

# PROPERTY MANAGEMENT AND IMPROVEMENT

The Basics:

Force Appreciation

Examining Expenses

Increasing Cash Flow

Understand your numbers

Maintain Focus On Your Exit Strategy

# CREATE A SYSTEM

1. Begin looking for Private Money
2. Get lead generating machine moving
  - i. Auctions
  - ii. Brokers
  - iii. Bankers
  - iv. Realtors
  - v. Internet
  - vi. Letter Campaign
  - vii. Market yourself
3. Assess your personal financial situation
  - i. Do practice deals – Min 2 per week
  - ii. Keep updated on market conditions
4. Implement your roadmap (personal Plan)
5. Setting goals
6. Streamline your repetitive tasks
7. Scale of Economy
8. Concentrated Efforts
9. Developing core Efficiencies
10. How to profit from those who don't have one a plan.
11. Constantly re-evaluate your own investments  
(NO STAGNATION)

## **Build your team**

Office Staff

Surveyor

Leasing Agent

Contractors

Appraiser

Engineers

Title Company

Architects / Designers

Service Companies

Screening Agents

Lawyers

Property Managers

Environmental Company

Labor and Supervisors

Banker

Maintenance Crews

Mortgage Broker

Auction Houses

Private Lenders

Deal Scouts

Real Estate Broker

## FIVE “MUST HAVE” CLAUSES

1. Closing and Possession
2. Contingencies
3. Real Estate Taxes
4. Access to Property, Further Assurance
5. Representation and Warranties by Seller

## **CONSTRUCTING AND PRESENTING OFFER**

Your offer is based on what the property is worth, not what it will be worth

When you know how to value property, and understand financing, the offer almost creates itself.

Know your exit before you enter.

When you are making an offer on a property with large differences in unit prices or cap rates, you want to make a heavy contingency-laden, with escape hatches, offer.

There is no such thing as a boilerplate contract for commercial real estate. You deal with different

Cap rates

Number of units

Management styles

A lot of things need to be built into these contracts. Use a Competent Commercial Property Broker and an attorney.

## **Who in their Right Mind would Seller Finance?**

People just like you and me. They may have one or more of the problems listed below, one that's not listed, or even no problems at all.

- Too Old to Maintain
- In foreclosure or about to be
- Divorce
- Loss of Job
- Death of Spouse
- Bankruptcy
- Failing business
- Inherited
- Lawsuit Pending
- Failing Health
- Wants to retire
- Very Little Equity

## **FINANCING YOUR DEALS**

### **Ways to buy Commercial Real Estate**

1. Traditional Financing
2. Private Money
3. Partners
4. Seller Financing
5. Non-Traditional
6. Substitution of Collateral

## 7 Main Exit Strategies

1. Quick Turn
2. Force Appreciation
3. Refinance
4. Sell with Owner Financing
5. Conversions
6. Highest and Best Use
7. Outright Sale

## Debt Coverage Ratio (DCR)

-also known as “Debt Service Ratio” or “Debt Service Coverage Ratio”

$$\text{Debt Coverage Ratio} = \frac{\text{Net Operating Income (annual)}}{\text{Debt Service}}$$

$$\frac{\$100,000 \text{ NOI}}{\$110,000 \text{ Debt Service}} = \text{_____ DCR}$$

$$\frac{\$157,000 \text{ NOI}}{\$110,000 \text{ Debt Service}} = \text{_____ DCR}$$

## **How to make money in Commercial Real Estate**

1. Get Cash when you Buy

a. Security Deposits

b. Prorated Rents

c. Tax Prorations

d. Repair allowances

2. Sell

3. Keep and Refinance

4. Quick Turn

5. Options (easy to identify)

6. 1031 Exchange

## **Step 4 Evaluation**

- Get copies of all leases
- Formally inspect the property, **be thorough**
  - Inspect units, every single one of them
  - If you can only see some of the units, use contingencies to rebate sale proceeds
  - Reference your contractor's notes
  - Interview existing tenants
  - Find issues to challenge deferred maintenance as stated by seller

- Evaluate the need for Private Money
- Hire a Contractor to Inspect Property  
“Unofficially”
- Get TWO bids for any improvements over \$3,000
- EPA – Phase I, Phase II, or more...
- Keep your Eye on the Ball, Appraisal, & Evaluate your exits

### **Step 3 Evaluation – THE DEVIL IS IN THE DETAILS**

- List of Deferred Maintenance items and Costs
- Complete Rent Survey
- Calculate (using most current information)
  - Cap Rate
  - Cost/Unit
  - Debt Coverage Ratio
  - Operating Expense Ratio
  - Cash of Cash Return 1<sup>st</sup> year
  - Total Return on investment 1<sup>st</sup> year
- Renegotiating price / Terms with Seller
- Initiate a Title Search
- Research funding options with Brokers and Lenders

## **Step 2 Evaluation**

- Questions to ask yourself – Check your personal roadmap:
  - Your financial goals
  - Time restraints
  - Comfort level
  - Finding the money
- Seller's Schedule E Tax Return on Property
- Complete and most complete Rent Roll
- List of Recent Improvements
- Seller's list on any expenses not listed above
- Check verifiable expenses (Water, Gas, Electric, etc)

- Five Minute Evaluation:
  - Purchase Price
  - Gross Potential Rental Income (GPRI)
  - Vacancy & Credit Loss
  - Gross Operating Income (GOI)
  - Total Operating Expenses
  - Net Operating Income (NOI)
  - Cap Rate

## 4 STEPS IN ACQUISITION OF COMMERCIAL PROPERTY

### **STEP 1: The Pre-Acquisition Analysis**

- Income and Expense Statement
- Other Income (laundry, vending, etc.)
- Current rent roll
- Initial Value Check
  - Cap Rate
  - Cost/Unit
  - Debt Coverage Ratio
  - Operating Expense Ratio
- Create 3 potential offers:
  - Cash on Cash Return – 1<sup>st</sup> year

Total Return on Investment – 1<sup>st</sup> year

The 3 powerful cap rate formulas you need to learn:

$$\text{CAP RATE} = \text{NOI} \div \text{VALUE}$$

$$\text{VALUE} = \text{NOI} \div \text{CAP RATE}$$

$$\text{NOI} = \text{VALUE} \times \text{CAP RATE}$$

Cap rates are kind of fickle friends:

- as the rates increase, values decrease
- as the rates decrease, values increase

Safe Investment: 5% Cap  
Average investment: 10% Cap  
Risky investment: 20% Cap

	Acquisition	Leasing	Management
Income	\$400,000	\$400,000	\$400,000
Vacancy	-100,000	-50,000	-50,000
Expenses	-150,000	-150,000	-100,000
NOI	=\$150,000	=\$200,000	=\$250,000
Cap Rate	10%	10%	10%
Value	\$1,500,000	\$2,000,000	\$2,500,000

\$100,000 in Additional Cash Flow

= \$1,000,000 in additional value

\*Note: NOI is Net Operating Income. Income not including debt service

## **SITUATIONS THAT CREATE OPPORTUNITY**

- Too Old to maintain
- In Foreclosure or about to be
- Divorce
- Loss of Job
- Death of Spouse
- Bankruptcy
- Failing Business
- Inherited
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## **6 Powerful Pipelines to Keep Deals Flowing**

1. Auction Houses      [www.loopnet.com](http://www.loopnet.com)
2. Attorneys
3. Commercial Realtors
4. Courthouse / Internet
  - a. Courthouse –
  - b. Internet
5. Letter Campaigns
6. Properties with unpaid taxes- Tax Lien Sales