



BUYING COMMERCIAL REAL ESTATE

Why Now is a
Good Time to Buy

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Introduction



Carl Eldred, in his book "Investing In Real Estate" states that "Unlike investing (or speculating) in stocks, bonds, gold or commodities, you can generate returns from properties through research, reasoning, knowledge and entrepreneurial talents. In contrast, when you buy stocks you had better pray that the market goes up, because that's

your only possibility to receive a reasonable return."

Today's real estate market offers multiple low risk, high profit possibilities. No one can predict the course of prices during the next year or two, but you can look for and buy solid values in today's market. It doesn't matter whether "the market" has hit bottom, it only matters that you are buying at a bargain price and you can get the property to cash flow based on the rents that can be achieved today and in the future. Buying, improving and holding income properties, especially when you purchase them at bargain prices and finance with smart leverage, offers the surest, safest and quickest way to wealth. The most experienced and successful real estate investors typically look to an investing horizon of three to ten years. They also realize that in addition to price increases, real estate provides them with many possible sources of return such as cash flow growth, use of leverage to magnify returns, equity growth through amortization, refinancing to create cash or increase cash flow, shelter other income from taxes, shelter capital gains from taxes, growth through inflation and to diversify away from stocks and bonds.

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Why Commercial Real Estate Rates at the Top Compared to Other Investments



If you're considering investing in commercial real estate, you'll want to understand why it so often comes out at the top when compared to other forms of investing.

Even though *immediate* realizable returns are relatively low in contrast to other investment vehicles, here are some of the factors that make

it such a highly rated investment:

1. Ability to produce large cash flows which in turn produce **financial independence**.
2. Provides **tax advantages** by replacing active income that is earned with passive income that is managed.
3. Creates the opportunity to utilize a large amount of **leverage**.
4. Provides **a hedge against inflation**.

No other investment offers all of these features better than investing in real estate.

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Why Commercial vs Residential?



Many people start out buying residential income property simply because they're more familiar with buying homes, but investing in commercial real estate can be a great way to diversify your portfolio.

Some of the benefits that commercial investments provide over residential

investments include:

1. **More stability:** The terms of commercial leases are longer than residential leases, providing more stability to your cash flow
2. **Greater cash flow:** The yield is usually higher per square foot and on an initial investment basis for commercial real estate than it is in residential. If you lease or rent a multi-unit commercial property, you have more tenants to generate income than you do with a single-family dwelling.
3. **Diversification of risk:** If you own a commercial property with 10 tenants and you lose 1 tenant, you only lose one-tenth of the income, instead of losing the entire income with a single-family dwelling.

4. **Valuation:** The value for commercial property is based on income and capitalization rates; the value for residential property is determined by comparable sales in the market.

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Is This A Good Time to Buy Commercial Real Estate?



My answer is **“yes”** and here’s why:

In commercial real estate investing, **timing** is a key factor in assuring the success of the investment.

And in any market, all commercial properties are “on sale” due to **increases** in either **cap rates** and/or **vacancies**.

Here’s an example of the result of Increasing Cap Rates:

Assume Net Operating Income (NOI) is \$120,000 per year and cap rates have increased from 6% to 8%:

- At 6% your purchase price would have been \$2,000,000
- At 8% your purchase price would be \$1,500,000
- You receive a \$500,000 discount just because of the change in cap rates

If you are a long term holder, you know that cap rates will go down again, so even if NOI doesn’t increase, the value of the property will increase.

Here's an example of the result of Increasing Vacancies:

Assume a property at 100% occupancy has NOI of \$120,000.

- The property was previously leased at 95% occupancy which would have produced NOI of \$114,000
- Now it's leased at 85% occupancy, which places the NOI at \$102,000
 - This \$12,000 decrease in NOI, at a 6% cap rate, means a \$200,000 discount

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International Interest in U. S. Properties

“U. S. Commercial real estate is new target of global investors”



In a recent article posted by Kevin Brass, who has spent more than a decade chronicling the global real estate business for the International Herald Tribune and New York Times, he points to a report stating that the amount of global capital targeting commercial real estate is expected to jump in the next year, with the U.S. the biggest recipient.

“DTZ Research estimates \$281 billion will be **available for investment in commercial real estate purchases this year**, a 22 percent increase from its earlier estimates. *The U.S. is expected to see a 54 percent increase in activity*, while Asia Pacific might see a 29 percent bump, the consultancy's latest report says. (Europe remains the largest target market.)”

In the first half of last year, global investment doubled from the first half of the previous year, rising to \$133 billion, DTZ found. Growth in Asia Pacific tripled,

while European investment jumped 86 percent. But the U.S. was flat, with many lenders keeping undervalued property off the market.

"The current attractiveness of the U.S. is in stark contrast to the situation a year ago," said Nigel Almond, DTZ's associate director of forecasting and strategy, in a press release. "Most U.S. markets were cold, offering expected returns below risk adjusted required returns.

"This opportunity remains largely unexploited to date, since transaction volumes in the U.S. have not yet seen the levels witnessed in Europe and Asia Pacific."

Publically-listed companies, which have been sitting on the sidelines, are re-entering the market, accounting for 17 percent of transactions, compared to only 4 percent last year, the consultancy says.

The majority of investors are targeting multiple countries, although more are now focusing on single countries, the researchers found. **Of those aiming at single countries, 51 percent are focused on the U.S.**, the report says.

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Why International Interest in U. S. Real Estate?



Here are two reasons why I expect more international investors to buy U.S. Real Estate.

1. Compared to prices in the past few years, U.S. real estate is cheap.
2. Compared to real estate prices in most other Western countries (and Japan), U.S. real estate is a *really good value*.

Another reason why there may be growing international investments in the USA?

The ever falling U.S. dollar. The U.S. dollar is almost certain to continue its long term fall. U.S. debt is too high; it probably cannot be repaid. The question is how does one eliminate the debt?

Debt only makes sense when it can be repaid. When it cannot be repaid, the problem is usually greater for the lender than the borrower. The two most likely losers are America's lenders and those on fixed incomes.

The first way the U.S. will default on its debt is via a shriveling U.S. dollar.

China has about \$3 trillion of reserves; about 65% of this (\$2 trillion) is in U.S. dollars. The U.S. dollar this decade has fallen from 8.30 Yuan to about 6.6 Yuan or 20% as shown in the chart above. The U.S. wants the dollar to fall much more.

In other words, the Chinese already lost about \$400 billion dollars on their dollar reserves. They'll lose more.

Viewed another way... the U.S. eliminated \$400 billion dollars of debt and will eliminate more debt. **This means that a lot of foreign investors will be wanting to buy some asset in the US that will rise against the loss of the U.S. dollar... such as a US business or U.S. real estate.**

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How to Get Started Investing in Commercial Real Estate



If you want to build significant wealth in commercial real estate, it's going to require that you take the time to think things through. It requires planning, patience and persistence – or, in other words, it requires you to develop a strategy.

First, get your finances in order.

Figure out what cash resources will be available and your borrowing power. Of course, cash is king in the current real estate market, but if you're planning to finance a purchase, know what the lender will expect

Next, establish your parameters in terms of property type, size and location and the level of return you are looking for. The types of commercial properties are:

- **Apartments** - 5 units to hundreds of units, single level or high rise buildings
- **Hotels** – range in size from small bed and breakfast to large multi-story hotel
- **Office properties** – single building, high rise building or campus of buildings

- **Industrial properties** – small building with 1 tenant, large building with 1 tenant, large building with multiple tenants
- **Retail properties** – single buildings, neighborhood shopping centers, power centers, regional malls, lifestyle centers
- **Multi-use properties** – any combination of apartments, hotels, offices and/or retail stores

Once you have found a property that meets your requirements, value the property based on its condition and potential return based on projected financials. Ask yourself: “What is this property worth to me?” not “What is this property worth?”

Finally, learn how to structure deals and make offers that will be accepted (see my webpage on Negotiating). Plan the next steps to move forward once the deal is accepted.

And remember, a successful disposition is as important as a good acquisition. **Develop an exit strategy** which will accomplish your financial goals – and then stick to it. A common cause of people not reaching their financial goals in real estate investing is due to their failure to stick to their exit strategy – especially the timing for disposing of the asset.

Getting help from professionals can help you understand the issues so that your real estate deals can be solid assets which will position you to build wealth over the long term.

Closing Thoughts



TIMING IS EVERYTHING WHEN BUYING COMMERCIAL REAL ESTATE

The most successful commercial real estate investors in the business recognize that transitioning times present great investment opportunities for them.

Pay attention to the investment opportunities that will be coming your way. Any investor can make money in real estate when times are great, but the investors who buy during the more difficult times are the ones who make more money than anyone else. And when the real estate market gets better once again these are the investors who will realize the greatest gains on their investments, while all the other investors who got into the market later on will have purchased their properties for higher prices.

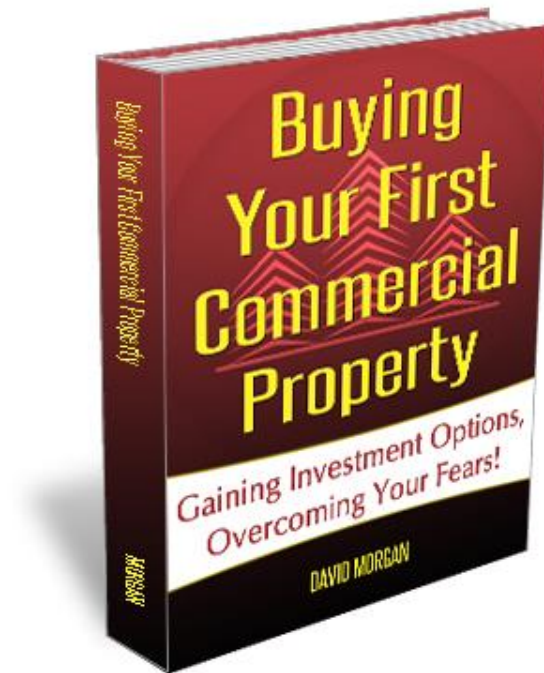
Look for the opportunities that will be coming your way, capitalize on them, and you'll do what the savviest real estate investors have always done... buy low to position yourself to sell high later on when the timing is perfect.

About the Author

David Morgan has been a commercial real estate broker, developer, investor and manager for over 40 years. He is currently a consultant and a best selling author of books about commercial real estate.

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