YOUR GUIDE ON HOW TO CREATE GENERATIONAL WEALTH THROUGH REAL ESTATE

THE POWER OF CHANGE: CREATING GENERATIONAL WEALTH THROUGH REAL ESTATE

MARCUS N. DANIELS

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He has extensive experience working on several successful sales and leasing assignments including owner-occupied corporate headquarters, major building renovations and repositioning projects. As evident by his repeat client base, Marcus understands that every real estate transaction begins with the needs of each client as predetermined by specific corporate goals that are supported by the execution of a strategic real estate service plan. Marcus has an unfailing work ethic and a commitment to excellence in providing clients with confidence and clarity for every real estate decision.

Prior to joining NAI Michael, Marcus was Founder and CEO of Maryland Community Development Corporation and Assistant Vice President of Community Development Banking at Harbor Bank of Maryland where he managed community development lending for the construction of charter schools, business facilities, community centers and healthcare facilities. Mr. Daniels started his career as a Chief of Staff in the Maryland General Assembly where he handled legislative matters including housing, community development and judiciary issues for a member of the House of Delegates. Mr. Daniels also served as an legislative fellow at the United States Department of the Treasury at the Community Development Financial Institutions Fund during the Obama Administration.

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Marcus N. Daniels

Contents

Introduction 0-1

Chapter 1

1.1 Commercial Real Estate 1-1

Chapter 2

2.1 Reasons to Invest in Commercial Real Estate 2-1

2.2 Your First Commercial Deal? 2-2

2.3 Create Instant Wealth with Forced Appreciation & Equity 2-3

Chapter 3

3.1 The 7 Habits of Highly Successful Commercial Investors 3-1

3.2 7 Commercial Investing Myths 3-2

Chapter 4

4.1 10 Opportunities to Invest in Commercial Real Estate 4-1

4.2 Apartment Complexes (5+ units) Office Buildings 4-2

4.3 Retail and Shopping Centers Self-Storage Facilities 4-3

4.4 Industrial Properties Hotels and Motels 4-4

4.5 Mobile Home Parks Special Purpose Properties Commercial REOs 4-5

4.6 Commercial Short Sales REITs 4-6

4.7 TICs 4-7

4.8 Real Estate Crowd Funding 4-8

Chapter 5

5.1 Getting started in Commercial Real Estate 5-1

5.2 Tools You Need to Get Started in Commercial Investing 5-2

5.3 Tools not Required to Get Started in Commercial Investing 5-3

5.4 How to Become a Commercial Real Estate Investor INSIDER 5-4

Chapter 6

6.1 A Simple Way to Analyze Commercial Real Estate 6-1

6.2 3 Steps to Cash Flow 6-2

6.3 How to get mastery of property evaluation 6-3

Marcus N. Daniels

6.4 Key Investment Terms to Master 6-4

Chapter 7

7.1 4 Guiding Principles of Commercial Investing 7-1

7.2 Establishing your 4 Guiding Principles of Investment 7-2

Chapter 8

8.1 Commercial Analysis Examples 8-1

8.2 Types of leases and the lease agreement: Retail's number one priority 8-2

Chapter 9

9.1 Learning the Language: Understanding Commercial Real Estate Terminology… 9-1

Chapter 10

10.1 Case Studies...10-1

Chapter 11

11.1 Conclusion 11-1

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Introduction

Real estate investing has long been a proven approach to helping individuals become their own bosses, build wealth, and achieve financial independence.

In this book, you will learn the basics of investing in real estate and how to start your journey towards escaping your 9 to 5 and building generational wealth for you and your family.

For beginner investors looking to get higher returns from the investing world, here are several quick tips as you consider your options:

1. Focus on word of mouth recommendations for banks, lenders, appraisers, real estate agents, educators, investment groups, etc.
2. Focus on portfolios that align with your pocketbook. If you have $10,000 to invest in a property, focus on properties that cost $20,000 to $50,000, generally in minority neighborhoods, and learn how to ethically invest in long-term rentals for relatively low-down payment amounts but extremely high cash flow.
3. Ensure you are receiving guidance and education from investors who understand and can speak to navigating the racialized components of getting funding and implementing strategies.
4. Learn how to find these low-cost markets, be it an hour’s drive away or a plane trip away, and learn how to successfully manage them through long-distance investing so you can easily achieve great deals without having to manage it hands-on.
5. Show up in the energy of doing good for yourself and the community you’re investing in. That way you can create the business you’ve always wanted, financial freedom, and stabilize neighborhoods at the same time.

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Chapter 1

What Is Commercial Real Estate?

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- Commercial real estate is a building or parcel of land intended to generate a profit, either from rental income or capital gain.
- The business of selling or buying properties such as office complexes, industrial plants, apartment complexes, and retail properties.
- Any real property except a property with only one to four dwelling units for residential use. Any property mixed with both residential and commercial.
- Real estate used in the operation of a business. Commercial real estate can be leased or owned and may include a wide variety of property types, such as apartment buildings greater than 5 units, office buildings, retail space, and industrial facilities.

Commercial real estate includes:

- Office buildings
- Apartment buildings great than 5 units
- Retail shopping centers
- Medical offices
- Self-storage facilities
- Industrial complexes
- Warehouses
- Mobile home parks
- Hotels and motels

Investing in real estate and diversifying your streams of income through property ownership has been one of the most effective strategies for creating generational wealth that creates positive cash flowing investments that will pay you every month and every year.

As a new investor, it is important to track and understand your current financial position and consider how to generate additional revenue streams from starting a business, increasing your current salary and expanding your current services so that it will turn into income that could potentially pay you dividends.

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As a real estate broker and investor, myself, I am committed to executing and delivering an investment strategy that incorporates commercial real estate that will help create positive change and opportunities for people to live a better quality of life. One of the greatest benefits of real estate investing is the ability to own a physical and generate revenue on a monthly basis while achieving the value of appreciation during the hold period. As an investor whether you own a property for a short-term hold or a long term buy, you will always benefit in these ways when effectively assessing and evaluating a good deal from a bad deal and executing your real estate game plan.

This book is geared to helping new investors understand the basic concepts of real estate investing and how to prepare yourself to start on your journey towards building generational wealth through real estate.

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Chapter 2

Key Principles to Investing

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Here are the key principles to investing in commercial real estate:

1. You are responsible for your debt obligations.
2. You determine the performance of the property.
3. You can determine what services and contractors you use.
4. You can increase the income by raising rents and the income of the property.
5. You lower the expenses because you are the owner of the property.
6. You have 100% control of the property because you can sell or refinance the property.

Case Study: Ben Green, 53 Years Old, Orlando, Florida

Ben Green is a school teacher who is thinking about retiring in the next 5 to 10 years and wants to make sure he has enough savings and income to support his lifestyle. Ben has some retirement savings, but not enough to retire on. Ben inherited a townhome two years ago. His brother had lived in it since, but now has re-married and is ready to move on to live with his wife. Ben lists the house for sale.

The real estate agent listed the townhouse for **$420,000**. Ben has to now decide what to do with his net proceeds.

Savings? CD? Stocks and mutual funds? Buy a business? Or invest it in real estate?

After a few weeks of pondering those questions, Ben decides to invest it in an income-producing property. Ben settles on purchasing a 32- unit apartment complex and hires a professional property management company to run the property. The investment generates about what Ben would earn in a year from his job as a school teacher.

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Here are some of the key benefits of investing in real estate:

By creating a cash-generating business that your employer has no control over, if you were laid off or fired, income to pay your living expenses still exists.

You can force the appreciation. You have some control over the appreciation level of your property. As you raise rents, the value of your commercial building goes up since the net income has increased.

Automatic Equity Build Up: As the mortgage is paid down (thanks to your tenants' rental payments), your equity in your property grows automatically.

You have a good hedge against economic volatility. If the real estate market has a downturn, you can lower rents to keep the building full. When the economy turns around, you can raise the rents and ride the wave to higher cash flows.

You have an excellent tax shelter. Rental income from real estate is extremely tax advantaged. The main reason is due to a wonderful piece of IRS code called "Depreciation". It is not an out-of-pocket expense, but still a deduction against your net income on your taxes. This allows you to pay much less in taxes than your ordinary income from your day job.

Leverage and velocity: two powerful wealth-building words. Would you rather own 50 homes or a 50-unit apartment building? With 50 homes, you'll need to obtain 50 loans, 50 appraisals, 50 closings, take care of 50 roofs, mow 50 lawns...get the picture? With 50 units, you'll have one loan, one appraisal, one closing, one roof, and one lawn to deal with. Which do you think would be easier and quicker to sell? 50 homes or one 50-unit building? From the management point of view, is it more efficient to manage 50 separate homes or 50 homes under one roof?

You have no day-to-day management on your part. Wouldn't it be great if you could reap all the benefits of ownership (cash flow, appreciation, and tax advantages) without having to do any work? Well, if you hire a good manager or management company, that's what happens.

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Create Instant Wealth with Forced Appreciation & Equity

Force your property to be worth more by increasing the rents of your tenants. One of the main ways a commercial property's value is determined is by its net operating income. Therefore, the higher the net income, the higher your property value is. It's that simple. Raising rents and lease rates is by far the simplest way to do so.

Decreasing operating expenses of the property. Think of a commercial property as a business that sells products. If you can reduce the cost of the product you sell while maintaining the same price, then your profit is greater. The same applies to the value of your commercial property. If you can reduce the cost of operating it, but maintain the same rent and lease rates, then you're more profitable, right?

Typical operating expenses that one can reduce are the following: employee expenses, contractor usage, utility usage, office expenses, property tax assessment, insurance, etc.

Giving the property a facelift – inside and out. Making improvements to your property cosmetically or by rehabbing it, will not only increase the property's perceived value, but "handsome" properties can charge higher lease rates and rents. Giving your office complex a new front façade and remodeling the lobby will give your tenants a boost of prestige. This will allow you to raise your rents on new tenants coming in and set you up for higher rents when lease- renewals come up.

Changing the property's highest and best USE

My friend Linda inherited a large warehouse that was used as a plastic garbage can distribution center. The business closed up shop and an empty building was all that was left. It sat near the wharf behind a tourist-heavy shopping center. Linda went to the city planner's office and sure enough, it was the city's desire that the warehouse land be used for more retail shopping. She saw the potential and approached a few shopping center developers. In short order, Linda had the zoning changed from "industrial" to "commercial-retail" and soon work began on converting the

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warehouse to a glass-ceiling indoor mini-mall, while keeping the unique "industrial warehouse" look.

After 2 years since the plastic business closed doors, Linda is now majority owner of a bustling mini-mall sporting over 30 stores and open 364 days of the year. She kept one space to herself and opened a store dedicated to the development and improvement of self- image and self-esteem of young girls and women. Changing the property use not only significantly changed the value of the property and made Linda millions over, but it's going to significantly impact a great number of young woman's lives as well. Win-win!

Adding amenities...smartly

Many of the large apartments we've been involved with have swimming pools. So, adding a swimming pool is no big deal and it may be more of a hassle than what value it brings in some cases. We network with other property owners and share "best-practices" with each other to learn what the latest "in" thing to do to wow our clients, our tenants. Throughout the years, this is what we've learned to increase our property values, our client's property values, and the neighborhood values: a business center with computers (bolted down, of course!), fax machine, copier; a conference room to hold meetings; a fitness center with trainers available for hire, free wireless internet especially near universities, a cutely accented coffee bar (we copied the Starbucks theme); and concierge services. Now, obviously not every property has these amenities. Because these items take money and time to plan out and construct, we constantly look at the costs and benefits of each as they are used (or not used in some cases).

The goal here of course is to provide our tenants with a unique experience and well-thought service they could not get anywhere else, at least in our neighborhood.

As for a direct cash-generating amenity, consider putting a coin- operated laundry facility onto the property. If it's near a college campus, accessible, and well-marketed, it can be a cash-flow factory. For office building, consider charging for parking or valet parking. For self-storage, there are

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plenty of cash generators you can add to enhance the experience of your visitors and tenants.

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Chapter 3

Habits of Highly Successful Commercial Investors

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The 7 Habits of Highly Successful Commercial Investors

I really believe it is a smart thing to study others who are successful in the field you desire to be successful in. Don't you? With that said, I have observed, experienced, and gathered seven wealth-building habits for commercial real estate investors. Pay close attention to them as some of them are counter-intuitive to traditional real estate training and investing.

Habit # 1 – They Only Invest in One Asset-type at a Time...The Power of Focus!

The best and the brightest shopping center owners are the best and brightest at one thing – investing and operating shopping centers. The same goes for the best large apartment operators that are at the top of their game. They don't stray away from their specialty, but rather focus on one asset-type at a time. They don't try to be "jack-of-all-trades". Neither should you, if you want to be one of the best and brightest. Focus plus follow-through brings about quantum results. Focus, focus, focus...!!

Habit # 2 – They Don't Over-Leverage DEBT…

Heavy debt is a cash-flow killer. Even though debt is pretty much the norm on most deals, be smart about it. Having high debt is a trap that snares cash-flow and equity.

An easy way of measuring your "debt-safety" level is to figure out your break-even/occupancy percentage. To do this quickly, simply add up all of your annual operating expenses plus all your debt. Then, divide that number by your potential gross income. You'll find that your operating expenses will typically not very much, but that your debt can have a huge impact on your break- even point in occupancy. The higher the debt load, the higher the break-even point in occupancy needed. For example, if your break-even occupancy point is calculated to be 60%, then, after that, it's all cash flow. But, if your calculation comes out to be 90%, that spells trouble.

You have no room for error and must keep your property 90% occupied just to pay the bills.

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Having 50-60% debt (or 50-60% LTV) on your properties is ideal and not easy to achieve, but it will keep you out of trouble and allow you to enjoy greater cash flow and less risk.

Habit # 3 – Their Properties Are Managed Effectively and Professionally

Having top-of-the-line property management, whether you do it yourself or hire a company to do it for you, is a major key to success.

In a nutshell, a top management company's ultimate goal is to maximize potential rental income, reduce operating costs, strengthen tenant retention and relations, enhance visual appeal of the property, and increase property value. If they can do this, you have a winner.

Commercial properties that have the best reputation in the community have the highest rents, the lowest turnover, and have sound and solid property management.

Good property management has well-oiled systems of accountability for the **4Ms:** money, marketing, maintenance, and managing the staff.

Habit # 4 – They Patiently Acquire and Have Tolerance for Mistakes

Rome was not built in a day.

Building a good-sized and wealthy portfolio requires years to build and is built one property at a time. Successful commercial property owners take their time and strategically plan out their acquisitions over a period of years. The real estate cycle and market conditions have to be just right in order to make the best buying/selling decisions. Time and timing are the keys. The average real estate cycle is ten years in length, so give yourself at least that to build your Rome.

Have you noticed that life tends to have built-in provisions for the mistakes we make? The most successful commercial property owners whom I personally know made huge mistakes in the past that have brought them literally to their knees, but the most successful ones bounced back to do

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even bigger deals. The moral of the story is...it's human to make mistakes, but it is also human nature to be an overcomer.

Allow yourself room and grace to make mistakes. It is the highest form of learning there is.

Habit # 5 – They Effectively Partner

Throughout history, no one has achieved impossible dreams or built amazing companies without effective partnering and/or outside advice. When you really think about it, there is no such thing as a self-made millionaire. Somebody somewhere at some point helped or advised that person.

The commercial investment business can be very dynamic with lots of moving parts to it. Don't be average over a lot and master of none. Do what you do best and hire out the rest to the best.

Successful commercial property owners know the value of relationships. Success is a relationship business. Finding the best deals, solving the biggest problems, and finding the money for your deals come from relationships.

To learn how you can effectively partner with the author of this book, go to www.commercialpropertyadvisors.com

Habit # 6 – All Their Business Systems Are Accountable

Well-run and profitable commercial investments seem to go under the radar. But what you will hear more of are the properties that are failing or are in deep trouble. Upon deep inspection, you'll find that the troubled properties have a key component to their operation that has stopped working (or has never worked). And that failed component has caused, or will cause, other facets of the operation to fail down the line soon. Nonetheless, a profitable commercial investment business has nearly every business component running at good to satisfactory levels.

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Successful commercial property owners have excellent internal communications and accurate financial and operational reporting. Their systems allow them to hold their business systems accountable to those responsible. Here is a sampling of typical commercial property business systems: accounting, revenue, internal controls, property staff, marketing system, maintenance, and marketplace.

Habit # 7 – They Are Well-Insured and Their Entities Are Set Up for Maximum Protection, Privacy, and Tax Strategy

"Plan for the worst and be happy if it doesn't happen" is the attitude and habit of the most successful commercial property owners.

Their goals are to build a legal fortress with strategic and intelligent insurance coverage and with the use of well-thought out entities such as LLCs, LLPs, Corporations, TICs, Trusts, etc.

A poorly protected investor may not only lose his or her properties to a real or frivolous lawsuit, but personal property as well. There are over one million attorneys in the U.S., all wanting to deploy their skills (on your property!).

Before doing any of this on your own, consult an asset protection attorney and tax strategist first.

7 Commercial Investing Myths

Myth # 1 – You need to be a millionaire and have good credit to get started

Truth – Master lease techniques is one of the many ways of buying commercial real estate with a reasonable down payment but not involving a bank (no credit required).

Myth # 2 – Analyzing the numbers is too difficult

Truth – Can you add up rents? Can you add up expenses? Can you use a mortgage calculator? If so, that's all you need to calculate the most important figures in commercial real estate.

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Myth # 3 – Property management is the key to success

Truth – Yes, this is a myth! A very important word was left out that would turn this myth into truth: effective. Effective property management is the key to success. Not just any ol' property manager will work! You'll learn that 9 out of 10 property managers are no good and how to find and keep the best in the business.

Myth # 4 – It's a good idea to park your money in a down market

Truth – First of all, if you are not a student of investing, then it is wise to park your money in a down market. Never invest in anything you have no knowledge of. But if you have been in the investing game, you know that the best opportunities are around when the market is mostly down. As Warren Buffet quotes, "Buy when there's blood in the streets!" Actually, there is no bad time to invest – if you're skilled enough, you'll have great deals to buy. You'll discover that the business of commercial real estate is a "relationship" business. And so long as there are people, good people, you'll have good deals!

Myth # 5 – All the good deals are gone

Truth – As long as people believe in this myth that just leaves more deals

for you and I!

Myth # 6 – Investing in commercial is too risky

Truth – Never invest in anything you don't understand. Your next investment is only as risky as your level of understanding in whatever you're investing in. If you have no knowledge of something you want to invest in, then it is risky. Go get the knowledge. Get help. Why would you make the biggest dollar investment of your life without any trusted mentors and advisors to guide you?

Myth # 7 – I can't invest in commercial while having a full-time job

Truth – We recommend for you to have a full-time job when you get started so that your cash flow to pay your living expenses is there. As your portfolio grows, you'll find that your job will start to get in the way of your investing.

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Although you won't find a perfect time to leave your job, you'll know when it's time. Do the smart thing – have your passive income from your investments at least match your take home pay before planning on leaving your job. Get help from people who have already been there and done that.

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Chapter 4

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10 Opportunities to Invest in Commercial Real Estate

Apartment complexes (5+ units)

This commercial property category includes everything from small apartment properties (five units plus) to large apartment communities that span several city blocks. You drive by these types of commercial properties every day. Every apartment building you drive by is owned by some type of commercial investor who's in it to make money. What we find great about in investing in apartments is that they're easy to find, everyone needs a place to live, banks love to lend on them, and they're great cash flow generators. The advantage of starting off with apartment properties is that they're a great way to jump into the exciting world of commercial real estate investing. Most commercial investors we know, start off by investing in small- to medium-sized multi-unit properties.

Great reasons to invest in apartments include:

- Everyone needs a place to live
- Tremendous cash flow potential
- There are many apartments to choose from to invest in
- Apartments are the bank's favorite to lend money on
- Easiest to sell compared to other types of commercial real estate
- Excellent asset to invest in when economy is most volatile

What's driving the demand for apartments?

Echo-boomers are driving the demand to keep apartments full for years to come. Echo-boomers, Generation Y, or Generation Next (all the same) are defined as people born between 1982 and 2002. NAHB (National Association of Housing Builders) chief economist believes that 83 million echo boomers entering the market over the next decade is a positive demographic trend for the apartment rental market. This trend is going to drive the longer-term improvement in apartment fundaments. Echo boomers affected by the housing and financial crisis are going to be biased towards renting over ownership making rental properties valuable. They

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prefer the life of tenant to home ownership making apartment ownership valuable for landlords.

Office buildings

The office building or warehouse you're sitting in right now is owned by a person just like you and me. As time goes by and your city grows, more and more office buildings are being built. One of the most enticing methods of investing in office buildings is by way of triple net leases. This type of lease is one where the tenants in the property pay you the rent plus they also pay for the following:

- Any kind of property maintenance, upkeep, and repairs
- The property's taxes and insurance

This is the true meaning of passive income. In most cases, you'll hire a property management firm to keep the building full of tenants, handle all tenant issues, and pay the bills (plus sending you your check every month).

Triple net leases are so called because all three categories of expenses are paid for by the tenants in your office building. Tenants pay all three of these costs so that the rent you get is a net amount that you don't have to pay expenses out of. So, after the tenants pay for all of the expenses and you pay the mortgage, the rest goes into your pocket. Lastly, it's quite typical for a triple net lease to be five to twenty years in duration with rent increases every few years. But that could be a disadvantage as well and here's why. Let's 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 and shopping centers

Retail centers, shopping centers or malls, are at the center of most towns and cities in our country. These are the places where people come to shop, eat, and meet with friends. Most investors like retail centers because, like office properties, many retail properties are leased out on a long-term triple net leases where the tenants pay for all of the expenses. The upside to this

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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.

Let's quickly explore the different types of retail and shopping centers that exist and some familiar terms you probably have already run across:

Anchor tenant - Usually the first, and the leading, tenant in a shopping center whose prestige and name recognition attracts other tenants and hopefully, shoppers.

Power center - is an unenclosed shopping center with leasable area that usually contains three or more big box retailers and various smaller retailers (usually located in strip malls) with a common parking area shared among the retailers

Big box retailer - is a physically large retail establishment, usually part of a chain. Examples include large department stores such as Wal-Mart and Target.

Strip center - A shopping area made up of a row of retail stores traditionally anchored by a supermarket.

Credit tenant - tenants that are usually publicly traded or large private entities with a strong S&P credit rating.

Mom and Pop tenant - the saying says it all, these are small businesses in small square footage

Pad site - A single freestanding retail site, often adjacent to a mall or larger shopping center. An example would be a photo kiosk, a burger stand, or a drive-thru gourmet coffee shop.

Self-Storage Facilities

Let's face it, Americans keep a lot of stuff and they need somewhere to keep their stuff. When their stuff outgrows their homes and businesses, they turn to self-storage facilities. According to the Self-Storage Association (SSA), self-storage has grown into a $220 billion industry.

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A slow housing market can actually help storage facilities, according to industry analysts and local facility operators. As the housing market slumps, people downsize their house sizes, and need a place to store their extra stuff. Many use self-storage facilities to store their RVs, campers, boats, classic cars, and snow mobiles. Businesses use them as warehouses too. Today's typical storage facility may comprise several one or two-story buildings on 2 to 6 acres of land, or a multiple-story building, containing a carefully designed unit mix of spaces. The units typically range in size from 5 x 5 to 10 x 30 feet with 30,000 to 120,000 total rentable square feet of space.

The typical self-storage investors will enjoy the following perks:

No tenants to deal with on a daily basis and no toilets to fix

Minimum income collection issues – tenant payments are automated and non-paying tenants are locked out.

You have multiple profit centers under one roof – sale of boxes, moving supplies, locks, billboard leases, and the list goes on...

Low risk – no single tenant move-out will greatly affect your cash flow

Industrial Properties

This asset-type usually falls into 3 categories: manufacturing, light manufacturing and assembly, and distribution. Warehouses, commercial condos, distribution centers, assembly plants, office/workspaces, art studio, workshops, showroom are all examples of industrial real estate.

Experts predict that we'll see less and less warehouses as time go on and technology continues to grow by leaps and bounds. With the development of bar-coding, inventory control systems, improved stacking and warehouse handling equipment, industrial space has become very expensive to maintain as it is used. The question is often asked, is the land (space) a lot more valuable when used for another purpose? What happens if on the same land as the 20,000 square foot warehouse stands, you built a 36-unit apartment complex?

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However, industrial real estate opportunities will always be in almost every metropolitan area, concentrating in major transportation hubs. With these areas, it is critical to be as close as possible to transportations facilities since shipping times means money, and the ability to get goods in and out of storage is often critical between both the shipper and the receiver.

Hotels and motels

Hotels and motels are a different animal. Let me explain. Once you buy a hotel/motel, you buy the property and a 24 hour a day 365 day a year business. This business requires hard work and marketing skills to keep the rooms constantly filled. The rooms are worthless if they are vacant. The business tends to be seasonal and may be affected immediately by economic downturns and political events, e.g. 9-11. Many of the businesses are family-run due to its very dynamic and intense management requirements. Hotels and motels are not the easiest place to get started, but many experienced investors have found it to be a highly profitable niche.

Mobile Home Parks

Mobile home parks, trailer parks, manufactured homes, it's all the same. Look at these commercial investments as two pieces – one, the land, and two, the home that sits on it. Wouldn't it be great to own the land and just rent out the spaces (called pads) to the owners of the mobile homes? That way, you have no roofs, no toilets, and no utilities to mess with it. That's as passive as you can get.

Most mobile home parks are owned and operated by "mom and pop" investors and these investments are usually a combination of the land and the mobile homes themselves. Although banks will readily lend on the land, rarely do they want anything to do with lending on the mobile homes. Therefore, typically sellers of mobile homes offer seller financing in order to help a new buyer with funding the purchase. Most mobile home park investors provide a very sizable down payment to the seller and then use bank and seller financing to fund the rest of the purchase. And although some people snub their nose at this commercial property type opportunities are many in this niche.

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Here are 3 great advantages for owning mobile home parks:

- Mobile home parks can range from 10 to 20 acres. As a result, the land becomes so valuable that eventually those homes are replaced by retail or residential real estate. But in the meantime, the mobile home park is creating an incredible cash flow because in essence you are renting the dirt that the mobile homes sit on - so you are leasing the land to people - which makes it a very attractive investment.
- There is a minimum amount of maintenance required. By leasing the land to residents, you have very little maintenance needed.
- •There is also the possibility for many profit centers. For example, there is the option to bring in homes to provide tenants with a lease option. So, you are not only leasing the land, but you are selling the mobile home on terms as well.

Special Purpose Properties

Special purpose properties are commercial real estate designed for a specific purpose in mind. They include restaurants and gas stations, for example. Brand name restaurants like McDonalds and Burger King are single tenant properties with long term triple-net leases which often require no management responsibilities from you, the investor. Here’s how it works: The restaurant operators sell the property (not the business) to investors and lease back the property for 20 years. They in turn use the sale proceeds to expand their business by building more restaurants. You, as the investor (landlord) can expand with them, buying and owning the property while being paid handsomely with zero restaurant business opportunities.

Let’s discuss gas stations. When you buy a gas station, you buy both the property and the gas station business. Most gas stations also have convenience stores and sometimes several car repairs bays. The profit margin for gas is fixed at 10-20 cents per gallon. This is considered an owner-occupied property which qualifies you to a SBA loan with as little as 10% down payment is required. If you don't plan to get involved in running the gas station, auto repair and convenience store business, you may want

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to stay away from gas stations as gasoline is a chemical that could contaminate the soil. Once a leakage occurs and contaminates the environment, it takes years and lots money to clean up the soil. You may even be liable to damages from owners of adjacent properties as contamination may spread out to their properties. It's almost impossible to sell your property as no lenders want to loan the buyers the money to buy it. So, buyers beware!

Commercial REOs

Commercial REOs ("real estate owned") are commercial properties that banks have foreclosed upon, now own, are available for you to purchase, and at times can be acquired at large discounts. Banks are not in the land-lording business and don't want to be. By selling off their REO portfolio of properties, the banks free up cash to lend on "higher performing" properties. Although commercial REOs are not a property-type, they are very much commercial opportunities you should pay attention to. It is not unlikely to purchase REO commercial property for pennies on the dollar. For example, I have seen fully occupied $2 million dollar retail strip centers sell for $750,000. Now that's how you build significant wealth. The ideal way (to get the best deal) to purchase commercial REOs from banks is to come prepared to pay all cash.

Commercial Short Sales

Commercial short sales work very much like residential short sales. A short sale occurs when the amount owed on the property, or the loan, is more than the current value of the property. The bank that holds the loan has to agree to let the current owner of the property sell the property for a steep discount to a new buyer thereby "shorting" the loan. This is done to keep the property from going into foreclosure.

You know the saying, "another man's trash is another man's treasure"? Well, this is how you make significant profits using short sales as a strategy. A property that is ripe for short-selling will be in the "distressed" category. Therefore, you, as the new owner, will have to overcome potential issues such as catching up on repairs, low occupancy, and poor property management. The upside potential on most short sale commercial

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opportunities can be huge if done right. There are no limits on the amount a commercial property can be short-sold nor are there any limits on the type of commercial property that can be. The sky's the limit here!

REITs

For many people, investing in real estate, particularly commercial real estate, is simply out of reach financially. But what if you could pool your resources with other small investors and invest in large- scale commercial real estate as a group? REITs (pronounced like "treats") allow you to do just that.

REIT stands for real estate investment trust and is sometimes called "real estate stock." Essentially, REITs are corporations that own and manage a portfolio of real estate properties and mortgages. Anyone can buy shares in a publicly traded REIT. They offer the benefits of real estate ownership without the headaches or expense of being a landlord.

Investing in some types of REITs also provides the important advantages of liquidity and diversity (unlike actual real estate property, these shares can be quickly and easily sold). And because you're investing in a portfolio of properties rather than a single building, you face less financial risk.

REITs came about in 1960, when Congress decided that smaller investors should also be able to invest in large-scale, commercial real estate. It determined that the best way to do this was the follow the model of investing in other industries -- the purchase of equity.

A company must distribute at least 90 percent of its taxable income to its shareholders each year to qualify as a REIT. Most REITs pay out 100 percent of their taxable income. In order to maintain its status as a pass-through entity, a REIT deducts these dividends from its corporate taxable income. A pass-through entity does not have to pay corporate federal or state income tax -- it passes the responsibility of paying these taxes onto its shareholders. REITs cannot pass tax losses through to investors, however.

From the 1880s to the 1930s, a similar provision was in place that allowed investors to avoid double taxation -- paying taxes on both the corporate and individual level -- because trusts were not taxed at the corporate level if

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income was distributed to beneficiaries. This was reversed in the 1930s, when passive investments were taxed at both the corporate level and as part of individual income tax. REIT proponents were unable to persuade legislation to overturn this decision for 30 years. Because of the high demand for real estate funds, President Eisenhower signed the 1960 real estate investment trust tax provision qualifying REITs as pass-through entities.

A corporation must meet several other requirements to qualify as a REIT and gain pass-through entity status. They must:

- Be structured as corporation, business trust, or similar association
- Be managed by a board of directors or trustees
- Offer fully transferable shares
- Have at least 100 shareholders
- Pay dividends of at least 90 percent of the REIT's taxable income
- Have no more than 50 percent of its shares held by five or fewer individuals during the last half of each taxable year
- Hold at least 75 percent of total investment assets in real estate
- Have no more than 20 percent of its assets consist of stocks in taxable REIT subsidiaries
- Derive at least 75 percent of gross income from rents or mortgage interest

At least 95 percent of a REIT's gross income must come from financial investments (in other words, it must pass the 95-percent income test). These include rents, dividends, interest and capital gains. In addition, at least 75 percent of its income must come from certain real estate sources (the 75-percent income test), including rents from real property, gains from the sale or other disposition of real property, and income and gain derived from foreclosure of property.

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Here's a look at the different types of REITs:

Types of REITs

Let's start with the three REIT categories: equity, mortgage and hybrid.

Equity REITs (EREITs) purchase, own and manage income- producing real estate properties such as apartments, shopping malls and office buildings. Equity REITs are different from typical real estate developers because they purchase or develop real estate to operate it as part of their portfolios instead of developing it for resale. Equity REITs are considered superior for the long-term investing because they earn dividends from rental income as well as capital gains from the sale of properties.

Rather than investing in properties, Mortgage REITs (MREITs) loan money for mortgages to real estate owners or purchase existing mortgages or mortgage-backed securities. Their revenue is generated primarily by the interest that they earn on the mortgage loans. Mortgage REITs react more quickly to changes in interest rates than equity REITs because their dividends come from interest payments. Today, there are close to 40 mortgage REITs. Of these, about 25 invest in residential-mortgage securities and the rest invest in commercial mortgages. Mortgage REITs are considered a good speculative investment if interest rates are expected to drop.

As their name suggests, Hybrid REITs are a combination of equity and mortgage REITs. They both own property and make loans to real estate owners and operators. Hybrid REITs earn money through a combination of rents and interest.

Some REITs are established for a single development project and set up for a specific number of years. At the end of that time period, the REIT is liquidated and the proceeds are distributed to the shareholders.

There are also classifications based on whether or not the REIT can issue additional shares. If the REIT is a Closed-end, it can only issue shares to the public once and can only issue additional shares, which dilutes the stock, if current shareholders approve it. Open- ended REITs can issue new shares and redeem shares at any time.

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Although some REITs have a broad focus and invest in a variety of property types in a range of locations, many REITs focus their investments either geographically or by property type. An individual REIT may hold properties only in a specific region, state, or metropolitan area. Or, it may hold properties across broader geographical areas but focus on healthcare facilities, apartments or industrial facilities.

The National Association of Real Estate Investment Trusts (NAREIT) divides REITs into three classifications based on how they can be purchased: private, publicly traded and non-exchange traded.

Private REITs are not registered or traded with the Securities and Exchange Commission (SEC) and raise equity from individuals, trusts, or other entities that are accredited under federal securities laws. Private REITs generally are subject to less regulation, with the exception of guidelines associated with maintaining REIT status. There are almost 800 private REITs in the United States.

There are nearly 200 publicly traded REITs registered with the SEC and traded in major stock exchanges such as the New York Stock Exchange, NASDAQ and the American Stock Exchange. Because they're traded on an exchange each day, publicly traded REITs are simple for investors to buy or sell and offer great liquidity. Total assets of these listed REITs exceed $400 billion.

About 20 non-exchange traded REITs are registered with the SEC but not traded on any of the public exchanges. Instead, they have private sponsors who market them to investors-often those who have been burned elsewhere in the market and seek relative stability. In exchange for easy liquidity, REIT sponsors focus on the benefit of not having to "time the market." They often promote non- exchange traded companies as providing insulation from fluctuations in the market and, in part, as fixed-income investments that offer better returns than bonds, certificates of deposit, money market funds and similar financial instruments.

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TICs

TICs are a way to own commercial real estate without physically managing it while getting a pretty much fixed return on investment. Basically what you're doing is buying piece of the property along with other investors. And it will be managed by the TIC company, the company sponsoring the investment.

Tenancy in common investments ("TIC" or "TIC Investments") have become a booming industry in the United States in recent years. A tenancy in common investment (better known as a TIC) is an investment by the taxpayer in real estate which is co-owned with other investors. Since the taxpayer holds a deed to real estate as a tenant in common, the investment qualifies under the like-kind rules of a 1031 exchange. TIC investments are typically made in projects such as apartment houses, shopping centers, office buildings, etc. TIC sponsors also known as TIC companies arrange TIC syndications to comply with the limitations specified by the IRS with Rev Proc 2002-22 which, among other things, limits the number of investors to 35.

This type of an investment can appeal to taxpayers who are tired of managing real estate. TICs can provide a secure investment with a predictable rate of return on their investment. Management responsibilities are provided by management professionals. Cash returns on these types of investments are typically in the 6% to 7% range. Syndicators of TICs are called "sponsors." Investment offerings can be made directly by the sponsor or by brokers who can assist taxpayers with an assortment of offerings currently on the market.

TIC investments are treated by most sponsors as securities because they meet the definition of securities either in the state where the property resides or in the various states where the sponsor intends to offer the investment for sale. The SEC has not ruled on this issue but most states are quite clear in their statutes that these investments are securities under state law. This means that only licensed security dealers may market these investments. However, even though the investments may be securities

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under state law, the investment is a real estate investment for purposes of a 1031 exchange.

Some sponsors of TIC investments structure their TIC so that the investment is a real estate investment not subject to state security laws. Usually this means that the TIC sponsor will not be responsible for management of the investment and independent management will be employed.

TIC investments are commonly structured in one of the following ways:

- A single-tenant property with an established credit rating,
- Multiple tenants subject to a single master lease with the TIC sponsor who subleases to the tenants,
- Multiple tenants each with separate leases managed by professional management.

Taxpayers considering a TIC investment should be prepared for an investment which may last for several years with limited liquidity. As with any other real estate investment, an investment in a TIC can be subject to various business risks. Taxpayers should research track records and management performance of sponsors who are offering TIC investments. They should also carefully review any available proforma operating statements and prospectus.

A list of TIC sponsors and brokers by state can be found on the website of the Tenant in Common Association (TICA) at www.ticassoc.org.

Real Estate Crowd Funding

Title II of the JOBS Act of 2012 included a provision allowing companies to sell securities through open platforms such as the internet and lifted a ban on general solicitation and advertising in specific kinds of private placements of securities. This gave rise to a brand new commercial real estate investing opportunity for accredited investors, called Real Estate Crowd Funding. In a very short period of time, there has been an absolute

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explosion in the number of companies offering these investments and currently we are in the infancy of this investing opportunity. With real estate crowd funding, you are buying shares of an investment property. Proponents of this new type of commercial real estate investment argue that investors have a much greater understanding of where their investment dollar is going than in REIT because it is specific to one particular property. But the drawbacks would be that you have to be an accredited investor to participate and depending on what the exit strategy of the crowd funding manager is, your funds could remain tied to that investment for a significant period of time. Further, as with any industry in its infancy, proceed with caution since no company has a long-term track record.

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Chapter 5

Getting started in Commercial Real Estate

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Tools you need to get started in commercial investing

- Desire is numero uno! A great mentor of mine shared with me that "to achieve anything great and worthy, it's not going to be easy, you gotta have a strong desire in you". A strong desire outdoes talent and gifts any day when it comes to real estate investing.
- A computer with internet access – thankfully technology allows us to search and research commercial properties and owners of commercial properties nationally without leaving the comfort of our homes.
- A cell phone or telephone with voicemail – you'll have to call real estate agents, sellers, property managers, set up appointments, and perform simple due diligence tasks.
- Simple calculator – get one, nothing fancy is required, or you can use online calculators or phone app calculators.
- Start in your own backyard. I suggest starting your market research and having an intention on investing in your own city first. It is by far the easiest and most efficient way to begin. Investing out-of-state for the first-timer should be your last resort and should be done with the help and guidance of a skilled- advisor. By starting locally, you'll be able to drive around, meet people in person, check up on the property easily, and learn the business faster.
- Minimum two-four hours per week of dedicated time to work on this endeavor. Obviously, the more hours you put into your goals, the quicker they will come to reality.

Tools not required to get started in commercial investing

- You don't need a real estate license to buy commercial real estate. • You don't need to have started in residential real estate investing
- first to go into commercial real estate.
- You don't need to have a business MBA to understand everything in commercial real estate.
- You don't need to be a millionaire to do your first deal (although a little bit of money can go a long way).

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How to Become a Commercial Real Estate Investor INSIDER

To become a commercial real estate investor insider, it is pertinent that you are up to par, and even an expert in your comfort zone. These things listed here are how you are constantly informed and a step ahead of other real estate people, as well as your own market.

Besides doing these things religiously, and always analyzing the data that you collect, there are a few other specific tools that will allow you to see into your commercial real estate future and identify opportunities that others will miss.

The first is a city's future land use master plan or map that shows the future zoning and use for all the land within a city's limits. Some cities may not have one if they are too small and not looking for growth. However, most cities do have master use plans that are used to dictate the entire future of a city's economic make-up.

This map is used to plan for growth so that all elements of a city are controlled. Zoning and use may change for operating properties; others may remain the same. There is the possibility of raw land to be annexed into the city, having a specific use, offering huge opportunities to the commercial real estate investor. There may be a need to tear down or renovate old properties, and develop them for a different use.

The possibilities of what a future land use map holds is gold in the eyes of an investor, and extremely important to all those working in commercial real estate. Refer to this map, and actually visit the locations of where there is change to identify opportunities. As every area is different, you will be amazed as to what opportunities will unveil themselves when you bring to it a little vision, creativity, and insider information regarding the zoning and use of a property.

Another tool to see into the future is the economic forecast for your area. By looking at both the past and future per capita income, population growth rates, housing costs and other such data that can be found through the census and local Chamber of Commerce, you

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can see the overall economic environment of your city and how it is performing.

Perhaps a continuing decrease in population means people are moving out of the city, telling you not to invest in new home or apartment development in that area. Or, the growth has been so extreme that the city is in desperate need of commercial property in order to support the influx of people. You can definitely plan on how you are going to move in the market with this information by your side.

The final tool I urge you to utilize when predicting your commercial real estate future is already approved infrastructural changes within your city. This will require you to attend city meetings regarding zoning, planning, development, etc. There could be discussion of a new development a year or more before it actually occurs, and once you hear about it, you can start putting your own ideas into place.

As I am sure you already know, large, influential, infrastructural changes can greatly increase the land values of properties that surround them. For example, a large strip mall being developed will increase the value of all the land surrounding it, as well as possibly call for a greater demand of residential units, and an increase in the lot and rental prices that can be charged according to the new market.

Let's say that you hear two years in advance about a strip mall that will begin development after it is approved. You are then going to get a jump on all competition, look at the site, the land surrounding

it, and the opportunities it may offer. Can you purchase the now extremely cheap land adjacent to this site, or perhaps the poor performing apartment complex in anticipation of this new development so that you may benefit from the price increase this major infrastructural change is going to cause?

Absolutely!

These things happen all the time and I urge you to be a visionary and look to the future. After all, this is where a majority of commercial real estate profits is made- by creating something that either wasn't there, or improving upon what is there.

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As you can see, you may not have a crystal ball that does all the work for you, but I promise that if you use these tools and follow these guidelines, you will be preparing yourself for great opportunities that others, quite simply, will overlook. It will take some effort and constant dedication. However, the results that you yield will be more than worth it. Actually, it is much easier to be the first mover, rather than suffering the increased land prices and changes after a development is already in place or even underway.

Realize your power to predict the future and plan your goals accordingly! You will be successful with these tools, so implement them today.

Many people may not realize you can literally become a commercial real estate insider just by working in your own local community. There is a wealth of opportunity for those who are motivated and wanting to make a difference, not only in their own lives, but in the lives of people in the community as well.

You do not have to travel across the United States or around the world to find money making properties that will financially take care of you for the rest of your life. It simply takes two things in order to become a real estate insider: knowledge of your community's real estate opportunities and a steady increase in your own education.

What makes a commercial real estate insider?

A commercial real estate insider knows the ins and outs of the real estate market in his or her own area of interest. This interest could be in office complexes, strip malls, large apartment complexes, medical buildings, and various other income producing properties The commercial real estate insider recognizes trends, the value of property, changes in values before they happen, all zoning laws and regulations, and infrastructural changes that can drastically affect the values of land on or around the new development.

The commercial real estate insider also knows the city decision makers. He or she knows with whom to speak with in order to get information, advice,

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notice regarding changes in the zoning laws or regulations, and to stay ahead of the real estate market.

How do you become a commercial real estate insider?

To start, you should understand that a large part of commercial real estate is dealing with the officials and decision makers of the city or county because they are the ones who decide zoning and use for every piece of property within the city's or county's boundaries. They plan for future growth, and attempt to create a balance among both residential and commercial properties so that the community does not grow too quickly or become unbalanced.

Due to the fact that the city officials are so important to your ability to develop, renovate, and otherwise do what you want to a property, it is crucial that you get to know these people and create a rapport. You also need to know what is occurring in your community regarding real estate at all times. Zoning often changes, there may be new regulations or codes regarding the zoning, or the intended use could be limited to only a few uses that will hinder your intended project. All these things can greatly affect your dealings with a specific property and how you pick and choose your opportunities.

A good way to meet these important officials, as well as learn about the real estate market in your community, is to attend zoning and planning meetings at your local Chamber of Commerce or courthouse. It is there that you can meet face to face the people who will influence your future as a commercial real estate insider. Introduce yourself as a real estate investor, and give them your card. Ask intelligent questions regarding real estate in your community.

Eventually, after building a rapport with these influential people, ask if you could meet with them to discuss a certain project, or something in which you could use more information or advice. You should always come to these meetings prepared with your questions so you stay on task and topic. Show that you appreciate their time, knowledge and expertise.

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It is a great idea to ask for a few more introductions to people they know who may be able to help you. Always send a thank-you note that briefly reviews your discussion, what advice you used and how it will or has helped you. When you show appreciation for their advice, they are more likely to help you in the future, or share information of which others may not be privy. You will begin to make excellent contacts and learn key elements regarding your specific market. This is how you become a commercial real estate insider.

Beyond meeting the people who make the big decisions regarding the use of property in your community, you must know the laws and regulations regarding the various types of zoning. Zoning labels may differ from city to city, as do building criteria, the size of lots, building and fire codes, and limitations. You must study these rules and regulations so you know what you can and cannot do to a property. As these rules and regulations often change, it is important that you listen and take solid notes at all zoning and planning meetings, and other important real estate related meetings you might attend.

Your goal is to know your market inside and out so you can make decisions based on the changes in the market before anyone else even knows they are coming. You do this by recognizing certain points, such as an increase in vacancies of commercial property, or an increase in the median home price, or how the new mall planned to be developed in one year is going to greatly affect the land values around it.

In addition to understanding your own market, you should be reading the newspaper, trade journals, commercial real estate books, attending seminars, and speaking with others in your area who are involved with real estate so that you are constantly increasing your knowledge. It is with this constant training that you will learn strategy, finance, information about private lending, how to find deals, how to present offers, what markets are hot, new opportunities in the area others are not aware of, and many other tools and strategies that will keep you ahead of the rest.

To be a real estate insider, you must always be on your game. Make those contacts. Ask pertinent questions. Learn everything you can about your

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business, and act on this information. You will discover that you find opportunities that you did not know existed, and you will become a commercial real estate investor insider sooner than you would think!

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Chapter 6

A Simple Way to Analyze Commercial Real Estate

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To get straight to the point, once you find a commercial deal to evaluate, you'll need to find the answer to this all-important question rather quickly:

How much is the cash flow?

In evaluating any commercial deal (or any income-producing property), there are 3 Steps to figure out Cash Flow:

3 Steps to Cash Flow:

- Step 1: Get the income per year
- Step 2: Get the expenses per year
- Step 3: Get the debt service per year

This is all you need to initially evaluate any commercial deal!!! After you do this, all that's left is simple subtraction:

Step 1 amount - Step 2 amount - Step 3 amount = Cash flow per year

Step 1 is to find out what the total rents are per month. Add it all up and then get the yearly amount by multiplying by 12.

Step 2 is to find out what the operating expenses are on a monthly basis. The operating expenses do not include mortgage principal or interest, but do include typical items such as taxes, insurance, utilities, repairs and maintenance, property management fee, salaries, landscaping, administrative costs, advertising, and supplies.

Step 3 is to find out what the monthly mortgage would be if you bought the property and then multiply that amount by 12 to get an annual mortgage amount.

Let's do a quick 'n easy deal evaluation: 8-unit apartment building

Step 1:

The income is $600 per month per unit x 8 units = $4,800 per month total x 12 months = $57,600 per year. Therefore, income is $57,600 total per year.

Step 2:

The expenses total up to = $17,000 total per year.

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Step 3:

The debt service is:

1. Figure out the principle: $250,000 – 20% down payment: $250000 - $50,000 = $200,000
2. Figure out the monthly payment on the principle at a 7% interest rate with 30-year amortization. Using an online mortgage calculator, the payments come out to be $1331 per month.
3. The debt service is $1331 x 12 months = $15,972 per year. Now, you have all three things you need to calculate the cash flow. Therefore, the cash flow is:

Was that too difficult?

What you just did can be used for any type of income-producing real estate – office, shopping center, self-storage, mobile home park, etc.

How to get mastery of property evaluation

What does it take to have mastery in anything? First of all, mastery is earned, not born with. Masters deliberately practice their field and concentrate their efforts on improving their skills. And, if you'd like to have mastery in evaluating commercial deals, you'll need to do three specific things:

1. Know and understand fundamental investment terminology
2. Put it to use on a regular basis
3. Practice even more

Want to build instant rapport and credibility with brokers and property owners? Then start using some of the terms you learned here in your conversations with real estate agents, brokers, and owners. When I was new to investing, I noticed that when I used words such as operating expenses, expenses per unit, cap rate, and debt service, they paid more attention to me. It seemed that using those words "bought" me inside their world. They no longer saw me as a newbie wasting their time. It gave me instant credibility even though I hadn't purchased one property yet. Try it and you'll see what a difference it makes.

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The following are 10 most basic and key commercial real estate investment terms that are a must to become familiar with. These 10 are the bare minimum you must know to become successful.

Key Investment Terms to Master

Gross Income ($)

Rents, laundry, or vending machine income (could be monthly or annual).

Vacancy ($)

A unit that is left unoccupied and is not producing income is a vacancy. A unit that is vacated and re-rented in the same month is not considered a vacancy. It is considered a turnover.

Vacancy Rate (%)

The number of vacancies divided by the number of total vacant units

# of total units

Effective Gross Income ($)

Gross Income - Vacancy

Income – (Vacancy Rate (%) x Income) = Effective Gross Income

Operating Expenses ($)

Annual operating expenses of the property typically include taxes, insurance, utilities, management fees, landscaping, maintenance, repairs, and advertising. This does not include mortgage payments or interest expense.

Net Operating Income (NOI) ($)

Effective Gross Income - Operating Expenses

Effective Gross Income - Operating Expenses = NOI

Debt Service ($)

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Monthly Mortgage Amount multiplied by 12 Months Monthly Mortgage Amount x 12 = Debt Service

Cash Flow ($)

Net Operating Income minus Debt Service

NOI – Debt Service = Annual Cash Flow

If you then divide this number by 12, you end up with the monthly cash flow

Cash-on-Cash Return (%)

Annual Cash Flow divided by Down Payment Amount Annual Cash Flow

Down Payment

Capitalization Rate (%)

Net Operating Income divided by the Sales Price. Also known as the "cap rate", it is the measure of profitability of an investment. Cap Rates tell you how much you will make on an investment if you paid all cash for it, therefore financing and taxation are not included.

NOI

Sales Price

The next step is to understand how these terms are used in every day deals. We'll do that by using all of them in example or practice deals. There's no need to memorize the terms at this point, but what you'll discover is that these 10 terms will start to sink in your head as you go through more and more examples and practice deals. Guaranteed.

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Chapter 7

4 Guiding Principles of Commercial Investing

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Establishing your 4 Guiding Principles of Investment

What types of commercial property should I consider making offers on and buying? That's a very good question. On what basis do I make my buying decisions? What is a good cash flow? What is an acceptable return on investment? What is a decent cap rate? How and when do I use gross rent multiplier? These are all good questions that you or anyone contemplating investing in real estate should be asking.

First of all, you'll need a working knowledge of the following: cash flow, cash-on-cash return, cap rate, and gross rent multiplier. You'll need to know the definition and know how to calculate them.

Secondly, you'll need to know how cash flow, cash-on-cash return, cap rate, and gross rent multiplier affect your investment. We'll learn this in a second.

I am assuming that, by now, you can define and calculate cash flow, cash-on-cash return, cap rate, and gross rent multiplier. So, what is left to learn is how each of these investment terms affects your investments and decision-making. The following investment terms are now your Guiding Principles of Investment Terms.

1. Cash Flow
2. Cash-On-Cash Return
3. Cap Rate
4. Gross Rent Multiplier

Cash flow

Positive cash flow will be the main goal and it will be one of our primary objectives. Positive cash flow creates and maintains your investments' momentum. What puts you in a good mood – positive cash flow or negative cash flow? When purchasing commercial property, a bank's basis for lending is the building's cash flow abilities and property condition. A building with poor cash flow will almost always appraise much lower than its comparable for the area.

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1st GUIDING PRINCIPLE: POSITIVE CASH FLOW

Cash-on-Cash Return %

This is the velocity of your money. In other words, how long does it take for your money (down payment) to come back to you? If your down payment was $20,000, how soon does your cash flow add up to $20,000? If your cash flow added up to $20,000 in one year, then your cash-on-cash return is 100%. If it takes two years, then your cash-on-cash is 50%. If it takes three years, then it is 33% and so on. Real estate can potentially produce phenomenal returns. Cash-on-cash returns of over 100% are not uncommon. Now, if you were to go to your local bank and deposit $20,000 into their most aggressive CD investment for one to three years, what type of cash-on-cash return can you expect? 2%? 4%?

We need to put an emphasis on cash-on-cash return when we invest simply because you need to know how fast you can get your down payment back so you can invest it again...and again.

2nd GUIDING PRINCIPLE: DOUBLE DIGIT Cash-On-Cash Return%, 10% OR GREATER

Capitalization Rate %

A cap rate is used as a measure of a building's performance without considering the mortgage financing. If you paid all cash for the investment, how much money does it make? What's the return? Cap rate is a standard used industry-wide. It's used in many different ways. Here are a few ways to consider:

A high cap rate usually typifies a higher risk investment and a low sales price. High cap rate investments are typically found in poor, low income regions. A low cap rate usually typifies a lower risk investment and a high sales price. Low cap rates are typically found in middle class to upper income regions. Therefore, neighborhoods within cities have "stamped" on them their assigned cap rates. With that said, if you know what the NOI is, and you know the given cap rate, then you can calculate what the sales price should be. Sales Price = NOI/Cap rate.

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3rd GUIDING PRINCIPLE:

CAP RATE OF 8% OR HIGHER

Gross Rent Multiplier: Gross rent multipliers are used as a measure to compare income properties in one area or neighborhood. Let's say there are three rented apartment complexes in a neighborhood.

One of them goes up for sale. If you know the gross rent multiplier for the neighborhood, then you can gauge if it is comparable to the other two complexes.

If the gross rent multiplier of one of the complexes being sold is higher than the other two, then you may be paying too much. If the gross rent multiplier of the complex being sold is lower than the other two, then you may be getting a property under market price.

Gross rent multiplier is also a good indicator of the investments' ability to cash flow. As the gross rent multiplier lowers, your cash flow increases in most cases. And the opposite is true. As the gross rent multiplier increases, your cash flow typically decreases.

4th GUIDING PRINCIPLE:

GROSS RENT MULTIPLIER OF 9 OR LOWER

(Important Note: When you are looking at income properties and analyzing them, it is absolutely necessary to have your four Guiding Principles of Investment.)

Listed above, we have established your starting guiding principles. Without them, you will wander aimlessly in the real estate investment game. No working goals = a very weak game.

Your established guiding principles of investment are your standards. If an income property does not match up to your guiding principles, then the property must be passed on. Go on to the next property in search of one that matches. The one exception you'll make occurs when you are analyzing a value-add opportunity.

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In summary, HERE ARE YOUR GUIDING PRINCIPLES OF INVESTMENT

1st Guiding Principle of Investment – POSITIVE CASH FLOW

2nd Guiding Principle of Investment – DOUBLE DIGIT Cash-On-Cash Return%, 10% OR GREATER

3rd Guiding Principle of Investment – CAP RATE OF 8% OR HIGHER

4th Guiding Principle of Investment – Gross Rent Multiplier OF 9 OR LOWER

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Chapter 8

3 Commercial Analysis Examples

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Mastery of real estate investment terms through property analysis

The purpose of these exercises is to measure your readiness in understanding how property is analyzed by using the investment terms and mastering them. As each property is analyzed, each investment term will take on a more definite meaning. The terms will begin to sink in and things will start to “click”.

There are 3 practice properties. Remember, it’s practice. It’s okay to not know. It’s not okay to pretend you know. Take as much time you need in completing both exercises. By the end of the exercise, our goal is to enable you to fundamentally analyze just about any commercial investment by knowing how to calculate cash flow, cash-on-cash return, and cap rate.

We will review each practice property in full detail. Each of these properties has their own unique problem or twist. Solving problems and spotting twists are keys in spotting poor, average, or great investments. You will learn this.

How to Look at Example #1

1. Here’s what I see right away:
2. Appears to be well-maintained and a stabilized investment on paper.
3. A lot of upgrades have been done so repair costs should be in-check.
4. Cash flows well and conservatively. 5. Solid class C property.

Here’s what to pay attention to:

1. 5 units or more is considered “commercial” and requires at least 20% down payment or more.
2. Expenses are 50% of Effective Gross Income. That’s rather high for a 20-unit apartment building. Should be in the 40% range.
3. Pay attention to the price per unit (sales price/no. of units) figure. It’s an important indicator that all apartment experts use to gauge how much they are paying for in terms of value. Apartment experts talk “price per unit” rather than overall sales price. It will help you

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determine if you are paying too high of a price or if you are buying under market.

4. Who pays for what utilities? On this property, having the tenants pay for their own electricity and heat with the owner paying for water and garbage is ideal and typical. Beware of properties that are “master-metered” for electricity and heat. That means that there is one utility meter for the entire building and the owner pays the whole bill. Not good.
5. Don’t miss out that the live-in apartment manager gets free rent. Did you run your analysis on 20 units or 19 units rented? Do you plan on keeping him or just using a property management company and rent out his unit?
6. There is plenty of storage on the premises. Could this be a possible means of additional income?

Does this deal meet the guiding principles?

Is this a deal you’d be interested in pursuing? If so, what qualities do you like?

What would you offer? Full price? Or how much lower?

How to Look at Example #2

A few points of discussion here:

1. This seems to be a pretty solid deal.
2. I would research the leases and make sure all of them don’t expire soon. If they do, I’d attempt to re-negotiate a lease extension to ensure my income for at least 5 years.
3. I’d look for ways to profit from acreage that’s not being utilized. Perhaps add a pad site or two.
4. The mix of tenants is excellent.
5. The comment above, “right in the path of progress” concerns me. Does this mean that the neighborhood could get worse if revitalization does not continue? In retail, there’s a saying – “you can fix a property, but you can’t fix a location”. Therefore, in retail, location is of the utmost importance.

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Types of leases and the lease agreement: Retail's number one priority

I once had a large mall owner share with me, "when you buy a shopping center, what you buy and invest in are the leases, and building comes for free". Of course, that's not exactly true, but what that statement does do is illustrate how important leases are to the value of the investment. A lease is a written legal agreement between the landlord and the tenant that establishes how much the tenant will pay in rent; how long the tenant is legally committed to stay; any additional payments by the tenant for taxes, insurance, or maintenance; rent increases; renewal clauses and options; and all rights, privileges, and responsibilities of the tenant and landlord.

Even though retail leases are long term — say, 5 to 15 years in length — it's common for leases to have rental increases or "bumps" as we call them during the leasing years. You could have a rent escalation of 5 percent once every five years until the lease expires, for instance.

Here are three types of leases you'll most likely come across in retail investments. Each has its small differences, so pay close attention:

Gross lease: the landlord agrees to pay all operating expenses and charges the tenant a rent that's over and above and covers the operating expenses. The types of expenses covered include taxes, insurance, management, maintenance, and any other costs associated with operating the property.

Modified gross lease: this lease is slightly different from the standard gross lease in that some of the operating expenses — such as maintenance, insurance, or utilities — aren't paid for by the landlord and are passed on to the tenant. These expenses are called pass-through expenses because they're passed through to the tenant. Many office-type buildings use a modified gross lease.

Net lease: in a net lease, the tenants pay the operating expenses of the property and the landlord gets to net a certain amount every month by charging rent over and above the total operating expenses. This lease is favorable in many ways: It's favorable to the landlord because she isn't

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responsible for any operational expenses of the property. It’s favorable to the tenant because he gets to fix up his store as he sees fit and do his own maintenance and cleaning. Net leases are typically customized to fit tenant needs. This type of lease is used mainly by retailers. The landlord takes care of the common area maintenance, and the expense of that is spread among the tenants and billed back to them.

There are four different levels and types of net leases:

Single net lease (N): In a single net lease, the tenant agrees to pay property taxes. The landlord pays for all other expenses in the operation.

Double net lease (NN): In a double net lease, the tenant agrees to pay property taxes and insurance. The landlord pays for all other expenses in the operation.

Triple net lease (NNN): This type of lease is most favorable for landlords and is one of the most popular today. The tenants agree to pay the landlord rent plus all other property- related expenses including taxes, insurance, and maintenance. The landlord gets a true net payment. Banks, fast-food restaurants, and anchor tenants typically use triple net leases.

A great income generator for landlords is to have a clause called percentage of sales built in the lease. Here, the landlord gets an additional payment from the tenant if and when the tenant reaches a certain sales volume or profitability. For example, say a coffee shop has agreed to pay an additional 4 percent of its gross sales after its sales reach a certain level. The landlord would be paid the 4 percent in addition to its normal lease payment.

Treat leases and every piece of language in it like treasure!

Understanding Commercial Leases

Your lease is a contract between you and your landlord. A lease can be for a short term (as little as one month) or long term (up to 15 years!), and it can be written or oral -- although a lease for more than a year must be in writing to be legally enforceable. Some people use the phrase "rental agreement" to describe a short or oral lease for which rent is typically paid

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once a month and the tenancy can be terminated on a 30-day written notice. To avoid confusion, we'll stick to the word "lease."

Terminology

Sometimes a written lease talks about the " Lessor" and the "Lessee." The lessor is the landlord; the lessee is the tenant.

It's crucial to understand from the get-go that, practically and legally speaking, there are oceans of differences between commercial leases and residential leases. Commercial leases are not subject to most consumer protection laws that govern residential leases -- for example, there are no caps on deposits or rules protecting a tenant's privacy. Also, since a business will often need to modify the existing space (add cubicles, raise a loading dock, rewire, etc.), the terms of commercial leases are usually subject to at least some negotiation.

The following checklist includes many items that are often addressed in commercial leases.

- Rent, including allowable increases and method of computation • Security deposit and conditions for return
- Length of lease (also called the lease term)
- Whether the rent you pay covers utilities, taxes, and maintenance (called a gross lease) or whether you will be charged for these items separately (called a net or, if the tenant must cover three additional costs, a triple net lease)
- Whether there's an option to renew the lease
- If and how the lease may be terminated, including notice requirements
- What space is being rented, including common areas such as hallways, rest rooms, and elevators
- Specifications for signs, including where they may be placed
- Whether there will be improvements, modifications, or fixtures (often called buildouts) added to the space, who will pay for them, and who will own them after the lease ends
- Who will maintain the premises?
- Whether the lease may be assigned or sublet to another party

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- Whether disputes must be mediated or arbitrated as an alternative to court
- A lease should address what improvements or modifications can be made to the property, which party will pay for the improvements, and whether the tenant is responsible for returning the unit to its original condition at the end of the tenancy.
- Many lease agreements will incorporate a use clause to define the activity the tenant can engage in on the premises. These clauses are in place to protect the property from damage and limit the liability of the property owner. If possible, ask for a broad usage clause just in case the business expands into other activities.
- Exclusivity clause is an important clause for retail businesses renting space in a commercial complex. An exclusivity clause will prevent a landlord from renting space to a competitor.
- Ask the landlord for the right to assign the lease or sublet the space to another tenant. This is an important term because the tenant is still responsible for paying the rent if the business fails or relocates, but with an assignment or sublet clause in place, the business can find someone else to cover the rent.
- Compliance with the Americans with Disabilities Act: Under the act, if a business is open to the public and has more than 15 employees, the premises must be accessible to people with disabilities. The lease should determine who is responsible for making any necessary alterations to the property and who must pay for these changes.

The Due Diligence chapter includes more about leases and what to look for.

1. Are the Guiding Principles met? If not, what areas could you address to meet them?
2. What areas could you improve to increase the cash flow?
3. What price would you offer?
4. Does this deal excite you? If so, why? If not, why?

How to Look at Example #3

Here’s what I see right away:

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1. This is a distressed property in many ways.
2. Why is it 25% vacant and what caused it?
3. There is lots of room for improvement.
4. The unit mix is good.
5. Need to find out how motivated the owners are.
6. There is a lot of upside potential in income on this deal, but it's going to take a lot of work to realize it.

Here's what needs to be addressed:

1. Deferred maintenance.
2. The 25% vacancy. It is 75% physically occupied. I wonder out of that 75%, how many are actually paying tenants that are not delinquent. In other words, I wonder what the "economic" occupancy is.
3. What the partnership issues are. This may put roadblocks to getting the deal done and waste much of your time.
4. What's the cost going to be to fix up the property and how long will it take?
5. Need to find out the following: once the property is fixed up and stabilized: What would it be worth then? And what would the cash flow be if you could bring the vacancy down to 7%?

6. Your other concern should be getting a new loan for this property. Is it possible to get a decent loan in the current lending environment? Also, is the current loan assumable? If so, what is the balance and terms? You should explore creative financing strategies such as a "master lease" or "land contract". That way, no banks are involved.

How much money over time could I make with this property?

1. To figure this out, let's fast-forward and also make a few assumptions.

    a. You were able to get the vacancy down to 8%.
    b. You were able to raise the rents by $25 per unit after the rehab.
    c. You brought the expense percentage down 5% to stabilize at 50%.
    d. We'll use the loan terms given above.

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2. Therefore, the income would increase in the following way. The 1-bed rents would go up to $420/mo. The 2-bed rents would go up to $525/mo. And the 3-bed rents would go up to $600/mo. That gives you a yearly gross income of $480,600.

Now, subtract 8% vacancy and you get an effective gross income of $442,152.

Next, we decided that the expenses would be 50% of the effective gross income and that comes out to be $221,076. Therefore the net operating income (NOI) is $221,076. That's an increase of $66,008 from when you first started.

Now, divide the NOI by an 8cap to get the new value. Here's the math: $221,076 / .08 = $2,763,450. If you paid the asking price of $2,060,000, you would have made over $700,000 in profits. That's not too bad for fixing up a few apartments over time. This example shows the power of the NOI!

In addition to the new higher value, the cash flow is now $221,076 – 124,992 = $96,084 per year which is an increase of over $66,000 per year from when you first started. This deal is a keeper!

A Parting Word from the Author...

I have saved this last part to share with you some additional reasons why you should invest in commercial real estate.

In my humble opinion, here are five compelling reasons to get started:

Reason #1: It's the Most Flexible Way Out of the Rat Race.

Investing in commercial real estate is the greatest method to build cash flow to supplement your income and to build true wealth over time. The cash flows that are generated are considered "passive" income, while other income (from your job or stock investments) is considered "earned" income which is highly taxed. I personally don't believe in wide diversification of investments as it indicates investors don't understand what they are doing. Invest only in something you have understanding in... focus, focus, focus. You can actually diversify your real estate investing by investing in different

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types of apartment properties such as small apartments, large communities, A-class apartments, C-class apartments, TICs – and the list goes on.

Reason #2: It's Not About You.

It really isn't all about you. It's about your loved ones, your kids, your spouse, and your family members. It's about charities, ministries, and organizations you always wanted to help, but you didn't have enough resources to do what you really want to do. It's about being abundantly wealthy (defined as having more than enough) so that you can turn around and be a blessing to others.

Reason #3: It Gets You Closer and Closer to Your Big "WHY".

What's your "why"? Why are you here on earth? What gifts and talents have been put into you, but you have not used to the fullest? Or at all, perhaps. What drives you? What is your purpose?

A good friend of mine, Ryan, who grew up very poor, went to a birthday party of a well-to-do family. In the backyard, they decided to play a game of "find the money hidden in the bushes". All the kids ran into the bushes and many yelled out that they found money, lots of it. Ryan couldn't find any, but kept digging and jumping in the bushes. In short order, he became a dirty, sweaty mess. It soon became really quiet. Not only did Ryan find no money, but as soon as he looked up, everyone was laughing at him. It was a joke planned against the "poor" kid. There was no money hidden anywhere. As Ryan walked home in complete disgust, he told himself that he would never, ever, be put in a situation like that, or allow his family to be ridiculed ever like that again.

Today, Ryan is a millionaire business person many times over and helps thousands of people with building their business as well. Ryan found his passion and purpose in his adversity. What's your passion or purpose, and what are you doing about it?

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Reason #4: Let's Prove the World Wrong.

Are you an over-worked professional? You can't see yourself out of the rat race with your current job? Are you a minority, too old, too young, have plenty of past failures, fearful, a woman, divorced, a single parent, no money? If any of this is you, welcome to the club!

Humans are designed by God to be overcomers by nature. It's never too late to start investing wisely. Just because you have failed at several businesses (like yours truly!) doesn't define your future. Your actions today will do that for you. Begin to take action now because the past is behind you, the future is not guaranteed to us, and all we have is today. Do something today. Be intentional about what it is you truly want – today. Let's prove the world wrong. Let's do it together.

Reason #5: It's a New Season for You.

Life happens in seasons, have you noticed? You have this book in your hands for a reason. Could it be time to begin a new season in your life? A season of doing something you always wanted to do, but didn't because of the fear of rejection or fear of failure. This could very well be the season to confront those lies you believed for far too long and dare to be what you were called to do and be. This is your season!

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Chapter 9

Learning the Language: Understanding Commercial Real Estate Terminology

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Development Terminology

This section contains a collection of terms and concepts most commonly used in the commercial development of land and buildings. Included are the various stages of the development process, and types of development and redevelopment projects.

Development Process and Asset Lifecycle

Below are listed the general categories typically used to define the development process and the asset lifecycle.

- Purchase land or asset.
- Assess general economic conditions.
- Assess the capital markets and obtain financing.
- Assess the space markets.
- Understand demographics and social forces.
- Develop a master plan or site plan.
- Design the base building or interiors.
- Obtain entitlements and permits.
- Construct the project.
- Lease the project.
- Operate and maintain the building.
- Sell the asset.

Building Status Definitions

Delivered

A building that has completed construction (i.e. obtained its certificate of occupancy). With a COO, the property will be considered delivered whether or not tenants have occupied the space. (Synonyms: completion; new supply)

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Letter of Intent (LOI)

A letter of intent is an agreement(s) between two or more parties before an actual agreement, such as a lease, is finalized. It is similar to a term sheet or memorandum of understanding (MOU). While LOIs may not be binding, provisions of them can be, e.g., non-disclosure and exclusivity. The intent is to protect both parties in the transaction until the transaction is executed.

Proposed or Planned

A building that has received zoning approval but has not yet started construction.

Under Construction

A building is under construction when construction permits have been obtained and site excavation has begun. If a site is being redeveloped, demolition of existing structures does not necessarily indicate that construction has begun. Sites are sometimes cleared years in advance of a groundbreaking.

Under Renovation

A building is typically under renovation when construction permits have been obtained and demolition has begun. A building is under renovation if it remains inhabitable by tenants during the construction. If an existing building is gutted extensively (i.e., elevators and bathrooms do not function and it can, therefore, not be occupied by a tenant), then the building should be removed from inventory and redelivered when the occupancy permit is issued.

Types of Development and Redevelopment Projects

Adaptive Reuse

A building converted to a different use in order to meet current demand. Examples include a factory converted to retail use or an office building converted to a school. (Also see conversion)

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Build-to-suit

A building is designed and tailored for a specific tenant, often because the tenant is unable to find suitable space in the speculative market. Sometimes (but not always), a build-to-suit project includes specific design features not commonly found in the speculative market, thus compelling the tenant to have a special facility built. The build-to-suit project is usually contracted with a developer who owns and operates the completed facility occupied by the tenant. Generally, a build-to-suit project becomes a single-tenant building upon completion.

Conversion

A building that is changed from one use to another (i.e., an office building that is converted to a multifamily building). Space being converted is removed from current inventory and included in the under construction category for the planned future use (i.e., an office building being converted to an apartment building will be removed from office inventory and included under apartment space, or number of units, under construction). (Also see adaptive reuse)

Infill

Infill is the development of one or more buildings on underutilized land situated between existing buildings. Infill development is typically done in dense environments where land is scarce. The slightly broader term “land-recycling” is sometimes used.

Redevelopment

A building or site that involves teardown and rebuilding of most—if not all—structures on that site. This change typically occurs in sought-after areas that are usually well located, where buildings have become unattractive or obsolete or where there is a demand for different uses.

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Renovation

Upgrading and modernizing common areas in a building such as lobbies, bathrooms, parking areas, etc. The tenant remains in the building, and the building use and square footage do not change. Renovation is often done together with a retrofit.

Retrofit

Modernization of building systems such as heating, ventilation and air conditioning (HVAC); security; fire alarms; and energy management. The tenant remains in the building, and the building use and square footage do not change. Retrofit is often done together with a renovation.

Speculative

A building developed and constructed without any preleasing in place. Construction commences without a prelease when the developer believes there is so much demand for that type of building in that market or submarket that a lease commitment is bound to come through.

Measurement Terminology

This section provides information about metrics and measures used to define and quantify market, parcel and building elements.

Location and Site Definitions

Air Rights

A type of property interest referring to the “space” above land.

Brownfield

Abandoned, idled, or underused land or facilities where expansion or redevelopment is complicated by real or perceived environmental contamination.

Exurban

An emerging residential area beyond built-up suburbs and edge cities.

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Floor Area Ratio (FAR)

FAR is the relationship between the total square footage of a building and the total square footage of the parcel on which the building is located. It is typically calculated by dividing the total square footage of the building by the land area in square feet. For example, if a 20,000-square-foot building is built on a 10,000-square-foot lot, the FAR is 2.0.

Market and Submarket

In commercial real estate (CRE), the terms “market” and “submarket” have many characteristics.

Hierarchy: In terms of geographic hierarchy, a region is made up of markets, and a market is made up of submarkets.

Boundaries: Markets and submarkets have generally accepted geographic boundaries that do not overlap. They are most commonly bound by streets, roads and natural features such as parks and rivers, which clearly indicate where one market or submarket ends and another begins.

Purpose: Markets and submarkets are the foundation upon which analysts track real estate fundamentals such as vacancy, absorption, rents and construction activity.

Markets and submarkets are further broken down by total buildings and by total square footage in those buildings.

Product types: Office and industrial product types may share generally accepted market or submarket boundaries because in the United States, office space tends to be clustered together as does industrial space. However, there may also be separate and distinct boundaries for each respective property type. Suburban retail is more closely tied to residential and, therefore, is dispersed across large geographic areas, whereas urban retail is typically clustered in specific areas or on specific streets.

Submarket

Submarkets are geographic divisions of markets. These smaller divisions or boundaries are generally recognized and accepted by the real estate

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industry and the business community in a market and region. Submarkets are geographic boundaries that delineate core areas that are competitive with one another, and together they constitute a generally accepted secondary set of competitive areas. In the real estate industry, submarkets are building-type specific and are nonoverlapping contiguous geographic designations with a cumulative sum that matches the boundaries of a market. They contain properties sufficient to provide meaningful information for aggregate statistics.

Suburban

Suburban means a geographic area that contains a variety of property types arranged in a setting that is less dense than neighboring urban areas. This broad term can be defined or measured a number of ways and is often defined relative to urban and exurban areas.

Town Center

A historical term used to refer to the commercial, civic or geographic center of a community. Today, the term is associated with retail and has come to be known as a robust retail cluster with civic or open spaces in proximity to a variety of uses such as residential, office, retail and hotel.

Transit-oriented Development (TOD)

Real estate projects that are built around transit to maximize access to shared transportation modes. Typically, the TOD project is dense and walkable, and it includes a mix of uses such as residential, office, retail, hotel and entertainment.

Transit Score

Transit score is a number between 0 and 100 that measures the relative usefulness of nearby routes. “Usefulness” is typically measured by a weighted algorithm of characteristics such as distance to the nearest stop; mode of the route such as bus, ferry or rail; and frequency of service.

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90–100 Rider's Paradise

- World-class public transportation
- 70–89 Excellent Transit
- Transit convenient for most trips
- 50–69 Good Transit
- Many nearby public transportation options
- 25–49 Some Transit
- A few nearby public transportation options
- 0–24 Minimal Transit Possible to get on a bus
- 6 | Commercial Real Estate Terms and Definitions

Urban

Urban areas are commonly identified with a city, are typically built on a traditional street grid, have consistent building setbacks, have sidewalks and usually include multiple-story buildings.

Walk Score

Walk score is a number between 0 and 100 that measures the number of amenities such as retail, businesses, parks, theaters and schools that can be accessed by foot inside a 1-mile radius from a particular address.

- 90–100 Walker's Paradise
- Daily errands do not require a car
- 70–89 Very Walkable
- Most errands can be accomplished on foot
- 50–69 Somewhat Walkable
- Some errands can be accomplished on foot
- 25–49 Car-dependent
- Most errands require a car
- 0–24 Car-dependent
- Almost all errands require a car
- Base Building Definitions
- Common Area

The generally accessible areas found on each floor of an office building such as washrooms, janitorial closets, electrical rooms, telephone rooms,

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mechanical rooms, elevator lobbies and public corridors that are available for use by all tenants on that floor. It does not include major vertical penetrations such as elevator shafts, stairways, equipment runs, etc., (identified as a percentage of rentable area).

Core Area

The common area plus vertical penetrations in an office building measured in square feet. Core area is typically expressed as a percentage of net rentable area. This factor, which ranges from 5 to 20 percent for typical office buildings, can be computed for an entire building or a single floor of a building.

Floor Plate

The gross square footage of each floor in a multistory building. Individual floor plate sizes may vary according to the design of a building.

Functional Obsolescence

A descriptive term used to characterize a building that cannot be improved to meet current market standards or tastes without a complete replacement of buildings systems and finishes.

Load Factor or Core Factor

The load factor is calculated by dividing the rentable building area (RBA) by the usable area. This factor can then be applied to the usable area to convert it to RBA for comparison. In markets were space is leased on the basis of the usable area, if the load factor is 15 percent, then the usable area can be multiplied by 1.15, resulting in the RBA. (Synonym: add-on factor)

Shell Space

Space within a property that is currently not built out.

Year Built

The year the building was delivered to the market as a result of completed construction.

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Year Renovated

The year the building last received a certificate of occupancy (COO) for a major renovation.

Energy and Natural Resource Efficiency Definitions

As environmental awareness has grown, the real estate industry has developed rating systems as well as its own lexicon to capture and quantify efficiency measures. Some of the systems, especially those that pertain to ratings, have been developed by government agencies.

Energy Star®

Also referred to as an “EPA rating” or an “Energy Star rating,” the rating is a standardized national benchmark that helps architects and building owners assess energy use relative to similar buildings in the program. An Energy Star-qualified building means the building meets EPA criteria for energy efficiency and displays the Energy Star building label.

Green Globes®

Founded in Canada in 1996, Green Globes is a green building guidance and assessment program that offers a way to advance the overall environmental performance and sustainability of commercial buildings. After achieving a minimum of 350 of the total number of 1,000 points, new and existing commercial buildings can be certified for their environmental achievements and sustainability by pursuing a Green Globes certificate that assigns a rating of one to four globes.

LEED® (Leadership in Energy and Environmental Design)

LEED is a third-party certificate program under the U.S. Green Building Council (USGBC). It is a nationally accepted benchmark for the design, construction and operation of high-performance sustainable buildings. Certificate levels are as follows: Certified, Silver, Gold or Platinum. The levels are based on points obtained in six areas: sustainable sites, water efficiency, energy and atmosphere, material and resources, indoor environmental quality, and innovation in design.

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Sustainable Development

In commercial real estate (CRE), this term generally means the practice of developing, redeveloping and operating CRE in ways that cause zero, minimal or improved environmental impact.

Space Markets and Leasing Terminology

Data help provide information about the health of real estate buildings and real estate markets. Real estate metrics run the gamut from basic measures of inventory and available space to indicators of leasing activity, rents, concessions and various forms of leases.

Space and Lease Definitions

Available Space

The total amount of space that is currently being marketed for lease. It includes space that is vacant or also space that is currently occupied but will be vacant in the future. Available space can include both direct and sublet space. If sublet space is excluded from the calculation, the term “direct available space” is recommended.

Asking Rent

The amount asked by landlords for available space, expressed in dollars per square foot per year in most parts of the country (and per month in areas of California and other selected markets). (Synonym: face rate)

Blend and Extend

A blend and extend lease is a type of renewal that allows tenants to blend their existing lease into a new and longer lease. If a tenant is paying rent that is above current market rents, this arrangement will lower the current rental rate. The tenant benefits by an immediate reduction in the rental rate, and the landlord benefits by securing a tenant for a longer term. Conversely, if rents are rising quickly and lease expiration is approaching a tenant may renew early and extend to lock in lower rates.

Competitive Inventory

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Single-tenant and multi-tenant buildings typically consist of 10,000 square feet or more that are owned by one party and are made available for lease to another party. Owner-occupied and government-owned buildings are typically excluded from the competitive inventory.

Note: It is important to note that data providers each have their own set of buildings that make up the competitive inventory in their foundational data set. Some include buildings larger than 20,000 square feet, while others include buildings as small as 5,000 square feet. Those modest differences in the competitive set can cause variations in metrics such as vacancy and absorption reported by each shop.

Competitive Set

A subset of total inventory that enables one to isolate and compare buildings on the basis of similar characteristics rather than simply by location. For example, a broker preparing to show available space to a tenant may identify five properties to be toured on the basis of location, square footage available, class, asking rent, parking ratio, etc. An investment sales or finance broker may generate a competitive set of buildings according to access to transit, year built, percentage leased, etc., to help estimate the value of an asset to be bought, sold or refinanced.

Concessions

To secure a tenant when vacancy is high in a market or submarket, a landlord may need to grant concessions in the lease. Those concessions most often take the form of free rent but may also include lease buyouts, moving allowances and above-market tenant improvement allowances.

Contiguous Block(s)

Multiple suites or spaces on either the same floor or the adjoining floor(s) in the same building.

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Construction Starts

The total number of buildings that broke ground (commenced construction) over a given period. The starts are typically measured in number of buildings and square feet.

Contract Rent

The rental rates stipulated in an executed lease agreement. Typically, the contract rate is based on the first-year rate as opposed to the average rate over the term of the lease. (Synonym: base rate)

Creditworthy Tenant

A tenant with a business that has been in existence for numerous years, that has strong financial statements, or that has a large market presence that could be rated as investment grade by a rating agency. Financial and business stability implies that the tenant is highly likely to honor its lease commitment; the tenant is, therefore, viewed as a low-risk renter. Buildings with credit tenants as anchors are considered less risky investments for lenders.

Cubic Volume

In many industrial facilities, the cubic volume of the building must be calculated so a user can determine the size and type of racking and sorting equipment that can be accommodated.

Direct New Space

Space that is offered for lease directly by the building owner or landlord. If space is offered for lease by a building tenant, it is not direct space but rather is sublet space.

Direct Vacancy Rate

The total amount of physically vacant space divided by the total amount of existing inventory, expressed as a percentage. Space that is under construction (and, therefore, is vacant) is not included in vacancy calculations.

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Effective Rent

Expressed in dollars per square foot either per year or per month depending on market standards, it is a measurement of the value of the lease when all the concessions plus escalations are included. Effective rent calculations may vary according to local market practices; for example, in some markets, broker commissions are included.

Effective Rent Calculation

- Effective Rent = (total rent – free rent – cash allowances) / lease term / rentable square foot
- Total Rent = rent paid during the term of the lease including escalations
- Note: Cash allowances can include free rent, moving allowances and other cash considerations.
- Assumptions: 5,000-square-foot (sf) lease 36 months
- $25 contract rate with $0.50 annual escalations 1-month free rent (first month)
- Year 1 (11 months)
- Year 2 (12 months)
- Year 3 (12 months)

Formulas

- $25.00 x 5,000 sf x (11/12) = $114,583
- $25.50 x 5,000 sf = $127,500
- $26.00 x 5,000 sf = $130,000
- Total Rent = $372,083 $24.85/sf/year

Total Rent or Consideration Effective Rental Rate

Encumbered Space

A block of space offered for lease by a landlord to which another tenant has some right to lease or occupy at some future date.

Gross Absorption

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The total amount of space occupied over a given period of time, without subtracting the amount of space vacated. (Synonym: leasing activity)

Gross Building Area (GBA)

The total interior floor area of a building, usually measured from the inner-most edge of the outside walls.

Gross Lease

A legally binding contract in which a landlord receives stipulated rent from a tenant and is obligated to pay all or most of the property's operating expenses and real estate taxes.

Note: Disclosure of the specified costs of operation is required in some states. (See Common Lease Types Matrix.) (Synonym: full service lease)

Ground Lease

A lease agreement (contract) whereby the landowner (lessor) agrees to lease a parcel of land for a set period of time to a third party (lessee). Depending on the agreement, the lessor can stipulate what the lessee can or cannot do with the property or build on the property. The lease term is typically 20 years or more, but many extend to 99 years. Upon expiration of the lease agreement, the lessor typically gains control and ownership of whatever is constructed on the land, unless the lease is renewed or an exception is created in the lease.

Leased Space

Space under contract between a landlord and a tenant or between a tenant and a subtenant.

Leasehold

A leasehold is an ownership structure in which a temporary right to use land has been granted by the landowner to another party. (See ground lease.) Although the tenants do not own the land, they are able to improve the land and operate it as stipulated in the ground lease for the term of the lease.

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Leasing Activity

Leasing activity is a term that refers to the number of leases signed or square footage committed to over a specified period without regard to occupancy. Typically, leases are executed many months before a tenant occupies the space. This arrangement means that a lease can be executed in a given quarter, but the space commitment will not show up in the absorption figures until the space is occupied at some point in the future. Leasing activity includes direct leases, subleases and expansions of existing leases. Leasing activity also includes any preleasing activity in buildings that are under construction, are planned or are under renovation. (Synonym: gross absorption)

Master Lease

The controlling lease identifying the terms and length of the lease. Note that a sublease cannot extend beyond the term of the master lease. (See Common Lease Types Matrix.)

Modified Lease

A lease in which the landlord receives a stipulated rent, and payment of the property's operating expenses is divided between the lessor and lessee via specified terms in the lease; also called "Modified Gross," "Net-net" (Double Net), "Net-net-net" (Triple Net), etc., depending on the degree to which the tenant or landlord are responsible for operating costs. (See Common Lease Types Matrix.)

Net Absorption

The net change in occupied space over a specified period of time. This change is measured in square feet at the building, submarket and market levels. This figure reflects the amount of space occupied as well as the amount of space vacated. Net absorption can be either positive or negative and must reflect increases and decreases in inventory levels.

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Net Lease

A lease in which the tenant pays a share of operating expenses in addition to the stipulated rent. Disclosure of the specific expenses to be paid directly by the tenant is required. (See Common Lease Types Matrix.)

New Space

Space delivered to the market that was never previously leased or occupied by a tenant.

Occupancy Cost

Includes rent, real estate and personal property taxes, plus insurance, depreciation and amortization expenses.

Occupied Space

Space that is physically occupied by a tenant, subtenant or owner. Occupied space is calculated by subtracting total vacant space from total competitive inventory. If subtenant space is excluded from the calculation, then the term “direct occupied space” is recommended.

Preleased Space

The term applies to space that has been leased in a building that is under construction.

Pro Rata Share

The percentage that, when multiplied by reimbursable expenses (less an expense stops if referring to a gross lease), equals the amount to be reimbursed by a tenant to the landlord for expense recoveries. Typically, the percentage is calculated by dividing the net rentable area of a tenant’s leased premises by the net rentable area of the building, although this is not always the case.

Relet Space

Sometimes called “second-generation space,” it refers to existing space that was previously occupied by a tenant.

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Renewal Option

The right of a tenant to extend the lease term for a specified period of time at a predefined rental rate. In many instances, the rate is defined as a percentage of market rent, and in other instances, the rate is a specified dollar amount. An auto-renewal option is a type of renewal option whereby the lease term is extended automatically on the expiration date without any notification requirement. Often, there is a date by which this option must be executed; otherwise, the option expires.

Rentable Building Area (RBA)

The total square footage of a building that can be occupied by or assigned to a tenant for the purpose of determining a tenant's total rental obligation. Generally, RBA includes common areas in the building including hallways, lobbies, bathrooms and phone/data closets. (Synonym: gross building area)

Sale or Leaseback

An owner-occupied property that is sold to a third-party investor. The previous owner becomes the tenant that pays rent to the new owner. This tactic allows property owners to convert their ownership (equity) into cash while still occupying the property. The seller's (now the tenant's) lease term must be for two or more years.

Shadow Space

A portion of leased space that is not being used by the tenant. This area can include unused space that a tenant leased and is holding for expected future growth. It can also include unused space that was previously occupied but is no longer used as a result of downsizing the company's workforce. Shadow space is difficult to measure because it is not officially marketed or tracked in industry databases. (Synonym: phantom space)

Straight-line Rent

The accumulation of rental income (including months that have free rent, discounted rent and fixed-rent increases) divided by the term of the lease

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will generate a straight-line rent. Straight-line rent provides a way to compare rents on various properties using a consistent methodology.

Sublet Space

Space offered for lease indirectly by a tenant rather than directly by a landlord.

Takeup

When the space is physically occupied. (Synonym: leasing activity)

Total Inventory

The total number of buildings and total square footage (net rentable area) in the competitive inventory. Buildings under construction are not part of total inventory. Total inventory increases when a new building is delivered and decreases when an existing building is demolished or changes use. Total inventory includes properties under renovation if the building remains inhabitable during the renovation but excludes properties converting to a different use.

Total inventory is typically measured at the submarket and market levels. A description of the characteristics and numeric thresholds that make up the total inventory should be provided. The total inventory figure may vary from one data provider to another as a result of tailored definitions of what constitutes the competitive inventory. (See competitive inventory for more information.)

Triple Net Lease

A lease agreement whereby the tenant pays taxes, maintenance and property insurance as well as all operating costs associated with the tenant’s occupancy, including personal property taxes, janitorial services and all utility costs. The landlord is responsible for the roof and the structure and sometimes the parking lot. (See Common Lease Types Matrix.)

Usable Area

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This relative term is best compared to rentable area. Usable area is the amount of space that can actually be used by tenants within the space

they lease. For example, columns inside a tenant space are counted in the measure of rentable area, but the space occupied by the column cannot be used by the tenant. A tenant's usable area does not include common areas in the building.

Vacancy Rate

A measurement expressed as a percentage of the total amount of vacant space divided by the total amount of inventory. This measurement is typically applied to a building, a submarket or a market.

Vacant Space

Inventory that is not currently occupied. If subtenant space is excluded from the calculation, the term "direct vacant space" is recommended.

Work Letter

A legal document that outlines the obligations of the landlord relative to the improvements necessary to prepare leased premises for a tenant's occupancy. Items typically found in a work letter include a description of the improvements, the cost thereof, and the portion of the cost to be paid by the landlord, the completion date and the insurance requirements of contractors performing the improvements.

Common Lease Types Matrix

- Lease Type
- Responsibility for Expenses
- Other
- Gross (full service)
- Net
- Master
- Landlord pays all or most of the operating expenses and taxes.
- Tenant pays all operating expenses.
- Costs of operation must be disclosed in lease.

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- Landlord must disclose tenant responsibility in lease.
- Controlling lease stipulates terms and length.
- Modified Gross
- Expenses are divided between tenant and landlord.
- Costs can be double or triple net depending on terms of lease.
- Triple Net (Net-net-net, or NNN)
- Tenant pays all operating expenses, taxes and insurance.
- Landlord is responsible for structure, roof and maybe parking lot.
- Investment Sales Terminology

This section contains a group of frequently used terms related to the purchase and financing of real estate assets.

1031 Exchange or Like-kind Exchange

U.S. Internal Revenue Code Section 1031 permits the deferral of capital gains taxes on the sale of property held for investment or productive use in a trade or a business. With a 1031 exchange, property owners can sell their real estate and then reinvest the proceeds in ownership of a like-kind property or several like-kind properties, thus deferring the capital gains taxes. The like-kind exchange under Section 1031 is tax-deferred, not tax-free. When the replacement property is ultimately sold (not as part of another exchange), the original deferred gain, plus any additional gain realized since the purchase of the replacement property, is subject to tax.

Basis Points (BPs)

Values equal to one-hundredth of one percentage point. For example, 100 basis points = 1 percentage point.

Capital Expenses or Cap Ex

Improvements (as opposed to repairs) to a fixed asset that will increase the value or useful life of that asset. A capital expenditure is typically amortized or depreciated over the useful life of the asset, as opposed to a repair, which is expensed in the year incurred.

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Capitalization Rate or Cap Rate

Unlevered initial return from the acquisition of a real estate asset calculated by dividing net operating income (NOI) by the property sales price. For example, a property's capitalization rate (cap rate) is 10 percent if it is purchased for $10 million and produces $1 million in NOI during one year. The cap rate is typically calculated using the NOI generated in the first year of ownership so investors can normalize and compare potential returns among competing investment properties.

Commercial Mortgage-backed Securities (CMBS)

CMBS are a type of bond that is commonly issued in U.S. securities markets and is backed by the cash flow from a pool of mortgages on commercial properties. The CMBS are often arranged into groups or "tranches" according to geography, property type or underlying credit rating.

Core Investment

An investment in a high-quality real estate asset that is located in a highly accessible and highly desirable submarket. The asset commands among that submarket's highest rents and requires virtually zero near-term capital expenditures. The asset is at least 80 percent leased, carries long-term leases with creditworthy tenants, and is among the most sought-after assets in the market, suggesting there is significant market liquidity.

Debt Coverage Ratio

The debt coverage ratio is the ratio of the net operating income to the mortgage payment. If net operating income is projected to change over time, the investor typically reports the first year's net operating income.

Discount Rate

Interest rate used in discounted cash flow (DCF) analysis to determine the present value of future cash flows.

Internal Rate of Return (IRR)

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For income properties, it is the interest or discount rate needed to discount the sum of future net cash flows, including amortization and payments of loans and depreciation of the real property, to an amount equal to the initial equity of the property.

For development projects, it is the interest or discount rate needed to convert (or discount or reduce) the sum of the development expenditures and incomes to equal zero.

Loan to Value Ratio (LTV)

The ratio between a mortgage loan and the value of the property pledged as security, usually expressed as a percentage.

Net Cash Flow

Net cash flow is the annual income produced by an investment property after deducting allowances for capital repairs, leasing commissions, tenant inducements (after the initial lease is up) and debt service from net operating income.

Net Operating Income (NOI)

The income generated after deducting operating expenses but before deducting taxes and financing expenses.

Opportunistic Investment

Ground-up development of a real estate project is considered an opportunistic investment. It is an investment in a parcel or site that typically involves some or all of the following: rezoning for use or density or both; net new or ground-up construction; conversion of a building from one use to another; complete gut or significant rehab of a building, requiring that it be entirely vacant to complete; introduction of uses not previously seen on this parcel or in this area; etc.

Real Estate Investment Trust (REIT)

A REIT is a company that owns or finances income-producing assets, such as apartments, shopping centers, offices and warehouses. It may also

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invest in air or water rights, unharvested crops, permanent structures and structural components that are part of a structure but don't themselves produce income. Shares of REITs can be traded like stocks and can allow owners of the shares to participate in the real estate market.

Real Estate Owned (REO)

A sale in which a lender, either institutional or private, sells a property that the lender has taken back through foreclosure.

Recapitalization

A term used when owners liquidate some or most of their ownership position in an asset by selling some or most of their equity position.

Return on Investment (ROI)

A measure of the value created by a real estate investment. It is the difference between the net gains from investing in the property less the net cost from investing in the property divided by the purchase price of the property. Usually, it is reported as a percentage.

Short Sale

When the sale price of an asset is less than the amount owed to the lender and when the lender accepts this amount as full payment for the loan. Those funds not repaid to the lender will be written off.

Stabilized Cap Rate

A stabilized cap rate is the ratio between the net operating income produced by a property upon achieving target occupancy, and its purchase value.

Tenants or Tenancy in Common (TIC)

An estate held by two or more persons, each of whom has an undivided interest, which means that each party has the right to sell or transfer the ownership of his or her ownership interest.

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Value Add Investment

An investment in a real estate asset with existing cash flow (and value) that can be increased by raising occupancy, rents or both. Owners typically carry out one or more of the following to add value to a building: improve or replace building systems, provide new finishes, introduce new amenities, improve access or circulation to the building, add square footage, etc.

Industrial Terminology

The industrial real estate vocabulary section includes definitions, characteristics and features of the major industrial product types.

Industrial Building-related Definitions

Apron

The area, within the truck court, where trucks are parked for loading and unloading. This area will be paved with more durable material than will the rest of the truck court (e.g., concrete or other structural reinforcement vs. asphalt) to withstand the heavy loads being parked there.

Automobile Parking Ratio

A ratio calculated by comparing the number of automobile parking spaces at a project to the gross leasable area (GLA) of a building. This ratio is usually expressed in number of spaces per 1,000 square feet of gross leasable space. It varies by property use, with labor-intensive operations needing higher parking ratios. For example, a building with a GLA of 800,000 sf would have 800 spaces expressed as 8 spaces/1,000 sf.

Bay Depth

The distance between columns. (Synonyms: clear span, column spacing)

Bay Width

The distance from one side of the bay to the other.

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Biotech Space

Highly specialized laboratory or research and development space. The space is uniquely configured and is typically developed to the needs of the biotech tenant. It may require significant retrofit should the tenant vacate the space. The space is often characterized by robust mechanical, electrical and plumbing systems, as well as by sophisticated ventilation systems to accommodate the highly specialized and complex activities that occur inside and that involve the handling of chemicals, drugs and biological matter.

Cantilever Rack

Racking system containing shelving supports that are connected to vertical supports at the rear of the rack. This type of rack is used for storing long material such as lumber and piping.

Ceiling Height

Distance from the floor to the inside overhead upper surface of the room. This measure will be higher than any hanging objects, beams, joists or trusses, unless there is a suspended ceiling.

Clear Height

Distance from the floor to the lowest-hanging ceiling member or hanging objects, beams, joists or truss work descending down into a substantial portion of the industrial work area. This is the most important measure of the interior height of an industrial building because it defines the minimum height of usable space within the structure. (Synonyms: clear headway, clearance)

Clear Span

An open area with no obstructions.

Column Spacing

The distance between posts or vertical supporting beams in a building.

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Cross Dock

Loading docks on opposite sides of a relatively shallow distribution facility that allow for quick loading, sorting or unloading from one vehicle to another (i.e., materials from one truck at a loading dock are unloaded, sorted and reloaded onto one or more trucks).

Distribution Building

A type of warehouse facility designed to accommodate efficient movement of goods. (Typical characteristics are shown in the Industrial Building Types Matrix.)

Dock-high Door

A loading dock door that is not at ground level but rather is elevated to 4 feet in order to be even with the standard tractor-trailer height for loading or unloading goods without a change in elevation. Some doors, called "semidock" or "half dock," are constructed at a 2-foot height to accommodate smaller or lower delivery trucks.

Door-to-square-foot Ratio

The ratio of the total number of loading docks and drive-in doors to the building's total square feet.

Drive-in Door

A door through which trucks, forklifts, and other machinery or vehicles can enter and exit without a change in elevation.

Flex Facility

As its name suggests, an industrial building designed to be used in a variety of ways. It is usually located in an industrial park setting. Specialized flex buildings can include service centers, showrooms, offices, warehouses and more. (Typical characteristics are shown in the Industrial Building Types Matrix.)

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Fulfillment Center

An industrial property type that enables goods to be efficiently moved or transported from a warehouse directly to a consumer. (Typical characteristics are shown in the Industrial Building Types Matrix.)

High Cube

A relative term that refers to industrial buildings with an abundance of clear height or vertical cubic space. (Synonym: high bay)

Industrial Building

A structure used primarily for manufacturing, research and development, production, maintenance, and storage or distribution of goods or both. It can include some office space. Industrial buildings are divided into three primary classifications: manufacturing, warehouse or distribution, and flex. (The typical characteristics of the most common types of industrial buildings are shown in the Industrial Building Types Matrix.)

Leveler

Steel plates that are moved by auto-hydraulic lifts to make a loading dock level with a truck bed. A fully loaded truck may sit 4 to 6 inches lower than a standard 48-inch-high dock. The device is used to account for the difference so a forklift can be driven into and out of a truck. A building equipped with multiple loading docks may not have a leveler for each dock.

Less than Truckload or Less than Load (LTL)

Shipping

LTL is the transportation of lightweight freight or smaller groupings of freight. LTL shipments typically weigh between 151 and 20,000 lbs. LTL carriers collect freight from various shippers and consolidate that freight onto enclosed trailers for line haul (the movement of cargo between two major cities or ports) to the delivering terminal or to a hub terminal.

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Loading Dock

An elevated platform at the shipping or delivery door of a building; it is usually situated at the same height as the floor of a shipping container on a truck or railroad car to facilitate loading and unloading.

Loading docks can be exterior ramps that protrude from a building and that are covered with a canopy or some element to protect the loading area from the elements. Otherwise, they can be flush with the exterior of the building and accessed through a sliding door that is adjacent to the interior of the building.

Manufacturing Building

A facility used for the conversion, fabrication or assembly of raw or partly wrought materials into products or goods. (Typical characteristics are shown in the Industrial Building Types Matrix.)

Mezzanine Office

Office space that is built in an industrial facility. It is usually along the perimeter of a facility and creates an intermediate floor.

Office Percentage

The percentage of total square feet in an industrial building that is built for use as office space. When the mezzanine office is built above a space that would otherwise be an industrial work area, this additional square footage is not counted in the total square footage of the building.

Push-back Rack

Racking system with a sliding device that pushes back pallets, thereby allowing multiple pallets to be placed in the same location.

Radio Frequency Identification (RFID)

Inventory-tracking technology embedded in devices that are attached to labels on packages so an item’s location can be tracked.

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Rail Door

A door that is generally side-loading, that has access to railroad tracks, and that facilitates the loading or unloading of goods from a railroad car to an industrial building.

Rail Service

A railroad spur adjacent to a building structure that allows the building to be served by rail operations.

Ramp Door

A dock-high door that has been converted to a drive-in door by creating a ramp from ground level to dock level.

Service Center or Showroom

A type of flex facility characterized by a substantial showroom area, usually fronting a freeway or major road. (Typical characteristics are shown in the Industrial Building Types Matrix.)

Side-loading Dock

A loading dock configuration designed to facilitate the loading and unloading of a vehicle through its side.

Super Flat Floors

Concrete floors with minimal variations in elevation from point to point. The floors are found primarily in warehouses with automated systems. Precisely calibrated and leveled picking machinery and racks require level flooring to ensure proper operation.

Third-party Logistics (3PL)

Businesses that provide one or more logistics services including multiclient warehousing, contract warehousing, transportation management, distribution management, inventory management and freight consolidation.

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Truck Court

Exterior area adjacent to an industrial building's loading docks where trucks maneuver. The most important measure of the truck court is the depth from the building to the end of the truck court. Greater depth allows for greater maneuverability and better accommodates multiple trucks.

Truck Terminal

This specialized distribution building for redistributing goods from one truck to another serves as an intermediate transfer point. The facilities are primarily used for staging loads (rather than long-term storage) and possess very little, if any, storage area. (Typical characteristics are shown in the Industrial Building Types Matrix.)

Truck-turning Radius

The tightest turn a truck can make, depending on several variables such as truck configuration, trailer size and location of adjacent objects that obstruct the inner turning radius.

Truss

A framework of beams forming a rigid structure (as in a roof truss).

Truss Height

Distance from the floor to the bottom edge of a truss used to support the ceiling or roof of a building. If there are hanging objects, beams or joists below the truss, the clear height will be lower than the truss height.

Warehouse

A facility primarily used for the storage or distribution or both of materials, goods and merchandise. (Typical characteristics are shown in the Industrial Building Types Matrix.)

- Industrial Building Types Matrix
- Manufacturing
- Warehouse
- Flex

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- Primary Type
- General Purpose
- General Purpose Warehouse
- General Purpose Distribution
- Truck Terminal
- Fulfillment Center
- General Purpose Flex
- Service Center or Showroom
- Primary Use
- Manufacturing
- Storage
- Distribution
- Truck Trans- shipment
- Distribution
- Research and Development, Cold Storage, Office, Lab, Light Manufacturing, High-tech, Data or Call Center
- Retail Showroom
- Subsets
- Heavy, Light Manufacturing
- Bulk Warehouse, Cold or Refrigerator Storage, Freezer Storage, High-Cube
- Overnight Delivery Services, Air Cargo
- Heavy, Light Manufacturing
- Delivery directly to consumer
- Size (sf)

Clear Height (ft) Loading Docks or Doors Door-to-square-foot Ratio Office Percentage Vehicle Parking Ratio Truck-turning Radius (ft)

Any

10+ Yes Varies < 20% Varies 130

Any

16+

Yes 1:5K–15K < 15% Low

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130

Any

16+

Yes 1:3K–1K < 20% Low 120–130

Any

12–16 Cross-dock 1:50K–5K < 10% Varies

130

100,000 – 1,000,000 +

32+

Yes Varies

< 20% Very High 130

Any

10–24 Yes 1:15K+ 30–100% High

110

Any

Any Yes 1:10K 30+% High 110

Note: This matrix is intended to be an aid in classifying the principal industrial building types. It is subject to the following considerations:

- These are intended to be typical characteristics of different properties, but actual characteristics may vary.
- In classifying properties, the owner should select the classification that most closely fits the design and use of the property.
- The most important characteristics of each type are highlighted. Although the characteristics are not "acid tests," they should guide the user in most instances.

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- The truck-turning radius is an important consideration and varies by building size. Large, pure distribution facilities need a turning radius of at least 130 feet, medium to large facilities need 120 feet and smaller facilities typically need 110 feet.

Office Terminology

The office terminology section is a collection of essential and commonly used terms describing various types of office space—often identified by the type(s) of tenants occupying the space. This section captures defi- nitions around the current trends impacting the sector such as shared office space and more traditional terms such as “space classification.”

Office Building-related Definitions

Accelerator

A programming-based workplace designed to help startup companies grow more rapidly by providing them with technical and educational assistance, mentoring, networking opportunities and workspace.

Coworking Space

Workspace offered for lease for short- to long-term periods in a communal setting. Space for office, artistic or manufacturing use can be leased by the day, month, year or even hour. The physical space leased can range from

a traditional dedicated private office with a door to an unassigned seat on a bench along a communal table. Coworking spaces go beyond just providing a physical work environment. They are typically operated by entities that offer business-related lectures, social events and a sense of community for their entrepreneurial tenants, thus helping them grow their businesses.

Creative Office Space

Previously industrial space with high ceilings and exposed air ducts. The space is often made of brick and timber and has been converted to office or studio space that often caters to technology, advertising, media and entertainment tenants (TAME).

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Government Office Building

A building that is owned (and typically occupied) by public sector entities.

Incubator

An economic development tool created to support new businesses. Typically, lab or office space or both provided for free or at a deep discount in buildings owned or leased by municipalities. Business assistance and financing opportunities may be provided as startups gain momentum.

Innovation Center or District

Geographic areas with concentrations of innovative firms and entrepreneurial activity that focus on strengthening and growing new businesses and commercializing their products or services or both.

Medical Office Building (MOB)

A structure with at least 75 percent of its interior built out to accommodate healthcare providers such as doctors and dentists or healthcare technicians who perform exams with specialized equipment. Typically, the buildings have more robust mechanical, electrical and plumbing systems as well as reinforced floors to accommodate numerous exam rooms and heavy medical equipment.

Mixed-use Development (MXD)

The grouping of multiple significant uses within a single site or building such as retail, office, residential or lodging facilities. Examples include office buildings that contain ground-level retail and housing, plus projects that have separate office, retail and multifamily properties.

Clustering of at least three different uses such as office, retail, residential and/or hotel adjacent to or in close walkable proximity to one another. Uses can be contained in the same building or dispersed in different buildings that are adjacent to or close to one another.

Multitenant Office Building

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A building that is not owner occupied and space that is leased to two or more tenants.

Office Building

A structure providing environments that are conducive to the performance of management and administrative activities, accounting, marketing, information processing, consulting, human resources management, financial and insurance services, educational and medical services, and other professional services. At least 75 percent of the interior space is finished to accommodate office users, but the rest of the space can include other uses such as retail, restaurant or fitness.

Office Building Types and Sizes

- Low-rise: Fewer than 7 stories above ground level
- Mid-rise: Between 7 and 25 stories above ground level
- High-rise: More than 25 stories above ground level

Office Condo

Short for “office condominium,” this term refers to the ownership structure of an office property in which individual units housed in one structure are sold to independent owners. Typically, there are covenants that govern the activities that can be carried out in and improvements that can be made to each unit. Such covenants also stipulate the distribution of costs related to the maintenance and operations of common elements in the building such as the roof and the elevators.

Office Park or Office Campus

Contiguous acres of land, master-planned with roads, sidewalks and trails, and extensive landscaping that accommodate stand-alone office buildings with adjacent surface parking lots or parking structures.

Owner-occupied Office Building

- Buildings that are occupied by the owner and that generally are not included in the competitive inventory.

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- Secured Compartmental Information Facility or Sensitive Compartmented Information Facility (SCIF) Space
- Highly secure space that meets specialized design guidelines and restrictions for building systems relating to data, power, communications, security, ductwork, ventilation and more. The highly controlled facilities are required by firms such as defense contractors or law firms that deal in sensitive industries.
- Single-tenant Office Building
- A building for which there is a single lease obligation.

Stacking Plan

A floor-by-floor and suite-by-suite graphical representation of each floor and suite within a building. The plan shows the suite number, the square footage of each suite and the tenant occupying each. On many stacking plans, lease expiration dates are also provided to give a quick view of the occupancy exposure within a building.

Office Building Classifications

The real estate industry uses a subjective classification system that divides buildings into three qualitative categories: Class A, Class B and Class C. Building classifications are relative and applied to all buildings that make up the competitive inventory in a market. A building that is Class A in a second-tier market may not be Class A in a first-tier market. The designations are determined primarily on the basis of building locations or submarkets, rents, building systems and finishes, and building upkeep and services.

Trophy Building

A landmark property that is located in a highly desirable submarket, is designed by a recognized architect, and features high-end finishes and modern or efficient systems. This building commands among the highest rents in the market and is more than 80 percent occupied by the market's premier tenants. It is highly sought after by institutional investors such as pension funds and insurance companies as well as by foreign investors. These properties are more desirable than Class A buildings.

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Class A Building

A classification used to describe an office building with rents in the top 30 to 40 percent of the marketplace. Class A buildings are well-located in major employment centers and typically have good transit, vehicular and pedestrian access. Additionally, they are located adjacent to or in proximity to a high number of retail establishments and business-oriented or fast casual restaurants. Building services are characterized by above-average upkeep and management.

Class B Building

A classification used to describe an office building with rents that are based between those of Class A and Class C buildings. Class B buildings are in good to fair locations in major employment centers and have good to fair transit, vehicular and pedestrian access. They are located adjacent to or in proximity to a moderate number of retail establishments and business-oriented or fast casual restaurants. Building services are characterized by average upkeep and management.

Class C Building

A classification used to describe an office building with rents in the bottom 10 to 20 percent of the marketplace. Class C buildings are in less-desirable locations relative to the needs of major tenant sectors in the marketplace. They can be older, neglected buildings in good locations or moderate-level buildings in poor locations, so transit, vehicular and pedestrian access may vary. Typically, fewer amenities and restaurants are found in or near these buildings, and they are usually of moderate to low quality. Building services are characterized by below-average upkeep and management.

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30 | Commercial Real Estate Terms and Definitions

- Office Building Classification Matrix
- Class A
- Class B
- Class C
- Rents

- Building Systems
- Asking gross rents are based on a specified range in the top 30–40% of the office rents in the marketplace.
- The mechanical, elevator, HVAC and utility systems
- can deliver services that meet both current tenant requirements and anticipated future tenant needs.
- Services include above- average maintenance, management and upkeep.
- Asking gross rents are based on a specified range between the asking gross rents for Class A and Class C space.
- The mechanical, elevator, HVAC and utility systems are adequate to deliver services currently required by tenants.
- Services include average- to-good maintenance, management and upkeep.
- Asking gross rents are based on a specified range in the bottom 10–20% of the office rents in the marketplace.
- The mechanical, elevator, HVAC and utility systems have capacities that may not meet current tenant needs.
- Services include below- average maintenance, management and upkeep.

Location

- The site is excellent and well-located.
- It has an average-to-good location.
- A less-desirable location depends chiefly on a lower price to attract tenants.

Building Finishes

- The finishes feature high-quality design and materials. Buildings must remain competitive with new construction.
- The finishes use average- to-good quality design and materials.
- The finishes project a dated appearance.

Building Services

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Note: This matrix is intended to serve as a guide for those who are evaluating buildings and determining their classifications with the following caveats:

- The final designation of Class A, B or C is always relative to the local market or submarket being analyzed. For example, buildings considered Class B in the central business district (CBD) might be considered Class A in the suburbs.
- The primary considerations for determining class are listed in the matrix. However, other variables worthy of consideration may include age, amenities, parking, construction materials and architecture.
- Buildings must exhibit more than one of the characteristics in each category, but they need not exhibit all of them to obtain that classification.

Retail Terminology

Retail-related real estate has been changing as a result of online sales and home delivery stemming from demographic shifts and technological advancements. This section defines traditional and new retail-related concepts, especially those relating to store formats and methods of delivery.

Retail Building-related Definitions

Anchor Tenant

The primary and usually the largest tenant in a shopping center. Larger shopping centers may have more than one anchor tenant. Rent for anchor tenants is often significantly lower than rent for other tenants in a shopping center because they draw consumers to the center.

Big Box

A freestanding structure occupied by a dominant retailer such as Home Depot. (See Retail Building Types Matrix.)

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Breakpoint

The point at which an additional lease rate kicks in. For example, in addition to base rent, after a certain amount of sales revenue is generated in a month, a retailer will pay the landlord some percentage of in-store sales, typically about 5 percent.

- Buy Online and Pick up in Store (BOPIS)
- (See omni-channel retail.)
- Buy Online and Return in Store (BORIS)
- (See omni-channel retail.)
- Community Center or Community Shopping Center

A retail property with a wide range of apparel and general merchandise stores, as well as discount retailers or department stores such as Walmart, Kmart and Target. (See Retail Building Types Matrix.)

Co-tenancy

A clause in a retail tenant's lease that provides remedies to a tenant in the event that another tenant, typically an anchor or major tenant, ceases its operations at the property.

E-commerce

Electronic commerce is the buying and selling of products or services mostly through the Internet. Typically, transactions are carried out via desktop and laptop computers as well as on mobile devices such as smartphones and smart tablets.

Experiential Retail

The notion that people buy goods online but pursue experiences at brick-and-mortar locations (i.e., do yoga, eat at restaurants, visit flagship stores for experience and entertainment, etc.).

Freestanding

A stand-alone retail structure that is not part of a complex (i.e., bank, bowling alley, Walmart, etc.). (See Retail Building Types Matrix.)

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Go Dark

A clause in a retail tenant's lease that allows a tenant to cease operations at a property if a defined event, such as the departure of an anchor tenant, should occur.

Gross Leasable Area (GLA)

A site calculated as the summation of all rentable areas plus all common areas of a building.

High Street Retail

A concentration of shops in urban or urban-like areas that may also be referred to as "Main Street retail" in the United States and Canada.

In-line Store

A retail store placed adjacent to neighboring retailers so that the fronts of the stores are in a straight line and behind what is considered the lease line. Tenants operating in the common area are not considered in-line vendors.

Kiosk

A small, physically independent stand or cart often placed within the common area of a retail structure (typically a regional mall) from which specialty goods are sold.

Lifestyle Center

A type of retail property in an urban-like or Main Street setting with pedestrian circulation in the core and with vehicular circulation along the perimeter. Tenants are typically upscale, national-chain specialty stores, restaurants and theaters.

Locker

A storage compartment that enables a purchaser to pick up merchandise at a convenient satellite location. This arrangement allows for a type of self-service parcel delivery. Customers can select any locker location as their

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delivery address and can retrieve orders at that location by entering a unique pickup code on the locker touchscreen.

M-commerce

Mobile commerce is buying and selling via non-tethered devices such as smartphones and smart tablets.

Neighborhood Shopping Center

This type of retail property is most commonly found in the United States. Anchored by supermarkets and drug stores, the centers are typically one-level, rectangular structures with surface parking in the front and merchandise loading areas in the back. They provide for the sale of convenience goods (food, drugs, etc.) and personal services (laundry, dry cleaning, etc.) for the day-to-day living needs of the immediate neighborhood. (See Retail Building Types Matrix.)

Omni-channel Retail

The merging of online and brick-and-mortar retail operations so customers can purchase and return items via more than one “channel.” For example, they can buy online and return in store (BORIS), buy online and pick up in store (BOPIS), buy online and pick up at a locker, etc. (Synonym: Multichannel Retail)

Online or Pure Play Retailer

A retailer that sells exclusively online and does not have any brick-and-mortar retail locations.

Pop-up Retail

A retail store, restaurant or kiosk intentionally designed to be in a location for a finite amount of time (i.e., a restaurant that opens for six months so it can test a market, or a store that operates in a location during the holiday season only).

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Power Center

Among the largest types of retail properties, they typically feature three or more big box retailers such as Home Depot, Target and Walmart. Various smaller retailers are usually clustered together in a community shopping center configuration. Power centers are typically made up of multiple large buildings that are one-level, rectangular structures with surface parking in the front and merchandise loading areas in the back. Often, more money is spent on features and architecture at these locations than at big box shopping centers. (See Retail Building Types Matrix.)

Regional Shopping Center

Among the largest types of retail properties, the center typically features large anchor tenants that sell general merchandise and fashion. Regional shopping centers were historically configured like traditional suburban malls, but many have evolved to Town Center or Main Street retail formats. Parking is accommodated via surface or structure spaces or both. (See Retail Building Types Matrix.)

Retail Flagship

Flagship stores serve as retailers' main stores and are aimed at serving large numbers of customers. They are found in prominent shopping districts (e.g., Madison Avenue, Savile Row) and target high-income shoppers. They are typically larger than outlet or mall stores and hold large volumes of merchandise.

A retailer's primary location, a store in a prominent location, a chain's largest store, the store that holds or sells the highest volume of merchandise, or a retailer's best-known location.

Strip Shopping Center

A strip shopping center is an attached row of stores or service outlets that are managed as a coherent retail entity with onsite parking usually located in front of the stores. Open canopies may connect the storefronts, but a strip center does not have enclosed walkways linking the stores. A strip

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center may be configured in a straight line or may have an "L" or "U" shape.**(See Retail Building Types Matrix.)**

Super-regional Shopping Center

The enclosed, large anchor tenants that sell general merchandise and fashion offer more variety than does a regional center. (See Retail Building Types Matrix.)

Traditional Outlet

The tenants offer a discount version of mainstream retailers and are often called "factory stores." They usually focus on apparel. Traditionally, the stores have been located far outside a city center. The outlets are designed as a destination or tourist magnet. (See Retail Building Types Matrix.)

Traditional Retailer

A retailer that started selling in brick-and-mortar locations but that now also sells items online.

Turn-key

A term used to describe a landlord's agreement to provide and pay for improvements to a tenant's premises. The landlord is required to deliver the premises in a condition ready for the tenant's stipulated use.

Superregional

Enclosed, large anchor tenants, general merchandise and fashion, more variety than a regional center

Open to parking lot, provides general merchandise and commodities

Open to parking lot, located along suburban transportation arteries on shallow parcels

Multiple category- dominant anchors such as Home Depot (i.e., multiple big boxes) with a few small stores

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Stand-alone retail struc- ture that is not part of a complex (i.e., bank, bowling alley, Walmart, etc.)

800K +

Five or more department stores, tenants that sell a very large variety of goods

Discount department store, supermarket, drug store

Surface or structured

25 miles

Tysons Corner Center, Tysons Corner, VA

King of Prussia Mall, King of Prussia, PA

Mall of America, Bloomington, MN

Retail Building Types Matrix

Center Type

Concept

Square Feet (approx.)

Typical Anchor(s)

Parking Type and Ratios

Primary Trade Area

Examples

Regional

Enclosed, large anchor tenants, general merchandise and fashion

400K to 800K

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Fewer than five department stores, tenants that sell a large variety of goods

Surface or structured

15 miles

Santa Monica Place, Santa Monica, CA Roosevelt Field, Garden City, NY

Community

Strip or Convenience

125K to 400K

Less than 30K

Surface

Surface

3 to 6 miles

Neighborhood

Open to parking lot, provides commodities to nearby neighborhoods

3K to 125K

Supermarkets or drug stores

Surface

3 miles

Lifestyle

Upscale national chain specialty stores, dining or entertainment, urban-like Main Street concept, pedestrian circulation in core, vehicular circulation along perimeter

150K to 500K

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Bookstore or other large-format specialty, cinema, small department store

Structured or street

8 to 12 miles

The Grove,

Los Angeles, CA Americana at Brand, Glendale, CA

Power

Freestanding

250K to 600K

Home improvement; warehouse club; off price

Surface

Surface

5 to 10 miles

____

____

Big Box

A freestanding category- dominant retailer such as Home Depot

Minimum of 50K

Surface

____

Outlet

Manufacturers' outlet stores

50K to 400K

Manufacturers' outlet stores

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25 to 75 miles

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