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Commercial Classroom: Listing Investment Properties - by Edward Smith Jr.

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Back to Basics - An Agent's guide to Listing Investment Properties

Think, what the buyer will want to know? With investment properties it's all about the numbers. Before your interview with the seller, prepare them by telling them you will need to review the income and expenses of the property when you meet.

A buyers first question is what kind of return would I get on this investment? To answer this, we need to look at the rental income from the tenants. If there are any vacancies, we need to realistically project income from those units based on the current market conditions. Also consider any other income to the building, antenna on the roof, advertising billboards, vending machine revenue. If apartment laundry room income, rental of garages etc.

Next, what are the owners' operating expenses? Best to get this information from an accountant's Income and Expense Statement or examine the latest tax return for this building. Review these expenses with the owner asking if any of these expenses are expected to go up this year. Subtracting the owner's operating expenses from the projected rental income will give you the Net Operating Income (NOI).

The buyer will divide the NOI by the asking price and see what Return on Investment (ROI) they would get if they purchased the property all cash.

As an agent you need to be aware of financing options that are available to buyers from the banks in your area. You should meet with four or more commercial lenders regularly (at least quarterly) to get a consensus. What type of loans are available, what is the required down payment (on commercial properties typically 30% to 40% or more) and what interest rates they are charging.

Ask each bank what current capitalization rates (CAP rates) they are using for office, retail, industrial and multi family investments. The CAP rate reflects what return other investors are getting on similar properties they have purchased. The banks use this information to determine the value of a property and consequently how much they will loan.

If you divide the NOI by a CAP Rate you get value, the price another investor would pay to buy this property. We can use the same formula to determine what would be the correct price for this property based on the current market conditions. This is called the Income Approach to Valuation. When determining price, we also use Comps, previously sold similar properties, and Comparables, properties currently on the market.

Do a physical inspection of the condition of the property. Advise the owner that all potential investments will need to have an Engineering Inspection done, the condition of all mechanical systems will be checked. With apartment investments buyers will want to examine the condition of several of the units. Ask the owner are they aware of any issues?

Think of your first meeting with the owner as a “fact finding mission”, where you will gather the financial material, and do a physical inspection of the property. Then you will need time to review all and do a financial analysis and determine your price recommendations. Schedule a second meeting to do your actual listing presentation, showing your marketing plan and what you can do for the client that they can’t do themselves. Explain current market conditions, review comps and comparables, and the basis for your valuation of their property. Get the listing signed and enter it into the numerous commercial listing services.

Another thing potential buyers will want to know is how will this property do in the future? An examination of the tenant’s leases or a summary of them called a Lease Extract is required (request this from the owner at the time you get your listing signed). This will identify who the tenants are, indicating their current base rent and any other additional rent (expenses) they have to pay. Also, how much their rent increases each year, the date the lease started and when it ends and if they have any options to extend their lease.

By calculating each tenant’s yearly rent increases and making a cost-of-living adjustment to expenses, you can project the NOI for next year and each year thereafter. Create a spreadsheet showing a five-year projection, this gives potential buyers a good picture of the future value of the property.

Another thing buyers will look at, and we should do so ourselves. Who are the tenants and how are their businesses doing? Ask a tenant and they will say my business is going great! If one is considering buying an office building you would expect the parking lot to be full by mid-morning. If it is not, this could reflect that businesses in the building are in trouble. Retail stores need a lot of customers, observe activity for a few hours. Industrial buildings should have a lot of trucks coming and going.

Investors will ask the question, what if I lose a tenant? You need to know the current market conditions, and what are the vacancy rates in similar buildings. How long will it take to replace a tenant, and would they be able to get the same or higher rent?

Now get out there and list those investment properties!

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