

Things to Consider When You Purchase a Commercial Property



By David Tran

When you evaluate a commercial property for acquisition purposes, rental income or cap rate should not be the only factor. There are other things that may affect the current and future value of the property.

Rent/SF: you need to look beyond the rent per square foot. If the current rent is below the market rate then there is potential for up-swung. On the other hand, if the current rent is higher than the market rate then the value of the property may go down when the leases expire. Your investment advisor can provide you with market rent for the area. It's also very desirable if there is annual rent increase based on the Consumer Price Index (CPI). When the rental income increases, so does the value of your investment.

The Leases: as an investor, you prefer triple net (NNN) leases over gross leases. The NNN leases will protect you from property tax increase as a result of the purchase as well as any new taxes or assessments. With the NNN leases, the tenants will have to absorb the difference. Besides, with the NNN leases the tenants will pay for the maintenance

costs which will motivate you to keep the property in good condition. This in turn protects your investment. So look for the word NNN in the rent roll. Some single tenant properties have absolute NNN leases. The tenants will pay everything and even take care of all repairs & maintenance for you. All you have to do each month is to cash the rent check!

The leases are often guaranteed by personal or corporate assets of the tenants. Find out what kind of assets the tenants have. If the tenant is a national credit tenant listed on the New York Stock Exchange with good S&P rating then you know your lease is solid.

Look at the rent roll to see when the tenants moved in. If 5 out of 10 tenants of a 12-year old shopping strip just moved in the last 3 months, then you know future rental income is not very stable. You also prefer that most of the leases don't expire at the same time. Otherwise you might end up with lots of vacancy in your property.

Lot Size: the bigger the lot the better the property. Eventually the building will be demolished, what is left is the land. Besides with a bigger lot, you may be able to build more to increase income and thus improve the value of your investment.

Price/SF: This number is between \$100-1000/SF. Brand-name fast food restaurants tend to have very high price per SF while Grocery store have low price per SF. The fact the number is low does not automatically mean it's a good buy or if the number is high it's not a

good buy. This number is just one of the things used to quantify the purchase.

Tenant Mix: you want tenants with different businesses in the commercial property so they don't compete against each other. For example, In a 6-unit strip, you definitely don't want 3 barbershops as they may compete against each other and take others out of business. You will end up with a vacant building. On the other hand, a Chinese, an Italian and Mexican restaurant on the same strip may even attract more people to the shopping center as they offer customers more choices.

Tenant Type: brand name tenants like 7-11, Subway, HR Block are more likely to be around next year to pay the rent. So the more brand name tenants in the property the better it is.

Growing Area: you want to invest in an area that is growing so your investment property has a good chance to appreciate in value. So review the demographic data for the area in the property brochure. Find out the population figures. Of course you don't want to invest in a little city at a middle of nowhere. See how fast the population has grown in the last 5 to 15 years within 1, 3, 5 miles from the property. Look at the average household income to see if it's below, at, or above the national average.

Location: the 3-rd quarter newsletter has an full article about how to determine a good location for a commercial property. You can get a



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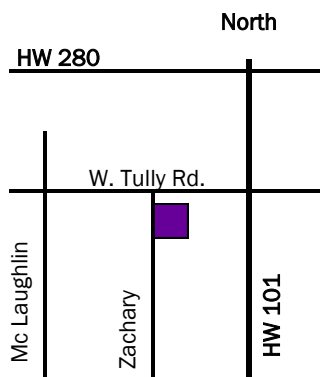


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Investment Advisor

Shu Young is a new advisor at eFunding joining us in September 2005. She is a resident of Silver Creek Country Club in San Jose. Shu has been married to Dr. Fred Young for 34 years. They have 2 sons: one is a Surgeon and the other is a Hardware Engineer. She has invested in commercial real estate since 1985 and practiced real estate since 1992. In her recent investment, she learned about eFunding, liked its business philosophy and decided to join the company. She will be working as a team with her husband Dr. Fred Young, also a new investment advisor at eFunding. They hope to help other investors emulate their success in commercial real estate investment. eFunding is very pleased about their decision to join the company.

Direction to eFunding, Inc.

From HW 101 exit at Tully going West towards the Fairground. Make a U turn at McLaughlin. Turn right at Zachary to enter Tully Business Center. eFunding is at the entrance of this complex.



copy of this issue on www.efundingcom.com.

Age of the property: Newer properties tend to appreciate faster and are easier to find tenants. They require less maintenance as everything is still new and under warranty. The effective age is more important than the chronological age. A property may look newer than its age due to good maintenance or recent renovation. Lenders offer lower rates and longer amortization (30 years instead of 20-25 years) for new properties.

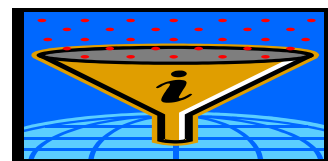
Quality & Condition: see if the property is well constructed with quality materials. Properties with quality construction will hold value, attract better tenants as well as customers and require less maintenance.

Parking Spaces: commercial properties must have at least 1

parking space per 1000 SF. 5 to 7 spaces per 1000 SF is more desirable. Some shopping strips increase the number of parking spaces by making each space narrower. This may discourage a certain customers from coming to the property as they are afraid their cars will get a dent.

Architectural & Neighborhood appearance: tenants will look for a certain neighborhood and a certain type of properties that are appealing to their customers. So drive around the area and pay attention to the landscaping, cleanliness, and graffiti's.

The Big Picture: Use Google Earth (see "Tips For Investor" in this issue) to see the satellite map of the property. Display all the shopping centers, restaurants, Hotels and main roads near the property. This will give you a big picture about the area.



TIPS FOR INVESTORS

Google provides a free software called "Google Earth" that allows you to display satellite map of any properties. You can display name of roads, shopping center, restaurants, hotels and major buildings. You can also rotate, tilt the map to see the topography of the area. This is a powerful tool to evaluate the neighborhood of the property you are interested in investing. To download the software, go to <http://earth.google.com> and click on "Google Earth".

FOOD FOR THOUGHTS:

In real estate investment, Uncle Sam allows you to defer your capital gain with "1031 exchange" when you sell your investment property and put all of its equity in a more expensive investment property. You could later cash out your gain tax free by refinancing the mortgage. Who says Uncle Sam is not kind and generous?

WOULD LIKE TO INVEST IN COMMERCIAL REAL ESTATE BUT DON'T KNOW WHERE TO START?

NEVER THOUGHT ABOUT INVESTING IN COMMERCIAL REAL ESTATE?

NOT HAPPY WITH THE PERFORMANCE OF YOUR STOCK PORTFOLIO?

Where Should You Consider Investing Now A Day?

The commercial retail real estate market continues to be red hot in California. As there are more buyers than sellers, the cap rate continues to go down which means the price keeps going up. The cap rate for most of the retail properties is in the 4-6% range, even for properties in the \$5M and up. Just a year ago, the cap rate was in the 6-7% range. So if you want to invest in California, you will need 45-65% down payment. This may be too much for many investors. The alternative is to look for properties outside of California:

* **Nevada:** Las Vegas is a fast growing city. However, there are not too many properties for sale there and the cap rate is 6-7% range.

- * **Arizona:** Phoenix real estate market is booming. The cap rate is in the 6-7% range there. However, there are not too many properties on the market.
- * **Texas:** the cap rate is in the 8-9% range. There are quite a few properties in good conditions there. This is a good place to invest if cap rate is very important to you.
- * **Georgia:** Atlanta is a fast growing city. The Northern suburb is more affluent. The properties are newer & cap rate is 7-9% range.
- * **Florida:** if you worry about the hurricane, invest in Orlando, or Gainesville. The cap rate is in 7-8% range.



Investing in Commercial Properties

2-hour seminar covering these topics:

- Why should you invest in commercial properties?
- Which property should you invest? Shopping strip, Office building, Apartment, or Gas station? Single tenant or multi-tenant properties?
- How to choose the right property.
- How to determine if it's a good buy or location.
- Where should you invest? In San Jose or somewhere else ?

- Could the sellers inflate the numbers?
- Should you invest alone or ask friends/relatives to join?
- Leases: gross lease, net lease, & percentage lease. Which one investors prefer?
- Property Management issues.
- What you should know about financing for commercial properties.

Please call Maria at 408-288-5500 to sign up.