

# How to Profit Most from Different Types of Income Property

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Take a few minutes to look at what you will have to sell. Just what types of properties do we classify as income property?

Income property brokerage is a specialty within a specialty. First, you must understand the difference between real estate investments and income property.

## How an Income Property Differs from a Real Estate Investment

Income property is to real estate investments as an apple is to fruit. Income properties (apples) are a kind of real estate investment (fruit); however, not all real estate investments (fruits) are income properties (apples). What makes the difference? Let's look at each in order.

- *Real Estate Investments (in general)*. Any form of real estate can be bought for investment purposes. This includes raw land, houses, apartment houses, condominiums, vacant warehouses; in short, any real estate, anywhere, can be bought for investment. Ten thousand acres of swamp in Brazil—vast acres of desert land—a house lot in ski country—a 40-story skyscraper—all real estate investments!
- *Income Property (a real estate investment that generates rental income)*. The name itself includes the element of *income*. In short, income property includes a real estate improvement which generates *rental income* out of which must be paid the regularly recurring operating expenses (i.e., real estate taxes, insurance, heat, payroll, etc.). All financing costs (principal and interest pay-

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ments) must also be paid from the rental income. What is left over is the “cash flow” or “net return” on the owner’s invested capital.

### **Why Income Property Is So Attractive to Investors**

A vacant industrial building can be bought for investment, but not for current income. The same industrial building with rent-paying tenants can be bought for *income*. Vacant land can be bought for investment, but unless leased, cannot be bought for income. The main reason that income property makes such an attractive brokerage commodity is that the investor can often purchase it with relatively low cash down, finance 60 to 90 percent (sometimes more), and obtain enough income from the tenants to pay the operating expenses, the cost of financing, and give him a *current* return on his invested capital. We will discover that even when there is insufficient income to cover all of these costs, it is quite possible, because of our tax laws, to enjoy a positive *after-tax* cash flow.

Potential investors for *non-income*-producing real estate (such as land) are in much shorter supply, because they must not only have 50 to 100 percent cash available for the initial purchase, but must also have sufficient capital to carry the year-to-year expenses—such as taxes—until the time comes to develop or sell their investment. For every such investor there are several thousand investors who are ready, willing, and able to buy income-producing properties.

With this understanding, let’s look at some specific types of income property.

### **Types of Income Property**

#### **Apartments**

The most common and best understood form of income property is the apartment house. The apartment house can run from the frame two-family house up to the 500-unit apartment complex. Newer apartment houses are generally of brick construction, and range from the suburban *garden type* apartment house to the urban high-rise apartment building.

Older apartment houses of brick construction are usually located in urban areas (although there are a few in older suburban areas). They are often referred to as elevated buildings or *walk-ups* (without elevators).

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Smaller apartment houses of frame construction are scattered throughout both urban and suburban areas. These are generally considered less desirable than brick apartment house investments, but may be just right for certain types of investors who want higher cash flow.



Many larger older homes have been converted into apartment houses. This type of conversion gains momentum as zoning laws are changed to reflect increasing housing demands. If well located, these can make excellent investments. The illustration above shows a suburban stucco mansion that was converted into luxury apartments. It will probably still be standing when some of today's new apartment buildings are long plowed under. This building was purchased in the mid-1960s for \$68,000 with no cash down. It sold in the 1970s for \$272,000, and was converted into condominiums in the 1980s. Some individual units today sell for over a half a million dollars.

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### **Office Buildings**

In time, you may want to add office buildings to your inventory of income properties. They are not so easily managed or understood by the unsophisticated investor; however, they comprise an integral segment of income property offerings. The most common type of office building is the older urban multistory building. In most urban areas, there is a great upsurge in demolition of older structures and construction of new ultra-modern office buildings. Suburban areas are now dotted with smaller office buildings often called *professional buildings*. They are relatively easy to manage and make prime candidates for income property listings.

### **Retail Blocks**

A *store block* may be located in heavily populated urban areas, or may comprise the entire downtown of a small suburban locality. They are made up of anywhere from one to a dozen or so retail stores, usually abutting each other and under one roof. Each store usually has its own heating system. Some of the strip store blocks in marginal locations are suffering from the heavyweight competition of the shopping centers. However, store blocks in low-vacancy areas, in prestige towns, or in high foot-traffic areas make sound acquisitions for the investor who doesn't want to be bothered with apartment-house-type complaints, providing the investor is aware that a vacant store takes considerably longer to fill than a vacant apartment and is willing to take the risk inherent to this situation.

### **Shopping Centers**

Shopping centers are a glorified form of retail block, usually located on a large parcel of land with self-contained parking facilities, and usually leased in part to highly rated retail concerns. Shopping center investors are a sophisticated lot and must, by the nature of the investment, be well versed in the intricacies of complicated lease negotiations.

### **Industrial Buildings**

Industrial buildings leased to one or more tenants make excellent investments; however, this is a specialized type of acquisition, and owners of industrial buildings are well versed in negotiating with large business concerns and in the pitfalls of im-

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proper lease protection in various areas. Usually an older industrial building will provide a higher-than-average return, and will additionally allow the owner to control strategic land for future development.

New industrial parks now dot the suburban landscape. Many times the developer of an industrial park will sell individual buildings or, on completion, the entire complex of leased buildings. These newer industrial buildings on long-term leases make excellent investments.

### **Other Special Situations**

The income property broker may be called upon to market other special types of income property, including special purpose properties such as post office buildings on lease to the United States Government, gas station sites on lease to major oil companies, ground leases, parking lots—in short, any specialized form of real estate, including single-family homes and condos, which is leased and producing income.

The average income property broker will avoid excessive involvement in properties that require a high degree of business management. Included in this category, for example, are hotels, motels, nursing homes, marinas—and even cemeteries. Also, generally included in this category are restaurants, taverns, and any other form of business where the major portion of the income is produced not by the real estate itself, but by time-consuming management.

### **Single Tenant Net Leased Properties**

Properties that are leased on a relatively long-term basis (10 to 20 years or longer) offer a special opportunity to income property brokers. Usually some good solid experience with other more common property types will provide an agent with a background to deal successfully with this type of product. Single tenant net leased properties are often quite attractive for certain specialized tax situations, are generally management free, can be relatively risk free, and lend themselves to online marketing as discussed later in this guide.

### **Types of Income Property That Comprise the Bulk of Sales**

The average income property broker finds that his time is spent primarily on the sale of apartment houses because, as we have seen, the average investor understands

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them better and manages them more capably without a high degree of specialized knowledge.

Over the years our sales breakdown is roughly as follows:

Apartment houses	70%
Retail blocks and shopping centers	15%
Office buildings	10%
Other	5%

### **Should You “Draw a Line” in Taking Listings?**

Many brokers who want to enter the income brokerage field ask, “Just where do you draw the line when it comes to listing?”

To answer this properly I should say that, if you are going to augment your residential brokerage business with income property brokerage, then you would not draw any lower limit. A two-family dwelling would certainly be within your selling domain.

In larger offices specializing in income property brokerage, a line must be drawn, however, or the brokers would be swamped with listings that are outside their specialty. Many never accept a listing on a single-family house—no matter how big or desirable and no matter how high-priced. There is a great temptation, on the part of new brokers who have come into this specialty from residential sales, to take listings on expensive homes they run across in the course of normal business. Eventually they learn that, with their specialized knowledge and administrative support, they are much better off in terms of income and satisfaction when they stick to their specialty.

### **Time Consumers**

You may want to consider avoiding listings on going businesses—such as restaurants—or any other type of real estate that does not generate income in and of itself. Occasionally, we will accept a listing on a motel, hotel, or on land explaining to the owner that we can quarterback a contemplated sale of these types of property working with a broker who specializes in them.

Aside from apartments, which will be discussed shortly, the other types of in-

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come property—such as store blocks, shopping centers, office buildings, and industrial buildings—are all priced high enough so that we need not set a lower limit.

The important thing to remember, whatever your specialty, is to concentrate on *profitable* properties—and to be careful of time consumers!

### Why Size and Distance of the Property Is So Important

Small apartment buildings pose a problem to the income property specialist. We do not usually consider a two-, three-, or four-family dwelling as income property, but more as a private residence for an owner-occupant who wants additional income to offset his living expenses. We will accept a listing on a three- or four-family dwelling if it is very close to our office and in a high-demand area; however, because of the nature of our business, geographical considerations mean a lot. The farther from our office a property is located, the more difficult it is for us to inspire our agents to travel to it—unless it is a very substantial property.

There is one exception to our general rule of not accepting listings on two-, three-, and four-family properties. This occurs when a seller comes to us with several three-families in a package, and wants to sell. Even a small block of rented one-family units could bring a gross consideration that would make it well worth our efforts.

As a rule of thumb, the farther away a property is located, the larger it must be for us to accept the listing. The following illustration will give you some guidelines.

<i>Distance</i>	<i>Minimum Price</i>
4 blocks	\$200,000
2 miles	\$400,000
5 miles	\$500,000
10 miles	\$1,000,000
20 miles	\$2,000,000
50 miles	\$4,000,000
over 50 miles	\$6,000,000+

The limitations are arbitrary, but are based on how much money a selling broker can earn in relation to time expended. Exceptions may occur when an unusually

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prime investment becomes available; then the area will expand. I know, however, that the limits will not expand much beyond the limits indicated above. I owned an exceptional waterview apartment building which today would be listed at around \$800,000 and was located twenty miles from our office. If this property had been a two-to-five-mile drive from our office, it would have sold in four weeks after about ten showings. As it happened, though, my agents didn't show it twice in four months!

### **How to Use Your Efforts Most Profitably**

Agents entering the income field often ask, "Where should I direct my efforts? What general type of property is easiest to deal with?"

Apartment buildings are the most productive in terms of total sales from time expended. As noted earlier, there are many more investors for apartments than for the other types of income properties. The average man or woman can understand renting an apartment to another individual, and can understand the relative simplicity of apartment-house leases. The average investor with the assistance of a qualified broker can easily analyze the income potential and operating expenses. On the other hand, they will often shy away from the complex operating procedures of large office buildings, shopping centers, and industrial buildings.

As you continue on in this Guide, you will find that generally we have used the apartment house in examples of how to apply most of the practical techniques given to you from chapter to chapter. This procedure is intentional, as apartment houses are so easily understood. Wherever a technique differs in its application to office buildings, store blocks, shopping centers, or any of the other various forms of income property, this difference is spelled out.

Keep in mind, however, that each of the methods you will learn generally applies to all types of income property. The methods of finding owners who will sell and of obtaining the listings are essentially the same. Pricing at the action level, financing, and setting up the operating statement involve the same basic procedures. The special benefits of ownership apply equally to all income property types. The techniques you will use in dealing with prospects while qualifying, showing the property, and closing the sale are all the same, whatever the type of property involved.

If there is an abundance of non-apartment income property in your area, simply apply the practical procedures in each chapter to that type of property. In most



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areas you will find that there is a greater abundance of apartment-house listings, and that the turnover in ownership is much greater than in other types. In any event, start with smaller buildings but, after some experience, be prepared to move on to big complexes. The brokerage procedures are exactly the same—the figures are just larger (and so are the commissions).

### **Cyberspace Marketing Tips**

As you begin to use the special cyberspace marketing techniques contained in this Guide you will begin to appreciate the effect your ability to easily reach out across geographic boundaries and market areas will have on your selection of the types of properties you will list and sell.

You can use the Internet to see what properties are for sale by type. Just go to any search engine (Google is in vogue at this writing but others may come into vogue). Type in “apartments for sale.” Today that search brought 623,000 results.

Narrow your search by typing “apartments for sale” + “Florida.” That narrows your search to 36,500. Narrow your search again by typing “apartments for sale” + “Orlando.” That narrows your search to 10,900. By zeroing in on the Internet you can identify the various types of income properties available and very quickly gather significant insights into the availability and characteristics of your potential inventory.

There are also several databases available online that provide specialty specific information. Current examples are those located at [www.loopnet.com](http://www.loopnet.com) and [www.ccimnet.com](http://www.ccimnet.com). The Real Estate CyberSpace Society maintains very thorough links to just about all industry for sale databases not only in the United States but also in many countries outside the United States. Because companies and links often change your best starting point is usually at: <http://www.REcyber.com/ciproperties.html>.