the following:

1. Verify deposit amounts and leases.
2. Verify rents.
3. Make sure there are no "side agreements" between the owner and a tenant. Many times what you'll find is a tenant's able to lease a space for say, \$600 per month; however, once you dig a little bit, what you'll find is that the tenant is really only paying \$300 a month, but is also in charge of cleaning the hallways, common areas, etc. That's not uncommon; however, you'll want to make sure you understand all of the agreements that are in place like that before you purchase a profit versus afterward.
4. Make sure you have insurance in place. You'd be surprised how many people forget this at the closing table.
5. Make sure you have management in place if you are hiring a management company.
6. Make sure you have down payment ready and lender is ready to close.
7. Make sure you have all keys to the property.
8. Make sure you have clear title free of liens or other issues.

One final note. Make sure that all parties agree upon two important things. One is a rent proration amount. Rent proration happens if you happen to close on a date other than the 1st or the 30th (or 31st) of the month. For example. Let's say you are going to close on the 15th of the month. If that is the case the owner should have already collected all of the rent for the month, however, since you are closing on the 15th you should get credit for 15 days of rent since you are going to be the owner effective the 15th. Another example. Let's say that you are going to close on the 20th. The owner should have gotten the rent already for the month and should be crediting you 10 days of rent.

Just keep in mind that if you close on a date other than the 1st or 31st there will be a rent proration. Just make sure you and seller agree on what that is PRIOR to closing.

Lastly, rental deposits. Make sure that if there are rental deposits that you verify that amount with the seller PRIOR to closing. The seller should be issuing you a check for the total deposit amounts of the tenants.

When not discussed prior to closing these two items can be a problem for you because there you are, at the closing, 99.9% of the way there and you are finding out then that the rent proration amount is not correct nor are the deposits. The time to find this information out and get it taken care of is before the closing not during the closing.

CHAPTER 14

RETAIL PROPERTIES - MULTI-TENANT.

Many of us are also familiar with retail properties or as some people call them, strip centers or shopping centers. The largest example, of course, is shopping malls. Shopping malls are nothing but multi-tenant retail properties. Many of these cover acres and acres of ground. All tenants and vendors in a convenient location for shoppers all the way down to the small mom and pop one-two tenant retail shop that you see in every town, both small and large.

Retail properties provide advantages to owners such as ease of management and they are usually in good locations. All of us are familiar with retail properties either by being a "shopper" or possibly a tenant in a retail property as well. In this section, I'm going to go over the dos and don'ts of purchasing a retail property.

Percentage rent. Percentage rent is rent that is usually rent that is usually charged to tenants based on the tenant's sales. You don't see percentage rent much anymore, but it used to be the rage in the 1980's and the early 1990's. Once in awhile, you may run into a percentage rent lease.

What a percentage rent lease basically says is the tenant pays you, say \$2,000 per month; however, once their sales reach over say, \$1,000,000, anything over \$1,000,000, you get 1% of. So, for example, if the tenant pays you \$2,000 per month and their annual sales volume is \$1,200,000 and you get 1% of their percentage rent, you get an additional \$2,000 "bonus" on top of the rent that would be paid to you month. Of course, the logic behind it is that you as the owner are providing the tenant such a fantastic location that you should share in some of the profits over a certain dollar amount as well as receiving monthly rent from the tenant. As I've said, you don't see these much anymore; however, you may run into them and

it's important to know what the percentage rent means

CHAPTER 15

SINGLE TENANT COMMERCIAL PROPERTIES - OFFICE, INDUSTRIAL AND RETAIL.

There is more risk involved in single-tenant properties versus multi-tenant; however, the benefits cannot be denied. 1: They're usually long-term leases. 2: They're usually large tenants of large corporations, which provide you with somewhat of a cushion against the risk. 3: They're very easy to own and manage, they basically run themselves.

If you do a good job of analyzing and obtaining a single-tenant property, it can work out very well for you. What I want to do in this section is go over some of the dos and don'ts of single-tenant properties to make sure that if you do decide to go that route, you make the best decision you possibly can.

Of course, many of us are familiar with single-tenant properties. If you live near a Best Buy, Walgreen's, Barnes and Noble, Bed Bath & Beyond, Staples, or Office Max these are single tenant properties. This not only applies to the retail sector which most of us are aware of, but also the office-building and industrial property sector too.

For example, I just put a transaction together with a group of investors that purchased a 40,000 square foot single-tenant office building leased by a large, multi-national company. There are also many examples of large companies leasing industrial property where they are the only tenant. Many of them can be trucking companies, manufacturing companies, etc.

Before we get too far I want to start out first by talking about and discussing the things that you need to be aware of and watch out for with single-tenant properties.

Beware of government tenants. That's right; beware of the U.S. Government as a tenant in a single-tenant property or even multi-tenant property for that matter. Examples are: IRS, District Attorney, USDA, SBA, etc. Not that these aren't good tenants, of course they pay you right on time every single month; however, please be aware that the leasing negotiation arm of the U.S. Government is called the GSA or General Services Administration.

One of the policies of the GSA is they can give you a 90-day notice and be out of that property and as quickly as 90 days.

For example, the IRS could have a 10-year lease on your property, with a 90-day out. You could be in year two of your 10-year lease and all they have to do is give you a 90-day notice and they could be out of that space. Many people aren't aware of this and think Government tenants are fantastic and are golden. They are good, don't get me wrong; however, many people are surprised and even shocked, when they find out that the tenant they thought they had for 10 years is going to be moving out in 90 days. Plus, how successful do you think you would be if you chose to fight the Government regarding your lease? Probably not very successful.

Beware of the tenant. Ideally, you want to get the biggest tenant with the biggest net worth you possibly can in your single-tenant properties. In other words, if I had a 10,000 square foot retail property, I'd want to make sure I put a large tenant in there versus, Joe and Irene's Office Supply Store. That way, if they do default on the lease, you usually have a large company to fall back on to collect payment or at the very least, you have the possibility of collecting rent payments; however, with Joe and Irene's Office Supply Store, many times you aren't going to be successful in collecting rent payments in the event that there is a default.

Beware of the lease term and option periods. If you're considering a single-tenant property, you would be smart not to look at any kind of a property with less than a seven-year lease and that's a seven-year lease on a primary term, not primary term and option term. In other words, some brokers and owners like to present their properties by combining the primary term and any options to renew.

For example I have seen something like this way too much:

Walgreen's for sale, 10-year lease in place, call: 555-1212.

Upon calling, what you find out is there really isn't a 10-year lease in place, Walgreen's has a five-year lease remaining on the primary term, but has an option to renew for another five years. So in essence, what you really have is a five-year lease.

A lease less than seven years could spell trouble for you. You need that amount of time to not only pay down any debt you may have incurred, but also to put away enough money to take care of any improvements, repairs, etc. that may be needed if a tenant would decide to move out. Of course, if you can get one with over seven years, you'll be doing fine. But a minimum term is seven years. Anything less than that can spell considerable problems for you no matter how good the deal seems to be.

Beware location. On and on in the all of the sections throughout this book, I've talked about the importance of location. You probably noticed it's usually the first thing that I discuss. The same is true here. Usually, single-tenant properties are located in the best locations; however, that's not always the case. Make sure you do thorough studies of the location and its surroundings. For example, is the busiest highway in town going to be rerouted and they're going to do it a quarter of a mile away from where your property is....whereas right now, the highway runs right by your property? If you own a retail property with retail tenants, that could have a negative impact on their business.

Environmental concerns. Make sure you do at least a Phase I environmental study on a property you're thinking of purchasing, especially a single-tenant property. You don't want to discover any environmental problems later on down the road. If you do, guess who will be responsible in cleaning it up? You. And, if you have a single tenant and you happen to have a vacant single-tenant property on top of an environmental cleanup, it could literally bankrupt you.

Make sure before you purchase, you make your offer contingent

upon an environmental study of the property to make sure there are no environmental concerns that you need to be aware of.

CHAPTER 16

THE THREE THINGS BROKERS AND OWNERS NEVER TELL YOU THAT WHEN FINALLY FIND OUT CAN COST YOU LITERALLY THOUSANDS OF DOLLARS.

Now, don't get me wrong, I don't mean to set this up like people are intentionally trying to hide things from you; however, there are some things you need to be aware of that can surprise you. I learned this not only through my own investment, but also through clients who would complain to me about people that they had worked with in the past and how they were upset about the way they were treated or the information that was not provided to them.

So, having said that, here are three things you definitely needs to be aware of that most brokers or owners will not tell you:

1. The property tax dilemma. Depending on what state you're in the property taxes are based on the value of the property that you're going to own. In other words, if you buy an office building for \$700,000, the county/city tax assessor will probably assess that property at \$700,000 value and they're going to charge you taxes accordingly. Which, is fair, they should be charging you taxes based on what your building is worth. However, there is one caveat to this and it has to do with large increases in property taxes. You see, when you buy a property, you need to make sure you understand what the property tax amount is going to ultimately be before you purchase it so a large pending property tax bill won't surprise you.

For example, let's say you're looking at an apartment building and the owner's offering the apartment building for \$500,000. It looks like it's a good deal, you think you want to purchase it, all things are a go. However, once you look at the property tax bill and the property tax assessed evaluation, you find out that the building is

assessed for \$300,000. What do you think will happen once you purchase it for \$500,000? I'll tell you. Once the closing takes place, the documentation goes to the assessor's office, they're now told that you just purchased the property for \$500,000. A small little clerk with glasses and beady eyes takes that information and goes straight to that properties current assessed value and finds it is only \$300,000. Guess what will happen? More than likely, your next assessed value is going to be at/or close to the \$500,000.

So, what difference does that make?

Well, when you purchased the property, the property taxes you planned on paying are based on a valuation of \$300,000. Once that valuation jumps up \$200,000, your property taxes will also increase almost 50%. So, if the taxes you're paying are \$20,000 per year and they go up 50%, that's going to put kind of a kink in the cash flow that you thought you'd be getting from this property. In this example a huge increase of \$10,000 for a total tax of \$30,000 vs. \$20,000.

The moral of this story: Make sure that you understand what the assessed values are on the properties before you purchase them and understand approximately how much worst case scenario the property taxes could go up. Not to say that you want to avoid properties where there would be large tax increases, but arm yourself with the knowledge of what they could increase to when figuring out your present and future cash flow of the property.

2. Leasing commissions. One thing you're probably not going to be told when you buy your first office building, retail property, shopping center, etc., is that if you ever want to have the help of a commercial real estate broker in leasing your property, you'll have to pay leasing commissions. And, more than likely when you look at the financial statement of such a property, you're not going to find any leasing commissions accountable in that set of numbers.

So, what do you do?

Make arrangements mentally and financially to pay out leasing commissions. If you plan on doing the management, advertising and

leasing yourself, then this won't be much of a concern. However, it is a fact that in most cases a good commercial broker will get your property leased much more quickly than you doing it on your own. Understand that a broker will want to charge you a certain percentage based on the amount of monthly rent you get and how long you get it.

For example, if a commercial broker finds you a tenant that wants to pay you \$1,000 a month for five years, the broker figures you're going to \$60,000 of rent from them (60 months times \$1,000). The broker will want to charge you a percentage, say in this example, 6%. So, once that lease is signed, the commercial broker is going to have his hand out for a check of \$3,600 from you as a leasing commission. Not that this is wrong; however, you need to be sure and understand that when you do lease space and you hire a commercial real estate broker to do it for you that they will want to be paid leasing commissions, which as I've said before is not indicated on any of the information that you will get once you purchase your property.

3. Accurate financial statements versus puffery. Make sure that you understand there's a big difference between actual income and potential income. Many owners and brokers will market a property so that it looks much, much better using potential income and potential expenses versus what's actually going on at the current time. Based on information you've already read, that's not necessarily a bad thing, because if there is realistic upside potential, i.e.: higher rents, lower expenses, etc., it still could be an opportunity.

However, please be aware that many times brokers and owners will market their property not based on what's going on now, but based on some preconceived idea where they think it could be. Maybe their newfound potential numbers are accurate, maybe they do make sense. However, it pays to make sure you understand whether or not they are potential numbers versus actual numbers. You do this by verifying the income tax returns that are associated with the property as well as current rent rolls and examining the leases closely once you choose to inspect those. This due diligence

will take time; however, it's well worth it to make sure you're getting what you think you should be getting in the way of cash flow and return on your money.

CHAPTER 17

HOW TO MANAGE WITH LARGE PROFITS AND SMALL HEADACHES AND HASSLES.

A big key to success of any commercial investment real estate property is management. Bottom line, proactive and effective management can add literally tens of thousands of dollars in cash flow and profits in a short time.

Of course, bad management can suck out those profits just as quickly.

The nice thing is in general; management isn't as difficult as many are lead to believe, if you do it correctly. What I'm going to talk about in this section is doing the management correctly to make sure you get as much money, return and cash flow out of the property with as little amount of hassle and headaches as possible.

When you boil it down, there are only three types of property management.

You manage the property yourself. When you manage it yourself, you take care of everything, you field the phone calls, draft the leases, make arrangements for maintenance and repairs, etc.

You are the "business owner" and business operator.

Hire a manager. But still maintain total control. In this scenario, what happens is, you go ahead and hire a resident manager to run the operations on site for you.

In other words, let's say you buy a 24-unit property. You could have your resident manager live in one of the units and manage the property from there. In this scenario, you're still in control as I said before of finances, where the money goes, what gets spent, when the maintenance people get called, etc., however, you've got someone in

place to take care of all of the hassle factors involved; the small tenant complaints, things that come up here and there in the middle of the night, they can be taken care of easily without bothering you at all. Plus, you're still in control of the day-to-day operations, knowing what goes on every day (as long as you do talk with your manager on a daily or at least a minimum of a weekly basis.) You have all other jobs delegated and taken care of by someone else, but still maintain overall control of all of those that you do delegate.

Management company. Through the use of a management company, you release most if not all of the control over the day-to-day management of the property. In other words, someone is taking care of the day-to-day operations and sending you a check once a month for the cash flow, less their management fee, expenses, repairs, etc.

This option appeals to many because you have someone taking care of all of the details of the management and you're not involved in it at all. The management company only contacts you when major decisions need to be made. This option appeals to many investors because this way they don't have to deal with the day-to-day operations or even being involved with the delegation of any of the operations as well.

So, the question is which is best? Which of the three do I recommend?

Actually, I recommend all of them. You see certain management systems will make more sense to you than others and all of the answers are actually the right ones and there is no perfect way to manage a property. It will be up to you to choose which way would be the best for you based on your financial, personal and professional situation.

I do recommend that you manage your own property if you can for a minimum of 6-12 months so you know the process. Whichever management system you choose - doing it all on your own or having a management company doing everything for you - I think for at least the first 6-12 months you own any kind of commercial investment real estate, you should manage the property yourself.

This allows you to get familiar with all the day-to-day management processes that are involved, everything from dealing with tenants to bookkeeping. There are three main advantages to doing this.

You know exactly what goes on every day during the management process. You'll have a tremendous advantage when it comes to hiring management companies or hiring property managers or on site managers. You know what the day to day operations are, you know what goes on, you know what's expected, etc. In other words, you're operating from a position of strength.

You'll find out what it's really like to manage a property. I talked about the fact that you'll know everything that's expected of the property manager, tenants, etc. when you manage your own property. What I'm talking about here though is you'll know exactly what they're faced with day to day. So, your expectations will come in line with what your realistic expectations for their service should be. That's not saying that you're going to cut them slack for poor service, but you'll have a good understanding of what they're going through on a day to day basis when it comes to dealing with tenants and the property. You'll know what they're talking about when they have a problem they want to talk to you about, you'll know what they feel like when a tenant is not being cooperative for whatever reason, etc.

Get acquainted with the numbers. This is where the rubber meets the road as far as knowing how a property is going to operate from a business standpoint, what you can realistically expect in income, what you realistically can expect to spend in expenses, how you can work the expenses to your advantage.

In other words, management means cutting as many expenses as you can. How you can increase the rent as much as you can, etc. The only way to really know is by managing yourself, getting involved, and getting your hands dirty with it. It's a good motivator to increase your profits as quickly as you possibly can. Bottom line, management is the key to profits in investment real estate.

So, even if you bought the property at a huge profit, you've got to

make sure that it's managed well enough to maintain that profit. If there's a big mistake some investment property owners make, is that they take management too lightly and they don't place enough emphasis on it when actually, as much emphasis needs to be placed on it as possible. Think of it this way, you wouldn't buy a business and not oversee the daily operations of it, would you? Or, at the very least, have someone in place that could oversee the day-to-day operations of the business; someone competent, good at what they do, and can increase your bottom line. The same goes for apartments.

Always keep in mind that no matter how well you bought the property, no matter how nice the property is, how much profit potential is in it, etc., if you do not manage it properly, you will not even come close to the property's profit potential.

CHAPTER 18

THE KEY TO THE VAULT: TENANT SELECTION AND WHY.

Have you ever heard the horror stories from property owners/ investment property owners? Horror stories include the bad tenants they couldn't get rid of, the damage that was done to their office building, shopping center, apartment, the mess that was left, the tenant that never paid rent on time, the tenant that always complained, the tenant that was a huge pain in the rear end, etc. We've all probably heard a horror story at least once or twice in our lifetime and this is the main reason why many people pass on owning commercial investment real estate, because of all the headaches that they feel they would have.

Well, I've got good news. Most of the time when you would hear these horror stories, they could have been prevented. That's right, they could have been prevented. 99% of the horror stories that you have heard about bad tenants, bad properties, bad situations, etc., could have been prevented. What I'm going to share with you now is the formula for preventing them and at the same time, give you an idea of how to select the very best tenant for your commercial investment property. As I've said, the key to short and long-term profits is management. The key to a hassle-free property is tenant selection. So, having said all that, if you were to boil it down to one sentence that is of utmost importance to the commercial investment property owner, here it is.

Take your time and do a good and thorough job of tenant selection.

Sounds easy, doesn't it? Sounds like I'm talking about something that's pretty much common sense, right? Well, you would be surprised how many owners simply put the first warm body that walks in the door in their office space, retail space, or apartment

property. On top of that you would be surprised how many do not do any kind of checking: background, references, credit check, etc. Hey, they're just happy to get their space or apartment leased. Why go through all of that hassle? It takes time, costs money, and they seem like "good people". So, I think I'm going to rent my commercial investment property to them. Bad thinking.

This thinking will cost you literally thousands of dollars in cash flow, thousands of dollars in profits, not to mention the wasted time you will spend chasing your rent, fixing your property, dealing with a tenant that you wish you never would've put in your property in the first place. As I said, in the majority of cases this is preventable.

Here's what you do: Make sure that with an apartment property, they fill out an application and they fill everything out. Do a thorough check on the application; check their credit, check their references, check their job history, check their criminal history. All of this is fairly easy nowadays, and can be done by computer. So, it doesn't really take that long to do this anymore, but it is necessary.

Anytime that I've gotten burned with my properties or anytime my clients and customers have gotten burned with their properties has always been because we did not do a thorough job of this. We were in too big of a hurry, had too much going on, etc. Don't make this mistake. If you want to prevent mistakes, prevent yourself from telling any horror stories, and want your property to run smoothly on autopilot, you will take the time to check out those tenants.

Commercial investment property. One additional thing you'll want is a financial statement from the potential tenant that's going to be moving into the space. The financial statement will list the tenant's assets and liabilities. This will give you a good idea of how experienced the tenant is before they move into your space, how much capital they have behind them, etc.

Let's say you have 3,000 square feet of office space you need to rent. You've been contacted by quite a few prospects and one tenant sounds pretty good. So, you meet the tenant at the office space. The tenant looks at it and says, "Hey, I like this space, I'm thinking I'd

like to sign a three-year lease with an option to rent it for an additional three years." At first, this sounds good because you could have this tenant potentially for six years. However, here's what the tenant says next, "However, I'm wondering if you could make some changes to the space. There's a lot of build out work I'd like to have done so I would have some separate offices, conference rooms, etc." After you bring a contractor in, he tells you it's going to cost you \$32,000 to have this space built out to the specifications that the tenant wants. Well, you may be leasing this space to the tenant for six years, so maybe it's worth it. However, to make sure it's worth it, you want to check their financial statement.

Upon checking the tenant's financial statement, they \$0 cash in the bank, a negative net worth, and they do have some credit problems. So, let me ask you, are you going to cough up \$32,000 on finishing this space out for a tenant with this kind of background? The answer is of course, no. Once again it's surprising how many commercial investment property owners don't do this and find out after the fact that it's something they shouldn't have done in the first thing.

So, as a quick checklist, here's something that you're going to want to do.

Apartment property owners: Have the tenant fill out a standard application form and check them out - check everything out. Make sure you're comfortable with everything's that's on that application form.

Office, retail space, etc. – Have them fill out an application form too. Along with that, I would ask for a current financial statement from the tenant. As long as you've got both of those, you're comfortable with what the tenant has completed on the application, everything looks good from your background checks, credit checks, etc., then it's a go.

The good news is this whole process should not take any more than two or three days. Heck, it may be a total of one hour of your time. That hour could be worth literally tens of thousands of dollars

to you. One important caution: If you are not managing your own property, i.e.: you have a management company in place; make sure they are doing these steps as well. Some management companies get lazy and don't do this. You certainly don't want to do this. So, before you hire them, make sure they understand what your parameters and specifications are as far as leasing your property.

CHAPTER 19

STRATEGY FOR MAKING SURE YOU STAY AS FULLY OCCUPIED AS POSSIBLE.

Why should I stay in your space or rent your apartment versus all others out in the marketplace?

Keep in mind this is a question that is going to be in the back of your tenant's minds when you're looking for tenants and also your existing tenants. You see there is competition for the tenant you're looking for and that will always be the case. However, if you answer this question effectively for the new tenant that would be coming into your apartment or commercial investment property, you will not have a problem in getting good tenants and keeping your space filled more often than not. Remember, it's not always about price. Price is important and tenants do have budgets, etc., however, many other things into it for a tenant as well: Cleanliness, nice neighbors, convenience, close to things they like to do, (movies, shopping, etc.), close to their home, desirable location, prestigious location, etc.

We could go on and on regarding reasons why a tenant should lease your office, retail, or apartment property. However, make no mistake they're not only asking this before and when they move into your space, but they're also asking it when they're in the space as well. When you get a good tenant, you want to keep a hold of them as long as you possibly can, of course, raising the rent over time. Obviously, if you have an office building that has six tenants and you can keep those six tenants for a number of years without any turnover, you have saved a substantial amount of cost and a substantial amount of time, because remember your time is worth money.

So, with that being said, let me give you a couple of tips for new tenant acquisition and current tenant acquisition.

New tenant acquisition. Prepare a "special report" of all of the mistakes that tenants in your market should avoid and how by renting your space you are answering those mistakes. This report is given and/or mailed to prospective tenants that inquire about our space or apartments that you have for rent. What this does is give the tenants a little doubt in their mind about what's out there and what they have to get into and how by leasing our space, we erase those doubts and by renting our apartment or our investment property, they are much better off and will not make any of those "mistakes". The result will be more people applying and more people wanting to rent your commercial investment or apartment property space. The nice thing is, you'll have it done much quicker.

What about current tenants? How do we keep answering this, "Why should I stay in your apartment or commercial investment property space?" It's really easy if you think about it. We just need to keep reminding them that is what they should do. How do we do it? A small monthly newsletter via a postcard. This is really quite easy. These postcards are your newsletters that you are going to be sending to your tenants once a month. You can call it, "The World's Smallest Commercial Investment Property Newsletter", the "Minneapolis Commercial Property Tenant's Newsletter", etc. Whatever you want to name it is fine; however, the point is you want to get this in front of them at least once a month. What should the content be? The good news is that it doesn't have to be anything that Stephen King would be proud of or anything that Hemingway would be proud of.

Some things to mention in your postcard:

Tenant of the month. Feature a tenant, give them a bonus for being a tenant of the month, free gift, fruit basket, passes for the staff to go to a movie on Friday night, etc. Whatever you want to do, but recognize them, they'll be glad you did and they'll remember it.

Interesting local information they'll want to know. What's happening locally with the economy? What are some business opportunities that could be available to them that if they knew could

enhance their bottom line? What are some associations that they could be involved in?

Make it fun. I would make your postcard more "folksy" than what you probably would think. Sure, have some information that would help them, have a tenant of the month, but also, have some fun in there. Have a contest, have a riddle, have some jokes, etc.

Remember, we're all human, let them see the human side of what you do and how you do it.

CHAPTER 20

The rule of 7% CAM.

There is a secret, an almost unknown way you can reduce your expenses dramatically, increase your cash flow and increase your bottom line. Now, would you like to know what it is? Before I tell you what it is, let me mention that it's easy and simple, not difficult, and can be done almost right away. But, the interesting thing is, many owners don't think about this, don't act upon it, and don't do it. Before I tell you exactly what it is, let me tell you how it can affect your bottom line with an example.

A couple of years ago, I worked with an owner of two 16-unit properties. His 16-unit properties were in an apartment property development that contained a total of 152 units. The 152-unit development consisted of eight and 16-unit buildings. As I said, this gentleman owned two 16-unit properties, or 32 units out of the 152 units total.

When we started the analysis of the property, I was amazed at how low his expenses were, because not only were the properties built in the mid-1970s, which meant they were over 30 years old, he was also paying the heat and water for the tenants as well. The only tenant utility responsibility was the electric, but his (owners) expenses were running 32-33% of the gross income (see buying strategies for where the expenses should typically be when you look at an apartment property).

Anyway, I ran over the numbers again and again thinking I had missed something. There had to be more expenses in here somewhere. I mean only 33% of gross?

Well, after spending hours on this I came to the conclusion that there were not any more expenses. This is what his expenses were and this was they had been consistently over the last three to five years.

So, of course, my question was, how did he do it? What was he doing to make his expenses so low?

I'm going to tell you what he did and how you can apply it to your situation no matter if you own or are going to buy an apartment building, or a commercial property like an office building, retail strip center, single-tenant building, etc.

Here it is: He shared all of the expenses with the owners adjacent to his property. You see, in this development, there were eight other owners. Instead of this total of nine owners hiring their own individual lawn care, snow removal, property management, garbage hauling, etc., they all hired the same person to do each one. By doing this, they were literally saving tens of thousands in expenses.

Think about it, if one person were to come out and take care of lawn care, they're of course going to charge each individual owner less per building because they're the only game in town; they're the only ones out there doing it all. So, on a per property basis, the owners were saving thousands of dollars a year by sharing this common area maintenance between them.

You need to do the same thing; where you find your commercial property or apartment building, see if the other adjacent property owners would be willing to share in the common area maintenance. Would the guy that owns the office building next door to you be willing to share in the snow removal, lawn care, etc.? If so, you can reduce your expenses substantially by having one vendor take care of all of it versus everybody running around trying to hire separate vendors for every single thing that needs to be done?

In this example that I just gave you, it added \$120,000 in property value to this guy's property by being able to do this. So, the next time you want a large increase to your bottom line, don't necessarily think about raising rents, think about reducing your expenses and think about implementing the rule of the 7% CAM.

Why 7% CAM?

Because most of the time when you use this strategy, you can shave an average of 5-7% off of your expenses which translates into profits, cash flow, and additional value. In the real example that I gave you it put an additional \$120,000 into this owners pocket at closing.

CHAPTER 21

REDUCING EXPENSES.

Once you take over your commercial investment property or apartment building, or if you have one currently, one of the things you should be aiming for is reducing expenses.

Because remember, it's all about that net operating income and getting that net operating income as high as we possibly can.

The first thing that most people think about to grow that net income is to increase rents, which is understandable. Another less obvious route you may want to take is the reduction of your expenses.

Are there any of your expenses that if you work on them, that could be reduced? That should be a question that should be on your mind right away and something that you should be working on consistently.

Let's talk about a few areas where you could reduce your expenses.

Property taxes.

Insurance.

Utility costs.

Common area maintenance (see section on the Rule of 7% CAM to do this)

Management.

Garbage hauling or waste removable.

Repair and maintenance costs.

These are the main areas where you can find some opportunity. Look at this list of expenses. Think of ways you can reduce the expenses. Because many times, it's far easier to reduce the expenses than to raise income.

For example, let's look at property taxes. Let's say the property you own is currently assessed by the tax assessor for \$400,000, but you know that your property value is say, \$350,000. Yeah, it's nice to have an assessment of \$400,000 and it kind of makes you feel good; however, it is assessed \$50,000 higher than what the property is actually worth. What do you do? You protest the assessment and you get it lowered to \$350,000.

What will this do for you?

Well, think of it this way, depending on how much property taxes you pay, it could save you thousands of dollars.

Let's get to the math of it. Let's say that for every \$1,000 you pay in property taxes, it costs you \$.40, so in other words, for every \$1,000 of assessed value, you're paying \$.40 in property taxes.

In our example here, we're paying \$50,000 more in property taxes than we need to be. \$50,000 times \$.40 is \$2,000. So, we're paying an extra \$2,000 in property taxes per year, or \$167 per month. Now, it doesn't sound like very much, does it? Even if you can improve your cash flow by \$2,000 that probably isn't a huge chunk.

It's nice, it's helpful, but it isn't huge or is it?

Well, if we are successful in getting our assessed value lowered not only have you increased your cash flow by \$2,000, but if the capitalization rate in your marketplace is say, 10%, you take your \$2,000 of additional net income you've just added, divide it by 10% and you will find that you've just increased your property value by \$20,000 by simply protesting your property taxes. (*For information on how to protest your assessed valuation on your property see your city or county tax assessor, each market has its own rules about assessment protesting.)

Do you see how powerful this can be? Do you see how this can really swing the value of your property quickly and substantially? And, this is just one example, just the property tax example.

Do yourself a favor, when you purchase your first property, your next property, or any properties that you currently own, go through the list that I have above. See where you can work on the expenses; see if you can get them lower than what they really are. If you do, I guarantee you that you'll add a minimum of \$10,000-20,000 in value to your property almost literally overnight and in most cases it will cost you next to nothing in time and money.

CHAPTER 22

SOURCES OF GENERATING OTHER INCOME.

Closets and other rental spaces. It sounds silly that I should say closets for additional sources of income; however, I want to give you the following example of how this can be very lucrative if you just decide to think outside the box just a little.

I had a client that owned two 16-unit buildings or 32 units total. In each of these buildings, there were eight closets. Of course, the closets were located in the common areas and when he bought the buildings, the closets mainly held cleaning supplies, garbage bags, and miscellaneous things.

However, one day he had not one but two tenants ask him if he had any additional storage space to store their bicycles, boxes of extra "stuff" that they had and he couldn't accommodate them. He got to thinking, what about his maintenance closets? What about the closets in the common areas that were just holding his cleaning supplies and would tenants actually pay to use those closets?

Fast forward to today. In both of his buildings, he now has eight closets rented out for \$10 a month so he's collecting an additional \$80 a month in cash flow or \$960 per year for doing nothing other than having people put their bicycles and other belongings in the maintenance closets. Now, before you laugh and think this isn't worth your time, think about a couple of things.

In this example, you get an extra almost \$1,000 of cash flow for doing absolutely nothing. Your asset is already there. An extra \$1,000 in cash flow for say, five years could add up.

Value. Let's say for argument's sake that you're grossing \$1,000 in

cash flow per year for your closets; however, let's say all that money doesn't stay in your pocket with that newfound money, you've got to pay taxes, insurance, maintenance, etc., and let's say for example once you're done with that, you pay \$400 out of your \$1,000 per year in expenses. So you're "net" is \$600 per year.

Not that big of a deal, you say? Well, let's take it one step further.

Let's say that investment property in your area is selling at a 10% capitalization rate. If that's the case, how much is this newfound cash flow worth in value? (\$600 divided by 10% equals \$6,000.)

You see, just by renting out your closets in this example for a measly \$10 per month, you increased your property value a minimum of \$6,000 AND you're getting \$1,000 of cash flow per year.

This kind of return is the kind of return you're looking for. The kind that you can create, literally out of thin air. So, the question you need to ask yourself is are there any other areas of the commercial or investment property building you own that can be leased out or used for additional income? Can you charge additional fees for carports, garages, pets, allowing your tenants to smoke, parking spaces, using heating and cooling that you provide, i.e.: air conditioning units in the summertime for example, etc.

It pays to sit down and brainstorm areas of a property you're going to purchase, or currently own to see where you can suck more income out of it without any more work or effort on your part. In many instances with many kinds of properties, you will find you will be able to do this and you will be able to increase your bottom line substantially, not only from a cash flow standpoint, but also from a value standpoint. There's nothing wrong with that.

Laundry strategies. This one is my favorite. I've seen people literally create thousands of extra dollars a year and tens of thousands of dollars in value overnight by using this one simple laundry strategy. What's the strategy? Well, here it is.

First of all, if you own any kind of commercial building, like an office building, retail, shopping center, etc., and if you have an area where you can put a coin-operated washer and dryer, it may be well worth it for you to purchase such and place them somewhere in one of the common areas of the buildings. Why? People will use them. That's correct. I know of owners that have placed coin-operated washers and dryers in their office buildings and say, the common areas of their lower levels of their office buildings. Employees in the offices, on their lunch hours, breaks, etc., like to get their laundry done, so what better way to do it, then to bring your laundry to work, put it in the washer and dryer and have the laundry done by the time you leave work that day. You'd be surprised how many people do that and you'd be surprised how much additional income that would create for you. (By the way, you can also do the same thing with vending things as well; candy machines, pop machines, etc.; however, when you do this, make sure that you get a good price on the machines and that you buy them, not lease them. Leasing them only makes the leasing company rich, not you. So, if you think if you can use vending machines of any kind, make sure that you own the machines, not lease them, because you'll be surprised how quickly you can pay them back and then have a net cash flow in your pocket.)

My favorite laundry strategy is what I call the \$10,000 overnight strategy. It's really easy to implement. What you'll find in many apartment buildings and other commercial properties is that the owners do not own the laundry equipment in place; they're leasing the laundry equipment in place. How this typically works is, a leasing company owns the machines and they sign a lease with the current owner. The lease basically states that a leasing fee is equivalent to somewhere around 50% of the income that the machines produce per year. So, the leasing company puts their machines in the building, they collect the money every month, and they write the owner a check for 50% of the money, and the leasing company keeps 50% of the money. Plus, the leasing company will actually take care of any repair and maintenance that the machines need; therefore, the owner is never bothered. Sounds like a pretty good deal, huh?

No way.

Not a good deal and it actually reduces the value of your building. Let's take a look at a real world example.

For a couple of years, I managed a 12-plex for a client. This 12-plex had two washers and two dryers. Almost every month consistently all those washers and dryers produced \$300 in income or \$3,600 per year. The ownership owned their machines. But, remember that all that \$3,600 is not profit we've got to pay expenses (taxes, insurance, maintenance), so let's say worst case scenario, out of our \$3,600 profit per year from our machines, we've got to pay 50% or \$1,800 towards the expenses. So, after the year is over, we have a net of \$1,800 from our laundry machines.

So how much are these machines worth to us?

Well, once again, if buyers are buying property at a 10% capitalization rate, all we need to do is take our \$1,800 divided by 10% and we get \$18,000. So, our laundry machines that we own are worth literally \$18,000 in property value to us. We added an additional almost \$20,000 in value in our pocket - tremendous!

Now, what would happen if we were to lease our machines instead? That's easy to figure out, because as I've said, most of the times, leasing companies want to take 50% of the income. So, if we owned our machines outright and had a net of \$1,800, we'll just divide that net in two and just assume that if we had a leasing company involved, we don't net \$1,800 per year, we net \$900 per year. What does that do to our building value? Well, \$900 divided by 10% is \$9,000. Let me ask you a question, would you rather have your laundry machines contribute \$18,000 of value to your building or \$9,000 of value to your building? Obviously, \$18,000 and by leasing laundry equipment, do you see that you are leaving literally almost \$10,000 on the table? That's \$10,000 that could be put in your pocket; that could actually be put in your pocket in value overnight by just owning your machines versus leasing them.

Plus, the bonus, if you go buy a commercial pair of coin-operated washers and dryers, you're going to be looking at roughly about \$1,500 per pair. Remember in our real world example, we were netting \$1,800 per year, so in other words, if you were to buy your machines, you would have them paid off in less than two years anyway, with all of the money being pure profit and even though washer and dryer leasing companies do take care of the repair and maintenance of coin-operated washers and dryers, if you buy a good pair, they will typically last you a very, very long time. They will give you hardly any maintenance headaches at all.

Don't let the argument of, "Oh, but we'll take care of all of the repair and maintenance headaches." be the deciding factor of whether you own or lease your machines because truth be told, your machines will hardly require any maintenance, repair, or attention anyway.

The Mabel Story

I call this the Mabel story because it actually happened to a customer and client of mine and I see it happen with many of my customers and clients as well.

Here's the story: A client of mine owns 24 units, has owned them for many years, I believe for 15-18 years. He decides he is going to sell the property. He contacts me to sell the property for him. Upon looking at the rent roll of the property, I noticed that most of his units, the average rent was \$550 per month. However, there were three units whose rent was anywhere from a low of \$375 per month to a high of \$450 per month. Now, I thought this was kind of strange because all of the units were the same; same size, amenities, etc., why would these three units be so much less than all of the others?

Well, it was because of the "Mabel" factor. What's the Mabel factor, you ask? The Mabel factor is something that hurts all commercial investment real estate owners and they don't even know it. The Mabel factor is really being a nice guy and giving a tenant a break on their rent.

You see the tenant that was paying \$375 per month was named Mabel. Mabel had lived in the property for 10 years, she sent the owner a birthday card every year, baked him a pie once a month, knew what was going on with the grandkids. In other words, she was a great tenant and a great person and went out of her way to be nice to the owner.

So what does the owner do?

The owner reciprocates by letting Mabel stay there for that low amount of rent just because she's a "good tenant". Now, don't get me wrong, I'm all for keeping good tenants as long as possible, nurturing good relationships with your tenants, etc., and all in all being a nice guy. I'm not against that one bit. But, I want you to understand what this can cost you if you decide to do this kind of thing consistently.

Remember, the average rent in this apartment building was \$550 per month. Mabel was paying \$375. How does this hurt our owner?

Well, let's look at this in two ways:

Cash flow. The owner is getting \$175 per month less than he should be getting. \$175 times 12 equals \$2,100 per year. So, each year just off of this one unit, he's missing out on \$2,100 of income per year and if this happens over a five-year period, he's missing out on \$10,000 of income that he should be collecting. That's problem number one.

Value. Remember, we said that he's missing out on \$2,100 of income per year. Let's assume that out of that \$2,100 of additional income that he could be receiving, he still has to pay his expenses, etc., so he wouldn't really net \$2,100 per year. Let's say worst-case scenario he'd net 50% of it, or \$1,050 per year. If a prevailing capitalization rate in the marketplace right now would be 10%, we would take the \$1,050 divided by 10% and find that Mabel is costing us \$10,000 in property value or in other words, we are leaving \$10,000 on the table because we are

letting Mabel getting away with paying low rent.

A gross cash flow per year of \$2,100 plus \$10,000 in property value is substantial. Remember, we're only talking about one unit here, in this example, I said there were two other units that were getting similar breaks. If you multiply these figures by three, it becomes pretty scary. \$6,000 per year in cash flow, \$30,000 in property value simply left on the table. Not a pleasant thought.

Moral of the story: Be a nice guy, but be smart. Of course, you want to keep good relationships with your tenants, but be smart about your rent. Your tenants should expect to pay at least market rent, especially if you're providing them with good service and doing a good job of maintaining and managing the building. They know that expenses go up and they know that their rent should go up accordingly and they should be paying what everyone else is paying as well. So, don't be afraid you'll lose a tenant if you get your rents up to market level. Remember, most of the time a tenant won't move, leave, get mad, take off, unless they are really, really inconvenienced by you charging them market level rent will not inconvenience them enough to get them to move. It will save you tens of thousands of dollars in cash flow and property value at the same time. Remember, the goal of effective management is to build our cash flow as high as we possibly can to build our net operating income to as high of a level as we possibly can.

CHAPTER 23

KEYS TO EFFECTIVE MANAGEMENT (TIPS FROM THE STREETS THAT WILL SAVE YOU THOUSANDS OF DOLLARS AND MULTIPLE HASSLES)

What I'm about to share with you will be some tips and strategies that I've learned the hard way. You're going to find none of this being really rocket science kind of stuff; however, some things to keep in mind as you manage your properties. Remember, the goal is to make it as easy and hassle-free as possible while building your wealth and your cash flow as quickly as possible.

Tip #1: Not letting the first warm body that walks in the door rent your office space, retail space, or apartment. You know, we're all busy people with busy lives and it's easy to want to get the leasing process behind us, whether it is a commercial or residential property. It's very tempting that once we do have someone that says they're very interested in our property to go ahead, meet them, lease it to them, get it behind us, and move on with other things that we've got going on that seem to be very important to us at the time. Bad decision. You make this kind of decision and you go through the process like this and you will pay for it dearly. Mainly through-uncollected rent and damage to your commercial property and/or residential property.

One of the biggest mistakes you can make is letting the first warm body that walks in the door that wants to rent the apartment and/or commercial space and let them rent it. Whatever you do, make sure you do the background checks, application checks, criminal records, credit checks, etc. By taking your time and doing it right and putting each applicant for your space or apartment through this process, you will save mountains of hassle and thousands of dollars in cash flow. Put it this way, it's just like spending a little bit of time and a little bit of money to save a huge

amount of time and a huge amount of money. If there's any time that I've been burned, it's been by not adhering to this simple strategy. So please, if you get nothing out of this book at all, keep this strategy in mind because it will save you tens of thousands of dollars and hundreds of hours of time.

Tip #2: Apartments do have a small advantage over commercial property and leasing. I've said it before in this book that apartments do have an advantage over commercial property during the leasing process as far as how long it will take to lease an empty apartment versus an empty commercial space. Bottom line is there are more people looking to rent an empty apartment than to rent empty office space. So, from a management standpoint, there's somewhat of a risk and a cash flow factor to keep in mind.

Obviously, when you have a 24-unit apartment building and you have one vacancy, it's not going to hurt you as much. Plus, you should be able to lease it pretty quickly. However, when you have a 4-tenant office building and you lose just one of those tenants, all of a sudden you have a 25% vacancy and it will take longer for you to fill that space. However, on the flip side, your office buildings will provide you with less management hassle. Typically, the tenants will be able to take care of their own business and you (or any management that you have in place) will be bothered once in a while, if at all during given week or month.

With apartments there's more management, it's more intensive and it requires more attention. Bottom line, think of your lifestyle, think of what's important to you, and think of your risk tolerance. If you have plenty of time or you're going to have management set up that has plenty of time to take care of apartments, fine. If you don't have plenty of time and you don't have management that's willing to take care of these things, you may want to steer more towards the commercial end versus the residential end of investment real estate.

Tip #3: Using tenant services. You're going to find tenants in really three ways for your apartments and commercial buildings. 1: You or the management that you have in place will find them. 2: Hire a real estate broker to find them. 3: Hire a tenant to find them.

A tenant service is a service that is usually local and specializes in directing tenants to your apartment building and/or commercial property. Many of these companies only specialize in one or the other areas. So, you may have tenant services that just do apartment properties or you may have tenant services that just do commercial properties. Rarely do you find tenant services that will do both. Mostly and in most market places, they do specialize in residential. These tenant services typically do not charge you a fee; they charge the tenant a fee. The fee is paid for convenience.

In other words, the tenant service basically says to the tenant, "Hey, Mr. and Mrs. Tenant, give us an idea of what kind of apartment you want to lease, we'll go out into the market and find it for you, you don't have to spend your time looking for apartments, we'll do it for you, give you a list once a week, you go check it out, and more than likely you'll be able to lease at least one of those units." If the service is free, it makes sense to register your apartment property with these services. Check your local internet search or ask around, you'll be able to find them and if you can, I suggest using them as much as you possibly can.

Tip #4: Have a system in place for finding and locating tenants.

If there's another big mistake I find many owners making is they do not have a system in place to find tenants. They wait until they have a vacancy then they come up scrambling trying everything they can to find a tenant as quickly as possible, wasting a lot of time and a lot of energy. However, if you have a system in place to find the tenants, it makes it so much easier.

If you own a commercial property or plan on owning a commercial property such as an office building, retail center, strip center, single-tenant building, etc., I recommend hiring a competent real estate broker to lease the space for you. Even though this will cost you money via commissions, hiring a competent real estate broker will not only give you good cash flow, but will also raise the value of your property by getting the property leased at the highest possible rental rate that's available in your marketplace at the current time. Plus, competent real estate brokers, especially commercial real

estate brokers, have systems already in place that they use to get your space leased, saving you a lot of time, headache, hassle and frustration. In other words, it's worth the commission that you pay and even more so, based on what they can bring to the table.

One caution: Make sure that you are dealing with a competent real estate broker that thoroughly understands leasing commercial real estate and has a system in place for such. If you don't do this and you use "Betty Open House", it will be a huge detriment to you and will cost you literally thousands of dollars in value and cash flow. Don't be cheap on this and use your common sense. Typically commercial brokers with the designation of SIOR or CCIM are usually the best ones to use. They typically know the market better than anyone else, have the connections, and have made commercial real estate their career. Search out these people, find them, build relationships with these people, and you'll find your space being leased much quicker than you ever thought possible.

If you plan on leasing your commercial property yourself, let me give you a quick checklist of places to look, check and ferret out possible tenants:

Tenants residing close by to your building. Probably one of the best prospects for your space that you'll have for lease will be a tenant that are either right next door to you or close by to you.

Many of them have solidified locations that their customers are aware of and don't want to move very far away from where they're currently located, but many times they may need more and/or less space. That would be the first place to start is getting in touch with them.

Tenants in that category. In other words, if you have an office building and you had a couple of doctors renting from you and they used it for medical space, then a logically good place to check for possible tenants once they vacate would be physicians. If an insurance leased your office space and have moved out, a good prospect would be other insurance companies or related, like financial planning, etc.

Chamber of Commerce. Many of times it's worth it to be a member of the Chamber of Commerce because you have access to the Chamber of Commerce mailing lists. Most every business located within your community is probably going to be a member of the Chamber of Commerce. So, for a couple of hundred of bucks a year, you have access to a mailing list of thousands of possible prospects for your property. Not a bad investment. So, I would recommend exploring using the Chamber of Commerce list as well.

Signage. If your building is in a high-traffic retail or office location, signage can help tremendously. I'm not a big fan of signage being the all-knowing problem solver for getting commercial space leased; however, if you've got 20,000+ cars a day going by your space, having a sign in front of your office space, retail, industrial property, etc., would probably be a very good idea.

If you do this, don't be cheap about it. Plan on spending the necessary money to make a nice 4' x 4' sign with a description of your space, how many square feet available, contact information, when available, etc. Whatever you do, don't use one of those small, cheap yard signs they never work.

Online advertising. Small classified online ads for your space is not a bad idea, it's usually pretty cheap or free to run them and you can usually get some pretty good leads. In your ad, tell as much as you possibly can about your property to save time and phone hassle for yourself.

Don't hide a bunch of things just to get some phone calls.

Remember, you're in the business of leasing your real estate; you're not in the business of capturing prospects and trying to convert them into customers or clients to lease or buy more real estate. Most real estate brokers are trained to give as much information as possible without giving away all of the information to produce phone calls that produce leads for them. That's not the case for you. Make sure that you have as much description about your property in the ad as possible as far as location, square feet available,

price, etc. That way you'll know when people do call, they'll already have been pre-qualified before you get on the phone with them.

By the way, if you plan on having a management company manage your commercial property or even residential property for that matter, make sure that they have some kind of system in place for generating tenants that will look consistently at your space and/or apartments. You will want to specifically ask what kind of system they have in place before you employ them at all. If they look at you with a blank stare and wonder what you're talking about, get up out of the chair and run as fast as you possibly can until you find someone who has an idea of what you're talking about.

CHAPTER 24

WAYS TO GET TENANTS FOR YOUR APARTMENT PROPERTIES.

If you're planning on managing your own apartment property or having a manager in place as being a resident manager, some things to consider about having your apartments leased as quickly and with the least amount of hassle as possible.

Existing tenants. Probably the best source for a good tenant and which is really the most overlooked source by most owners are the existing tenants. When you have a vacancy coming up, offer the tenants some kind of a bonus or a premium for giving you a referral. This is fantastic, especially if it comes from a good tenant that you like, pays their rent on time, doesn't cause you a problem, etc. Many owners never ask their existing tenants about possible referrals. Don't make this mistake, make it the first thing you do once you know you have an opening coming up in your apartment property.

Signage and advertising. Make sure you have a nice sign placed in front of your apartment property with a telephone number, and a brief description such as: 2 bedroom, 1 bath, all utilities paid, \$535 per month, dial: 555-6665. Once again, in your ad online or even in a newspaper, you want to make sure you tell as much as you possibly can to screen as much as you possibly can. I suggest making sure that you at least at a minimum tell how many bedrooms, bathrooms, size, utility structure (who pays what), garages or other amenities if any, rental amount, and location such as NE side, SE side, etc.

Leave a message. There's nothing worse than being tied to the phone 24 hours a day. If you plan on managing the property yourself, most owners think they've got to be tied to the phone 24 hours a day to answer phone calls from possible tenants that will

want to rent their apartment. That's the old school way of doing it. Of course, if you have a resident manager in place, make sure that the calls go to the resident manager and then they can answer those questions. By the way, make sure the resident manager understands what their responsibility is regarding this. It does no good to spend the money on generating calls that goes to a resident manager that isn't there, is lazy, and never returns any phone calls. That's just a huge waste. You may want to think about their compensation being tied with re renting the apartments as well so there is some incentive on being on the ball and return and take phone calls on empty apartments as they become available.

Anyway, if you plan on taking the calls yourself, what I would suggest you do is set up a separate phone line either in your home or in your office. This phone line is now known as the "rental phone line". That's all that's it's going to be used for. In all of your rental activities with your existing tenants, new buildings you acquire, etc., this is the phone line that you use. This will also be the phone line that you use in advertising or marketing your apartments. Once a prospective tenant calls, here's what I would suggest your message would be, "Hi, and thanks for calling. If you're calling about the 2 bedroom apartment we have for rent at 1315 Maplewood Dr. NE, that's 1315 Maplewood Dr. NE, in Cedar Rapids, I'd like to tell you a little bit about it. It's a 2-bedroom, 1 bath, and 900 square foot home with a one-stall attached garage. It has gas heat, central air, a dishwasher, and garbage disposal. We have recently replaced carpet and linoleum in the property and it's in a nice, clean, quiet area with good neighbors and it's been well maintained and well managed over the years. The rent on the apartment is \$625 per month; the deposit is also \$625 per month. It will be ready for occupancy as of September 1st. I'm sorry, but at the current time, we do not accept any housing assistance, or any pets in the apartment and it is a non smoking apartment. So, if this apartment sounds like something you would have an interest in, we recommend you take a drive by at 1315 Maplewood Dr. NE and get back to us for a private showing. Our number once again is: 319-555-2222. Thanks for calling and leave a message after the tone."

Now, what have you just done? You've just given the prospective

tenant all the information they need regarding your apartment that you've got available and it's all been handled by the answering machine or your voicemail and you didn't even have to be there. You've also screened the tenant. You notice in the above example I said there was no housing assistance and no pets, so right away if someone has a 100-pound dog, they know they won't be able to lease your apartment. You also know if someone is requiring housing assistance, they also will not be able to lease your apartment. This is a good tool to use and it does the screening for you.

If you use this method - which I do recommend you do - make sure that you at least get back to prospective tenants that leave a message, at least once a day, preferably later in the afternoon or early evening, because if they've heard the description, and have actually driven by the property and want to take a look at it, then whatever you do, get back to them because you know that they've jumped through a few hoops in order to get to this point.

Showing the units. Whatever you do, don't schedule separate showings at separate times. Let's say you had five possible tenants that have an interest and said they wanted to look at your apartment you had for rent. Make sure you schedule the showings at one time versus separate times. You want to do this for two reasons.

- 1: No shows. Make sure you understand that 50% of all the tenants that say they will meet you at an apartment property at a certain time to look at it will not show up. In the meantime they've changed their mind, they found another apartment, they forgot about it, etc. So, you'll want to schedule everybody at the same time simply because you will have your full share of no-shows.
- 2: Competition. If there are three-five tenants that show up at the same time and look at the apartment and each want to complete applications you've got a sense of competition going on, which helps you get a lease that much more quicker.

CHAPTER 25

BOOKKEEPING, CHECK WRITING, RECORD KEEPING, THE BIG TIME DRAIN.

Many times when you think of investing in commercial real estate and how much time may actually be involved, you look at it usually one of two ways. One way is of course having a resident manager or a management company handles the property for you. If that's the case, usually in the case of a management company, they will go ahead and take care of the bookkeeping for you. With a resident manager or if you manage the property yourself, you're going to be the one that takes care of most of the bookkeeping.

Are you aware that the activity that takes the longest and will take the most of your time if you manage a property yourself will be the actual bookkeeping?

It's true, keeping track of the bills, writing the checks, tracking income, expenses, etc., will be the most time-consuming part of the management job. The interesting part is no one really realizes it until they manage their own property. There's actually an advantage to this and one of the reasons why I recommend you manage your own property in the first place, at least for a while, is to get an idea of what's involved in the bookkeeping, get an idea of what's involved in keeping track of the income and the expenses, writing the checks, knowing where the money is going every month, etc. It is an advantage; however, do keep in mind that the most time-consuming part of this is the bookkeeping. Of course, as I've said before, if you have your property managed by a management company, they'll do the bookkeeping for you.

CHAPTER 26

FINANCING STRATEGIES FOR COMMERCIAL REAL ESTATE.

The myth and reality of no money down buying commercial real estate. This is an important topic that needs to be discussed because there are so many myths out there about no money down transactions. First, let's talk about the definition of no money down since this is a questions I am asked about frequently.

Definition A: No money down means no money at all, in other words the seller of the property collects no cash whatsoever from you or any other buyer to make the transaction happen.

Definition B: Definition B is where the seller receives cash but it's not from you. You get the cash from somewhere else, usually by borrowing it against something, whether it be a credit card, a signature loan, friends, family, whatever, you borrow the money from somewhere else so it's really a no money out of your pocket transaction, but not necessarily really a no money down transaction.

Rarely will you find a transaction in the world of commercial investment real estate where the seller will accept absolutely nothing for down payment. I'm not saying that it isn't possible; however, spending your time solely focusing on this and this alone will make you miss many an opportunity. And I'll talk about why that is in just a moment.

When it comes to low down payments where you get the money from somewhere else is in my second definition, that's more possible; however, please keep in mind the majority of commercial investment real estate owners don't want small down payments. Most of the time they're going to want to be cashed out of their real estate if they do sell. I'll share with you some specific strategies later that will get us there without taking a lot of money out of our pocket.

However, one thing that needs to be mentioned about no money down real estate. Please, please, please understand that 99% of the time, if the owner is willing to take no money down, it means that there is a big problem with the real estate and it is a big problem that you don't want to inherit. So, don't get solely focused on finding no money down real estate and buying a property solely by the fact that it is no money down. That doesn't guarantee you anything and like I said before, it will mainly guarantee you problems. Most no money down real estate have bad property problems, bad locations, bad tenants that will never improve, the property needs tens of thousands worth of work with Housing Authority or Building Inspectors ready to crack down at any minute. The owner understandably just wants to get out, but just wants to unload their problem onto somebody else, which could be you.

Before you get involved in any kind of no money down transaction, make sure you do a thorough analysis as I've described earlier in this book. It's very important to do so.

Put it this way, if I owned one of the nicest office buildings in the city, and it was in one of the best locations, why in the world would I want to sell it for no money down when I've got people lining up ready to buy it? That's just it; most of the really good commercial investment real estate is not the no money down real estate kind. But, don't panic, I will share with you some strategies that can help lessen the down payment, lessen the blow and make the property very profitable for you.

There are typically four financing situations.

All cash. Well, technically all cash is not a financing situation; however, there may be a time where you have enough cash built up in an account where you just want to pay cash for a property. It's a possibility and yet one of the ways that real estate can be bought.

Conventional financing. This is when you go to a bank or mortgage company and get a loan to purchase the property. They'll finance

a certain percentage of it - usually around 75% - and will ask you to come up with the other 25% in down payment.

Owner carry back. In this example, the owner is willing to finance part of maybe most of the property for you. In other words, instead of going to the bank to get the financing, the owner will loan you the money and accept a smaller down payment.

Combinations. Combination financing is used widely in the commercial investment world and it takes into account really all three of the above in many instances. I'm going to talk to you about combination financing where we can also, for example, get a conventional loan, while also having an owner carry back as well, combining #2 and #3 to put together a profitable transaction together for us.

Ok, before we go any further lets go over some terms that you are going to need to know so that you can talk intelligently to the lenders, loan officers and the appraisers. Many times when they talk to you about a specific project, you may be thinking about purchasing some of these terms may come up, so at least you'll have an idea of what they're talking about. Once you've shot these terms back and forth between each other for a while, and after you've gotten used to them, you'll get an idea of exactly what they are and how you can respond and understand exactly what the lender may be telling you.

LTV or loan to value. LTV or loan to value is the percentage that the bank is willing to lend on a specific piece of commercial investment real estate. Most of the time banks and mortgage companies will lend 75-80% loan to value on the property. In other words, if it's a \$100,000 property, the bank or mortgage company will lend \$75,000 or \$80,000. Remember, it's called "loan to value". What that means is that the loan is based on either the appraised value of the property or the purchase price whichever is less.

In the glory days of the early 1980's, you used to be able to get loan to values based on appraisals and it didn't matter what you paid for the property. So, if you paid \$100,000 for the property, but

the property appraised for \$200,000, the bank would loan you everything you need and you wouldn't have to come to the closing table with any down payment. Heck, you could have even walked away from the closing with money in your pocket!

Well, as you may know, in the early and mid-1980's, with the S & L Crisis, that created a huge problem for lenders, so because of that, they no longer have that policy. (Once in a while, you may find a bank that is willing to work with you on this, but it is rare.) So, what that means to you is most commercial investment real estate properties that you look at when you want conventional financing involved, they're going to be using the loan to value ratio, which is usually 75-80% of the property's appraised value or purchase price, whichever is less.

DCR or debt coverage ratio. You'll hear a lot of lenders talk about debt coverage and it's really a simple term actually. All debt coverage is cash flow. It's really the spread between the net income the property produces and the loan payments.

You see, lenders want to make sure they've got plenty of cushion so they want to make sure there's plenty of room between the net income that a commercial investment property is going to throw off and the debt service or the mortgage payments. If those numbers are too close, the lender's not going to be comfortable financing the property because they're going to think there isn't as much cash flow there. If there's a big difference, they'll feel more comfortable. Most lenders will want to use what's called a 1.2 debt coverage ratio. Where's the 1.2 come from? Well, you simply divide your annual mortgage payment or your mortgage payment times 12; you divide that by the annual net operating income of the property. Let's take a look at a couple of examples.

Debt Coverage Ratio Examples...

Annual Mortgage Or Loan Payment \$12,222

Net Operating Income Of Property \$16,322

Debt Coverage Ratio $\$16,322/\$12,222 = 1.34$ Debt Coverage Ratio

Annual Mortgage Or Loan Payment \$10,123
Net Operating Income Of Property \$12,329

Debt Coverage Ratio $\$12,329/\$10,123 = 1.22$ Debt Coverage Ratio

Commitment fee. Many times when you work with lenders, they will be happy to finance your property whether it be a refinance or an acquisition; however, once they give you a loan commitment and tell you the exact terms that they're willing to loan on, those terms are only good for so long. Why? Because the market is changing every day. Interest rates, terms, etc. are changing all the time. So, what a bank says they'll do for you today, necessarily won't be what they'll do for you tomorrow. So, to overcome this sense of being unsure what to expect from the bank from day to day, you can lock in the terms the bank has given you usually by giving them a commitment fee which is usually a percentage of the loan amount.

For example, let's say a lender has agreed to give you a \$200,000 loan at 6% interest, 30 years, and your payments are \$1,722 per month. This all sounds good to you and you're ready to move on it and you would like to lock this in. However, the lender says in order for you to lock this in, they do require a 1/4% commitment fee which is 1/4% of the loan amount. Once you pay this commitment fee, you usually lock in for a certain period of time, usually for 60-90 days.

When shopping around for lenders, make sure that you understand that there may be a commitment fee involved. It's not necessarily a bad thing that there is a commitment fee involved as long as the lender does a good job for you. But, you'll want to know this upfront rather than finding it out at the last minute. Some lenders don't require a commitment fee, others will. It's good to know if they will or not right up front.

Rate lock. Interest rates are very important. Obviously, the lower rate you can get for yourself, the better off you're going to be.

However, as with a commitment fee, rate lock is really the

same thing, interest rates go up and down every day, so you'll want to lock in your interest rate as soon as you can for the lowest amount possible. This usually is in the form of using a commitment fee to do so. So, quite simply, when a lender asks you if you want a rate lock, he's asking you for a commitment usually of some funds to lock the interest rate in for a certain period of time, usually for 60-90 days, even up to 120 days.

Owner carry back. Owner carry back is when the owner is willing to loan you the money to buy his or her property. The owner carry back can come in many different forms that I'll discuss later. However, what you need to know about owner carry back now, is that instead of going to a bank or another lender, the owner, him or herself will loan you the money to buy the property, either a small or large amount. Other places it's called owner financing, contract for deed, etc. They all basically mean the same thing; the owner will finance the property for you either all or part. We will get into strategies on how to work with that if an owner does have the ability or desire to finance the property with you.

The most important piece of financing advice I could give you.

The most important piece of financing advice I could give you has nothing to do with a weird technique, wild strategy, or even some whiz bang new method of buying commercial investment real estate. It has to do with lenders. You need to face this fact. If you already own commercial investment real estate, you know this to be true. If you don't, you will find this to be the case.

What am I talking about?

Well, at some point in time, you will need to work with a lender to buy and/or refinance any commercial investment real estate that you decide to own. That's a given fact. Eventually that's going to be the deal. So, anything that you can do to align yourself starting now with a good, competent commercial investment real estate lender will lead you down paths that can be very profitable for you; however, you need to forge the relationships with these people now, not when you need a loan within one week. Think of it this way,

you want to be in a position where you pick up the phone, call your lender and say, "I'm going to be buying an office building, are you ready to loan me the money?" And when the lender says, "Yep, come on in, let's do the deal." You know you've got the relationship down pat.

Well, if there's one skill or strategy that has benefited wealthy commercial investment real estate investors very well is the ability to work with lenders and lenders understand exactly what they're trying to accomplish. But let me tell you this, it's not easy. Why? It's very difficult finding a lender that knows what they're doing and understands what you want to accomplish.

So, to shortcut the situation, let me give you some things to look for in lenders when you're shopping around trying to find a lender to build a relationship with.

1: Ask commercial real estate brokers. Once you've lined yourself up with a good real estate broker or brokers, ask them whom they think you should go to talk to about financing. Ask around. They'll tell you whom you need to go to. Let's face it; commercial real estate brokers have a large frequency of transactions, so they are going to know the "go to guy" is in the market for commercial real estate loans. That would be the first source.

2: Other commercial investment property owners. Once you've networked with other commercial investment real estate owners, ask them whom they use for their lenders. They'll tell you. Take note, after a while the same names are going to come up over and over again. Start at these two areas first. Whatever you do, don't just go online and start calling people. Get a list of about three or four good lenders that you heard their name over and over again and ask for specific people, not specific banks or mortgage companies, ask for specific people to talk to. Then, make an appointment to sit down with them, tell them what your goals are and what you want to accomplish with your commercial investment real estate investments and see how they take you. See if they're willing to work with you or not.

What do I mean?

There'll be some lenders you'll get a good feeling of after talking with them; you'll get a feeling that they do want to help you and do want you achieve your goals. There'll be others that will give you the impression that you're not worth the time of day and they've got better things to do. Take note: The ones that are willing to work with you and have an interest in helping you are the ones you want to start a relationship with. Once you meet with them, get an idea of what their structures are; what's their loan to value, what's their debt coverage ratio, what would they prefer, and when would they be willing sometimes to bend the rules a little bit? Because most lenders can and do have the ability to bend the rules a little bit on things like loan to value, debt service coverage ratio, etc., based on the merits of you and the property.

What do the lenders actually look for when it comes to making a decision to loan you money? Lenders will look at three things.

1: Property. The main method of loan repayment is going to be from the property, so it better darn well cash flow. That will be the first method they are going to use in figuring out whether or not they want to possibly finance this project, so of course the property does need to cash flow.

2: You. They'll look at the second method of repayment from you. In other words, what if the property goes bust, what if there are large vacancies, what if there's an economic downturn, does the buyer (you) have the ability to keep the property afloat for a while based on your current income and financial situation?

3: Character. That's right, I said character. What does that mean? What they'll do is they'll take a look at your credit report, have you fill out a loan application and just see what kind of a person you really are or have been in the past. If they deem that you have the character in your personal, financial, and professional dealings that will also play a factor in it as well.

The most popular way to finance commercial investment real estate IS??

Equity. That's right, equity. If I look at all the transactions I've been involved in over the last 20+ years with all of the commercial investment real estate investors, I would tell you that there's one method of financing that more than any other is the most popular and that is using equity.

What do I mean?

What I'm talking about is using equity in one property as down payment to purchase another property. The equity can be another commercial investment property, recreational property, your own home, etc. In other words, borrowing from one property to get the down payment to purchase another.

Here's what a typical scenario will look like.

Let's say you want to buy a single-tenant office building and the owner is asking \$600,000 for it. Here's what the transaction would look like if the owner says he wants to be fully cashed out of the deal.

A) The lender says they will lend you 75% of the \$600,000 or \$450,000 and they would ask us the borrower to come up with an additional \$150,000 in down payment. Where do you get it?

B) Well, you currently own an apartment building that has \$300,000 of equity in it. You approach the bank with this deal. Let them make you two loans. Loan #1: \$150,000 secured by your apartment building. Loan #2: \$450,000 secured by the office building you want to purchase.

So, in essence, you have two loans, cash flow from each property, the apartment building paying the \$150,000 additional loan, the office building paying \$450,000 loan to cover everything and the nice thing is, there is no real cash out of your pocket. You're borrowing using equity you've got in your commercial investment

real estate to grow your empire.

Speaking of growing your empire, as I've said, this is the most popular and efficient way to do it. Lenders understand equity and property; they understand cash flow. So, this is easy for them to understand and work with as well.

If you currently own one or more properties, make sure you are using the equity in those properties to leverage more real estate if the object is to grow your empire. You don't necessarily have to tap into cash reserves for down payment when you've got equity in other properties that will work equally as well, especially when you have enough cash flow from those properties to cover any additional loans that you may place on them.

Also, if you're looking to purchase your first commercial investment property, remember, the first one is probably the most important one you buy. I'm not saying that any other commercial investment properties you buy after your first one aren't important, but the first one really establishes your base. Once you've got the first one bought, your base is established, and you can start pulling equity out of that property as soon as you're able to leverage yourself to buy more property and grow your empire. So really you don't want to make a mistake on your first one because it'll take that much longer to grow your empire if you don't buy that first property right. Buying that first property right can make all the difference between growing your empire quickly and growing it slowly.

What lenders will require from you to underwrite the loan.

Here are the mandatory things a lender will require to underwrite any kind of loan they're going to give you on any commercial investment real estate you wish to purchase or refinance. Having these items ready and ready right away can cut the waiting time in half and give you more options if you choose to shop around.

Here is the list of exactly what lenders will want every single time you purchase a piece of commercial investment real estate property.

- 1: Current income and expenses of the property in question (property you want to buy).
- 2: Last two years of income and expenses on the tax returns related to the property you want to buy.
- 3: Your personal updated financial statement (what your net worth is).
- 4: Your last two years of tax returns.

That's it.

The nice thing about this really is it's much easier to qualify for a commercial investment property than it is to buy a single-family home. That's one of the weird quirks of the lending world, since they basically make their loan based on the property's performance and you and your financial condition, that's all they need to know. They don't verify accounts; they don't go around and have 25 people sign a document saying you're a good person, etc., like most personal resident's loans require. It's actually much easier to get a commercial investment loan as long as you have the above items ready to go and ready for the lender to take a look at.

A quick note: When you have these items available, it makes you look very professional at what you do, it makes you look like someone that knows what they're doing and that instills confidence in a lender, so anytime you can have these things available, it does nothing but help you in your current situation of getting a loan.

Ways to minimize down payment.

- 1: Simply ask for lower down.

Many times investors will take what a seller has at face value and not offer the kinds of price and terms that the investor's willing to buy under. In other words, if a property is listed for \$600,000 and the seller wants all cash, many buyers think that since that's the case

with a high asking price is high and/or it does not look like the seller will do any financing then most investors choose to move on.

However, before you do, one thing to think about is that things change. In other words, when the seller initially put his or her property on the market, indeed that's probably what the seller wanted to accomplish get \$600,000, have an all-cash sale, and be on their way. However, things do change and many times they change right when the property is for sale. And, you never know what it could be, it could be a family emergency, death of a loved one, a tenant problem, etc., that would make the owner maybe think twice about possibly selling to you with a lower down payment and maybe the owner doing the financing.

Now, don't get me wrong, 95% of the time, when the owner says they want all cash in their price, they're going to want all cash and probably something pretty close to their asking price. However, if the property is something you're very interested in and it's something that you think would work well, but the only way you can swing it is to have the seller do some financing for you, offer the seller a deal where they do the financing at least all or in part. A good way to shortcut this and shortcut the time involved is have your commercial real estate broker that represents you just simply call up the seller or the seller's real estate agent and basically say something to the effect of, "Look, I've got this buyer who's a good buyer that's wants to buy your \$600,000 listing. He wants to put \$75,000 down and have the owner carry the remaining balance on a 20-year note at 6% interest, with a 10-year balloon payment. Do you think this is something the seller would accept?" The agent representing the seller will have a pretty good idea of what the seller will want to do and will either say no, yes, or I'll check into it and get back to you. Of course, if the feedback is positive, it may be something you'll want to pursue.

The moral of the story is: Don't be afraid to offer something that makes real good sense to you. Remember, you're the one buying the property and asking for lower down payments is a good way to leverage yourself especially by using positive leverage in growing your empire.

2: Second mortgage.

Many times if the seller isn't willing to finance all of it for you, many times the seller will finance at least a portion. That's where the second mortgage strategy comes into play. This strategy works very well and it's good for all the parties involved; it's good for a lender, it's good for the seller, and it's good for you because it lowers your down payment that's required. The benefit to the seller is they get, in the example that I'm going to give, 85% of their purchase price in cash and the other 15% get paid to them over time. The lender is happy because they've got a 75% loan to value on the property and they're in the first position, so heaven forbid something were to ever happen they would be able to get the property back and be in the first position to do so, foreclose and take back the property. So, they should have a comfort level with this as well.

So, with that being said, here's how you approach it.

Let's say you have a \$100,000 property and it's a four-plex. You've done the research and you've had your commercial real estate broker or yourself and talk to the seller or their agent and you've found out that the seller would like to cash out, but may have an interest in carrying a small part of that asking price over time - five-seven years, let's say.

Here's how you would structure your offer: \$100,000 in price, \$75,000 first mortgage obtained from a lender at 6%, \$10,000 second mortgage to be carried by seller at 5% interest, 30-year amortization, payments to be \$53.68 per month with a seven-year balloon (cash out). (* Note: Cash out and balloon means that the loan needs to be paid off in full on or before this date.) Down payment \$15,000 from you, total: \$100,000.

You see, you've just gotten into this \$100,000 property, gotten bank financing, and have gotten the seller to contribute to the financing as well and gotten into it for 15% or \$15,000.

Remember, most banks require a 25% down payment, but in this

example, the bank should be satisfied because they have their 75% loan to value met. This is a good strategy to use to leverage your empire and to grow your empire and it works on all kinds commercial investment real estate. The seller is really the one that has the most risk here, but in this case, the seller's only risking \$10,000 and the likelihood that they would have to reclaim their property just for \$10,000 is probably pretty slim. Plus, they're getting \$75,000 from the bank, plus \$15,000 from you for a total of \$90,000 in cash. They get 90% of their purchase price in cash at closing and the other \$10,000 they get to carry over time. It's a small low risk deal for them.

3: Borrow down payment from equity.

Make sure you check out the prior section on how I describe using equity for down payments. Equity is the best leverage that you've got in using down payments for a lot of reasons, mainly because bankers understand it and it doesn't require any cash out of your pocket as well. Also, among millionaire commercial real estate investors, it's the preferred way of growing their empire.

4: Credits at closing from rents and tax pro rations.

Earlier in this course, I talked about getting credits at closing when you buy from using rents and tax pro rations. It's worth mentioning again. This can reduce your down payment substantially if you time your closing correctly. The nice thing is you can combine this tax credit and rent pro ration strategy along with the second mortgage strategy and reduce your down payment even further.

A note about leverage: When I use the term leverage, I mean borrowing. In other words, using other people's money to buy the property. Leverage is a double-edged sword and you need to realize this right up front. Good news of leverage is it helps you buy a property without having to come up with all cash. Obviously it's easier to borrow money and buy a \$100,000 property than to come up with \$100,000 of all cash. However, understand the more debt-service that you have to pay (i.e.: the higher the mortgage payments

you have) the less cash flow you're going to have. That's well and good until problems occur. Problems such as maintenance, repairs, unexpected damage or repair problem, etc.

The Truth: Make sure you're comfortable with your margins, no matter how much leverage you're using. Make sure that under worst-case scenarios, you feel at least somewhat comfortable that if you had to make the project work, you could make the project work. If you look at the property and after taking into account all of the different kinds of leverage you can use and you don't have that kind of comfort level, you need to either: Find more equity somewhere and lower the amount of debt you have on the property or look for another property.

Commercial investment real estate is a whole different ballgame than single-family homes. Many of the people that you hear about buying no money down and making huge profits are usually doing it through single-family homes or small apartment buildings. What you don't hear about are the countless people that have done this and have lost many thousands of dollars, many hours of time, and even may have had to give the properties back to the bank or to the owners. I want to make sure you don't become that statistic and you use your common sense in analyzing the properties to make sure that it's going to be one that going to be a good short and long term investment for you. Leverage is a fantastic tool to use if it works. Just make sure you spend the time in analyzing the property to feel comfortable that it's going to work.

If it's no money down, there's usually a reason. I've mentioned this before, but I want to talk about it just one more time. Scores of people go out into the marketplace and buy commercial investment real estate looking for that no money down deal and buy the property simply and only because it's a no money down deal. Not because it makes great financial sense, not because it's in a good location, not because it could be a good wealth builder, but because it's no money down. Usually there's a reason why properties are no money down deals. 99% of the time, they're bad reasons. I've seen people get into no money down deals into properties where tenants haven't paid rent for months, they have to evict 20 out of 24 units, people are

selling guns, selling drugs, etc., out of the buildings. I've seen people buy no money down deals where the building was in such disarray that the building inspection wanted to condemn the property.

Remember, there's got to be a reason why it's no money down and usually the reason is not good for you. Now, having told you all of this, do I think there's opportunity to find a good no money or low money down deal in the commercial investment real estate marketplace? The answer is absolutely yes. But please, do not buy a property just for the sake of buying it with low or no money down, do all of the analysis strategies that I talk about in the buying part of this system. If you do, it will be a profitable transaction with no surprises.

CHAPTER 27 (BONUS CHAPTER)

ENTREPRENEURIAL LESSONS AS THEY RELATE TO COMMERCIAL INVESTMENT REAL ESTATE.

Lesson #1: How to build the empire - the best approach.

There will be some that purchase this book and purchase commercial investment real estate whether it is apartment buildings, strip center, shopping centers, single-tenant office buildings, etc., that are looking for just one or two buildings to add to their portfolio of investments to diversify. That's well and good and there's nothing wrong with that. However, there will be others that buy this that want to use real estate as a base to building their wealth and to build their wealth as quickly as possible, while using real estate as the sole base for that wealth building. If that's the case, I applaud you and I want to share with you the single most productive strategy that I have used and I have seen used by millionaire commercial real estate investors that I have worked with over the years.

Sometimes they say the most effective things are the simplest things to explain and to understand. I have referred to this strategy a few times in this book and I'm going to refer to it one more time and explain in a little bit more detail some of the thoughts behind it.

The biggest, most successful strategy that I have seen millionaire investors' use is they never sell.

That's correct, they never sell. They buy and they hold, and they do not sell their properties. Why does this work so well? There are two reasons why this works so well.

1: You're earning money every single day.

Think about it, every single day that goes by when you own

commercial investment real estate, you're making money. You're really making money in three ways. One is appreciation. Commercial investment real estate over time appreciates every year. Now you don't usually get on average huge numbers - like 15-20% - but usually every year you're between 2% and 5% appreciation at the very least. So, every single day, your property is going up a little bit more in value, which means you're putting a little bit more in your pocket every day.

2: Cash flow.

Of course, your property is going to be producing cash flow for you every single day and that cash flow can be used for a variety of things; it can be used for personal, more investment, etc., it's up to you. But you've got an asset that's producing cash flow for you every single day and every single day you're pulling a little bit of money out of that property.

3: Principal reduction.

If you get a loan on your property to purchase or loans, every day that principal amount is going down. So, the nice thing is, the value goes up, the property produces cash flow, and the principal balance on your mortgage is going down every single day. Do you see how combining these three easy to understand principles can make you a lot of money over time? Can you see that if you have more than one property, i.e.: multiple commercial investment real estate properties, how this can exponentially expand and increase your wealth? There are not many other investments that you can get involved in that can do these kinds of things for you.

Secondly, the ability of leverage. The ability of quick empire growth. Another main reason the millionaire commercial real estate investors never sell their properties is they use their properties they already have to borrow money to buy more. I've covered this equity strategy in detail in the buying section and the financing section of this system. But, it's worth repeating one more time. What literally happens is: Joe Millionaire investor starts out by buying his first 8-plex. He owns that eight-plex for a couple of years. He finds an

office building that he wants to buy. He approaches his banker and says he wants to borrow the down payment from the eight-plex he bought two years ago. The banker says that's fine. He's just purchased his office building. He's owned his office building for two years; he finds a 72-unit property he wants to buy. He approaches his banker and says he wants to borrow money from his office building as down payment to purchase this 72-unit property. The banker says that's fine. Etc., etc. Do you see how the empire can grow by being proactively involved in taking equity out of one property and putting it into another?

This is a huge advantage of never selling. You see, when you never sell your properties, the equity builds up a lot quicker and the empire also grows a lot quicker.

Lesson #2: Successful systems in place.

The most successful commercial investment real estate owners that I'm aware of have systems in place for everything. They have systems in place for bookkeeping, repair, maintenance, taking calls, showing units, dealing with tenants, etc. They've got it all down and planned out. In other words, they treat it like a business. Now, I'm not saying they have any fancy business model, a cool company logo, etc., I'm not saying this has to be Fortune 500 company, but what I am saying, is the most successful ones I've dealt have systems in place to deal with all of these things.

If the system needs improvement or tweaked, they go ahead and improve them as they go along. So, a smart decision that you can make right now is to think about setting up systems for your commercial investment real estate empire. If you already own property right now and have some systems that you think you could use and want to implement and think you should, by all means don't waste any more time and do it. If you haven't bought your first commercial investment real estate property yet, sit down and map out some systems on how you can deal with the things that bug you regarding your commercial investment properties. Once you have the systems in place, you'll find out (whether you own your properties now or plan on owning your first one) the properties will

literally run on autopilot without much being needed from you.

Lesson #3: Dealing with Tenants.

Whether you're going to be managing the property yourself, which I do recommend as you recall for at least a while, or have a property management company manage it for you, it's important you understand all the nuances in dealing with tenants. Understand that the commercial real estate business is a people business and people can be predictable and many times they can be unpredictable. The fact is, many of us have heard the horror stories, the apartments that they couldn't get tenants out for months, the damage, how tenants have destroyed commercial investment properties, etc. As I've said, we've all heard the horror stories from time to time. But, here's the good news: The majority of those stories are from the minority amount of people; I would conservatively say that 1% of the people (tenants) will give you these kinds of problems. The other 99% will not, they'll treat you and your property with respect.

So, what's the game and the goal? Do everything you can to screen out that undesirable 1%. Take the time to initially screen them, check them, do your due diligence to make sure that you are avoiding that bad 1% that would cause you problems. This may take a little bit more money, this may take a little bit more time; however, it's definitely worth it in the long run.

The other good news part of this whole thing is if you do this correctly commercial investment real estate wealth building, whether it be slow or quickly, will be a lot easier than what you originally thought it would be.

Lesson #4: Dealing with vendors.

If you either own or plan on owning a commercial investment property, more than likely you're going to be dealing with vendors. Just for review, vendors are people that do things like mow your lawn, remove your snow, remove your trash, clean your hallways, clean your building, do your bookkeeping, do your property management, etc.

Here are some things to make sure you avoid when it comes to vendors.

1: Avoid long contracts.

I have been burned on more than one occasion by an irresponsible vendor and had to fight my way out of it just because I signed a long-term contract. Of course, if the vendor doesn't live up to what they say they'll do the contract is not enforceable, but it's a legal nightmare and the process is a huge waste of time. Do yourself a favor when it comes to hiring a vendor; make sure you never sign a long-term contract. 12 months should be the longest-term contract you should ever sign with any vendor.

2: Always review their work, invoices, etc.

Many times we get locked into a vendor that we feel is doing a good job for us and many times they are. Many times we tend to forget about them, paying the bill once a month as it comes and sometimes not paying as close attention to it as we should be. Bottom line is making sure you're checking your vendor's prices versus what the competition's doing in the marketplace.

Now, there's a difference between using someone that's cheap and does a terrible job versus someone that's a little more expensive but do a good job. Obviously, you want to make sure you use the people that do a good job versus the people that don't do a good job. But, it is worth checking at least twice a year. Review your invoices, shopping them around, to see if you can get a better deal somewhere else. Why? It all comes down to the net income that the property produces. The higher the net income, the higher the property value and the more cash flow you're going to have too. So, if you can increase the value of your property simply by doing this twice a year, it's well worth it.

Lesson #5: Your first property is the most important one.

As I've mentioned in the financing section of the book, the first

property that you purchase is really the most important one. Now, I'm not saying that properties two, three, and four, etc. aren't equally as important, but if you sit down and think about it, the first property is the most important.

The main reason why is this is where you're going to be building your empire. This is where it starts a solid foundation, a solid base. If you make a mistake on your first property by either not doing the analysis property, buying for the sake of buying, etc., it could cost you not only money, but a lot of time. Look at it this way, if you don't correctly buy your first commercial investment property, it will not only cost you cash flow and value, but it will cost you years and years of time waiting for your property to appreciate so you can refinance, pull equity out and buy another one to grow your empire. You see that first property's job is really to grow your empire. So the game for you should be to get as much equity in that property as quickly as possible, pull that equity out and purchase another property. If you make a mistake on your first property by not following the steps I've outlined in this system, it will take you twice as long to grow your empire and ultimately twice as long to buy even your second property. So, take a little bit more time on buying your first one. Do a little bit more due diligence, ask more questions, do more probing, do a little bit more analysis, etc. and the pay off will be substantial.

Lesson #6: Do not buy just to buy.

It's amazing how many people set out to build their wealth with the thought in mind of building it as quickly as possible and run out there half-cocked, ready to buy something that half-way meets their criteria. A real big example is the no money down buyers. They go in search of a property that has no money down, once they find it, they buy just because it's no money down. Not paying any attention to the cash flow, equity, location, condition, etc., just because it's no money down, that's why they buy. Or the investor's that looking to buy a 5,000 square foot office building, looks around the market, spots a 5,000 square foot office building, buys it. Buying just to buy.

It may sound strange and for some of you, you may wonder what the heck I'm talking about and why in the world would anybody go out buying just to buy? Well, you'd be surprised. Many people do. Make sure you don't do this. Do the due diligence, do the analysis, follow the steps and the strategies I've outlined in this system, if you do, it will save you countless hours, countless frustration, and thousands of dollars in wasted money.

Lesson #7: It all starts with buying the property right.

Remember one thing, you want to make money when you buy AND when you sell, not just when you sell. If you follow this simple advice, you will do very, very well as a commercial real estate investor. Knowing when you go into a deal that you're making money at the closing table is not only a great feeling, but it also can help you build your commercial investment real estate empire quickly. Think of it this way, in the end when it does come time to sell your property - and that time will come some time - you're going to want to get the absolute highest price for your property. Who wouldn't? The highest possible price that you can get with your property when it does come time to sell is to make money when you buy.

Look for the opportunities that I've described within this book; look for the lazy owners, the bad management, and the lazy real estate brokers. That's where you'll find your opportunities. Hook yourself with a great real estate broker, one that can identify these kinds of properties and knows right away when a deal comes available and can call you and let you know about it. They are literally worth their weight in gold.

Now on to some basics to remember..

Selling systems and timing.

When it comes time to sell your commercial investment property, it really is all about timing and timing in two parts.

Part #1 is market timing.

Of course, it probably wouldn't be a good idea to sell your commercial investment property when interest rates are 28%, all of the commercial investment properties have 60% vacancy and city hall has just instituted a whole bunch of new building codes that you have to start enforcing, which means thousands of dollars go into the property. Now, don't worry, this probably won't happen I'm just giving you an exaggerated worst case scenario, but it is something that you need to be paying attention to: market timing.

Ideally, the best time to sell a property is when interest rates are low and demand is high. Even when interest rates aren't low (everyone has their definition of low and high), and the demand is there, you're still going to get a good price for your property. One of the keys you're going to make sure about is the demand. The demand does need to be there for your commercial investment property, particularly your niche property, being an apartment building, shopping center, office building, etc. Put it this way, when I work with sellers that have a property that have seven buyers that want to buy, the seller's going to get their price and usually more than their price.

Part #2: The sale from a property management standpoint.

In other words, you just don't wake up one morning; call your favorite real estate broker and say, "Hey, Jim I want to sell my commercial office building today." There needs to be preparation; you need to work on income, expenses. Quite simply, you need to raise that net operating income as high as possible, especially right before you sell the property. The good news is that it does not take that much work or effort and the little work and effort can pay off in literally thousands of extra dollars in your pocket.

So, remember this, there are two ways of timing when it comes to selling your property.

1: Market timing. Making sure that there's good demand for your property before you sell it.

2: Property timing. From a management standpoint. Make sure you have everything primed, pumped, and ready to go for that property

to be sold.

What About The Time Between Now and The Time I Decide To Sell?

I'm going to share with you now some strategies that you need to implement between now and the time you sell the property. Try to do whatever you can to give yourself a minimum of 12 months before you actually put the property on the market.

Strategy: Use new income and past expenses.

The nice thing about using income and expense information is you get to get by with a little bit of, shall I say, unfairness. Here's what I mean. What will typically happen is a buyer will take a look at your current income and expense information and then review the last two years of tax returns to support what you've given the buyer. That makes sense, sounds like something that's doable; however, here's a big benefit that you can use that can increase your price by thousands of dollars. What is it? Use the "new income". What do I mean by "new income"? You can use the rents that you're obtaining from the tenants today, not what they were last year.

You see, when property is analyzed, it's analyzed on a calendar year. For example, here's the property cash flow in 2015, here's the property cash flow in 2016, etc. But, if you put your property on the market let's say in April of 2017 and your rents have gone up \$50 a month per tenant, you can use the new rents to establish your value, not what the old rents were for the last calendar year, which in this example was 2016. So, bottom line, the nice thing is you can use the current income that the property is generating right now today when it comes to putting your Performa together to sell your property.

Now, here's the big benefit, you can also use past expenses. For example, let's say that your expenses in 2015 were \$12,000. At the end of 2016, there may be a property tax increase, your insurance may go up, your utilities may go up, etc., so potentially, you could be looking at expenses of lets just say \$14,000 or \$2,000 more.

Here's the good news.

You can use last year's expenses to establish today's value. Here's the example: We'll call this Office Building J. You plan on putting Office Building J on the market. Last year your gross rents over the year's period of time were \$50,000. However, this year, taking into account what the property is renting for right now, it looks like your gross rents are going to be \$60,000.

Now onto expenses.

Last year your expenses were \$20,000; however, this year, property taxes may go up, insurance, utilities, etc., so you could have expenses at \$30,000 this year. But, guess what? Guess what expenses you get to use? You get to use last year's expenses of \$20,000 even though more than likely those expenses are going to go up by the end of this year. In this example, by using the new income past expenses rule, you have earned an additional \$75,000-\$85,000 in sales price just by using this technique. Is this a great strategy or what? And by the way, it's not illegal. Appraisers appraise the property based on this information, lenders lend and buyers buy.

However, one fault that the market has that is in your favor as the seller is they take a look at this year's income, what's happening now, but they look at the past expenses, what happened last year. *Note: Of course if expenses in the last calendar year were much higher than they are this calendar year, you'll definitely want to make note of that and substantiate what you're new expenses would be if they in fact would be lower this year.

Do you see why you need a little bit of time to get this going? The time is well spent. Always remember, new income, past expenses, it'll earn you tens of thousands of dollars at the Strategy: Create new income sources right before you sell the property.

In the buying section of this book, I talked about what strategies you can use to substantially increase your cash flow right away when you take over a property.

We can also use those same kinds of strategies when we sell. Let me give you a few examples to think about and apply when it comes to selling your commercial investment property.

Laundry machines. Two things you can do here. 1: Put in your own machines and take out any leased machines. (See buying systems for information on how much cash flow this would be worth to you.) Let's say you're currently leasing your machines from XYZ Leasing Company and annually those machines pay you \$3,000 a year in quarters. Now, XYZ Leasing Company takes 50% of the income away, so what that tells you is if you had your own machines in there, you'd be earning \$6,000 a year in quarters.

Why not, right before you put the property on the market, get rid of the leasing company's machines, put your own machines in and pocket an additional \$3,000. How much could that be worth to you? Well, \$3,000 divided by 10% is \$30,000, so this could have up to a \$30,000 improvement to your value just by switching out your machines (as in this example). It's something to think about and run the numbers on before you sell and it could be a big opportunity.

The same goes for other things.

What about vending machines? That could be a new source of income that could add some net to the bottom line. What about building garages for apartment buildings? If you own an eight-plex and you have eight garages that rent for \$60 per month, that's \$5,760 per year. Now, that \$5,760 isn't all going to be net. Let's take worst-case scenario. Let's just say half of that is going to be net, if that's the case, you will net \$2,880. You divide \$2,880 by 9% and that gives you a value \$32,000 for those eight garages. I guarantee you that it shouldn't cost you \$32,000 to build them. Now you've basically made money out of thin air just by building garages.

Another example: Single-tenant office buildings. Let's say a tenant in your office building has mentioned a couple times that he wished he had a bigger location and a couple more square feet would really do the trick for him. Well, why don't you propose building out for him before you sell? For example, let's say the tenant wants to

add on an additional 5,000 square feet. The additional rent that would be gotten from that square feet would be \$10 per square foot or \$50,000 per year in net rent. Well, \$50,000 in net income divided by 10% is an additional \$500,000 in property value. Remember, this can be done and negotiated before you even sell the building or you even put one spade in the ground.

I hope this gets you thinking, thinking of different ways that you can literally create income out of thin air when it comes to your apartment or investment properties. Doing so could be fun and profitable.

Creative tax preparation. If you have an idea you're going to be selling in the next 12 months, make sure that your income tax return reflects that. Let's face it, owners of commercial investment property love to exaggerate expenses and underestimate income; it gives them more tax savings. No, I'm not saying people cheat; I'm not saying that at all. However, when you can take a deduction, you're simply going to take it, I mean, who wouldn't? This does create a small problem though. Even though this does give you good tax savings according to the IRS so you have to pay less in taxes, it does create a value problem.

For example, if the last two years your property shows a loss on your tax return you're going to have a problem getting the price you want. So how do you avoid this? Set yourself up at least a year before with a proper tax return. What do I mean by a proper tax return? Have it look fantastic from the IRS's standpoint. That's right, from the IRS's standpoint. In other words, accurately report all of the gross income that you've gotten in for that year with the goal of getting that number as high as you possibly can and reduce your expenses as much as you possibly can as well and show that on your tax return. So, instead of putting down \$18,700 for repairs, you may want to cut that in half or more when you file your tax return the year before you sell your property. Why is it so important to maximize your income and reduce your expenses on your tax return the year before you sell? The main reason why is because everyone will be scrutinizing it: the buyer, lender, appraiser, etc., is going to be scrutinizing your tax return and making sure that it is at least

somewhat consistent with the income and the expense information that you've given the buyer. If it's somewhat consistent, no problem, the property will appraise and you're going to get your money (more money than probably what you thought), but if there are big problems, big difference in income and expenses, then there's going to be a problem with it appraising and a problem with you profiting as much as you possibly can.

What a closing statement looks like. Many times people are shocked when they receive their closing statements and unfortunately many sellers receive them an hour before closing. This is not the time to find out about surprises. The real estate business is notoriously guilty of getting closing statements to sellers and buyers right at the last minute and last hour before closing.

Now, the majority of those are fine and there's usually no problem. However, sometimes there are problems and questions and many times there is not enough time to deal with them. So, what do you do?

You make sure you request your closing statement a minimum of 48 hours before closing. That way, if there's any questions, problems, etc., it can be solved with plenty of time to get things closed. But please understand it's good to have a good working knowledge of what your expenses are going to be before you get to the closing table. There's nothing worse than expecting a large check then having it dwindled somewhat by some expenses you weren't aware of.

*Note: While we're on the topic of expenses, please remember this: Recently as of the last five years, lenders have been notoriously putting in prepayment penalties on their loans. This is something that many sellers forget and/or think that it's probably not as big as it usually turns out to be. Whatever you do, before you even think about putting your property on the market, check and make sure you don't have a prepayment penalty that needs to be dealt with and if you do, find out what the exact amount will be. As I said, many sellers forget they even have a prepayment penalty until, you guessed it, it's the day before closing, and guess what, you can't back

out of a deal because you have a prepayment penalty. It's definitely not the buyer's fault if that's the case. So, make sure you're as educated as possible before you go to closing regarding any possible prepayment penalties.

Tax deferred exchange. I could devote a whole course on tax-deferred exchange as big as this one book; however, I'm not going to. I'm going to hit the highlights on why I think every time you sell a property you should consider completing a tax-deferred exchange.

A little history, the Government and IRS have always liked real estate, even back as early as the mid-1900's, tax-deferred exchanges were allowed. Yes, real estate was one of the only investments that you could actually sell, reinvest the proceeds in yet another piece of real estate and not pay any capital gains taxes. You can't do that with stocks, bonds, mutual funds, etc., only with real estate.

It's been the case, I've said for many years and it's been a nice advantage for many real estate investors.

A quick story: In the early 1970's, a gentleman decided he wanted to complete a tax-deferred exchange. He had a large piece of land in the west and a lumber company wished to buy it. Once he sold, he would have a huge profit, but also have a huge capital gains tax to pay to Uncle Sam. So, the solution? Do a tax-deferred exchange and exchange into some more real estate.

The only problem was after he agreed to sell it; he really couldn't find any kind of real estate that he liked. He had already sold the property, had the proceeds sitting in a trust account, but he couldn't touch the proceeds per IRS regulations, because once he touched the proceeds, the IRS would consider him receiving them and tax him accordingly. So there the proceeds sat. One year, two years, finally about the third year, he happened to be talking to the lumber company again. He told the lumber company his problem. "Well", the guy said, "We have a bunch of investment real estate that we would be interesting in selling, why don't you look into buying our stuff?"

So, long story short, this gentleman sold his land to the lumber company and took three years to buy his replacement real estate. Of course, an IRS tax audit ensued after he completed this transaction and it went to the highest court in the land. Do you know what was decided? They went ahead and sided with the investor, not the IRS. You see, the IRS rules were not clear on how long you had to take to exchange your proceeds into a property, it just said if you exchange your proceeds from one property to another, you won't have to pay any capital gains taxes. But there was never a time frame involved in it.

Well, guess what exists now because of that story? A time frame. So, having told you that story let me give you the top five tips you need to be aware of when you complete a tax-deferred exchange.

Tip #1: Make sure that when the offer is accepted you have a clause in there that says, "This property is being sold to complete a 1031 tax-deferred exchange". What this does is put the IRS on notice that you are actually intending to do a tax-deferred exchange and that it wasn't a last minute decision. Remember the story I just told you? It's all about timing from the IRS's standpoint and if they think that at the last minute you decided you wanted to do a tax-deferred exchange without originally not really deciding that's what you wanted to do, they can go ahead and seek taxes from you if they choose to do so. So, protect yourself and make sure you have that clause in every contract that you use when you sell your property.

Tip #2: Keep your possession dates as long as possible. Many times when you sell your investment property, you may not have a replacement on hold as of yet. If that's the case, make sure you don't have a short possession date. In other words, it doesn't make sense to have a possession date, say 30 days into the future for the property you are selling when you haven't even identified a replacement property yet. It takes time to identify a replacement property, usually anywhere from two-six months. So, whatever you do, if you do plan on completing a tax-deferred exchange, put that possession and closing date as far out into the future as you possibly can. You'll need this added time to identify a replacement property.

Tip #3: Know your timelines. Here are the timelines that the IRS guidelines go by. If you don't go by them, even if you miss them by a day, the IRS does not care and they will still tax you accordingly. Here are your timelines you need to be aware of:

You have 45 days to identify a replacement property once you close on the property you sell. So, if you own an office building and you sold it on January 1st, you've got until February 15th to locate a replacement property. That's right, that's only 45 days. Secondly, you have 180 days to close on that property. So once again, you sell your property January 1st, you have to close on it 180 days later or by June 1st in order to qualify for a tax-deferred exchange.

Remember, the IRS doesn't care if that 45th day or 180th day falls on Christmas, New Years, your birthday, etc. It doesn't matter. Make sure that you get that stuff done and taken care of during those timeframes. If you don't it could spell trouble. Note: April 15th. One hook that the IRS puts in here regarding timeframes is the tax return filing date. In other words, think of this way: You have to have your exchange completed by the date that you file your income taxes (which is usually April 15th), if you don't or if you cannot, you have to file an extension.

Whatever you do, don't file your tax return with your exchange in limbo, it will trigger a capital gains tax.

When you complete a tax-deferred exchange, you can have your property located really anywhere in the United States, so if you own an office building in Minnesota and wanted to do an exchange for an investment property in Arizona, that would not be a problem. This is a good strategy, especially if you plan on being in a certain location different times throughout the years. A good strategy to write off management fees.

Type of property. You could exchange any kind of business/investment real estate for another type of business/investment real estate, so if you sell your apartment building, you can take the proceeds and exchange it into an office building. If you sell your office building, you can take the proceeds

and exchange into a bare piece of commercial ground. If you sell your single-tenant property, you can exchange that into a farm ground, etc. You can exchange into any kind of investment or business real estate, it doesn't have to be the same kind of investment or business real estate that you are selling.

Qualified intermediary. Make sure you have a qualified intermediary in place to handle the exchange for you. In other words, when you ultimately sell the property, the money cannot go to you, it needs to go to an intermediary, a go between. This is per the IRS regulations and guidelines, plus the intermediary cannot be related to you or have a financial interest in what you want to accomplish, so it cannot be your attorney, cannot be your brother, cannot be anyone that has a financial interest in you at all. So, the intermediary has to be someone neutral. I recommend bank trust departments, they're usually the best and typically a bank trust department that is not your bank. They're familiar with exchanges and do a good job typically in handling them. Caution: As I said, I could have a full-blown course (and I do have a course) on tax-deferred exchanges. This section is not meant to cover every single detail of completing a successful tax-deferred exchange and always get legal advice before embarking on an exchange.

Tip #4: Sell on contract for deed, get 10% more and don't worry if you get the property back.

What did I just say? You can sell on a contract for deed, get more money and you actually want to get the property back? You're probably wondering what I'm talking about. Stick with me on this because it'll make some sense once I'm finished.

If you decide to sell your property on an installment basis, that's actually good for a number of reasons.

Reason #1, it creates monthly income for yourself.

Reason #2, it does not defer but delays capital gains tax being paid all at once. Keep in mind you pay capital gains taxes as you receive the money, so if you receive the money over a five or 10 year period of time, by selling your property on an installment basis, you'll be

able to spread that capital gains tax over time, which can be an advantage for you. But get this, more people are looking to buy using small down payments than what the bank would like. In other words, many people would like to invest in real estate, but don't want to put the typical 20% down to buy a property and many times it's not that they couldn't put the 20% down, they would rather spread their money out over different kinds of deals.

To give you a case in point: I put a six-plex and a four-plex on the market to sell for a client here about two months ago. At first, the client said they wanted all cash for them, so we put them on the market for cash, with not much activity. Two months go by and I suggested to him that he consider selling them on an installment sale. He didn't need the cash, he could probably use the cash flow and that way he could spread his capital gains tax over time. Two days later we had an offer at the asking price and everybody walked away happy. The seller walked away happy; he's got good cash flow, the buyer walked away happy; he's getting it for less than the typical 20% down payment while owning a good piece of real estate.

Understand this, buyers will typically pay more for a property if they have to put less amount of a down payment down or in other words, they'll pay more for a property if they can bring less to the closing table in the form of a cash down payment.

It's kind of like this, when you want to sell a property for all cash, you will expect some kind of a discount for the buyer bringing all cash to the table and paying you off either in all cash or getting financing. However, when it comes to selling on an installment sale, you should be getting full price or in many cases you should be getting more than full price; you're saving the buyer a lot of money, closing costs, appraisal fees, etc., while at the same time, achieving a good cash flow for yourself. This is definitely the way to go if you want to create cash flow for yourself without any management headaches or you want to spread that capital gains tax out over time.

"But what if I get it back?" I always hear people say, "What if I sell it to this guy, things go wrong and I end up getting the property back through foreclosure?" Let me tell you something, you want

that to happen. That's right, I said you want that to happen. Now, before you think I've gone off my rocker, let me explain this to you. Let's take an example, a scenario.

Let's say I own an office building that's worth \$400,000, I sell it to an investment group for \$400,000 and \$50,000 down payment and I will finance or carry \$350,000 at 7% interest with a balloon or a cash out to me within the next seven years. The payments to me every month are \$2,144. Okay, so let's say the sale takes place January 1, 2016. All of a sudden, January 1, 2018, I get a phone call from the owner. He says he can't take the property anymore, it's draining him, he's going to walk away from it, he wants to give the property to me, he's going to default on his loan and says, "Darin, the property's yours, I'm walking away, goodbye."

Now, most people would be panicking in this situation. I would be rejoicing. Here's why: Remember, the payments to me were \$2,144 per month. He had the property for two years. \$2,144 times 24 months equals \$51,456 was paid to me. On top of that, remember, I got \$50,000 from him at closing. So, over the two year period, in cash I received from the buyer is a total of \$101,456. Now remember, I sold the building to him for \$400,000 so let's say worst-case scenario the property only appreciates only 2% per year or total appreciation over that year is approximately \$17,000.

So here's the math after two years: I received \$101,456 in cash, I have \$17,000 in appreciation, for a total of \$118,456. So now I take over the property, I walk in for my first inspection, I haven't been in the property for two years, I find that there's some damage, some things need to be fixed, some things have been broken, and some things were definitely neglected. After I walk through the property, I calculate that I'm going to have to put \$20,000 into this property to get it to where it needs to be. Even if that's the case, I am still economically ahead and in this example ahead by a long way.

Now that I have a \$417,000 building that is in great shape I have a decision to make.

I can put the property back on the market; sell it for a higher price than what I sold it to the buyer two years ago, or I can keep the

property and reap the benefits of owning real estate again. You see it's really not that big of a deal. And, if you think about it, it's a good way to make a profit as well.

So, don't get me wrong, not that you want to set up people to fail if they do buy a property from you once you sell on installment, but if they do default, many times it's in your best interest.

So, if I were to summarize the benefits of selling on an installment sale, here's what they would be:

Benefit #1: Higher price. You can get up to 10% more in price by selling it on an installment price.

Benefit #2: Cash flow. You'll have a nice monthly cash flow coming in that's pretty predictable.

Benefit #3: Management. You won't have any management headaches at all because the new owner will be managing the property, not you.

Benefit #4: Spread capital gains tax. Now remember, you don't get out of the capital gains taxes, but you get it paid over time rather than paying it all at once, which can be an advantage for you depending on your tax bracket.

Benefit #5: Getting the property back. Remember, we want our buyer to succeed, but if you get the property back, it will mean that much more profit for you in the long run.

What appraisers really do.

Most of us have a pretty good idea of what appraisers do. They go out and tell you how much a property is worth, right? Well, kind of. What I'm going to do is give you a brief summary of what an appraiser really does for really two reasons:

1: So you get a better understanding of what you're going to be dealing with when dealing with appraisers because once you venture into the world of commercial investment real estate, you will be more often than not talking with appraisers on a continual basis. Not only will they be calling you for information, but also there will be occasions where you will call them to get information on market

values, rent comparables, etc., so it is a good relationship to build.

2: Selling your property for as high a price as you possibly can. Remember, a lot of it's going to come down to what the appraiser says. No matter what you negotiate with your buyer, if the offer is subject to an appraisal, guess what, nothing is a done deal until that property appraises for the purchase price or higher. So, your goal is to understand what the appraiser is going to be looking at, what is it they really do, and how you can work with them.

(*Note: By the way, throughout this book, I've talked about building a relationship with very good brokers that will help you increase your wealth and make money from your commercial investment real estate properties. The same goes with your appraisers. Ask around. In your marketplace, ask, "Who are the big appraisers for commercial investment properties?" Or in other words, "Who appraises most commercial investment properties?" Typically you'll find two-five appraisers' names that will come up consistently as the "go to guys" for commercial investment appraisals. These are the people that you'll want to build relationships with. They are the people you will want to keep in contact with, because if they're doing most of the appraising, they're going to more than likely be making a decision on the value of your property or the value of the property.)

Like it or not, most offers that will be presented to you when you sell your property are going to be "subject to appraisal". You would probably want it the same way if you were a buyer as well, you'd like to have the property appraise for the purchase price, I'm sure.

So, what is it that an appraiser really does? The appraiser does not tell you how much your property is worth, the appraiser confirms that the value that has been agreed between the buyer and seller is absolute and correct. That's right, you may be thinking I'm talking about six of one, half dozen of another, but really I'm not. The appraiser isn't going out, blindly looking at the property and saying here's how much it's worth. No.

The first thing the appraiser does is look for comparables to get

an idea of what the subject property is like; how many apartments, how many square feet for an office building, etc., and he will go out and find comparables. If the price on the comparables is at least close to the price that is being paid for your property, it's going to appraise. So really what he or she is doing is substantiating that your property is worth what you've agreed upon. So in essence they are telling you or the lender that the price that you've agreed upon sounds fair in the marketplace and it isn't too much.

What happens if the property appraises for less than the price that you've agreed upon? Well, in this case you've really got some choices:

- 1: Lower your price to what the appraised value is. So, if you sold your office building for \$400,000, but appraises for \$390,000, sell the property and on you go.
- 2: If you don't want to do that, and you feel that you're very justified in the price that you've accepted on the property, you may want to ask for another appraiser to get involved. If you do this, make sure that you and the buyer agree on the appraiser and that you agree that this new appraiser will be the appraiser that will handle it.
- 3: Work out different terms with the buyer. If the bank will only loan you money based on \$390,000 value, but you've got an agreed upon price of \$400,000, why don't you create a \$10,000 note, second mortgage, etc. outside of closing to handle the other \$10,000 to bring it back up to \$400,000? I've seen this done quite often; especially on properties that the buyer feels is worth what he pays anyway.

Bottom line: If the property doesn't appraise for the purchase price, for the buyer, more than likely it's going to send up red flags that they may be paying too much. Sometimes the buyers won't care. Most of the time they will and most of the time they will want some kind of price concession from you. So, be ready; be ready to deal, but as long as you're proactive with the buyer and you go over all specific points and possibilities, usually you can get a mutually beneficial transaction taken care of in a mutually agreeable manner. Once again, this is where a good commercial real estate broker

comes in handy that can handle these kinds of specifics for you and help navigate you through these kinds of deals.

Selling Your Property for Top Dollar.

When it comes time to sell your commercial investment property, whom do you market it to?

Of course, if you decide to use a competent real estate broker, they'll do the marketing for you. As I've said many times in this system, if you do choose to do that, make sure they are a competent real estate broker that specializes in your kind of investment property, has a track record of sales in your kind of property, and has an ongoing relationship with the "movers and shakers" within your investment property niche.

So, having said that, if you plan on selling the property yourself or if you and your broker decide to sit down and have a strategy session before the property is actually marketed, one of the things you're definitely going to talk about is: Who do we market the property to? Who is more than likely the buyer for this property? I will give you three progressive steps to on who you need to talk to; who you need to get the property in front of to increase the odds of not only selling the property for top dollar but also selling the property quicker.

Here they are:

- 1: All similar property owners with a 1-mile radius of your property. That's correct; odds are the buyer for your property is right next-door especially if they own a similar property. The marketing should begin within a one-mile radius of your property. Now, if you have residential people living four or five blocks from your property, more than likely they're not going to be that interested. However, every commercial investment property owner within a one-mile radius should be made aware of your property's availability as soon as possible. More than likely you will find your buyer here. It

makes perfect sense. Why? A: It's closer. B: Most will own a similar or other kind of investment property. C: These owners will tend to be attracted to properties similar to theirs and especially since it's so close, the management makes it really for them to decide.

2: Owners of investment property in your marketplace. The second step should be to contact owners of investment property in your particular marketplace that are not within a one-mile radius of your property. More than likely, the buyer that will have the most appreciation for your property already owns some kind of investment real estate in the first place and many times are looking to grow their empire. They've already become "pre qualified" because they already own an investment property in the first place.

3: Niching the market. What I mean by niching the market is getting the attention of people that own property that's very, very similar to yours. For example, if you're selling your 24-unit apartment property, you could focus on marketing your property to anyone owning say, 12-unit to 72-units in your marketplace. If you own a 10,000 square foot office building, you can focus on those individuals that own office buildings of 5,000 square feet on up, etc. You get the picture. Even though you cut the list down substantially, you will be surprised to find how many more possible buyers that you will have versus doing a big broadcast marketing campaign. In other words, I would rather have 50 very good prospects that own property very similar to the one that I'm marketing versus 1,000 prospects that own just investment property.

So, what I would do if I were in a selling situation is approach these three markets aggressively in my marketing. You can hit them one at a time or really all three if you want to do it that way. All three need to be considered and marketed too. The reason why I mention this is many times people have an idea when it comes to marketing real estate that just sticking a sign in the yard or placing an ad online or even in a newspaper is how they're going to get it sold. Now, you can do this if you want to and it will work from time to time; however, you may want to use that in conjunction with the three ideas I've given you above. Rarely do you sell a property out of an ad and rarely do you sell a property because there's a sign in

the yard. The ways that will give you the best odds of getting a high price quickly are the three ways that I've described in this section.

Group Investments/Partnerships.

I wanted to have a small section regarding group investments only because many times you will be approached or even have the idea yourself of forming an investment group (or partnership) to buy a particular property. Maybe you want to lower your risk, which is fine. Maybe you want a larger property, but don't have all the funds to purchase it, so you may want to bring in one or two other partners to do the deal, which is fine as well. So, let's discuss the advantages and disadvantages of group investments.

First of all, the disadvantages:

Disadvantage #1: You have to deal with other people. That's correct, you have other people to answer to on a group investment. Since it's not just "your deal", there are other people that will require answers, will have input, will want feedback, etc. This of course can be a hassle especially if you and other members of the group see things differently. Maybe you want to do an improvement and other members of the group don't think it's necessary, or vice versa. Maybe you think the cash flow should be put into a certain part of the property, maybe you think the cash flow should be set aside to purchase another property. Maybe one or others in the group agree or disagree, etc. You've got more than one decision maker that can muddy the process.

Disadvantage #2: Liquidity. If you own your own property, you can typically make the decision overnight to sell it the next day and be out of it. However, with a group investment, it's not that easy. If you wish to be out of the investment, many times the others will not want to be out of the investment.

If this is the case you will either have to: A: Find one of the current partners to buy you out, or if you can't find a partner to buy you out, B: Go out into the marketplace to find someone that would have an interest in buying your share. Either way you slice it, it

becomes a little more difficult and more time consuming to complete. So, if you're going to be in a group investment, more than likely it's going to be for the long-term; at least a minimum of five years. Who knows, maybe you can find a buyer for your part of the deal or maybe one of the other owners would have an interest in buying you out.

Disadvantage #3: You're subject to the group member's problems. Here's an example: Let's say you've got three guys that own an office building. You're one of the three guys. You owned the building for 10 years. You guys have decided you want to sell and move on. Everything is going fine until one of the group members who got divorced two years ago tells you that his ex-wife has a lien on his ownership interest for child support and you're going to have to contact her and get releases and agreements so that lien can get taken off his ownership interest before you actually close.

The problem is, the ex-wife is mad at the husband, doesn't want to cooperate, etc., which postpones the closing another two-three weeks, until she's convinced that she needs to sign the correct paperwork to get everything completed for the partnership to sell the property. This is just one example. There are changes in everybody's lives over time and sometimes they can affect how the property is sold or even when it can be sold. You need to keep this in mind when entering a group investment.

Top advantages:

Advantage #1: You get to leverage your money into a larger property. Many people would like to own 20% of a \$2,000,000 property versus 100% of a \$200,000 property. With larger properties, you usually get better cash flow and much better tax savings as well. Partnerships allow this.

Advantage #2: Reducing the risk. If you have a partnership share, or say, are one of eight partners that own a property, your risk is reduced substantially versus you owning the whole deal yourself. There's nothing wrong with spreading the risk at all.

Advantage #3: No management, no maintenance headaches. The nice thing is in a partnership; many times you don't have to worry about the management or maintenance headaches that typically come with properties. We've discussed management systems before within this system and how you can have resident managers, management companies, and etc., take care of the property. Well, there's nothing saying that can't be done with a partnership as well; however, in a partnership, usually you do not have to do with any of that. So in other words, you don't have to deal with any resident managers or management companies at all on top of not having to deal with tenants, versus if you own your own property, many times you still have to deal with a management company or resident manager anyway. This is a very nice option for many investors who wish to own very good real estate with good cash flows, good appreciation, that are really good long term investments; however, they don't want to manage the properties or even deal with management companies. They've got better things to do. So, a nice alternative for them is the partnership situation where they get all of the great benefits of real estate without the management hassles or headaches.

Advantage #4: Good tax-deferred exchange vehicle. Partnerships are good vehicles for tax-deferred exchanges as well. Here's what I mean. Let's say you own a single-tenant office building and you've just sold it. You've got your proceeds in a trust account waiting to identify another property; however, you've decided that you don't want to really manage property anymore or even deal with managers, but you love real estate and still want to stay in real estate. What's an alternative? A group investment. Many times I've formed a group of investors for this sole purpose. They're coming out of a tax-deferred exchange, don't want to manage property, deal with tenants, deal with vendors, etc., but still want to stay involved in investment real estate and of course, avoid paying capital gains taxes. Group investments are the way that many of these individuals go because of the advantages that they have without having to hassle or deal with the tenants, vendors, etc.

A note about partners.

You'll want to do some research on all the partners involved. You'll want to make sure that they're the type of partner that you want; that they're the type of partner that has at least the same kinds of goals that you do in regards to the property that you wish to purchase. Of course, you'll want to do a good job of screening the partners as well. What I mean by that is you don't want somebody bringing problems into the partnership such as divorce, lawsuits, etc. But, if everyone has the same kinds of goals and objectives for the property, you're about 90% of the way there and as long they're not carrying any extra baggage with them that could cause the partnership problems, you're probably going to be fine.

More than likely you will be. Odds are that if you put a group investment together, everyone sees a property, has an interest in buying it, most everyone will probably have the same kind of objectives and will be pretty flexible with each other. That's been my experience anyway. But suffice it to say, do a good job of making sure that everyone has the same thought in mind, the same goals, the same ideas of handling cash flow, the same ideas of disposing of the property when it comes that time, etc. Remember, if you have one person that disagrees with everything you want to do, they're going to be a problem that you're going to have to deal with for years. Better to get rid of that problem now, versus having to deal with a problem partner for many years to come.

What entity do you use in your group investment?

This is where you want to get some local, legal advice from a competent commercial real estate attorney. However, having said that, I can tell you my best experience is to form an LLC with all of the partners having specific shares within the LLC based on their down payment monies. For example, if I have a group of four individuals including myself and we are buying a \$500,000 property and we need to make a \$100,000 investment. If each of us makes a \$25,000 investment, which of course totals \$100,000, we would each have a 25% interest in that LLC.

LLCs are good to screen you from any possible property liability problems that may arise, tenant breaking neck, hurting themselves, property burning down, etc. It keeps the majority of your assets out of the deal in the event that someone would want to sue you for damages. However, keep in mind that most lenders will want some kind of recourse when you purchase a property even under a partnership. The recourse though can typically be limited to the percentage of ownership that you have. In our last example, our loan would be \$400,000, all members would probably at least be responsible for \$100,000 of that \$400,000 loan. What I'm telling you is even if you form an LLC; it does not guarantee that you will be shielded from the lender as well. The lender will typically want you to sign personal guarantees whether you're buying the property all by yourself or in a partnership. Just be aware that this may be required and that you're comfortable with doing that.

Bottom line is partnerships can be very good investments, save you a lot of time, a lot of hassle, and can be very profitable. Of course, go through all of the analysis strategies that I've talked about earlier in this system before you get involved in it and take note of all of the tips that I've given you within this section. If you do, any kind of partnership deal that you decide to get into will turn out fantastic.