



530 Woodlake Circle, Suite 100
Chesapeake, VA 23320
(757) 523-1900

Robert L.



“Robb” Riddle, CCIM



The Riddle Report

Build-To-Suit And Flex Buildings

There has been a move on the part of industry to relocate from the cities to the suburbs during the past few decades. The prime reasons were cheaper land costs and a greater amount of labor sources.

The result of this has been the establishment of industrial and office parks in those suburbs. Many of these have been planned and developed by private investors; others have been planned or sponsored by public agencies. Preparation for construction of an office or industrial park is expensive. It includes plotting, grading, and installing streets, utilities, rail connections and other facilities. With the increasing difficulties in securing clearances and permits, speculative development in building these facilities is down.

With the economy improving, there is an increase of interest in some build-to-suit projects.

Benefits Of The Build-to-Suit

Some tenants require a certain type of building, so there is always some build-to-suit construction continuing. If the developer has a new tenant requiring certain specifications in a building, his exact needs can be planned in advance and worked into the original construction plans.

In this case the cash flow starts immediately as soon as the project is completed. There are no high risks of speculative development for the developer in such a project.

In good economy or bad, the tenant in any build-to-suit facility does not have to compromise on size or types of buildings.

The Speculative Flex Building

With the improved economy developers are again building industrial parks on speculation. To appeal to the most tenants, builders usually choose low-rise flex buildings.

The flex building is a speculative, low rise, single or multi-tenant building that is designed to accommodate different amounts of office and work areas, depending on the lessee’s needs. The developer finishes the outside of the building and the grounds, but leaves the interior only partially completed until the tenant takes the space. At that time, the interior is customized to provide space for light manufacturing, warehouse and distribution, research and development, sales and accounting or inventory control office space.



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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.

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The flex building is usually one-story. It usually contains standard attributes that help control construction costs, such as:

- Ceilings of 16 to 22 feet. This should suit nearly any manufacturing, distribution and office operation.
- A state-of-the-art HVAC system that will provide zoned temperature control capability, advanced security measures, and “clean” atmospheres throughout.
- Loading docks that are flexible enough to adapt to any tenant’s specific needs. Adequate parking space. Well planned driveways with access for all sizes of trucks.

Benefits For The Developer

Because the building is attractive to a variety of

tenants, the developer finds:

- Lower financing costs because lenders look more favorably on flex buildings than on standard speculative industrial buildings.
- Faster lease-up because a much larger pool of potential tenants exists from which to draw.
- Lower construction costs because the staged construction eliminates costly and time-consuming rip-outs of already installed interior spaces that do not meet a tenant’s needs. Further a tenant’s expansion needs are more easily met (and at lower cost) due to the building’s flexible design features.

In many cases, much of the space in flex buildings may be used for office use. With that use, the building becomes a lower cost all-office alternative to the typical low-rise office building. □

The Role Of The Asset Manager

The institutional investor has found that income property must be placed under the supervision of professional, experienced and innovative managers. With more property moving into the ownership of institutions and real estate investment trusts, the need for asset managers increases.

Asset managers have become more important during the past decade for three major reasons:

- New classes of real estate owners (notably, pension funds and foreign investors) lack the “hands on” expertise of the individual owners and small ownership groups of former years.
- Corporations now have approximately 25% of their total assets in real estate, and are now emphasizing its importance for profits.
- Investing in real estate has become much more difficult than in previous years because of increased competition for tenants, difficulties in getting financing, and increased government regulation.

Most real estate professionals are unfamiliar with the functions of an asset manager (apart from realizing that the asset manager has a different job from the property manager).

The Asset Manager

The asset manager fills the leading role in the profitable management and performance of a real estate asset. This manager assumes a fiduciary relationship with the real estate owner and accepts the responsibility for managing the real estate asset so that it

achieves the highest performance within the owner’s guidelines.

Example: An investor acquires a commercial property for \$15 million, of which \$6 million is paid in cash and the balance with an institutional loan. The investor’s goal is a 10% annual cash flow return (\$600,000 per year) and a sale in the tenth year, at which point cash will be needed to pay off the balloon loan. The investor hires an asset manager to oversee these objectives. The asset manager’s focus will be on maximizing the economic return through the use of profit-enhancing techniques. These include:

1. Balancing the loan/equity ratio in order to maximize leverage.
2. Employing and coordinating professionals with expertise in particular aspects of operating this property.
3. Minimizing liability exposure through appropriate lease provisions and insurance coverages.
4. Gathering and applying information concerning the market.
5. Constantly reviewing prospective buyers, since the maximum property value may be achieved some time before the tenth year.

Planning The Project

The roles of the asset manager’s are as follows:

- **Supervise property management.** The asset



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manager should supervise the overall operations of the property management company, i.e., define general management policies, monitor non routine decisions and transactions, and serve as a liaison between the property manager and the owner.

- **Supervise leasing and marketing.** The asset manager should review long-term leasing policies, monitor large or unusual transactions, and act as a liaison between the leasing firm and the owner.
- **Manage cash flow.** An essential and time-consuming role is to handle cash flow, the true measure of the economic success of the asset. Cash controls should be instituted and monitored.
- **Report requirements and timing.** Frequent reporting of pertinent information to the owner keeps him/her informed about the status of the property and makes necessary decisions easier.
- **If the owner is a foreign investor,** the asset manager may have the responsibility of preparing U.S. tax returns. For domestic investors, the asset manager's role would be limited to providing the essential tax information to the owner's accountant.
- **The proper maintenance of the property** is a major responsibility of the asset manager. This

includes overseeing a maintenance program and managing a capital improvements program. In making voluntary capital improvements, the manager must be sure that the prospective return exceeds the cost of the capital needed for the improvement.

- **Retain other professionals.** Attorneys, accountants, appraisers, and mortgage brokers are just some of the professionals who frequently must be retained in the course of managing improved real estate. The asset manager often has the responsibility of choosing a professional, although the choice may need to be ratified by the owner.
- **Contract adherence.** Contractual relationships often exist in connection with income real estate. These include the asset management agreement itself, the property management agreement, service contracts relating to the real property, tenant leases, mortgages and deeds of trust, and possibly a partnership agreement among the property owners. With the exception of the partnership agreement, the asset manager will be involved with these agreements in some manner. The manager should be aware of critical terms and provisions that give the owner valuable rights (e.g., a renewal right) or that can result in default if not complied with. □

Office Building, For Attorneys Only

Property managers must show some imagination to keep a property fully rented. One way to keep an office building occupied is to consider specializing—renting to members of one professional field.

Members of the medical profession have long realized the advantages of having an office in a medical building (that is, in a building occupied only by professionals in the health care field). The building is designed, equipped, operated and maintained solely for their particular professional needs.

This concept can also work for attorneys. Many attorneys would like to be in a building that is convenient to a central area, such as county and federal court buildings. One feature that could be even more important to attorney tenants and to the owner, in keeping tenants happy, is the fully equipped law library.

The Legal Office Amenity

When a law firm initially assembles a law library, it costs thousands of dollars. It costs thousands more each year to keep it up-to-date. This expense may

be the one thing that forces many attorneys to form partnerships or to share office space.

In one property, the developer created a long, enclosed room for the law library. He set aside one side of an entire floor and built in shelving to hold the books. Since the property was being developed for this purpose, the floor was given special design treatment. Floor loads for a library will be much higher than in other parts of an office building. The only furniture required for the room is worktables and chairs.

All of the tenant-attorneys in this building pay a small amount each month toward the salary of a full-time librarian who assists the attorneys with their research, handles the filing and book ordering, and takes care of the book collection.

In the building in our example, the suites filled quickly, rented to law firms only. The tenants stated that the law library was the attraction that convinced them to rent in this particular building. □

The Professional Approach To A Lease Renewal

No matter what the current vacancy factors are in any area, tenants feel they can negotiate with the landlord, whether in an apartment building, an office building, or commercial center.

With other space available in the local rental market, the tenant will certainly be aware of all the possible terms for a lease renewal. If the owner or manager of the property is inflexible and unreasonable, tenants know they will have no trouble finding available replacement space in a building nearby. A professional manager is aware that a prolonged lease negotiation can quickly result in a vacancy. In an eagerness not to lose prime tenants, landlords may try to sweeten the pot by offering new amenities or higher levels of service than tenants actually would ask for. These promises may not even be necessary.

According to surveys of tenants, they place nearly equal weight on three factors when deciding whether to renew their leases:

- The financial terms of the lease.
- Location and amenities of the building
- Quality of services and management.

When a tenant is satisfied with each of these factors, they are likely to renew the lease.

If they are dissatisfied with any of the three, they are likely to relocate. If the tenant is not happy with the service quality, cutting the rental rate by a small amount probably will not reverse the decision to leave.

If the building location is good, the lease terms are fair, management is handled well, the tenant usually is not in a hurry to move to another building for just a few simple amenities.

Removing a popular amenity, even temporarily, will affect the tenant's attitude negatively. However, tenants will tolerate the inconvenience and dislocation of a major renovation as long as the work proceeds on schedule and is completed when it was promised.

The most important factor in renewing a lease at any time is good management at all times. A professional property manager keeps the tenants happy by delivering top-notch service to every tenant, month in and month out, rather than trying to impress those with expiring leases with amenities and favors. Remember, every lease eventually ends, and tenants have long memories. □

Help With Investment Real Estate

When you have searched for new real estate investment opportunities, with values that have been changing, you know that finding and evaluating them is becoming more sophisticated and complex. More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors 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.

Real estate investing is not just looking for the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

Our office is open and ready to assist you. We have been experts in property values in this area for a long time. We can help you with enough information 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.

Let us guide you in your investments. □



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Robert "Robb" Riddle, CCIM



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.