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The Riddle Report

Convert The Use Of Buildings For Profit

There is a big difference between investing in the rejuvenation of real estate projects and investing in stocks, bonds and other securities. When you invest in securities, you have no control of any factors that can enhance the value. In real estate, you have control of the investment yourself.

In an investment in converting use of buildings in real estate, the investor can use creative imagination to change a property into something that has a much greater value, and even better than before.

But, real estate investments that involve changing the use of property are not for the faint of heart. They are riskier than other investments such as buying an established office building, a hotel or a strip shopping center. There are always unknown factors, more things that can go wrong, and fewer things that you can count on. Success is based more on the future than on the present, and the future must be predicted, partly with respect to the income that the property will be able to earn once the use is changed.

Remember though, the highest returns go to those who take the highest risks.

A Better And More Profitable Use

Most buildings can be changed so that they can be used for a different purpose other than the one for which they were originally intended. Therefore, the large supply of existing properties, many of them very solidly built, may be converted to a better and more profitable use. Older buildings were demolished in the past, but now more thought is given to recycling and preserving them.

The most common examples are the conversion of farmland to commercial or residential property. In most areas, large houses have been changed into multifamily apartments or condominiums. Investors have converted many former manufacturing spaces and warehouses into shopping and office complexes.

Maybe A Change In Zoning

Expect cooperation from city government. Property that has been declining in condition has also declined in value but can be recycled back to productive use. Immediately the building will be upgraded on the tax rolls to a higher value than before. The city or county now will receive larger tax revenue from the property. A change in zoning is often required for a use-change, but it is regularly granted with little difficulty if the investor has a well thought-out plan, that has the community’s needs in mind.

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If the conversion is changing apartments to condominiums there may be no zoning change required. Anytime you can avoid asking the city or county for changes in zoning, time can be saved. Another example of continuing with the same zoning is the upgrading of a shopping strip center or mall through physical remodeling and securing different tenants.

Look For Unusual Use-Changes

Manufacturing or warehouse space has been particularly popular for conversion to residential use in many cities. They have big, open spaces that can be partitioned easily into smaller units; the high ceilings provide an atmosphere that appeals to many people; and the locations are often perfect.

This type of building can often be less expensive and easier to rehabilitate and convert than to fix-up a very run-down apartment building. They are usually just empty shells so it is easy to design the interior according to what your research shows the market wants. Little, if anything, has to be removed.

Apartment occupants or condominium owners respond favorably to the idea of living in former warehouses, shoe-manufacturing buildings, and even in abandoned schools.

An example of a truly unusual conversion was in a western city. Garage facilities that formerly housed and serviced the city's fleet of trolley cars were converted to a highly successful shopping and entertainment center, which was named Trolley Square. The owners later added new buildings nearby, adding to the economy of the entire area.

In Chicago, the Century movie theater was one of the most ornate structures of the era of elaborate movie houses. The surrounding neighborhood began to decline. The transformation of the neighborhood began when investors bought and refurbished aging apartments nearby attracting a more affluent residential population. The theater was then purchased and transformed into a seven-level shopping center with 100 retail shops. The complex terra-cotta exterior of the theater was preserved, but the interior was completely gutted and rebuilt.

By cautiously evaluating, then changing the use and remodeling the underutilized property, you can share in the sizable profits of property-use-change investments. ❏

Keeping Key Employees Happy

Key executives were the ones who always had the "office with a view". Now, however, on modern buildings built in the past few years the atrium is one of the most popular (and expensive) amenities. It is popular because virtually every office can have a window view, either toward the conventional view, the outdoors, or toward the spaciousness and openness provided by the atrium. It is an example of "keeping key employees happy".

Trends in the newer buildings being built and refurbished today are to make the tenants happy and content. Part of this is doing everything to make the tenant's employees content and happy also. Skilled employees are not tied to employers as they were in the past.

Amenities might account typically for only about one percent of the space and less than one percent of the building costs. But amenities can make a big difference when the management company is showing it to prospective tenants. With good amenities, the building attracts tenants and has less vacancy problems. Few tenants seem to be concerned with the addition of a few cents per square foot for the amenities that appeal to them.

The atrium will add extra costs for window cleaning, heat loss, and higher premiums for liability insurance. Where that amenity has been offered, managers have found that the tenants are willing to pay the few extra cents per square foot.

Additional Changes

Outside or inside fitness centers are increasingly popular additions at modern office buildings. If it is a build-to-suit office building, a track around the inside perimeter can be used for both running and walking. If possible, have dressing rooms and showers, Health and fitness are important to workers today. If there are outdoor areas: a picnic table, Bocce Ball Court or some kind of game area is always a great addition to an outdoor area, especially in an industrial park that has fewer restaurants and shopping that can be done at lunch break.

Most office buildings have a small kitchen available with an eating area, microwave and refrigerator. Make this area as attractive as possible with good lighting, colors on the painted walls and carpeting on the floor. Make it a place that the employees are comfortable and relaxed. Employees of the tenant do not need much extra to feel that management is trying; after all it is a working environment. Close in parking is at the top of everyone's list. Any additions to the working environment help keep employees happy. ❏

Turn Cash Flow From Negative To Positive

In investment properties, when cash expenses are more than cash receipts, there is negative cash flow. Most investors avoid properties where this is the situation, unless there are strong underlying economic factors that indicate the cash flow can become positive.

• One six-tenant office building was leased out several years ago. After a few years operating expenses rose sharply and exceeded the gross rental income. However, the leases on all the units will soon expire and there are no renewal provisions. That means that there will be new leases negotiated. Leases that provide for higher rentals will replace the old below-market leases. The building's negative cash flow will soon become positive.

The underlying economic factors in this example clearly indicate that this office building can easily become a good investment. Just because it has a negative cash flow now is not a good reason to avoid considering the purchase of the property.

Light Manufacturing

• Another building is leased as a light manufacturing facility. However, the "best use" of the property is determined to be as a series of small research and development offices or as a conversion to condominium apartments. The negative cash flow from the present use as a manufacturing facility can be turned into positive cash flow when the property is put to its "best use".

The sole consideration of negative cash flow would have led an investor to avoid this property. In light of further consideration of the underlying economic factors, the underutilized property might well be an attractive investment opportunity.

Vacant Land

• A vacant lot in the center of town generates only a small amount of income when it is used to sell Christmas trees. But the lot costs money to hold (property taxes and clean-up expenses). There is a significant negative cash flow. But it may be one of the best real estate investments. The unrealized appreciation of market value may far exceed the tax and maintenance expenses so that the investor will profit when he sells the lot, even though he has experienced "negative cash flow" all the time it was held.

Always look at the reasons why there is negative cash flow from income property before you invest. The turn-around possibilities may be readily apparent. Don't miss out on an otherwise good investment simply because it currently isn't making money. ❑

Contact Your Property Manager *In Advance*

If you are about to acquire an income property, consider contacting the management company in advance. The ability to estimate income and expenses and a keen knowledge of the market makes the manager a valuable asset during the preacquisition process. The property manager has the background necessary to provide significant assistance in determining both the location, desirability and economic feasibility of a property.

The usual way that a property management company comes upon the scene is when the owner of a building makes a contact. Often the owner has just acquired the property through a purchase or exchange, then looks for a manager.

Inspection And Evaluation

When evaluating a property, the property manager should perform a comprehensive inspection of the physical property, thoroughly review current leases and past maintenance records, and, when appropriate, talk with the on-site staff, and current tenants and neighbors.

Preliminary market analyses and pro formas should be completed during the preacquisition stage to determine the property's operating costs and to project possible investment return. These analyses will help establish whether the property will perform according to the owner's investment objectives, or whether the property is too risky for acquisition.

The Rent Structure

When the property is acquired, the management staff will know in advance what can be done with the rent structure. The goal will be to increase the rents to market levels and/or the legal maximum. Tenants with leases can not be given rent increases if their leases prohibit them, but the rent for vacant space or for property with expiring leases may be increased. ❑

Investing In Land For Long-Term Profit

Land is always a good investment for the long term. In past years when investors made real estate investments, one consideration was the tax shelter of certain investments. Now, with fewer shelters, real estate investments must make sense as a dollars and cents return on capital, and must stand alone as a good business move. Land has never been a tax advantaged investment and should be worth considering as a way to increase wealth. The trend has always been up.

In most cases, the land investor spends money each year with virtually no income from the investment. He has expenses of property taxes, clean-up and maintenance costs, expenditures for travel to check on the property. The opportunity for income from the land is minimal.

When an investor puts money into land it is for the potential payoff when the land is sold. It is a very worthwhile investment when the land's price skyrockets and the "cheap" land becomes highly treasured property.

Types of Land

Land investments come in three major categories. The ultimate payoff for each of these categories can vary.

Raw Land. Unzoned rural land in its natural condition. This is usually in a remote area. It would typically take many years to appreciate significantly in value. The price to purchase is quite modest, and the costs to own it are small. The investor in this land will usually purchase hundreds of acres and then wait 20, 30 or more years to see a chance to sell at a profit. However, when that time comes, the profits can be incredible. The Florida land boom of the 1920s is an outstanding example.

Pre-development Land. This is land located closer to built-up sections and is located where there is a realistic expectation of development in the near future. It may already have basic zoning and could have utility service. The prices are higher than for raw land, and the costs to hold it are higher. But unlike raw land, the payoff can be much sooner. The smart investor picks an area where he has identified a "path of growth" and where commercial, industrial, and residential development will soon happen because it is needed there.

Infill Land. This land is between raw land and pre-development land in the sense that it offers a different kind of investment expectation. It may have been passed over for "easier" parcels during the first phase of an area's development. It could be located in a different direction than the main path of growth of the area.

When a community was originally developed, the suburbs may have extended to a commuting range of 30 to 40 miles. Later, after better highways were developed, commuters were more willing to travel 10 to 20 miles further. These improved highways created new uses for thousands of acres of land. This is land that can be used for homes, shopping centers, industrial or other commercial uses.

Look in Your Own Area

The price and value of land varies greatly throughout the country. In some parts of the country there is practically no raw land available. In other sections there is plenty. Some areas have pre-development land, but it is so obviously "in the path" that the prices are already very high for the investor.

In some areas, pre-development land may take a skilled, experienced investor to recognize just what can be used soon. The investors who takes the time to study and can recognize what others don't yet see, will be the one who makes these profits. ❑

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