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# The Riddle Report



## The Security Of A Commercial Property

The problem of security is a major concern of owners or managers of office buildings or other commercial properties. There are many things to check both inside and outside of a property. Particular attention must be given to the perimeter of the property, as this is where an intruder will make the first contact.

For example, an office building should be inspected thoroughly all around the exterior to search for danger spots. No area should be overlooked because entry is possible from almost any point. The age, design, and location of a building will affect perimeter security.

Older buildings can have more security problems because of the style in which they were built. Often there are street-level windows, exterior fire escapes, and operable windows. Each can increase the number of entry points that must be protected.

### Specific Items To Check

Every building will be different, of course. Each will have to be checked, starting at a point and going around the property to return to that point. Here are some things that will always need to be checked carefully:

**Fencing.** If there is a fence around the building, is it just ornamental or will it actually protect the property? Are there any vulnerable spots? If there is no fence, is it feasible to install one?

**Loading dock.** How is the dock controlled during regular operating hours? After hours? What provisions have been made to

ensure the loading dock’s proper operation? What personnel are involved? Are there procedures to control deliveries and removal of materials? Is the dock left untended at any time?

**Windows, fire escapes, and roofs.** Do any of these areas pose potential access problems? If any do, should new grates or locking devices be installed? Check on your local codes.

**Entrances and exits.** (Pedestrian and vehicular). How many entrances and exits are there? Where are they located? What kinds of locks are used? Are the locks effective and who has the keys? What are the hours of operation of each entrance and exit? Is there any kind of alarm system to signal when a door is open? Who responds to these alarms? Would closed-circuit television (CCTV) cameras be of value in any of these locations? If CCTV is used, are the monitors always watched? If there is a parking lot or garage, are the access routes safe?

**Guard service.** If there is a guard service, what are the guards’ assignments in regard to controlling daytime and after-hours traffic and patrolling the building’s perimeter?

**Exterior lighting.** Is there adequate lighting that can serve as a deterrent to crime? Do time clocks or light sensors control the lights?

**Landscaping.** Are there possible hiding places along routes to and from the building? □

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This publication is not a solicitation but is an information service from this office.

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

## Value In Good Management

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

Apartment properties lend themselves to the second way of making profits better than many other types of investments. Increasing the market value of rental units does require know-how, absolute understanding of the market values of this type of property and excellent management.

### Management and Income

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

hardware and software. Professional property managers will do a much better job than most owners and will more than cover their fees.

### Increasing Market Value

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

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

When working with larger commercial and apartment properties, there are two major actions:

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

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## Sale/Leaseback – A Good Investment

When an investor is looking for a management free investment, nothing can beat a sale/leaseback. This is the ideal investment for an absentee owner because the tenant pays all the operating expenses and the investor-owner usually has a completely management-free and trouble-free investment. Typically, the tenant—who is the former owner—will take care of the property. Therefore, a sale-leaseback can be an excellent investment. Watch out though! Make sure that the tenant is dependable and able to pay the rent regularly and promptly.

### The Transaction

Let's say the Smith Corp. owns and operates a manufacturing plant. The corporation wants and needs to free up the capital invested in the plant for other corporate uses. So, Smith Corp. offers to sell the building and lease it back from the new owner.

**Result:** The buyer gets a fully leased property, with an experienced and known tenant already in place.

### What You Need To Check

It sounds good, but here are some things to investigate:

**Tenant stability.** The rental income and the profitability depend on the success of the tenant. A stable, top-rated tenant with a history of past performance is the best kind of tenant to have in a sale/leaseback. Try to determine whether the tenant has any reason other than to free up capital for wanting to sell the building. Is the Smith Corp. getting ready to relocate to another part of the country? Is the product manufactured in this plant being removed from its product line? Is the company in financial trouble and is in need of the cash to try to survive?

**Building Design.** Be careful of single purpose buildings. If Smith Corp. must close its doors, will the building be usable by another tenant without a major overhaul?

**Location.** Is the building located in an area suitable for other tenants in the event it must be re-rented? □

## Things To Check With A Ground Lease

Landowners may choose the ground lease as a way to benefit an easy and risk-free investment vehicle and as a way to secure the long-term appreciation of the property. Sometimes a ground lease can put the lessor at risk. That is because the deal centers on the concept of sharing economic returns. The lessor becomes a partner of the lessee because the total rent is usually determined by the lessee's net operating income or net cash flow. If the lessee does well, the lessor does too. However, if the lessee's business is a loser, so is the lessor.

Therefore, the lessor must consider the financial feasibility of the project. Independent analysis should show that the project represents the correct improvement of the site and that the projected payments will actually be received by the lessor.

**There are at least four things that a prospective**

**land lessor should remember before entering into a transaction:**

- In most land lease transactions, the economic return to the lessor ultimately reflects the underlying performance of the real estate operated by the lessee.
- The lessor's evaluation of the deal must focus on the quantity of income projected pro forma but also must include a clear assessment of the likelihood of actual receipt of projected rent.
- Because the conditions and complexities of a land lease can mask the risk associated with achieving the projected rent levels, accurate assessments of the strengths and weaknesses of the real estate is essential.
- Land lease provisions must be tested against the current fee value of the land. □

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## The High Risk Problem Property

In any market, good or bad, there are always problem properties. Most are only troubled or problem properties because of the current ownership. Some may be neglected only because the present owner has failed to do fairly simple things that can solve the problems. Buying property and solving problems is a profit-making business.

Have you seen:

- An empty office building.
- A remodeled apartment house or hotel that has an excessively high level of vacancy.
- A large tract of undeveloped land that no developer has become serious about wanting to develop.

These are examples of troubled properties.

Properties that are a definite financial burden to continue to hold but which also are unattractive properties to some prospective buyers. Unattractive, that is, until very recently.

The timing now seems increasingly right for investors to obtain troubled property at bargain prices. The pressure on owners and lenders with troubled property to get out from under the on going burden is also high. The result is that syndicates have been formed to seek out and buy up troubled properties.

### The High Risk

Knowledgeable property developers and managers (especially those familiar with empty or near-empty office, hotel, and apartment buildings) caution that buying a troubled property requires taking a very high risk. The financial returns are uncertain and may be

a long time in coming. This type of investment is not for everyone; it's for those who can afford high risk situations.

The profits can come from any one or a combination of circumstances.

- A market turnaround caused by a boom in the local and/or national economy.
- An improved system for promoting and operating the property. Some syndicates are being formed solely to manage the troubled property with an option to buy when and if it hits a specified profit level.
- Purchase of the property at a bargain price, often combined with imaginative and untraditional financing techniques.

Some lenders are asked to share the financial risks by accepting a low initial interest rate in return for a big share of the profits later on. Sometimes the seller of the troubled property is asked to retain a financial stake in the property and to help turn it around. The seller's experience and involvement in the project from the start can be valuable.

- Including the troubled property in a larger development plan. An office building that sits empty might become part of a new industrial park with hotels, conference facilities, and residential apartments, all of which are successful.

Take another look at troubled properties in your area. With fresh new ideas and a re-structuring of the mortgages, the troubles may go away, leaving a profitable investment for you. □

## Controlling Delinquent Rents

A critical indicator of a management company's success is their effectiveness in controlling overdue rents. A well-run property should not have chronically delinquent tenants. However, when delinquency does occur, immediate action must be taken. A list of all delinquent rents must be prepared showing all tenants who have not paid, or for those who have partially paid rents and other monies due. In addition, a delinquency report recording the manner and date of all collection attempts should be prepared.

When initial notification of the delinquency does not help, the property manager should review the lease's termination rights and consider possible legal action against the tenant. Should a delinquent tenant suddenly vacate the premises, late charges and legal fees should be deducted from the security deposit.

Finally, if repeated notices and personal visits by the property manager fail to remedy the delinquency, the manager should contact legal counsel, research

relevant state and local laws, and prepare to file eviction proceedings for nonpayment of rent.

### The Legal Action

Each month, the property manager should review the delinquency report outlining all telephone calls, personal visits, notices, and other actions taken in an effort to collect the rent. This report, along with the tenant ledger, will help determine what legal action, if any, should be taken against each delinquent tenant.

Tenants who generally pay rent on time should be granted an extended grace period in which to pay. In many cases, the initiation of legal action will induce habitual late payers to remit rent monies owed; however, eviction procedures should begin immediately for tenants who are suspected of moving, as well as for those who continue to refuse to pay. Copies of the tenant's lease and the tenant ledger should be forwarded to the attorney, who can then begin legal action. □

## Your Investment Real Estate Experts

Come to our office when you need professional advice and help in commercial real estate. We are experts in values and knowledge of the entire market in this area. If you have been looking for a certain type of property we probably have the full information on several like it already.

Our information can help you so that you can make your own decisions on the value of property either in listing your present property for sale or in purchase of another. If you wish to consider structuring a tax-deferred exchange into that next property, we can guide and aid you with that transaction.

You do not have the time necessary to gather all

of the information to make intelligent decisions in today's complex real estate market. Today's investor in real estate must have a grasp of market conditions and potential that only a full-time professional can furnish. You need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of information, planning is better and there is less chance for error.

Let us be your consultants. □



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A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.