CHAPTER 1

An Overview of the Problem, a Solution, and a Game Plan

The Problem

If you are like 99 percent of the people on this planet, you have a problem: Namely, you must work to make money to eat and live.

It is a vicious cycle. You get up at 7:00 A.M., get out the door by 8:00 A.M., arrive at work at 9:00 A.M., push paper around all day, and leave at 5:00 or 6:00 P.M. You follow the same routine day after day. Your net pay is, say, $70,000 per year, you give 20 to 25 percent away to Uncle Sam, and your annual living expenses eat up the remaining money. The net result at the end of the year is no savings—zero, a goose egg, *nada.*

The next year you get a big promotion and an accompanying raise of 5 to 10 percent (if you are lucky). You have been waiting all year for this big raise. Your family has grown from husband and wife to husband, wife, and baby, and now you are expecting your second child. All year you have been putting off buying the new, latest and greatest big-screen television system and the much-needed trip to Hawaii, not to mention replacing that overused, tired Acura with a new Mercedes. What do you do to satisfy these pent-up demands? How do you satisfy these desires that have driven you for the past couple of years? The answer is that you move out of that cramped 1,500- to 2,000-square-foot apartment into a "decent" 3,000- to 4,000-square-foot home with a real backyard, you buy on credit the big screen "deal," you take the family on the long-delayed vacation to Hawaii, you lease a new car, and so on. The point is that you find a way to spend your increased wages and, with inflation, you are back in the same breakeven position you were in when you started a year ago, or even worse, since you have significantly increased your debt position.

We have identified The Problem, the cycle: You are working to meet the necessities of life including paying your silent partners (the state and federal governments), and you are consuming any remaining cash to satisfy pent-up demands for goods and services.

The Solution

The question becomes, how do you break this cycle? What is The Solution?

There is no single right answer to this question. There are several solutions to The Problem. The best solution I have found lies within the realm of real estate. You buy a *value-added property,* by which I mean a property that through your focused efforts can be improved and enhanced so it is worth significantly more after your efforts than when you acquired the asset. Your efforts usually revolve around increasing occupancy, but it can be a myriad of other tasks such as improving the overall appeal of the property through structural or cosmetic changes or changing the tenants by bringing in more viable businesses or more synergistic users, and so forth. Let's call your first acquisition "Property Number 1." You then:

- Acquire Property Number 1.
- Lease up or otherwise improve Property Number 1.
- Refinance Property Number 1, pulling out monies in excess of the existing debt at least equal to the original equity invested.
- Invest the refinance proceeds into another property (Property Number 2).
- Continue to manage Property Number 1, reaping the benefit of the positive cash flow and earning a management fee.
- Lease up or otherwise improve Property Number 2.
- Refinance Property Number 2, pulling out monies in excess of the existing debt at least equal to the original equity invested.

- Invest the refinance proceeds into another property (Property Number 3).
- Continue to manage Properties Number 1 and Number 2, reaping the benefit of their positive cash flow and earning a management fee.
- Lease up or otherwise improve Property Number 3, and so forth.

Four Key Elements in the Solution

Why does this Solution break the cycle? Because of four key elements.

Key Element Number 1

First, you are no longer limited in your earning potential by your salary or by your professional endeavors; rather, you have become an investor. You have converted active income into passive income. When you sleep at night, when you go on a vacation, you continue to make money. Your assets appreciate (hopefully) in value over time and in the normal course of events each month you build equity by paying down the principal on your mortgage. A mortgage usually contains an amortization feature; therefore a portion of each payment reduces the outstanding loan balance and consequently increases your equity, everything else being unchanged.

Usually the individual caught in the cycle is employed, earning a good living, but his livelihood is based upon his own individual capacity to do a job and get paid for that work. The basis of The Solution is a move to a business model that has the capacity to create wealth, not only from individual effort, but also based upon market forces. If you correctly analyze the market and correctly perceive that *capitalization rates* or *cap rates* (the rate of return an investor requires to induce him to purchase a property for all cash without regard to financing) will likely fall from 10 percent to 7 percent, then, even if no other change occurs in the real property investment, your property value will increase significantly. Market forces have resulted in a value shift. Similarly, if you purchase a property in a growth community and the resulting population growth fuels an increased demand for goods and services, that results in an upward push in rents, which translates into a higher net operating income, and therefore an increased property value. Again, market forces have driven value upward.

It is important to understand the difference between *active income* and *passive income*.

Active income is income earned through services rendered or goods sold. What is meant by "services rendered"? The concept of services for hire includes the broad area that comprises everything from practicing medicine to providing janitorial services. "Goods sold" refers to any product sold, from real estate to pencils.

The more difficult and more esoteric question is: What is *passive income*? Simply put, what I mean by passive income is income earned *not* by rendering services or selling goods. This does not mean that you do not have to work to make passive income, but rather that your work is of a different nature. Owning stock in a company, or for that matter owning the company itself, is an example of creating passive income. The employees of the company perform the functions that generate profits and dividends for its shareholders. The point is that the owner of the stock did not actually have to perform "labor" to receive the dividends paid. Similarly, the owner of real estate earns profits from rents, yet he does not actually provide services to the public or sell goods to the public. The delivery of services or the sale of goods is the function of his underlying tenants.

I want to emphasize once more that earning passive income does not mean that you do not have to work. The stockowner must spend time researching or hiring someone to research profitable stock selections and the monitoring thereof. Also, the real estate entrepreneur must operate his properties or employ a property manager. It can be demanding to invest in the stock market or to own and manage real estate. The individual who establishes a profitable stock portfolio did his research or had research done on his behalf. He verified that the company whose stock was purchased has a good management team, reasonable liquidity to survive tough times, growing sales, and net profits. He might also have an insight into the industry trends relating to the applicable field. Similarly, owning and managing real estate is a business. It requires insight to know when to buy and when to sell, as well as where to buy and where not to buy. Once a property is acquired, someone must invoice the tenants, collect the rents, coordinate vendors, and deliver services to tenants to ensure efficient operation of the asset. Someone must lease-up vacant space and make strategic decisions ranging from tenant mix to the overall look of the property to whether or not to expand the project by building-out additional leasable square footage to whether to refinance or sell. If a decision is made to refinance or sell, an individual must decide under what terms to borrow or under what terms to sell.

Notwithstanding the above, being a stock investor or a real estate owner is, in general, more akin to managing an investment as opposed to running an operating business that might require hundreds of employees. Yes, to be successful you need insight into what to buy, but you can to a large extent outsource the selection of the asset, as well as its care and feeding thereafter. That said, a good full-time investor will, at a minimum, manage his managers, and a superior full-time investor will take an active role in his business even though his business is not, in general, a labor-intensive one.

Rule Number 1

Convert active income into passive income.

Key Element Number 2

The second crucial step in breaking the cycle is to create a cash-flow model that generates consistent monthly dollars that can be built upon so that within a certain time frame the monthly cash flow equals $2X.

In other words, relating this step back to The Solution, if, for example, Property Number 1 generates $10,000 per month in revenue, then acquiring and leasing-up Property Number 2, which generates $10,000 per month in revenue, results in a cumulative cash flow of $20,000 per month. Acquiring and working Property Number 3 results in another $10,000 per month in net cash flow for a cumulative $30,000 per month.

Obviously, stating the objective is quite a lot easier than locating a property and executing a game plan that will generate a significant positive cash flow. However, the important point is that, yes, it is important to build value, but it is also important to build monthly cash flow.

Rule Number 2

Create a monthly cash flow model and build upon that model.

Key Element Number 3

The third key element in breaking the cycle is knowing that size matters. It is simple math. If your profit is $50,000 per year on Property Number 1 and Property Number 2 is 10 times as large as Property Number 1 then, everything else being equal, Property Number 2 will generate $500,000 in profits per year! The potential profit is ten times that of the smaller project, but usually not ten times the amount of work.

I have also found that there is more "wiggle room" in larger transactions. When you are working with a small real-estate project, the potential options to make money typically are not as readily available when compared to a much larger investment. For example, in a large real property project there might be excess land, which might allow you to build additional improvements or increase the size of the existing structures. Parking and its relationship to the net rentable square feet of the project is crucial when analyzing the allowable square-foot size of a development. The parking requirements for medical office projects typically require five parking spaces for each one thousand square feet of office space. Consequently, if you have a 60,000-square-foot medical office building the required parking would be 300 spaces, that is, 60,000 divided by 1,000 equals 60 times 5 equals 300 spaces. If you in fact have 400 parking spaces, 100 "excess" spaces, you have ample parking to support an additional 20,000 square feet of improvements without having to add more parking. Assuming a parking ratio of five spaces per thousand square feet, the calculation is reflected in the following formula:

$$\frac{X(5)}{1{,}000} = 100 \text{ spaces}$$

"X" represents the amount of additional square footage you can build. To solve for "X" you would divide by 5 and multiply by 1,000.

$$\frac{X\,(5)1{,}000}{(5)1{,}000} = \frac{100(1{,}000)}{5}$$
$$X = 20(1{,}000) = 20{,}000$$

In a recent project in which I was involved, I had excess parking and so was able to expand the project size by enclosing balconies. On other projects the excess parking allowed me to build an additional structure on the medical building campus and, in the case of a retail development, on an "out-pad" (a parcel removed from the in-line retail shops). Alternatively, you could possibly lease any extra parking spaces to an outside user, such as a local restaurant or a car dealer.

Rule Number 3

Size matters. If possible, work on large projects.

Key Element Number 4

Lastly, in our capitalist society the trick is to be able to expand your real estate portfolio so that you can create an infrastructure that allows you to employ individuals still trapped in the cycle. Going back to the model, The Solution builds in growth. You buy Property Number 1, lease it up or otherwise create value, refinance it, buy Property Number 2, continue to manage Property Number 1, reaping the benefits of the positive cash flow and the management fee, lease up or otherwise create value in Property Number 2, refinance it, buy Property Number 3, continue to manage Properties Number 1 and Number 2, reaping the benefits of their positive cash flow and management fees, and so on. Growth is implicit in the model. You acquire additional properties and manage the new properties acquired as well as the previously acquired properties. It is therefore important to hire personnel who can competently run the properties once you acquire them. Delegation is crucial. How can you search for Property Number 4 if you have to focus all of your energy on managing Properties 1, 2, and 3?

In the long run, my philosophy and opinion is that in order to keep valuable employees/partners you must involve them in the business so that they have the opportunity to participate in the company's growth and success and thereby also break out of the cycle.

Rule Number 4

Create an economic environment that allows your employees, your team, to become invested in the future success of your company and allows them the means to be able to eventually break out of the cycle.

Concerns about the Solution

Keep in mind that no solution is a panacea. If you find yourself at a cocktail party and hear someone saying, “Buy real estate, you can’t lose!” know that they are not telling the whole story, or that they have had one too many martinis. *Caveat emptor.* Care must be taken when purchasing real property. Buying real estate does not guarantee a profit. You can also lose money! If you purchase properties that have problems or that develop issues, your result may be a negative cash flow. Real property value is based upon rents derived from the project. If major tenants do not renew their leases or if they breach their leases and vacate the property, the resulting cash-flow disruption usually translates into problems. You can end up feeding the property instead of reaping a positive cash flow. What is more, purchasing marginal properties with marginal returns does not result in wealth creation. It results in marginal returns or even in losses if something goes wrong, which it often does. In part, proper due diligence procedures and follow-up on your part will avoid these results, but ultimately it is your execution of a viable game plan and your vision and foresight that will make the difference between winning or losing.

There is also the question of how to get started. When discussing The Solution with individuals seeking to escape the earn-pay tax-spend cycle, the first and foremost comment I often hear is: “I can’t achieve this. I can’t afford the down payment to buy this.” I believe a lack of capital can be overcome. However, I want to make it clear that I am not an advocate of the “nothing down” purchase. First of all, usually there is something wrong with these types of transactions: too much unperceived risk, undisclosed problems, and so forth. Second, even if this can be accomplished, it places too much burden on cash flow and greatly increases your risk of default.

The way to overcome a lack of capital is through firsthand knowledge and experience. The individual who applies himself through study and through practical work experience in the real estate field should be able to partner with a capital source. In order to be successful in this approach you should, ideally, move beyond obtaining your college degree in real estate, beyond securing your real estate license, and beyond accumulating professional experience in a real estate field such as real estate investment sales, financing, or appraisals. What is most useful is to specialize in a specific product type in a specific local geographic area or areas. By focusing on a specific product in a specific area, you gain the market knowledge you need to be able to identify undervalued projects as well as to develop a strategy whereby you may execute and create value through management skills and contacts you have nurtured. The key is to gain the know-how and the knowledge to understand whether one transaction or another will result in a superior return and to know how to move an investment from a marginally performing property to a phenomenally performing asset.

Acquiring the Skill Set to End the Cycle

Ideally, in order to break out of the cycle, you should focus on five areas. First, you need a basic understanding of accounting. Accounting is the language of business. This is not to suggest that you have to become a CPA, but an understanding that goes beyond college courses, a practical understanding, is helpful. Second, it is necessary to have an understanding of legal principles. Contract real estate law is a recurring element in real estate transactions. A lease, which is a binding legal contract between the landlord and the tenant, governs the economics of a project. Third, it is crucial to have a practical knowledge of real estate financing, since financing is usually 50 to 80 percent of a real estate transaction. Next, it is essential to understand the basic concepts of the field on which you are focusing. In real estate, it is important to have a grasp of basic real estate principles, for example, knowing the difference between a fee simple estate and a leasehold estate. It is necessary to be able to answer relevant questions such as, *If the property to be purchased is a leasehold, what provisions must be in the lease to make it mortgageable*? Lastly, you must know how to structure a transaction. This knowledge usually comes from a number of sources: experience, discussions with senior people in the field who have put transactions together, and studying Chapter 11 in this text!

A Game Plan to Achieve the Solution

In subsequent chapters of this book, I discuss The Solution in greater depth, but at this point it is important to understand the basic principles underlying The Solution:

- Converting active income into passive income.
- Establishing a monthly cash flow model.
- Understanding that size matters.
- Understanding that an infrastructure, a team, should be created to capitalize on investment opportunities that arise.

I have identified The Problem and The Solution. The next logical question is: How do you achieve The Solution? I could discuss taking responsibility for one's actions, and having a positive attitude. I could offer case studies showing ordinary people accomplishing seemingly impossible tasks. These elements are important and discussing them can be motivational, but my approach is, I believe, less theoretical and "heady." It is more practical and down to earth.

The objective in the balance of this book is to create a framework to achieve The Solution.

I set forth an outline, which I call a business plan. I then identify concrete goals and actions items or "to dos" that, when fulfilled, will allow you, over time, to carry out your business plan. To some extent, your business plan and your goals may overlap and the goals may be incorporated into the business plan. The distinction is that although the business plan may, at times, be lofty, its goals and action items are always detailed and specific. I call this methodology of achieving The Solution "The Game Plan."

The Business Plan

One of the product types I have specialized in is medical office buildings. Part of my time is spent counseling my doctor tenants on how to run their businesses. Medical schools do not, but should, teach doctors how to run a small business. To be successful, solo practitioners must understand where their lead sources come from and how to solicit these leads. They must also understand contracting, collections, personnel issues, and more. These subjects are not part of the medical school curriculum.

The first question I ask a doctor when I sit down with him or her is: Do you have a written business plan? Invariably the answer is "no." It is a mistake not to have a written business plan, especially for doctors who are just starting out in their practice. Established doctors usually have solidified their referral sources. Doctors that are just starting their practice usually have not created a solid referral base. By committing the business plan to writing it can be more systematically and logically analyzed and therefore improved upon, so a plan of action can be more effectively implemented.

My number one objective in a business plan is to bring out issues so they can be reflected upon and so that creative methods of dealing with these issues may be identified. I attempt to think outside the box.

There is no set format for a business plan. I prefer a written narrative business plan rather than bullet points. I find that a narrative generates thought and analysis rather than cursory conclusions. Suggested topics to cover in a business plan may be found in books devoted to this subject or even on the Internet. My narrative business plan attempts to cover the following nine areas.

1. **A short summary of what the business is all about.** What are you trying to accomplish? This section summarizes the entire plan. For example: *Purchase 50 million square feet of neighborhood shopping centers nationwide under centralized common ownership and management and then take the venture public by forming a real estate investment trust.*
2. **A description of the business.** Where is the business to be based? What product or service is to be provided? Who are the target customers? What price range is the focus?
3. **The philosophical viewpoint of the business.** The fundamental core values go beyond making money. Of course, the objective in a for-profit business is to make money, but this part of the plan should focus on ethics and assist in creating an ethical guide for the company.
4. **An organizational guide.** An organizational guide covers legal structure, percentage ownership, the composition of the management team including the function of each member, compensation, and an organizational chart indicating who reports to whom. In the context of a real estate company, the structure of the property management team should be addressed and possible anticipated staffing needs might be covered.
5. **Product or service?** This section contains a detailed description of the product or service to be delivered. Again, in the real estate context, such issues as the company's acquisition

criteria including size, location, product type, number of tenants, vacancy factor, capitalization rate, internal rate of return over a 10-year period, and so forth, may be covered. Part of the plan should also cover existing owned product—for example, steps needed to enhance existing owned shopping centers might be covered.

6. **Marketing.** In the real estate context, this section should cover both the acquisition of new product as well as the lease-up of existing owned projects. Should your acquisition efforts be geared to working with brokers, direct advertisements, cold calls, or a combination of these methods? Should filling vacant space be done through working with outside brokers, internal staff, or a combination of these two approaches? Extensive thought and effort should be placed in this section since marketing is pivotal between sterling success and mediocre results. (Please refer to Chapter 10 for additional comments regarding designing a marketing program for the lease-up of a project.)
7. **Financial analysis.** How is the company doing overall? What does the income and expenses of each project look like? Annual budgets should be generated for each project with comparison columns to last year's results. This section might also cover funding needs for the company as well as possible sources of capital.
8. **Future strategies.** Strategies for expansion and issues surrounding growth might be covered in this portion of the business plan.
9. **Miscellaneous.** This is a general catch-all category of broad and specific company issues and matters not specifically covered above, such as ways to improve employee and organizational performance.

Goals

Regarding goals, I set annual goals and long-term goals, that is, things I want to accomplish within the year and objectives for five-plus years out. My personal system is to write up my goals mid-year in June or July and then revise, update, and finalize my goals late December through New Year's Day.

I feel it is important not to have a thousand goals. It is my belief that if you have too many goals, your energy is dissipated and you accomplish nothing. I attempt to limit my goals to 10, with an absolute maximum of 12.

After I have written and revised my goals I post them at my bedside. I read them when I go to bed at night and again when I wake up in the morning. Consequently, they are constantly in my mind's eye. If you desire to accomplish something, focusing unwaveringly on that task is the best way to achieve the desired result. If you wish to own and operate your own trash removal business, if you get up each day and labor hard, working the same route, picking up the trash and driving the truck to the dump, thinking *how quickly can I get this over with?* you will never reach your objective. However, by contrast, if you get up each day saying *I want to own my own garbage disposal company* and follow the logical action items necessary to get there—namely, obtaining an understanding of how business works through college and practical work experiences and saving enough capital to buy your first truck—and if you couple this with working in the business from the trash pickup end through the administrative end, the likelihood of reaching your goal becomes highly probable.

Action Items or "To Dos"

In addition to the overall business goals mentioned above, I also view each property as a business and therefore set forth specific goals for each property.

Once the business plan and goals are established, I list detailed action items to enable me to reach my goals. In my real estate business, I first list on a separate piece of paper every property I own. Under the various properties, I specify "To Dos."

I have found that there are matters that do not fit into specific property categories. Therefore, I create what I call Special Project Lists to catch the other areas outside specific property action items.

Gary's Lists

The projects "To Dos" are then prioritized into a First Priority List and a Second Priority List. The task is to rank, in order of importance, the tasks to be accomplished. My First Priority List consists of matters of utmost importance that should be focused on immediately and completed immediately. The Second Priority List is important, but not, obviously, as important as the First Priority List.

I keep the lists on my computer, which facilitates the updating process. My daily review of the priority lists is cursory, because I want to get going, accomplishing the tasks on the list.

I also write up a daily To Do list. The Daily List usually contains a few items from the First Priority List and a few items from the Second Priority List, as well as other things that can be accomplished relatively quickly. The Daily List consists of things that must be done that day, for example, returning specific telephone calls, as well as work that must be furthered that day, such as finalizing a lease or a Purchase and Sale Agreement. The Daily List is made of the crucial items on the Priority Lists plus items that can be addressed and disposed of quickly.

After I have created a Daily List, I select the most important items that must be focused on immediately. I refer to these items as my Short List. These are no more than five items that must be substantially completed by the next business day. I always work on these items first when I walk into the office.

The key for me is to review and update my lists for at least 30 to 60 minutes every weekend, usually Sunday night, and then take one item at a time, going down the list and getting one item completed so it can be removed from the List or at least put into play so that it can be worked on until accomplished.

Please refer to Exhibit 1.1 for a graphic illustration of The Game Plan. The Game Plan is organized from the bottom up. The business plan serves as the foundation, and then the goals are established. The "To Dos" build upon the goals, for it is through accomplishing the "To Dos" that the goals are achieved. Lastly the "To Dos" are pared down and prioritized until you come to the Priority Lists and the Daily List and Short List of super-important items that must be worked on immediately.

Rule Number 5

Think out and commit to paper what you wish to accomplish. Keep detailed lists of action items.

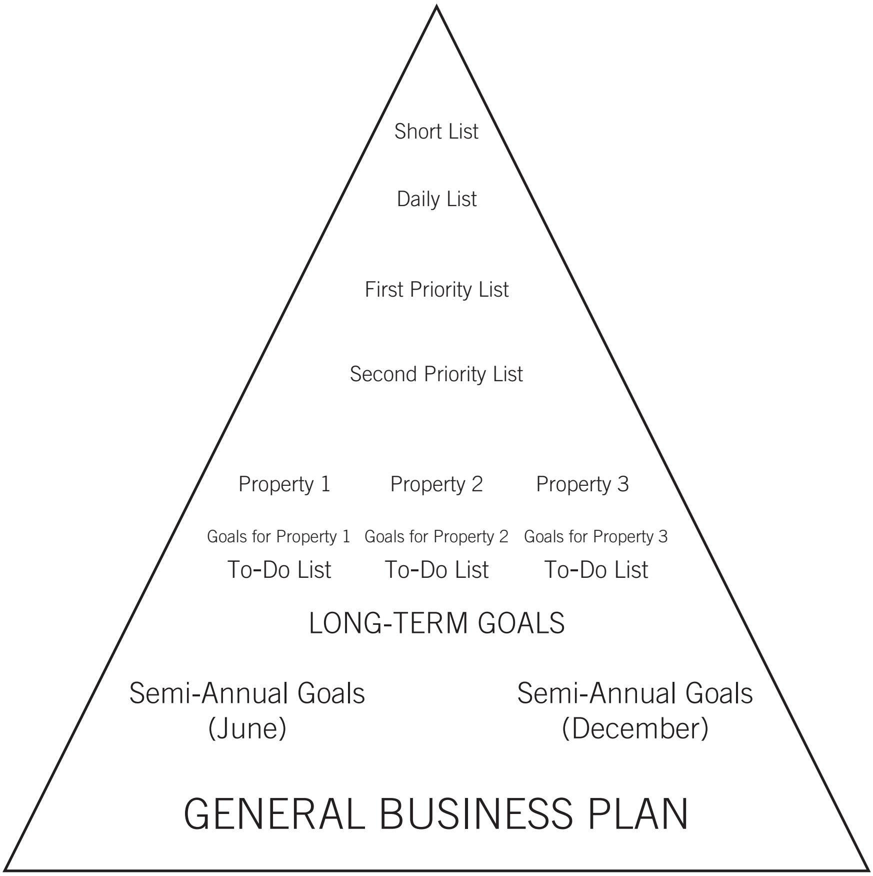

Exhibit 1.1 The Game Plan

If you can envision how to get from point A to point Z, that is, from an underperforming property to a fully leased successful transaction, that is half of the battle. The other half, however, is execution: doing the tasks necessary to get there. Execution can encompass everything from negotiating and consummating leases to hiring excellent vendors to servicing your complex. Without execution, vision falls short. Following through on the “To Dos” translates into execution.

Rule Number 6

Success equals vision with execution.

Focus, Focus, Focus

Another key to success, one that has more of an effect on success than education, capital, experience, desire, or personality type, is focus. Focus has two subcategories: concentration and discipline.

No Flip-Flopping

If you start out in business as a mortgage broker and then, after two years, decide you want to be a stock-broker, and then after two more years decide you want to sell insurance, your success ratio will probably not be very high. Hopscotching from one business to another results in failing to become an expert on anything. The consequence is that you never develop a clientele, never develop a network for referrals, vendors, and colleagues. You never develop a success formula if you keep switching from one field to another.

Stick with the Task at Hand

Develop discipline to concentrate on the task at hand no matter how unpleasant it might be or how much you would rather watch a television program or a movie, take a nap, or go for a walk in the park.

Rule Number 7

Focus on one field, no flip-flopping. Focus on one task at a time and get that task done before moving on to task number 2.

Please note that sticking with the task at hand does not mean devoting more time to it than it requires. I was recently having dinner with a couple and the wife bemoaned the fact that her husband worked so hard. She kept complaining that they had no family life because her husband constantly worked to pay the bills. It is not how many hours you put in that counts; it is results that matter. You measure achievement by results, not the length of time you work on a project. Often the more time and effort you put into a task translates into accomplishment, but not necessarily. If you get the job done and it takes one hour, isn't that more impressive than if you worked all night on the project? The "kill yourself" work ethic makes no sense. Results speak for themselves.

Rule Number 8

Judge yourself by your results, not by how long or hard you work.

Risk versus Reward

Every investor knows, or should know, that there are risks involved in a real estate investment. The general rule is that there is an inverse relationship between risk and reward: the greater the risk, the greater the return. Conversely, the rule states that the lower the risk, the lower the return. The trick is to identify the risks and then balance risk and reward by eliminating as much of the risk as possible while still achieving an acceptable return. Risk management is inherent in any investment, including a real estate project. The successful real estate entrepreneur focuses on the downside and structures the transaction to minimize the risk factors.

Rule Number 9

Look at the downside. Identify the risk areas in a project and put in place a strategy to cushion these risks, to the extent possible.

Identifying Opportunities

Assume there are two shopping centers in close proximity to each other. Both centers are about the same size, 150,000 net rentable square feet, and in comparable condition. Center A is 100 percent leased and occupied, while Center B is 50 percent leased and occupied. Center A is being offered for sale at \$15,000,000 (\$100 per square foot) while Center B is being sold for \$7,500,000 (\$50 per square foot). Which is the better buy? This is a trick question. There is no clear-cut answer. Most important, there is not sufficient information to make an informed decision.

You do not know, among other things, the income and expenses of the centers. The underlying credit behind the rental income might be far stronger in one or the other center. You also do not know the maturity date of the existing leases or the rent escalation schedules or the tenants' payment history. Nor do you know how well the tenants are doing, what is happening in the local community that might affect each project, or the overall strength of the leasing market.

In general, however, your decision depends to a large extent on your financial goals and risk posture. If you manage a large pension fund, then Center A, if it meets your yield criteria, would probably be your selection. It is fully leased, so it probably generates a stable cash flow. By contrast, if you are entrepreneurial, Center B is probably your choice, given its upside potential. It is only 50 percent leased so as you lease additional space, value is created.

This Book Is about Center B Properties

The focus of this book is value-added properties: Identifying value-added real estate, discovering creative strategies to enhance the value of a project, and executing those strategies. Usually, everything else being equal, the property with vacant space will sell for a higher *cap rate* than the real estate that is fully leased. The seller will argue that, given the upside potential in Center B, the buyer should pay a higher price. In a 100-percent-leased center the only way to go is down, in other words, to lose occupancy.

Again, in this example, there is not enough information about the two centers to make an informed decision. Possibly Center A is also a value-added B type of property. For example, possibly the rents are significantly under market so as to afford a buyer the opportunity to work the center when leases turn to significantly increase cash flow. However, in general, it is Center B that has the clear potential to grow and increase its value through leasing the vacant space.

Typically, when a property comes on the market, multiple potential buyers view the offering. The successful real estate player analyzes the project, figures out a game plan to increase cash flow, and then, taking the cost of his strategy into account and factoring in an acceptable yield, makes an appropriate offer.

The strategy to enhance cash flow might involve altering the physical elements of the project. The alterations might be as simple as adding attractive new paint colors and fresh landscaping or as extensive as a full exterior stucco remodel, with a change in the project's physical orientation.

The success of a retail project is often heavily dependent on the availability of convenient and ample parking. Envision a major box tenant with limited parking on the north side of the building. The developer acquires an acre of land on the south side of the building and reorients the entrance so that customers enter the store from the south side where there is an abundance of paved parking. Similarly, envision a movie theater operator whose business has adequate parking, but the location of parking is undesirable, since it is subterranean and tandem in nature (i.e., cars are parked so that one car might block another car). To enhance the desirability of his theater, the movie theater operator may enter into an agreement with the adjacent medical building owner so that his customers may use the extensive surface parking from the medical building lot after 5:00 P.M., when most doctors are no longer seeing patients.

A change in the nature of the tenants may dramatically affect the success of a center. A reorientation of tenants in a center from those that have nothing in common to those that have a synergistic relationship and can cross-refer clients may dramatically improve a property. Replacing weak mom-and-pop tenants with strong credit tenants might improve the financial performance of the project.

Change, whether it is a governmental rule and regulation change, or a change relating to the business climate in general, equals opportunity. The key is to be aware of the change and to take advantage of the opportunity that it offers. If you are considering building an assisted living facility and the state significantly increases the density requirements, altering your plans to take advantage of these developments might have a significant positive effect on profitability. Similarly, in a recessionary environment, players who are capital rich are usually able to take advantage of advantageous pricing. Should not purchases be made when values are depressed? Of course! Often, however, the difficulty is in determining when to buy. Will values continue to fall? Where is the bottom? This is where your knowledge, your research, and your strategizing come in. Remember, hearing opportunity knock is one thing; knowing when to open the door is another.

Rule Number 10

To effectively play the real estate game, it is crucial to identify opportunities and figure out strategies to take advantage of these opportunities.