



# SELBY REALTY

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## Buying Residential Rental Property

Apartment properties throughout the country are the most sought after rentals at this time. Assisting new buyers with the purchase of a residential rental is the job of the commercial broker. When you are looking at different properties, we will furnish full information on existing and potential loans, income, expenses, etc., to help you make the right choice.

In addition to the financial data that you expect, we can also evaluate the physical attributes of the property, giving you suggestions on what to look for and what to avoid. Here are a few of these hints:

- Look for properties with refrigerators and with space available for a washer and dryer in a common area such as the basement. While large apartment houses use coin-operated laundry units, for two-or three-unit houses it is better to use less expensive, standard units and provide separate electric outlets for each apartment.
- Avoid properties with common heating, hot water and electric service. If the property does not have separate utility services, plan to separate them immediately after purchase of the property. Let each tenant assume responsibility for utilities used.
- Be careful with wood buildings. Preferred for investment are brick, stucco, or aluminum (or vinyl) sided structures. These have less frequent and less costly maintenance.

- Avoid properties with common halls or stairs. Requirements for sprinkler systems and smoke detectors are often stringent for such areas.
- Make sure the property meets zoning requirements. A seller may try to sell an apartment property that has had a common area converted to a small rental. There may be more units rented than zoning allows. In a very small property, a seller might try to sell a house with a mother-in-law apartment as a duplex. If a variance in the zoning is required for the existing rental conditions, get the variance before the closing of the sale.
- Check insurance costs. Liability insurance is becoming very expensive for dwellings of three or more units. Fire insurance now on the property may not be adequate to cover the replacement value.
- Only consider a property for purchase that has rental income sufficient to cover all operating costs plus mortgages and taxes. With the reduction of tax benefits in the ownership of an apartment property, the income and expenses should be handled like any other business property, with a cash flow that allows the units support themselves and give the owner a return on invested capital. ■

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

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

# Basic Information For Investment Analysis

Analyzing real estate investments has become almost a science, as investors strive for exactness in estimating a property's return and appreciation in value. Too often, people buy property based on what they have been taught to see on the bottom line of a piece of paper. The analysis of real estate investments can take any number of forms, but no matter which approach you use for the property being invested, you should be sure to first address the important considerations that follow.

## Checklist of Factors

The best way to develop a clear picture of the property and its potential is to examine all of the principal factors and then integrate them into a meaningful conclusion.

- **Location:** This, of course, is one of the most important factors of all. The desirability of a particular location is a constantly changing factor, and a judgment as to the present quality of a certain piece of property can be seen as part of an evolutionary pattern. For example, consider the following.

(A) A fully developed residential neighborhood has probably reached a plateau and is likely to decline.

(B) A moderate-income residential neighborhood is more likely to decline than to improve.

(C) A strong retail or office district is likely to continue to improve unless it is challenged by a stronger district.

- **Improvements:** An improvement should be judged by other structures of its own type, in relation to its location, and by its rental structure. Certain types of improvements, such as hotels, motels, bowling alleys, and restaurants, are not really improvements of real estate but parts of business enterprises. When you buy such a property, you are in effect, buying real estate, plus a business. In many cases, if the business does not work out, the existing structures cannot be used for other purposes and must be demolished if the property is to be put to some other useful purpose.

- **Rental Schedule:** The questions that should be considered here are: How competitive is the

rental level, where is it headed, and what is a stabilized level? One mistake in this area is to assume automatically that the rental level is equal to the rental value. This is not always the case. The present rental level merely indicates what the present tenant is willing to pay for the premises. Premises rented at a bargain price in a good community have greater rental value than high-paying space in a declining area. Also, a poor apartment in a fashionable neighborhood will bring more than a much better unit in a middle income area.

- **Expenses:** Here you have to estimate what problems will develop during your ownership. Actual expenses incurred by the seller may be less reliable than an informed estimate, since there is usually a wide variance from year to year in such annual expenses as maintenance, insurance and renting. Using a percentage-of-income formula is also not all that reliable. As a building ages, rents are likely to increase, while income is likely to decline. Your best guide is an educated estimate of the future expenses based on the information that is available.

- **Net income:** Free-and-clear income is the best measure of real value—before a premium or penalty resulting from financing. One area to watch is earnings for the owner's services. The time and effort provided by the owner as well as the risk are factors that should be carefully considered when determining a capitalization rate.

- **Financing:** When must the mortgage be refinanced? Will replacement be readily available? How will service on the amortized balance compare with current charges? Is it likely that new, increased financing will be available?

- **Leverage:** You should know the amount of equity cash that will be required when you acquire the property and in the future. The less cash you invest, the better the leverage and the lower the risk. Spreading your capital over several properties will permit the same dollars to control more real estate.

- **Tax Consequences:** Low amortization (and higher interest) is great for taxes but not for refinancing. High land values hurt depreciation deductions but give the best opportunity for growth and stability.

- **Price:** It is a little better to pay a little more for what you want than to pay a little less for something that does not fit your goals. ■

# A Sales Presentation Of Your Apartment Property

When we are marketing your apartment property, we have a two-fold job facing us. First, we must persuade the prospective buyer to go out to see the property, then, second, get him to see it—though your eyes, with its full potential fully realized. Creating the well-conceived descriptive sales “package” or report on the property can help to accomplish both of these aims.

Assembling all of the data that prospects need and presenting it in a handy and attractive form can expedite the entire process of negotiation as well as the ultimate sale. Besides speeding up the communications process, the “package” also provides the seller with a means of getting his information to a wider range of buyers in a more effective manner.

## The Benefits of the Package

A well-prepared sales package serves essentially five marketing purposes:

- It helps the seller’s agent identify and reach prospective buyers or lessees.
- It provides an agent and his/her associates with an attractive and effective way of presenting the property.
- It gives the buyer, in one neat package, all the information needed to decide whether or not to buy.
- It provides dollars and cents demonstrations that will support the seller’s price.
- It spells out the property’s potential for development.

## What We Include

The following information should be of interest to a prospective buyer and should be preassembled in a handy, attractive form.

### *Physical Features:*

- Legal description of property.
- Plot plan showing survey boundaries and dimensions, access streets, sidewalks, buildings, structures, parking areas, easements, etc.
- Description of topography and surroundings.
- Topographic map, if available.
- Photographs of the property, including an aerial photo.
- Soil Analysis report, if applicable.
- For an existing building, a statement of its

physical condition, copies of floor plans, gross and net square footage.

### *Other Attributes:*

- Statement of present ownership.
- List of any encumbrances.
- Statement of present zoning status.
- Proximity to highways, public transportation, residential areas, schools, houses of worship, shopping, sources of employment, etc.
- For an established enterprise, financial statements for the past three years, a three-year financial performance projection, and a computation of the venture’s capitalized value.

## Knowing The Possibilities

Whether we are marketing developed or undeveloped property, packaging is an effective way of increasing the property’s value. In either case, the key ingredient is project formulation. Formulating and demonstrating the feasibility of a project plan that enhances an existing property’s income-producing potential can increase its value. Similarly, a higher price can be obtained for raw land if the property is conceived as being an integral part of a specific development project, rather than just a piece of land.

Following is some information that should be included in a sales package for a property requiring development, redevelopment, or remodeling:

- Schematic drawings and architectural designs.
- Estimates of the project’s capital costs (including any off-site improvements).
- Projections of financial performance.
- Estimates of the project’s capitalized value, as per its potential net income.
- Market studies for the present as well as projections for the future.
- A history of the property’s market value.

## In Conclusion

A careful preparation of a descriptive sales package like this will give us the opportunity to demonstrate the full economic worth of the property—its potential as well as present benefits and uses—to the prospective buyer. This will help justify the asking price and strengthen your negotiating position. ■

## Legal Definition Of A Shopping Center

We have all kinds of shopping centers from the smallest strip center up to the centers of the size of the West Edmonton, Canada or Bloomington, Minnesota centers, the super centers. Recently, in a case in a federal bankruptcy court, the court was required to distinguish between a "shopping center" and other types of retail properties. The federal bankruptcy code did not define the term. The Third Circuit provided the following 14 elements to be used in determining whether a property is a shopping center.

- A combination of leases;
- All leases held by a single landlord;
- All tenants engaged in the commercial retail distribution of goods;
- The presence of a common parking area;
- The purposeful development of the premises as a shopping center;
- The existence of a master lease;
- The existence of fixed hours during which all stores are open;
- The existence of joint advertising;
- Contractual interdependence of the tenants as evidenced by restrictive use provisions in the leases;
- The existence of percentage rent provisions in the leases;
- The right of the tenants to terminate their leases if the anchor tenant terminates its lease;
- Joint participation by tenants in trash removal and other maintenance;
- The existence of a tenant mix; and
- The contiguity of the store. ■

## Your Real Estate Investment

Knowing what you can do in some investment situations can be the difference between an annual profit or loss in your currently owned commercial property or the one you intend to acquire. How you acquire it can be important.

The professional commercial real estate broker is in the position to represent a client in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate. This real estate practitioner stays aware of current tax laws and court decisions in order to structure transactions, but does not give legal or tax advice (unless he/she is also an attorney or a certified public accountant). In any complex transaction that might result in changes in any

owner's legal or tax situation, the other members of the "consulting team" should be the owner's attorney and/or tax advisor. We always recommend consulting with these professionals during the planning and closing of major real estate transactions. All can affect taxes and estate planning.

We are the heart of your professional team, creating the real estate transactions that will be needed to expand your estate. Let's get together to evaluate your present portfolio of properties, or review your plans for future acquisition.

Starting with your present position and your goals for the future, we can set out moving directly toward achieving those goals. ■



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