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Property Prescriptions

Follow these doctors' orders to improve asset health.

by Rich Rosfelder

Today, CCIM asset managers are no longer just asset managers; they're asset-value physicians. For some, this means providing emergency, life-saving care: "As a court-appointed receiver, my role is often like a battlefield surgeon's," says Aaron Weiner, CCIM, CPM, LEED-AP, senior vice president of Weiner Property & Management Co. in Irvine, Calif. "The first order of business is to staunch the bleeding and address the infection." Luckily, Weiner always wears a dark suit.

Outside of the distressed-assets war zone, however, property owners and managers play the role of general practitioner. They check a property's vital signs, recommend preventative measures, and call in a specialist when necessary. If an asset looks weathered and needs a boost, they might even recommend cosmetic surgery. In all cases, whether the property is stable, on life support, or somewhere in between, the goal is to avert emergencies and increase immunity



against plummeting values.

“All savings translate into added value,” Weiner says, but in this epidemic of declining fundamentals, reduced expenses may not be enough to ward off value-eating afflictions such as unexpected vacancies, deferred maintenance, and unrealistic pro formas. Owners and managers must monitor even the healthiest properties. But like every patient, every property requires a slightly different approach. CCIMs were asked to share procedures they’ve successfully used to preserve asset value. The following strategies constitute a checklist for all property doctors faced with lagging fundamentals, looming loans, and an asset with the will to live.

1. Examine the Financials

If the foundation of any property preservation plan is to reduce expenses without compromising value, a forensic analysis of an asset’s financials may be the best place to start. “The income ledger reveals if the property is being marketed at a competitive level, if leases are being properly administered with respect to operating expense billings, and whether delinquencies have been addressed,” Weiner says. “The expense side of the ledger will reveal whether the appropriate services are being rendered at the property at the appropriate level.”

Roy Hanlin, CCIM, CPM, of Coldwell Banker McLain Real Estate in Huntsville, Ala., always looks for a lag between operating costs and actual expenses when he reviews financials. “The budget versus actual operating expenses should be reviewed at least quarterly,” he says. Typically tenant charges for operating expenses are set at the beginning of the year, based on budget projections. “If the actual costs are exceeding the budgeted projections, you can notify the tenant to increase the monthly payments,” Hanlin adds.

An asset may be sound in the short term but headed for trouble in the future. Avoid potential pitfalls by reviewing the assumptions built into the financials, which are often unrealistic, says Mark Lee Levine, CCIM, director of the Burns School at the University of Den-

ver. “There are often positive assumptions in internal rate of return or net present value projections that income will increase at a given rate and expenses will not rise as fast as reality might prognosticate,” he explains. “Thus, the interest rates are too optimistic, and the appreciation projection is unreasonable.” Once adjusted, these projections can reveal a more realistic picture of a property’s value and its cash-flow potential.

2. Prescribe the Best Use

“It is crucial that the asset always undergo what our firm calls the functionality stress test,” says J.R. Chantengco, CCIM, president and managing director of The Triwest Group in San Diego. “This unique process, which can be applied during any stage of the real estate life cycle, validates whether an asset’s current use is actually the most relevant in today’s marketplace.” When a property fails this test, it may be time to reposition.

For example, when Hanlin took over the 40,000-sf Madison Medplex building in Madison, Ala., it was 90 percent occupied by medical tenants. But within two years, four tenants left to buy their own properties. Hanlin and his team tried to entice other medical users, but the economy and the property’s distance from a hospital kept them at bay.

It was time to reposition. “We knew the property’s medical office features such as ample parking and canopies were attractive to non-medical tenants,” Hanlin says. They capitalized on these features by renaming the property Madison Professional Center and targeting a variety of office tenants. Within six months, a government contractor leased 3,000 sf, and other non-medical users have expressed interest.

3. Target the Right Tenants

For years, Rob Kost, CCIM, vice president of Sherman Associates in Minneapolis, struggled to fill the retail space in his company’s Midwest mixed-use properties. “These locations are certainly not cookie-cutter arrangements for national firms,” he explains. Mom-and-pop retailers, on the other hand, often thrived in these spaces, bolstering the properties’ occupancy and rents. Gradually,

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Kost began to focus almost exclusively on local tenants. “We are bending our credit underwriting to get these folks in the door,” he says. “Our ownership has made a conscious decision to take some risks with these ventures.” Kost currently is working with a coffee shop, bakery, primary-care clinic, barber shop, and restaurant — “all home-grown start-up companies.”

Depending on the property, however, targeting local tenants may be too risky. When Skip Duemeland, CCIM, chief executive officer of Duemelands Commercial in Bismarck, N.D., creates an asset-value business plan, the first things he asks are, “Can tenants pay the bills consistently, with a corporate guarantee, and can they maintain a 20-year lease?” Mom-and-pop operations often can’t guarantee anything — especially in this economy.

The lack of financing in the current market creates an opportunity to target potential owner-occupiers in need of funding. Vance C. Southard, CCIM, of The Moser Group in Indian Trail, N.C., and his team utilize an “economic stimulus package,” offering up to 90 percent financing for qualified buyers. “We serve as the bank to create a stream of interest and take away a major roadblock,” he says. “This, in turn, has propped up the value of our properties, opened up many high-level discussions, and resulted in transactions.”

4. Nip and Tuck

It’s not always what’s on the inside that counts. Lee Y. Wheeler III, CCIM, president of NAI Fidelis in Beaumont, Texas, focuses on cosmetic changes and parking lot upgrades, which usually translate into higher rents and longer lease terms. “Stucco or an exterior insulation and finishing system ... can turn a metal warehouse into a nice retail shopping center,” he explains. “And tenants love to see owners investing in their success.”

Making the property beautiful, however, doesn’t necessarily come at a high price. “Often overlooked is the most basic and cheapest upgrade of all: exterior painting,” Weiner explains. “A contemporary color scheme can change a building’s image more than any other improvement.”

Adding increased functionality can set a property apart from the pack. Duemeland built his area’s largest loading dock on a distribution warehouse. “We have extensively upgraded the project and now have a more desirable tenant that may pay more,” he says.

New doors also can be a gateway to increased value. Weiner



recently oversaw the makeover of a medical office building in Anaheim, Calif., that had suffered from lax enforcement of signage guidelines and low tenant standards. “After getting rid of the marginal practices and massage parlors, we retrofitted the entry doors ... with windows and fiberglass pediments and pilasters,” he says. “This simple change significantly improved the building’s professional image.” Marketed as office condominiums, the property is now occupied by a variety of reputable medical and dental practices.

5. Detox

Sustainable upgrades are hot right now — and for good reason. They can help owners and tenants save money on utilities, they’re often eligible for tax credits, and they make properties more marketable.

The key concern when considering expensive modifications like solar installations, highly efficient heating, ventilation, and air-conditioning systems, and xeriscaping is the return on investment, which can be unclear. “One can quantify items like the savings on utilities,” Levine says. “Other items, such as better air quality leading to less time off for employees, are more difficult to quantify.”

Vicki Beal McDonald, CCIM, asset manager with Foundation Communities in Austin, Texas, recognizes the limitations of these ROI analyses — especially for multifamily properties, where tenants often foot utility bills — but contends that sustainable upgrades can pay off. McDonald manages a 16-building portfolio that includes 2,163 multifamily units and 20,000 sf of office space. During the last five years, seven solar photovoltaic installations were added to properties in the portfolio, offsetting the cumulative utility expenses by more than \$27,000. Also, rainwater harvesting and xeriscaping at one of the multifamily properties have kept the utility cost for irrigation at a very low \$48 per month. “Since we have an older portfolio, these and other utility cost savings can be another way to attract residents,” McDonald says.

6. Boost Tax Immunity

When it comes to taxes, asset managers can use a variety of tools to increase their savings.

Weiner points out that with the help of an experienced firm, component valuation can be a very effective means of preserving asset value.

"All savings translate into added value."

— Aaron Weiner, CCIM, CPM, LEED-AP, of Weiner Property & Management Co. in Irvine, Calif.

"It's low hanging fruit that every property owner should avail themselves of," he says.

Wheeler recommends an extensive review of the appraisal district files. "Many mistakes can be found and corrected in favor of the property," he says. For example, square footage numbers can be over-estimated, which affects the property value and taxation level.

Cost segregation is another readily available tax tool. Hanlin commissioned a study when he consulted on the purchase of a single-use restaurant property. It cost \$15,000 but saved the owners \$45,000 — not a bad ROI. But Hanlin is quick to note that "if you're not planning to hold the building for a while, this strategy might not make sense" because in some circumstances the property taxes can be recaptured.

And finally, don't overlook anything, in particular, the potential for tax credits and other government programs. "In researching a recent



project, my team discovered that the subject property falls within the city's redevelopment district and would qualify for tax-increment bond financing and affordable housing funds," says Chantengco. The property also is in the state's enterprise zone, making it eligible for net income deduction for any loan made on the asset, including bridge or mezzanine financing and up to \$10,000 per employee in tax credits. Along with state and municipal programs, owners and developers should investigate U.S. Department of Housing and Urban Development financing, Section 42 tax credits, Section 8 rental housing vouchers, Small Business Administration loans, and historic preservation and new markets tax credits as potential funding sources.

Rich Rosfelder is associate editor of *Commercial Investment Real Estate*.