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Commercial Real Estate

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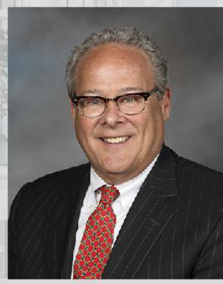

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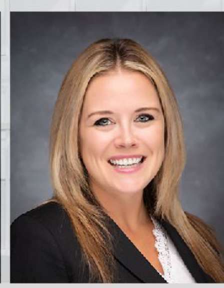

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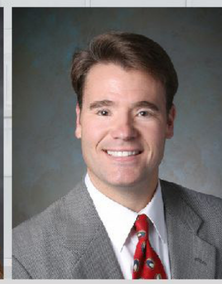

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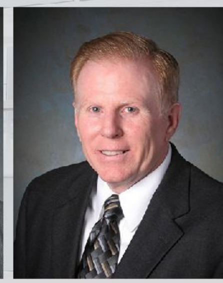

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Real Estate, Tailored To Your Needs.

Our many years of experience and local market knowledge will provide the highest level of services to help you make the best decision for you or your company.

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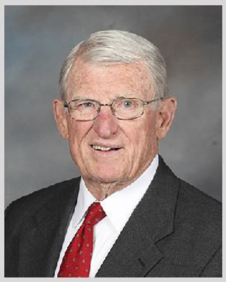

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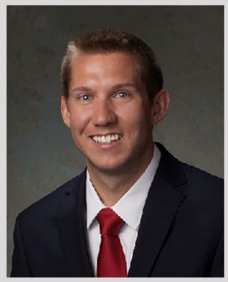

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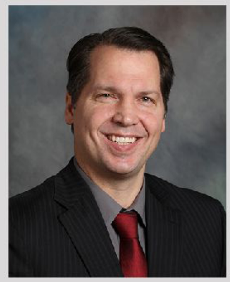

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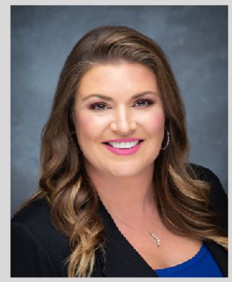

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OCTOBER 2022

A Service Joint Venture

Whether times are good or bad, lenders always have foreclosed properties in inventory. During a recession the inventory may be high. One of the problems that banks and insurance companies have is disposing of this real estate owned (REO). They are faced with the decision of whether they wish to dispose of the property immediately or hold it for a period of time to hope for an increase in value. They would like to see the value of the REO increase to equal the loan amount.

These lenders are not professional real estate investors but money managers. Therefore, they are reluctant to invest any additional money in the properties. This problem is compounded because a troubled property needs more attention than does a healthy one. It would not have been in foreclosure if it didn't need help.

The solution might be a service joint venture. This type of contract with a real estate firm allows the lender to minimize management fees until the property is generating cash flow again.

Asset Manager As An Agent

The service joint venture is a form of incentive compensation by which the lender retains an asset management firm as its agent, with the firm agreeing to defer a portion of its fees until payment can be made out of future cash flow. The relationship may be a straight principal-agent one, or a new joint venture can be created in which both the lender and the management firm are partners. Some lenders who want to avoid a formal ownership position in distressed property desire this approach.

The differences between the fee structure of a service joint venture and more traditional arrangements are as follows:

- **Management fee.** In a service joint venture, the agent receives anything from a below-market fee to no fee at all until the project achieves a specified level of net operating income (NOI). After that, the asset manager receives a designated portion (for example, 50%) of the NOI over the threshold amount. By comparison, the traditional management firm receives either a fixed fee or a fee based on a percent of the gross income.
- **Lease-up fee.** In a service joint venture, the agent may receive anywhere from a full leasing fee to none at all. The variable relates to the type of property involved. In the case of an office building, retail property, or industrial

(continued)

project, the agent normally receives the full market fee because payment is usually a commission rather than a straight salary. On the other hand, for residential properties, the fee often is deferred until a future date.

- **Commissions upon sale.** In a service joint venture, the manager receives a substantial portion of the sales price over a threshold price, together with a negotiated commission that is slightly below the traditional percentage. By comparison, a traditional arrangement gives the agent a higher percentage of the total sales price but no share of the amount over a designated threshold.
- **On-site marketing and management.** Here, both the service joint venture and the conventional agent receive a fee as provided for in the property budget.

The value of the service joint venture is that the management company is co-opted because it receives incentives in exchange for fees. In this way, the management company shares the objectives of the lender to maximize net operating income and value as fast as possible. ❑

Kinds of Commercial Leases

A lease is an integral part of many real estate investments. It should outline all the obligations of the tenant and of the landlord. This sounds simple, but many questions arise. If, for example, property taxes increase, does the tenant pay all of the increase or only part of it? If the property must be modernized, who pays for the improvement? Can the tenant be moved out during the renovation? If the costs of servicing the property rise, should the tenant pay none, all, or part of the increased costs? How should inflation be handled—with automatic rental increases? With increases tied to some index, perhaps the Consumer Price Index?

Kinds Of Leases

Here are some of the variations of leases used on commercial and industrial properties:

Flat Rate Lease. This is the traditional lease in which the tenant agrees to pay a flat periodic rate for the term of the lease. This might work with a very short lease, say one year.

Net Lease. Some investors try to protect their net income flows by requiring the tenant part (double net) or all (triple net) of the expenses. For example, the tenant may pay the property taxes; or property taxes and insurance; or property taxes, insurance, and all maintenance and operation expenses. When a net lease is mentioned, always ask what the landlord pays and what the tenant pays.

Sandwich Lease Or Subordinated Lease. The tenant leases all or a portion of the property to a third party who pays to the original tenant. The sandwich lease may be at a rate slightly higher than the original lease payments, thus allowing the tenant to make money from such an arrangement. For this reason, some leases do not allow subleasing.

Percentage Lease. The amount of rent is related to a fixed amount, plus a share expressed as a percentage of the gross or net sales or profits of the business to be paid as additional rent.

Ground Lease. Only the land is rented. The tenant owns the improvements. When the lease ends, provisions are made for allowing the tenant to buy the land or the landlord to buy the improvements.

Leasehold Estate. The value of the lease to the tenant. If the tenant has negotiated a rent below market the tenant has a valuable right (perhaps by subletting at market rents). If the rent is above market the landlord has an advantage, but if the tenant is a strong, credit-worthy tenant the lease may be subject to renegotiation.

Index Lease. The lease amount is related to an index and changes as the index changes. For example, banks located in shopping centers cannot be charged on the basis of percentage of sales because there are none. In such cases an index such as the Consumer Price Index might be used.

Renegotiable Leases. The rents are subject to review and renegotiation at a particular event or after a given number of years. These are usually related to inflation measures and indices.

Improperly drawn leases may not produce enough income to cover the costs of owning and operating the property. And long-term leases in particular present problems when prices, costs, and money rates are fluctuating. There is no substitute for a lease prepared by a skilled professional. ❑

Prospective Tenants For Commercial Centers

Owners must think about vacancies when checking a prospective tenant. Will the tenant's business survive? When you have a prospective tenant for a commercial center, you must consider whether that prospect would be a good tenant. There are two key standards to apply; (1) the prospective tenant's financial stability; and (2) the prospective tenant's potential for success.

Financial Stability

The prospective tenant must be able to afford the rental that you set. Its overall financial condition should be sound. Among the first things you'll do is to see if the prospective tenant pays its bills on time. Having a reputable credit agency do a credit check on the tenant can easily check this. It is also wise to talk to the tenant's main suppliers and its current landlord.

An examination of the tenant's assets is also essential. Ask to see the tenant's financial records, study them carefully, and discuss with the prospective tenant's accountant any questions you may wish to have clarified.

Once you are satisfied that the prospective tenant is financially stable, you must ask the question: Will the tenant be successful in your center? To answer this question you must determine the following;

- The tenant's reputation at its present location.
- The tenant's sales volume. In the retail business, a turnover of stock at the rate of four to five times a year is considered good.
- The trend of the tenant's sales. Has the tenant's sales been increasing from year to year?
- The type of merchandise the tenant will be selling in your center. You'll look to avoid duplications with other tenants in the center.
- The profile of the tenant's average customer at its present location.
- How efficiently is the tenant's business now being run? Is the efficiency or inefficiency likely to continue?
- The nature and extent of the tenant's advertising.

No Track Record

The preceding is for the prospective tenant who has an established record, who has been in business and offers tangible evidence of performance. But what about a newly owned business that wants to rent space in your shopping center as its first-ever place of business?

You should appraise this kind of prospective tenant by using the same two key standards: financial stability and potential for success. But instead of looking at past records, you will be predicting and forecasting and making judgments about the prospective tenant's ability, ideas, and business expertise. It is a riskier situation for the center's owner-manager but a totally new business might generate totally new interest in the center. It's not the same old merchants merely doing business from a new location. ❑

Providing Rentals For Seniors

Not all retired people want to own their own home. Many prefer to be tenants. Many feel that the proceeds from the sale of their old home can be used to supplement their pension and social security, rather than reinvested in another home. The money can be used for travel, visits to children and grandchildren or for medical expenses.

For living quarters, these seniors prefer to be rent payers, not owners. A modest-sized apartment suits their needs and, as tenants, they are relieved of any worries about maintenance and repairs.

Construction Design

Developers and investors are finding a huge, and relatively untapped, market for rental units designed specifically for the older tenants. These are architecturally sound structures designed with the special needs and concerns of the elderly in mind. For example, these buildings have wider than usual front doors to accommodate canes and wheelchairs, handrails in the aisles, fewer stairs and more ramps and inclines, and better than usual security systems with intercoms and spotlights. Inside the apartment units, there would be conveniences that these seniors appreciate (hand grips at the tub and toilet, electrical outlets at waist level, and cabinets that don't require bending or stretching to reach).

The Rents

When planning the investment in the rental market for the senior lifestyle, one financial objective should be to provide units that rent in a price range that is affordable for social security payment recipients. The upper end of the price range can be met by those older renters who have a private pension in addition to their social security payment. The lower end of the range should be affordable for persons who rely primarily on social security payments to meet living expenses.

The Tenants

Elderly tenants are financially dependable because they have a dependable monthly income. They are stable tenants because they are usually not interested in moving. They almost never move because they "need more space." They usually are quiet (no late parties) and they take pride in keeping their unit looking nice.

All of this adds up to few vacancy problems, few rent collection problems, and fewer maintenance expenses. ❑

Modern World Technology

With the invention of electricity the biggest breakthrough in home and office innovations was from 1906 to 1955. During this period, the introduction of household appliances and office machines in America, ranging from vacuum cleaners, electric ranges, food processors, electric typewriters, made the home and office life in general much easier with the use of electricity.

In 1939 Popular Mechanics, a magazine that helped people master the modern world, giving them technology and information on the newest and the latest breakthroughs in science and machines, predicted the home of the future. With the addition of the electric power supply it predicted televisions, lighting control, air conditioning and many of the things in our home and office that we take for granted using today's technology.

The electric toaster wasn't invented until 1909. It only toasted the bread on one side and you had to turn the bread over halfway through to toast the other side.

The home refrigerator wasn't invented until 1913, but it was several years before it became a common household appliance. Until then, to keep foods cold, the household had an icebox. The iceman came around and delivered a block of ice or you went to the icehouse and picked-up a block of ice for the icebox.

Around 1900 the first electric washing machine was invented by a Ford Motor Company employee but was not introduced for the household market until 1947. It took another 15 years for the electric clothes dryer to be introduced.

1924 the dishwasher that resembled the modern models of today was created.

The overhead garage door was put into use in 1921, but you had to lift it by hand. The electric garage door opener that we know of today was invented in 1926. Now you can open your garage door with the push of a button from down the street.

As electricity technology improved in the 1920's things like the electric range and oven became more common. The self clean oven was first introduced by Thermador in 1963.

1940's, mainly after World War II, the in home TV started to become more prevalent. Television stations and networks in most parts of the world upgraded from black-and-white to color transmission between the 1960s and the 1980s.

The microwave oven was on the market in 1947, but it was not until 1967 that it caught on in the American household.

You can check the security of your home, turn on or off the lights in your living room, and many other tasks from your cell phone.

Won't it be interesting to see what the technology of the future brings. ❏

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