

#### IN THIS CHAPTER

- » Understanding the basics of commercial real estate
- » Surveying the types of investments available
- » Discovering the tools you need to get started
- » Debunking the myths of investing in commercial real estate
- » Keeping timing in mind when selling, buying, and holding

## Chapter **1**

# A Crash Course in Commercial Real Estate Investing

**W**hat comes to mind when you think of commercial real estate? Downtown skyscrapers? Corner strip malls? Apartment complexes? Okay, that's a good start. But have you thought about being the owner of one? You may assume it'd be too complex or too expensive, but jumping into commercial real estate investing could be the wisest and most lucrative investment you ever make. To us, the benefits outweigh the risks. But find out for yourself.

In this chapter, you find out what commercial real estate is, and you discover the different types available. It breaks down the big world of commercial investing into easy-to-follow categories so that you can pick and choose your favorites. It also uncovers the five biggest myths that stop people from investing and understanding commercial real estate. Because the value of commercial real estate depends on the cash flow that it produces, you find out how cash flow is made on

a monthly basis, and you discover the steps to building long-term wealth. This chapter also tells you when it's the most profitable time to buy, hold, sell, or bail. By the end of this chapter, you're sure to be convinced that commercial real estate is, by far, the best way to produce true and lasting wealth.

## Comparing Commercial Real Estate and Residential Real Estate



REMEMBER

Here's our definition of commercial real estate: It's any piece of real estate that's bigger than one house on one lot. So, commercial real estate includes everything from small apartment buildings (five or more units) and large office buildings to shopping centers, to industrial parks, and even land development.

The three biggest differences between commercial real estate and residential real estate include the following:

» **Commercial real estate projects are passive investments only after they're up and running.** Unless you have a ton of money and don't care about getting huge returns, commercial real estate will take a lot of your time and effort to get started. After all, you have to deal with many things, including the learning process, finding the right mentors or teachers, searching for the right deal, financing your investment, picking management teams, protecting it from lawsuits, and overseeing the project.



REMEMBER

The good news is that after you have a commercial project off the ground, it's usually big enough that it allows you to pay other people to take care of it. So, it won't take much of your time at all — and that's why it's called a *passive investment*. Compare this to a single-family home that may require collecting rents and making repairs for many years to come.

» **All it takes is one big commercial deal for you to be set for life.** Doing one commercial deal the right way can generate you a profit several times your yearly salary in addition to providing you sizable monthly income as long as you own the property. Residential real estate can produce a sizable profit as well, but it will not generate anywhere near the cash flow that a commercial property will. You'll receive one check per month from a single-family residence, but you can receive several hundred checks per month from a commercial property.

Consider this: Some investors shared how they got started in commercial real estate. One of them is in a project that already has a profit of \$10 million or more. Another one bought a piece of land near their home for \$1.5 million, and it has jumped in value over the past two years to \$9 million (and they didn't even have to use their own money).

» **The people you meet who invest in commercial real estate are all big thinkers.** They're people who have decided that they want to think big, live big, and hang around other people who are just as passionate about life as they are. Until you get involved, it's difficult to really understand just what your life could look like. Investors of residential real estate think of one monthly check and one tenant; they wait for appreciation (which may never come); and they're limited in ways of creating massive value for their property.

## Deciding to Invest in Commercial Real Estate

We think commercial real estate investing is a great way to generate wealth, and the main reason we like it so much can be boiled down to one word: leverage. Leverage is what allows you to use a small amount of your time and money to bring you a magnified return. Commercial properties are usually bigger and more valuable than other types of real estate, such as houses. What this means to you is that after you figure out how to find, negotiate, and buy commercial property without using much of your own money, you'll be able to sit back and watch the magic of leverage work wonders for your financial future. Your family will thank you for generations to come.

When people get started with their investing, most of them dream of creating a six-figure annual income stream so that they can quit the rat race. However, deep down many of them have doubts that they can actually make it happen. But never fear. The goal of Book 8 is to give you the starting steps and specific know-how to help you realize that you really can live the life of your dreams.

Understand that there are still going to be naysayers out there who say you can't invest in commercial real estate in today's market, in today's economy, or in today's cosmic layering of celestial occurrences. But you have a choice. You can either buy into what these financially stressed-out individuals are desperately clinging to, or you can let go of everything that's been holding you back and go after the future that you want and deserve.



REMEMBER

To be clear: Commercial real estate allows you to make whopping piles of money. With commercial real estate you can make anywhere from \$20,000 to \$100,000 on a little deal. And you can make \$10 million or more from a bigger property. Sound interesting? Does it take work? Sure, it does. But a \$1,000,000 commercial deal doesn't take anywhere near ten times the work that a \$100,000 residential deal takes. So, what you're doing is working at a higher level that rewards you with the opportunity to make a lot more money with just a little more effort.

## HOW A COLLEGE DROPOUT TURNED \$4,000 INTO A \$120,000 PROFIT IN 60 DAYS

Morgan was the kind of teenager who struggled in high school. He didn't get good grades, and he didn't earn a college degree. He worked a variety of jobs until he found himself working as a bouncer in a bar and surviving on 69-cent cans of beans. Financially, he had a pretty bleak-looking future.

For some reason, Morgan had the wild idea that he could somehow make money investing in real estate. So, he drove around town talking to agents and looking at properties. One day he saw a sign on an empty lot that said, "Exxon Corporation Land for Sale." Morgan didn't know much about land, but after looking at the county records, he figured that the property might be worth about \$200,000.

After calling and meeting with the agent, he was able to put a contract in place to buy the land for \$160,000. But now Morgan had a big problem because the agent was calling about the \$4,000 earnest money deposit that Morgan had promised to give to them. So, he went down to the bank and talked them into lending him the \$4,000 based on the value of his car, which was the only real asset that he had.

Now Morgan was faced with the problem of having to close the deal in 120 days, or he would lose his deposit and perhaps his car, too. So, he went back to the county office and looked at all the other parcels of land around his piece that he had under contract. He saw that there was a larger lot behind his property that could have its access restricted depending on how he developed his property.

With the help of an architect, Morgan put together two sets of plans. One set showed a larger commercial shopping center that restricted access to the lot behind it. He also put together another set of plans with another smaller building designed as a gateway to the property behind it. Morgan's next step took a straight face. He marched into a meeting with the owner of the property that was behind his property and dropped both sets of plans down. Morgan told the owner (in a nice way) that they had a choice: The owner could either accept a wholesale assignment of Morgan's purchase contract for

\$320,000 so the owner could develop it with the gateway, or (if the owner didn't want to buy it) Morgan was going to develop the property himself and restrict the other property owner's access.

Morgan was scared stiff at this point because he knew that he didn't have any way to close the deal himself. Fortunately, the owner agreed to the wholesale assignment of Morgan's property for a total price of \$320,000 — and after they went through the due diligence, the price dropped down to \$290,000. The seller got the \$160,000 they were expecting, and Morgan walked away with \$130,000 in profit by assigning his purchase contract. This happened because of two reasons: One was that Morgan found himself in a place in life where he didn't have a lot of choices. Either he was going to go for it and make it in life, or he wasn't. The second reason that Morgan was successful is because he had guts. Guts boil down to a willingness to move ahead, even though you've never done it before and even though you're scared to death.

## Exploring the Available Types of Investments

Most people think commercial real estate is all about apartment rentals. Even though residential properties *are* a big part of commercial real estate investing, other types of properties make for excellent investment opportunities as well. For instance, commercial real estate includes offices and warehouses, retail centers, and even undeveloped land.

We define commercial real estate as any real estate that's bigger than one house on one lot. So even if people live in the property, it's still commercial as long as it's bigger than one house. Some people would argue that a little property like a duplex or a four-unit isn't really commercial. That's okay. We like keeping our definitions simple. Actually, five or more units in an apartment building is considered commercial, but who's counting? The following sections explain each of the different types of commercial property.

### Apartment buildings (also known as residential properties)

The commercial properties that are in the residential category include everything from small apartment properties (five or more units) to huge apartment building projects that cover several city blocks. You drive by thousands of commercial properties like this every day (or you may even live in one). Every single building you see is owned by a commercial investor who's in the game to make

money. (Now anytime you see a nice apartment building, you won't be able to stop thinking about getting into commercial real estate investing.) What's great about investing in apartments is that they're easy to find, banks love to lend on them, and they're great cash flow generators.

The advantage of starting off with residential properties is that they're a great way to jump into the exciting world of commercial real estate investing. Coauthors Peter Conti and Peter Harris both started off investing in small- to medium-sized multi-unit properties. This was a great experience because it allowed them to make the jump to get started. For most people, getting started is the hardest part. However, after you've started investing in commercial real estate, you'll have a difficult time going back to the old grind of the rat race that so many others find themselves trapped in.

## Office buildings

After you get the itch to invest in commercial real estate, you'll never walk into an office building again without thinking, "Somebody owns this building. Why couldn't it be me?"

As populations expand, more and more office buildings are being constructed. Offices are great for investing because they have what are called *triple net leases*. This type of lease is one in which the tenants in the property pay you the rent plus they pay for the following:

- » All maintenance and repairs
- » The insurance on the property
- » The real estate taxes

Bingo! It's called *passive income* for a reason. After you get your office building rented out, you can sit back and watch the cash flow come rolling in. Heck, you can even hire a property management company to lease it out for you. Then your only obligation is to sit on the beach.



REMEMBER

Triple net leases are so called because the tenants in your office building pay for all three categories of expenses. Tenants pay all three of these costs so that the rent you get is a net amount from which you don't have to pay expenses. So, after the tenants pay for all the expenses and you pay the mortgage, the rest goes into your pocket. It's quite typical for a triple net lease to be 5 to 20 years in duration with rent increases every couple of years. But that can be a disadvantage as well, and here's why: Say that the lease is for ten years. If your neighborhood experiences explosive growth over the next three to five years, you won't be able

to charge higher rents or capitalize on what's happening because you're locked into a ten-year lease agreement. But overall, triple net lease investments are very much sought after.

## Retail centers

Retail centers, also known as shopping centers or malls, are at the heart of most of the towns and cities in the United States. These are the places where people come to shop, eat, and meet with friends. And retail centers are one of the commercial property asset types that you can invest in. Most investors like retail centers because, like office and warehouse properties, many retail properties are leased out on a long-term triple net lease basis where the tenants pay for all the expenses. The upside to this as an investor is that your rates of return won't go down over time as the taxes and expenses go up. In fact, as rents go up over time, your returns just keep getting better and better. And as in most triple net lease agreements, rent increases are built into the agreement with the tenant.



REMEMBER

Office buildings and retail properties have gone through massive changes as a result of the COVID-19 pandemic. Thousands of office workers got the chance to become remote workers and discover they (most of the time anyway) like working from home. Big national companies have closed their stores at shopping malls with some of them going completely out of business. Other stores have transitioned over to doing a large portion of their business online. This change creates opportunities as investors. Office buildings are being converted into apartments. Some apartment buildings now include separate “work at home” areas. Department stores have been converted into warehouses for online companies that ship out their products.

## Warehouses or industrial properties

With the advent and growth of online shopping or e-commerce, companies that ship to customers need a place to store their goods. These buildings, known as warehouses, are pretty simple — large structures, four walls, multiple doors, and centrally located for shipping purposes. Warehouses tend to be relatively low-maintenance properties, focusing on storage more than aesthetics. Also, warehouse tenants may be more inclined to sign longer-term leases in the coming years as e-commerce grows.

## Self-storage facilities

Just like everyone needs a place to sleep at night, nearly everyone needs a place to store their stuff — old things, recently purchased things, and treasured personal things.

Why is it so popular amongst investors? Compelling reasons include

- » No toilets to clean
- » Low cost of operations
- » Low building costs
- » Operations can be automated
- » Low down-payment loans

The various types of self-storage facilities to consider are

- » Self-storage
- » Warehouses
- » Cold storage
- » Climate-controlled storage
- » Vehicle storage (including RVs, boats, and cars)



TIP

For you, the average investor, we recommend you begin your acquisition search for mom-and-pop self-storage facilities. Avoid the “big boys,” such as U-Haul and Public Storage, and all other franchise-types, because they are too expensive for the beginning investor.



TIP

One of the most important things to consider is your facility’s location. Ideally, it should be located where there’s demand for storage, where it’s easy to drive to, and where there’s high visibility. If there are a lot of small houses in a town, it’s good sign that there is an opportunity for a self-storage investment. Small houses mean a large percentage of people in that town require extra storage spaces for their stuff.

## Hotels and resorts

This asset type isn’t recommended as the place to get started, but many experienced investors have found it to be a fun and highly profitable area to focus on. Of course, other investors have also lost their shirts (and sometimes their trousers, too), so make sure that you know what you’re doing before jumping in. Most of the deals coauthors Peter Conti and Peter Harris have run into have been smaller hotels or motels rather than the larger nationally branded, or as they’re referred to, “Flagged” hotels.

One investor used a commercial master lease, a form of creative financing to get a 40-unit motel outside of Springfield, Missouri. They changed the name of the motel, hired new staff, and upgraded the units. Six months later they sold it for almost twice as much, making almost \$500,000. Another investor has a 135-unit hotel under contract with plans to convert it into apartments.



REMEMBER

The success of any hotel or resort is composed of two parts, the property itself and the business of marketing, managing, and operating the property. If you're going to invest in this niche, you should invest in the property and then lease it out to another company that will operate the hotel or resort.

## Getting Started

What's the secret ingredient that allows someone to make it big in commercial real estate? If we told you, how long would it take for you to jump up, bolt out the door, and go find your first commercial deal? Well, you're about to find out, so put on your running shoes. The secret ingredient is none other than motivation. If you were expecting some fancy formula, we're really sorry. But in the end, it really boils down to how bad you want it and what you are willing to do to get it.

If you are truly motivated, you'll find a way. But now that you know the secret, you still need to be familiar with the tools, techniques, and guidance that help you along the way. The following sections explain them.



REMEMBER

Investing in commercial real estate requires a handful of skills. You don't need to understand differential equations or know how to rebuild a transmission. However, the skills in the following sections are a must.

### Easily meeting people and making new friends

If you connect with people easily and like meeting new friends, you'll do well at creating a stash of contacts. It's important to network with the people who will be investing in your commercial real estate deals because they hold the "pot of gold." People that you meet will eventually be your advisors, investors, and partners, and they'll send deals to you and connect you with wealth-building resources.

If you're the shy type, we're betting that you'll sooner or later get over your shyness after you see all the money that's being made by other investors who love having a network of colleagues and friends. If you really want to succeed as commercial real estate investor, you'll have to gradually come out of your shell.

## Doing simple math

You'll need to be able to look at property information online, properly enter numbers into a simple spreadsheet, and use a calculator. These skills help you determine what a commercial property is worth, what you should pay for it, and what your payday will be.



TIP

If you need some pointers and guidance when it comes to numbers, a course in business math is sure to get you up to speed.

## Accounting and collecting

If you're going to be in business, you're going to need to be comfortable asking other people to pay you the money that they owe you (in rents). The neat part is that you can hire a property management company to do all the collecting for you. And if you're starting small, you need to get a good handle on accounting and other business essentials. Why? Because investing in commercial real estate is like investing in a real business where you have to pay bills, hire employees, deal with contractors, and know how to read simple financial reports.



TIP

When coauthor Peter Conti started his first business more than three decades ago, he read the book *Small Time Operator* by Bernard B. Kamoroff (Lyons Press) so he could understand the basics of accounting, setting up a business, paying various taxes, and staying out of trouble.

# Recognizing Myths and Questions about Investing in Commercial Real Estate

Like any complicated business, commercial real estate investing has its share of myths and questions. Knowing this information brings forth some valuable truths that will rescue you from the trappings of confusion.

The following are some pretty common misconceptions about investing in commercial real estate:

- » **You must start off in residential real estate to get into commercial real estate.** There's no rule, rhyme, or reason stating that you must first invest in residential real estate in order to make the leap into commercial real estate investing. These fields are two different animals, two different languages, and two different consumers. It's like comparing apples to oranges.

- » **Only the rich need apply.** As you can probably imagine, this myth is just that: a myth. It isn't true that you have to be rich to get involved with commercial real estate investing. You can be as creative in your financing here as you can be when investing in homes.

Here's an example: Donald recently purchased a 24-unit apartment building. The purchase price was \$750,000. The owner carried a second mortgage of \$100,000 for Donald. That left him \$50,000 for a down payment. Donald negotiated \$30,000 for repair credits at closing. That left him with an out-of-pocket cost of \$20,000, which he funded from a refinance from another property. Donald proves you only need to be rich in motivation and creativity.

- » **This game is only for big-time players.** In commercial real estate it doesn't matter where you start, and it doesn't matter if you only want to devote part of your time to do it. Having a full-time job or being a single parent doesn't matter either.

Coauthor Peter Harris started his career by buying small commercial properties. His first was a cheap seven-unit apartment building. His second was a small and quaint self-storage building used by the plumbers in town. He did this part time while holding a full-time day job and raising a small family. It all started from there and grew to owning and operating large community properties around the country.

- » **You need a real estate license.** A lot of investors don't have a real estate license, and they often wonder if not having a license poses a problem. Our answer is no. Not having a license will not hinder you, nor has it hindered many successful investors who invest full time or part time. Even one of your humble coauthors doesn't currently have a license. The fact is that as long as you're a principal in the transaction, you don't need to be licensed. (A *principal* is someone who buys property to make a profit.)



TIP

*Agents* and *brokers*, on the other hand, are those who help an investor buy or sell, and they're the ones who get a commission as compensation. The duties they perform require a license. As long you don't receive compensation or represent yourself or someone else in the transaction, you don't need one.

- » **Commercial real estate investing is riskier.** To this we say, "Compared to what?" If you compare it to stocks, do you have control over the companies you own stock in — in areas such as income, expense, debt, management, and insurance? Probably not. However, you do have these five controls in commercial real estate investing. If you compare it to residential real estate investing, what happens if you rent out your single-family home and the tenant moves out? What's your monthly income then? The answer: Zilch. If, on the other hand, you own a 24-unit apartment building and one tenant moves out, what's your monthly income? Answer: 23 paying tenants worth of rent! What's riskier? We rest our case.

» **Commercial real estate is too complex for simple folks.** Again, this isn't true. Remember when you started using some new software? You had no idea how to use it. It seemed too complicated, and it had entirely too many features. But there was a help section or YouTube tutorial to get you started. After that, through repetition and practice, what seemed much like a puzzle is now fully understood and appropriately used. Getting to know commercial real estate investing is the same concept. You have quite a few things to master, but it isn't rocket science.



REMEMBER

Real estate, like the rest of life, does have risks. If it didn't, it probably wouldn't be as fun. And it surely wouldn't pay off with the incredibly strong rates of return that it does.

## Timing the Commercial Real Estate Market

Wouldn't it be great if you could time the commercial real estate market precisely? For instance, what if you could predict what the office building market would do five years from now in your town? Imagine if you had a process and procedure for knowing the perfect time to buy in a certain market. Well, here's a secret: None of this exists. Sorry for bursting your bubble! But if we could predict such things, we'd be living on our own islands off of Tahiti.

But here's the good news. Remember the old adage, "Buy low and sell high?" Believe it or not, this truly is how you get wealthy in real estate over time. It's a tried-and-true method. And here's another secret (and this time we're serious): A tool exists that helps you buy low and sell high in any market anywhere in the United States. That tool is the *real estate cycle*. And when you pair this cycle with some knowledge of trends, you're sure to be successful.

### Knowing whether to buy, hold, or bottom-fish

Real estate cycles are like traffic lights. When you see a green light, you go. When you see a yellow light, you might go, but if so, you proceed with caution. When you see a red light, you stop. The trick, however, is knowing when you're facing green, yellow, or red lights. Here are some examples:

» A green light in commercial real estate investing may be spotted when you notice upcoming job growth due to a factory expansion. Or when the demand

to build exceeds the supply of available properties. Most likely, you'll also see a lot of undeveloped land sales activity.

- » A yellow light may be indicated by interest rates creeping up suddenly and causing you to examine your costs of new money to borrow. Or it could be when you see vacancies and "lease specials" increase. What if your newsfeed reveals many struggling businesses in an area? That has yellow light written all over it.
- » A red light may be revealed by a halt in new construction, which may be caused by overbuilding in the area. An increase in foreclosures and a decrease in property values is a sure red light.

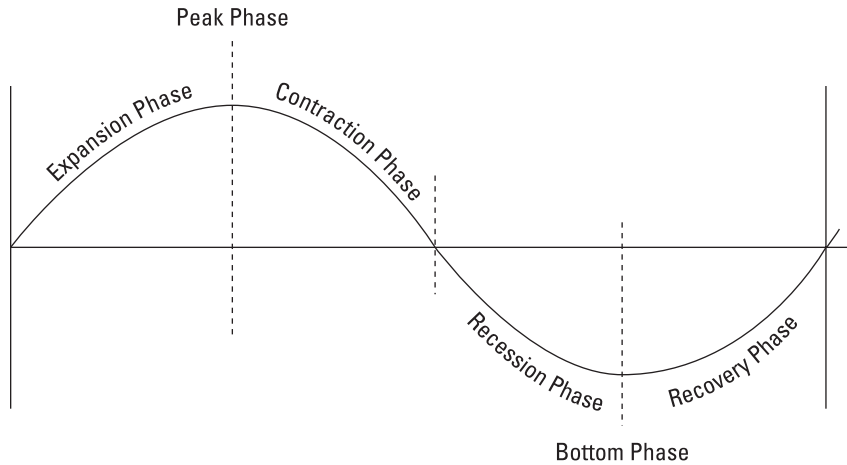


REMEMBER

Making big money in commercial real estate is all about managing risks. Understanding and gaining knowledge of real estate cycles helps you lower your risk. Even though predicting real estate cycles is largely a game of luck, it gets downright dangerous if you know nothing about the trends in the market in which you're investing. The following is an outline of the typical commercial real estate cycle. This cycle can help you determine the best time to buy, sell, or go bottom-fishing. Here are the phases of the cycle, which are depicted in Figure 1-1:

- » **Expansion phase:** During this phase, population increases, incomes rise, employment is good, vacancies are decreasing, and rents are rising. New buildings are planned. The human emotion here is excitement.
- » **Peak phase:** This is the time to sell for maximum profit. This is a seller's market, and in this phase, you see new building projects increasing and bidding wars between investors. Listings are on the market for only a short period of time. The human emotion here is sheer confidence.
- » **Contraction phase:** Most likely, you'll see a bunch of new projects on the market now, and you may see evidence of overbuilding. Inflation is up, interest rates are increasing, vacancy rates begin to creep up, and prices begin to level. Foreclosures generally grow during this time. The human emotion here ranges from mere concern and denial to utter shock.
- » **Recession phase:** Real estate in this phase is becoming more difficult to sell, and so properties stay on the market for longer periods of time. Property values decrease, interest rates are high, and landlords are competing for tenants because of overbuilding. Foreclosures are usually rampant. The human emotion here is complete panic.
- » **Bottom phase:** This is the best time to buy. However, this is the scariest phase there is: Unemployment and inflation are high, and the demand for apartments is decreasing. This phase separates the men from the boys, the women from the girls, and the true investor from the stock market refugee. The human emotion here is plain old depression for most folks.

» **Recovery phase:** This phase is the breath of fresh air. The local economy shows signs of life, vacancies decrease, rents level off and start to trickle upward, speculation starts again, and money begins to flow back into market. The human emotion here is pride, because you've waited out the storm.



**FIGURE 1-1:**  
The real estate cycle.

© John Wiley & Sons, Inc.



REMEMBER

If you can recognize the cycles of your local economy, three obvious questions come to mind, and answering them will determine whether or not you're a successful investor:

- » **When is the best time to buy?** The truthful answer is that it depends. If you're a smart investor, you should buy in the bottom or middle of the expansion cycle. That way, you're buying on trends and following the market and other investors. You'll likely feel safe because you're following what everyone else is doing.
- » **When is it the best time to sell?** The best time to sell is at the peak phase, right at the top of the market. And the biggest problem with selling here is knowing exactly where the top is. Here are two clues that have never failed us yet: Watch the rents and vacancy rates separately. After rents level off and become flat for three straight months or more, you've reached the top. Or for another indication you've reached the top: After vacancy rates are at a three- to five-year low, you've reached the top. It's that simple.
- » **When is it the best time to go bottom-fishing?** If you aren't a bold risk taker, you may find this advice uncomfortable (so consider yourself forewarned!). Maverick investors buy at the bottom phase or at the front end of the recovery phase. This is called "bottom-fishing" for deals. This is where the

big, big money is made. Maverick investors are brave and courageous trendsetters. They're usually the first investors in the worst part of town, and they're usually banking on the area to come back big time. If they play their cards right, they come out on top, and if they don't, they simply walk away with an "aw, shucks." Now that's bravery!

## Following trends

True friends are always around when you call on them, and they won't ever let you down. And economic and demographic trends are your true friends in commercial real estate investing. And best of all, these trends aren't terribly complex or difficult to determine. Here are the three trends that are plainly fundamental when investing in any commercial real estate:



TIP

» **Job growth:** This trend makes perfect sense: Where the jobs are, people are. And where the people are, demand exists for apartment rentals, office space, and consumer goods. Job growth is an excellent indicator of a healthy real estate market.

The best place to start in researching job growth is to contact your local economic development department or chamber of commerce and ask for historical and current job growth data.

» **Development:** This trend is all about supply and demand. After all, if a shortage of office space or apartment housing is evident, you clearly have a demand for new development. On the other hand, if you see that the city is overbuilding, it's an indication for you hold off and reassess.

» **In the path of progress:** It isn't too difficult to spot this trend with your own eyes. Whenever new building and development is either coming your way or surrounds your property, you're in the thankful path of economic development. You can feel the "buzz" of prosperity around you.

