BAUER & ASSOCIATES REALTORS

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THE BAUER REPORT

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The Assemblage Option

The option is an extremely versatile investment tool that comes in a variety of forms and can be used for a variety of purposes. The best part of an option is that it gives the optionee (the party holding the option) control over property (in the sense of the right to acquire it) for a very small cash outlay. In effect, it achieves a very high degree of leverage and conserves cash, two goals sought by both real estate investors and real estate speculators.

An option gives to its holder the privilege to buy a specific parcel of real estate, at a specified price, on specified terms within a fixed period. An option to buy also is known as a "call." (An option to sell, known as a "put," also may be used in real estate, although it is more common in securities transactions.) The person who grants the option (the optionor) agrees to refrain from selling the property to any other party during the option period in exchange for consideration, which the optionor will keep whether or not the option is exercised by the optionee.

Combine An Assemblage

An assemblage is when someone, usually a developer, combines an assemblage of separate parcels of land into a single parcel. The developer putting together the assemblage normally is interested in acquiring all or none of the parcels. Consequently, in order to avoid committing large amounts of capital to a project that may not succeed, the developer will proceed with options rather than purchase contracts. Of course, each contract could be conditioned upon acquisition of the remaining parcels, but this would reveal the assemblage plan and cause an immediate rise in prices of the parcels not yet acquired.

Most Favored Purchaser Clause

A landowner that suspects that an assemblage is in process may insist on a *most favored purchaser clause* before giving the option. This requires a developer to increase the exercise price of the option so that it is equal (on some comparable basis) to the highest price paid for any other parcel. Because the developer may be confronted by one or more holdouts and be forced to sharply increase the exercise price for them, this type of clause can substantially increase the gain to earlier optionors. ❑

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

In This Issue

Preventative Maintenance Inspections

Maintenance of any rental building, either residential or commercial, should be handled as much as possible as a routine rather than an emergency. Preventative maintenance must be performed on a regular basis to keep the level of service at the property high and to reduce equipment breakdowns and service interruptions. Toward this end, the maintenance staff and on-site manager should make regular inspections for the repair and replacement of items before problems occur. Preventative maintenance reduces the number of emergencies by anticipating wear and tear that the property, buildings and equipment will undergo.

Preventative maintenance is one of the most important components of successful property management. An appropriate preventative maintenance program should be developed for both large and small properties, regardless of whether building staff consists of only a part-time maintenance worker or a larger number of employees supported by a computerized maintenance program.

Careful preventative maintenance eliminates corrective and emergency repairs later. While many owners and managers consider preventative maintenance a poor use of cash, and some claim to have no time for it, the truth is that preventative maintenance, by identifying problems in early stages, saves both time and money.

How To Start

The following four steps are required to develop a good preventative maintenance program:

1. Prepare an inventory of all items that require servicing during the year.
2. Determine the type of service, frequency, and cost efficiency of performing the work required by each item.
3. Schedule the work throughout the year.
4. Control and revise the preventative maintenance program as needed.

The building, major equipment, and grounds should be inspected regularly by the maintenance supervisor to note both the unusual and normal wear and tear. This inspection is, by and large, a quick visual one. For work that needs to be performed, a work order should be prepared.

The property manager should inspect the interior and exterior of the property and a detailed inspection report form can be used as a reference for the daily inspections. These forms should be completed on a regular basis in accordance with the maintenance plan. In general, these inspection reports should be completed at a minimum of once each month.

Evidence of building settlement, structural damage, leaks, and corrosion should be noted during building inspections. In addition to regular daytime inspections, there should also be occasional night inspections to test and examine lighting and other security features; these inspections should include an evaluation of the property's appearance to visitors and prospective tenants.

Emergency Maintenance

Emergency maintenance is a form of corrective maintenance. Immediate action must be initiated to correct emergency situations that threaten the life and health of tenants, as well as the integrity of the property. Situations requiring emergency maintenance can be created by fires, floods, and burglaries, or the malfunctioning of major equipment (e.g., broken elevators, gas or water main leaks).

Preparations for such an emergency should begin upon occupancy. Tenants and building personnel should be versed in emergency procedures such as evacuation, and should receive a list of telephone numbers for the local police, fire department, and utility repair persons, as well as the building's 24-hour emergency number. Emergency maintenance is the most costly of all maintenance types because of dangerous conditions and the swift response they require. ❑

The Appropriate Management Plan

Real estate investments can be set up to generate one or more types of returns:

- Cash flow to owners (yield or return on investment).
- Appreciation of owner's capital (capital appreciation).
- Shelter of cash flow and/or other income from taxation (tax benefits).
- Preservation of capital (safety).

Once the owner specifies the type(s) of return desired, the mix of returns, and expected timing, the property manager can develop an appropriate management plan. Planning, with its resulting control, is the foundation of effective property management.

If, for example, the owner wants to maximize cash flow for a two-year period, the property manager would probably plan to defer as much maintenance and repair as possible. Considering the short time period, the manager can reasonably assess that deferring certain maintenance and repair would have only a limited effect on the property's resale value. If, instead, the property were expected to be held over a long term, the property manager would probably design a strong preventive maintenance program and give corrective maintenance high priority, thus preventing significant deterioration of the investment over time. ❑

Preparing A Loan Request Package

When preparing a loan request package for presentation to the lender, the real estate borrower must be as complete as possible the first time. Insufficient, imprecise, or incorrect data in a loan request package can mean a rejection for an otherwise attractive real estate loan.

Following are suggestions on things to include with the loan request package:

The Loan Request

There should be a detailed statement of the purpose of loan and the sources and uses of funds for the project. The property should be described in detail (whether it is a proposed development or an existing building), with a map showing the site and its relation to major roads, shopping access, recreation and other advantages.

Cash Flow Statement

The first thing the lender will think of is the cash flow on the property. Lenders have to be assured that the borrower will have sufficient cash flow (from the property or otherwise) to service the loan. The loan package should include a detailed cash flow statement covering the subject property and any others owned by the borrower. For each, the loan application should show percentage of ownership, date of purchase, original cost, present market value, present mortgage balance, and net (equity) value. It should also show the net cash flow before and after the debt service. Should any property show an unusually large difference between gross and net income, make sure there is a complete explanation.

The cash flow statement is a picture of the borrower's portfolio and ability to manage property and money. The borrower should emphasize acquisition and management strategies and successes with particular properties.

Details Of Expenses

When preparing expense analyses, the most complete information will avoid the need for the lender to come back with more requests for information, and delaying the loan approval process. Expenses for the property on which financing is sought should be broken down to show taxes, insurance costs, utilities and services, management fees, property security expenses, and general and administrative expenses. Provision should be made for structural reserves for such items as roofs and parking lots.

Also included with the expense analyses should be an expense reimbursement schedule, showing expenses that can be passed through to tenants on a prorated basis. These might include utilities, taxes, insurance and others.

Financial Statements

When the borrower is an individual or a partnership, the lender will usually want personal financial statements. These should be current and less than 90 days old for the borrower and any guarantor and be accompanied by bank and credit references.

The corporate borrower will need to provide legal details about its organization, names and addresses of its officers, and a certificate of good standing showing that it has paid all taxes in its state of incorporation.

The Appraisal

Usually the lender will want an appraisal made within one year by a qualified appraisal firm (one accredited by the American Institute of Real Estate Appraisers). The appraisal should be detailed, with notes and comments, comparable sales facts and figures, and assessed valuations.

The appraisal should be accompanied with photographs showing the property from its most attractive and impressive angles. Each photo should identify the view and the particular features shown.

Positive Features Of The Property

There should be a summary portion of the loan package that highlights the condition of the property and the reasons why it should be profitable in the future. Current vacancy rates, list of major tenants, traffic counts, availability of public transport, amenities and any other positive features should be included.

Any information about prospective improvements in the area, whether public or private, that will enhance the property's value should be included. ❑

A Few Energy Saving Tips

Conserving energy is important to everyone. Not only does energy conservation save consumers and businesses money, it saves precious resources for future use.

Saving energy is much easier than many people think. Insulating homes and commercial buildings, changing to double pane windows, lowering or raising the setting on the thermostat by just a few degrees has a significant impact on energy usage. Taking the stairs, not the elevator if possible saves energy and gives some much needed exercise.

Replacing incandescent light bulbs with fluorescent or LED lighting can save 30-40% of lighting costs. Seal cracks and major air leaks around windows and doors. Having heating and air conditioning systems cleaned and inspected regularly, replacing the filters often. This not only saves energy but also makes the air cleaner. These are just a few things that can save many dollars in utility bills.

Some utility companies will conduct energy inspections free of charge. ❑

The Buyers For Commercial Properties

If you are new to investing in income property, you may have made a choice in advance of the type of investment property that you wish to own. There are many good types of investment properties: apartments, office buildings, shopping centers, high rise parking garages in downtown areas, warehouses, resort rentals and many others.

Each of these takes a different type of management. Any and all should be under professional management during your ownership. Good management will ensure a profit for you when the investment is sold.

Even before buying the commercial property, you should consider who might be willing to buy it when you want to sell. The specific buyer doesn't need to be identified, but the type of purchaser should be. Will it be an individual, a syndication, an institution, or a pension fund?

Think about it! If you cannot think of potential buyers now, why is the property being purchased?

By identifying the type of potential future buyer, an investor in a property can better concentrate on what features such a buyer will most likely want. Then the investor is able to operate the property with the management company in such a way as to enhance the attractive features, thereby maximizing the property's value to the most likely type of buyer. Here are a few examples of resale factors for particular properties.

- **Apartment buildings** are usually purchased by pension funds and insurance companies only when they are Grade A properties. Syndicators look for Grade B or higher properties. Wealthy individuals are the most likely prospects for apartment buildings that need to be upgraded and modernized.

- **Office buildings** are typically purchased by users (a bank, an insurance company, or a corporation that intends to occupy all or a major part of the building for its own operations). Foreign investors increasingly seek fully tenanted, income-producing office buildings for long-term investment.

- **Resort properties** (time-share units, beach front condominiums, and campgrounds) generally have a weak resale market. Sale by auction is a distinct possibility and that often results in bottom-dollar prices.

Other Resale Considerations

In addition to identifying potential purchasers, an investor must determine carefully the appropriate time to sell, the economic outlook, potential tax considerations of a sale of investment property, and other uses for the money that a sale would bring. And an investor-owner should make every effort prior to offering the property for sale to ensure that the financial and physical condition of the property justify the maximum possible price. In a shopping center, for example, the rental income stream, cash flow, and occupancy level should each be at the highest possible level. When they are, a greater number of potential buyers will emerge.

Like-kind exchanges are often a tax-wise alternative to resale of investment property. Savvy investors keep alert to exchange possibilities as part of their focus on resalability of a property. ❑

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