THE 8 BEST COMMERCIAL REAL ESTATE ASSETS TO ASSUME

(...AND THE 9 WORST!)

THE COMMERCIAL INVESTOR

THE 17 BEST
ASSETS TO ASSUME

For the emerging commercial real estate investor, financing is the barrier to entry in this high-dollar industry.

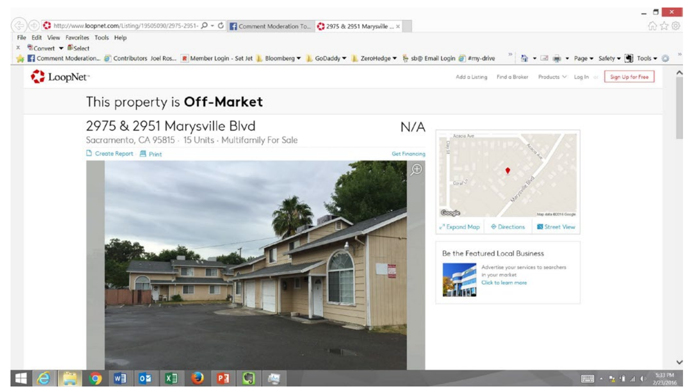
Banks have gotten tighter, their underwriting is tougher and, to many who don't have the 30% hard cash equity and pristine credit, it may seem that it's impossible to reach for the proverbial brass ring in real estate.

There are many drivers sellers utilize to become motivated to sell a perfectly performing asset. After all, timing and circumstances change everyone's mind once in a while.

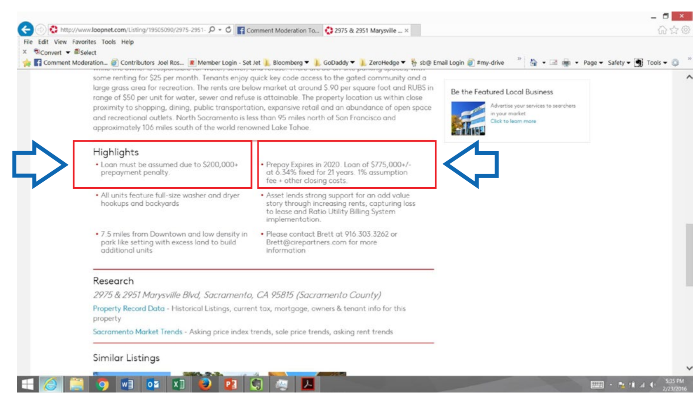
For the aspiring deal junkie out there, the markets have never been more ripe to be able to get in light – meaning little to no equity down. To keep it short, here are two of them we'll discuss:

1 DEFEASANCE CLAUSES

Most commercial loans have what are called Defeasance Clauses in them. These are most commonly found in CMBS loans ("Commercial Mortgage Backed Securities") or "conduit loans" that are underwritten and sold off to institutional investors (which also happens to be approximately 80% of the loans that were underwritten during the last credit boom.)



A defeasance clause means that the loan must be assumed when the property sells; otherwise, a prohibitive pre-payment penalty kicks in, among other liabilities to the borrower.



An example of this would be this listing here on LoopNet® that has a 13% pre-payment penalty if paid off before a certain date.

Why is this the case? It's because the investors who buy the bonds backed by this mortgage are looking for durational yield. Meaning they want to be able to rely on interest payments over a long period of time. These investors are usually institutional investors such as pension funds who have retirees they need to pay monthly, or companies like MetLife who sell annuities and life insurance policies. Those insurance companies depend on this income to provide for their beneficiaries when they retire or die, depending on the products they sold.

2 DEPRECIATION RECAPTURE

Here, you just sit back and let the IRS do all of the heavy lifting for you. Many people who bought commercial real estate during the past 10 years aggressively depreciated their assets over a 10 year schedule vs a conventional 27.5 year schedule. That's good for the short term, but Uncle Sam will get his sooner or late. Simply put, this means that the sellers – and their equity partners who invested in these deals – are facing a nasty tax bill soon. Believe it or not, their taxes may have just doubled. To add insult to injury, depending on how they structured their ownership may mean that they can't merely do a 1031 exchange.

So, if you're targeting the right assets, with the right loans in place and with motivated sellers, you'll see that it's not too difficult to quietly build a portfolio of assets for yourself not using too much – if any – of your own money.

THE 17 BEST ASSETS TO ASSUME

Just because an asset can be assumed doesn't mean that it should be. There are great assets that will add cash flow to your portfolio today and there are those what will require a lot of capital out of pocket just to keep afloat.

I. THE BEST

1. MOBILE HOME PARKS

When purchased correctly, these are bona fide cash cows. Traditionally, it is very difficult to get bank financing as banks don't really like nor understand this sub-asset class, so these parks almost always trade hands on seller-financed terms.

Management is critical. Make sure you use a lock box to collect payments (as most payments will be in cash or money order). Many pros will consider hiring a retired cop to live on the park for free in exchange for collecting rents and providing added security. For many elderly and young families that live in these parks, having a retired cop on site brings an added sense of security to residents and is often the difference between choosing your park as their home versus one with a marginally lower rent.

Minimum Size: 40 pads

2. SELF-STORAGE FACILITIES

Steel and concrete + security cameras = another great asset to assume and add to your portfolio.

The demographics are on your side, too. Americans are moving more in search of work or as a result of other life changes. Americans are also, by far, the largest consumers of toys and products; many television shows alone have been dedicated to these habits. And if you find a self-storage facility that you can buy on good terms and at a strong basis, with an assumable loan, an investor is sure to take interest in partnering with you.

Minimum Size: 100 units

3. SMALLER STUDENT HOUSING COMPLEXES

Depending on how these are managed, these can also be great “steady-Eddie” income-producing assets to hold. Be careful, though; not all colleges are equal.

You’ll only want to focus on large, well known NCAA schools where there is a fanatic alumni base. If you went to the University of Michigan, chances are you’ll want your kids to go there.

Same with the Ivy Leagues.

Avoid the "for profit" schools as they are relatively unknown, have proven to have been financially unstable, and don't have the same legacy culture stronger students gravitate to.

Dealmaker's Tip: When buying these, look at putting the parents checking deposit on auto draft. This way you lower the odds that the student didn't overdraft his account on beer the following month.

4. SUBURBAN OFFICE

These are also great income-producing assets that are in just about every city in the United States. These are smaller, professional offices where dentists, lawyers, accountants, financial advisors, insurance salesmen, and other professionals hang their shingles.

Qualify them by how long they've been on the rent roll.

Avoid tenants that are more sensitive to economic changes who can go dark literally overnight, such as Realtors® and mortgage companies, and those who are in certain markets linked to the price of oil, such as Houston.

Dealmaker's Tip: If you're considering buying a suburban office with a mix of tenants, make sure none of the income that comes from these economically sensitive tenants is accounted for into your bid.

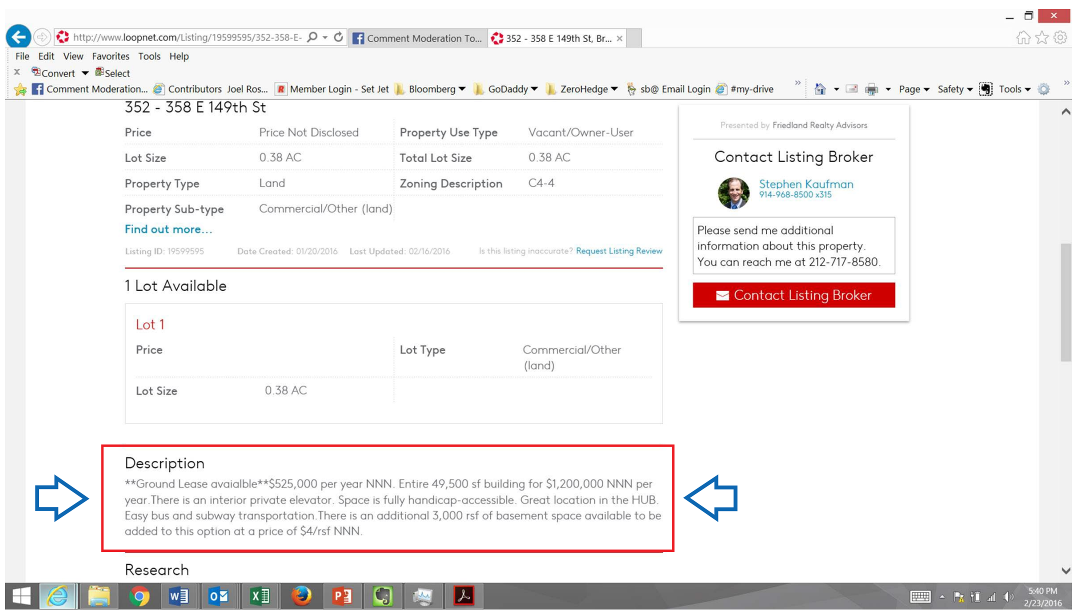
For example, if the Net Operating Income is $100,000, and $20,000 of that comes from the less stable tenant mix, only use the $80,000 that is left over to base your bid on.

5. LAND LEASES

Many of the world's most sought after pieces of real estate are built on leased land. Take most buildings in Manhattan or in Chicago, for example. Would you love to own the land lease on an apartment building on Fifth Avenue in New York City? Well, that may be a stretch, but there are several other cities where you can assume a loan on a land that is leased out for up to 99 years.

Minimum Lease Duration: 20 years.

Dealmaker's Tip: Make sure underlying loan matures before the lease termination date.



6. RETAIL

The common joke in the industry is that retail is dying and that Best Buy™ is now the showroom floor for Amazon™. That is true. No one needs to buy the next smartphone or flat screen TV; people can wait to have it delivered to their doorstep.

However, everyone needs food and prescriptions filled quickly, especially those in smaller, more rural cities.

Grocery-anchored or pharmacy-anchored, “broadline retail,” as they are called, are great, stabilized assets to buy that have assumable loans on them. Simply, everyone needs something to eat or medicines sooner than they need discretionary things like consumer electronics.

Other retail assets could be lifestyle centers that have a Crate and Barrel™ or Williams-Sonoma™ in them, or “big box” retailers that have a Target® in there. Not as common to find, but not impossible.

7. MULTIFAMILY

Just like everyone needs a place to eat, people need a place to sleep. And with many millennials saddled in debt more than any other generation before them, sadly homeownership is further from reach for many.

Combine that with the many people who are in between jobs and would rather have the flexibility to move on demand when they need to find work - all makes the case for owning multifamily long term a great play.

Buy in your market. Buying out of state will be tempting. Stay close to home when you're starting out.

Of course, just like all other assets you will buy with assumable loans on them, you need to buy right (meaning don't overpay) and have it professionally managed.

Minimum Size: 8 units

Class: C+ or higher

8. HOTELS

Hotels in the right cities or on large transportation routes are often great assets. The downside with hotels is that, unlike multifamily, each morning you don't know what the occupancy will be for the day.

Target flagged hotels, meaning they have a brand already in place operating the asset. An example of these brands are Hilton, Hyatt, Days Inn, Hampton Inn, Best Western and others.

Stay clear of anything that is not flagged, such as smaller "mom-and-pop" motels and hotels. This includes Beds and Breakfasts, too ("B&Bs").

Minimum Size: 100 keys

II.THE WORST

1. RESTAURANTS

Today, with inflation creeping higher while you sleep, there are businesses that suffer as, unfortunately, many people can't afford to eat out as much as they once used to.

Restaurants are now seen purely as a discretionary expense, and those on the lower tier have gone out of business, such as Friendly's® in the northeast.

Making the sub-asset more difficult to own are the razor-thin margins that restaurants operate on and this asset is also the most sensitive to economic downturns such as layoffs.

2. BULK SINGLE-FAMILY RESIDENTIAL

If you need to bring on an investor as a partner, most of them will want one roof over many tenants. It's just economically easier and more attractive.

Buying a portfolio of houses to rent or sell is very fragmented and very difficult to manage and will generally be seen by any prospective investor as being less economically stable.

3. PORTFOLIOS OF DEFAULTED, RE-PERFORMING, AND PERFORMING RESIDENTIAL MORTGAGES

Again, these assets are very fragmented, meaning difficult to manage, and capital intensive, meaning they are expensive to foreclose and service.

Generally, these purchases are structured in a fund structure where the risks can be contained more.

4. AGRICULTURAL

No cash flow or very little cash flow as compared to expenses related to holding the asset such as taxes and insurance.

5. LAND

No cash flow. Just expenses like taxes and insurance.

Dealmaker's Tip: Depending on area, could have very expensive environmental contamination issues that the seller may not be willing to disclose up front.

6. SENIOR LIVING FACILITIES

These facilities are often government subsidized and have high liabilities which equate to high expenses.

Changes in sentiment in government entitlement programs such as Medicare and Medicaid could render some of these facilities not profitable to own.

7. HEALTHCARE

Widely seen as prohibitively expensive to own based on constantly changing government sentiment on the healthcare indstry as a whole, where medical tenants are paying materially higher operating expenses and are having their fees continually cut.

8. GOLF COURSES

Generally not profitable and are usually subsidized by surrounding HOAs where properties must be sold first. In a market where mortgages for homebuyers with marginal credit are hard to get, these are the first to fall victim to economic downturns.

9. SPECIAL SITUATIONS

These are, by their nature, not stabilized, hence they are not throwing off any current cash flow today. Can include development deals that have existing financing, and other distressed, value-added plays where a key event must be executed.

An exception to this would be a Limited Partnership Secondary ("LP Secondaries") that is already throwing off cash flow.

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