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Investment Property Inspections

When a buyer makes an offer on an investment property, it is usually only after a thorough inspection of all of the data that is available on the financial records of the building. Certainly, a good physical inspection is also made.

Some investors pay more attention to the data than the structure. The physical inspection of the property could be as important or more important than the rents and expenses. By thoroughly inspecting potential investment property, a buyer may be able to:

- Work out a better price.
- Get ready for any upgrading or maintenance expenses.
- Avoid catastrophic repair bills for detectable problems.
- When actually purchased, get a higher return on the investment.

Where to Start

First, the investor needs to know what experts to call. He needs to know what needs to be inspected and how to do it. The property must be verified as physically sound and is a worthwhile investment.

There are some broad categories of problems that investment properties are subject to, and the type of expert that is needed for the inspection.

- **Soil Conditions.** When a property is located on certain types of land, a professional soil engineer or geologist should be called. Property could be low lying or reclaimed land; a former landfill or dump area; on hilly or mountainous terrain; located at lakeside or seaside; has structures or piers, pilings, stilts, or other unusual foundation conditions.
- **Drainage.** If the property is located within a flood plain area, it should be carefully examined by a civil engineer. The buyer can check basements and interior walls for signs of water damage.
- **HVAC.** Contact the representatives of the companies that manufactured or installed the heating, ventilating, and air-conditioning systems. Elevators and electric systems should be inspected by professionals in those fields.
- **Roofing.** A roofing consultant or structural engineer should be called to determine age, condition, ability to withstand loads, etc.
- **Pests.** Pest control companies

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are able to check for termites and other damage-causing pests.

Check the local building department and see what permits were issued and when. Some records may also show when fire inspections or health and safety inspections were made. Any violations will be on record.

The plans and specifications of the building may also be on file. These may contain the names of the original architect, engineer, contractor and developer. The investor may wish to contact one or more of these if any questions need an answer. ❏

The Need For Both Asset And Property Managers

When owners of large portfolios of investment properties need to make strategic business decisions involving management of these properties, they will usually call on asset managers. Areas of concern are overall leasing strategy involving rental rates and tenant concessions, in addition to repositioning or redevelopment, tenant mix, managing bulk service contracts.

There will be owner oversight to the manager's actions, but the asset manager usually controls such matters as contracts, leases, and capital improvements for portfolio properties and is directly involved in implementing strategies involving financing and tax or litigation-related issues. The asset manager will also be responsible for maintaining communication with lenders and equity partners with respect to financial reporting, debt negotiations, and significant operational issues.

The asset manager also can be expected to provide basic administrative services, including information systems support, in-house legal counsel, financial accounting, coordination of required appraisal, and preparation of annual operating budgets. The manager also may plan and coordinate exit strategies–sale and disposition of real estate. Finally, the manager will be responsible for overseeing property management personnel.

The Property Manager

Property management responsibilities differ from those of the asset manager. The property manager has a more tactical focus, dealing with the day-to-day operation of individual properties. These responsibilities include: overseeing repairs and maintenance, security, and cleaning operations.

Finance-related responsibilities of the property manager include tenant billings and collections at individual properties; lease negotiations; vendor contracts; cost control for property operations; and maintaining appropriate insurance coverage. They also handle tenant relations and deal with on-site issues such as space and leasing requirements. Finally, the property manager maintains accounting records and performs necessary inspections.

Property managers also may be called on to handle legal matters relating to building and tenant interests and to ensure compliance with local laws and ordinances. Finally, the property manager is the conduit by which information about each property and its operations passes to the asset manager. ❏

Upgrade And Modernize The Property

When you want an increased return on an older property it may be time to modernize the property. When you look around a community, you will usually find a number of properties that need to be upgraded. Some existing owners do not recognize the increased return that they could get or do not want to make the necessary investment. Often these buildings can be acquired at a price that reflects the return based on the current condition and income.

When you set out to modernize an older building, you will encounter three kinds of deterioration or obsolescence: physical deterioration, functional obsolescence, or economic obsolescence.

The first of these, physical deterioration, starts immediately after the building is completed and continues throughout its entire life, unless it is handled along the way with proper maintenance and repair. This type of deterioration usually can be taken care of by routine repairs and replacement of parts. Anytime the acquisition of a run-down building is being consid-

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ered, the investor must be certain that the deterioration has not become so bad that the building will have to be demolished.

Functional obsolescence happens when the property loses its usefulness as a result of changes in styles or in the needs of tenants. As an example, an older apartment property could have an electrical system that is inadequate to handle modern appliances such as air conditioning, microwave ovens, computers, television or other recently developed equipment. This type of obsolescence can be cured usually by installing updated equipment.

Economic obsolescence is a change in value that is caused by circumstances that are not directly related to the property. Often this is a change in the neighborhood, such as a change in the use from residential to commercial or industrial. When this has happened, modernization of the building may not be worthwhile. If the building is structurally sound, it could be a good prospect for conversion.

The Ways We Modernize The Building

There are five ways usually used to modernize a building. These are: (1) structural changes; (2) architectural changes; (3) functional changes; (4) mechanical replacements and (5) aesthetic improvements.

When a building is quite old, structural changes may be needed for safety reasons. Before you purchase the building, a professional engineer should make an inspection. This can determine whether the building is structurally sound and what changes, if any, will have to be made.

The building can be partially redesigned with architectural changes during the modernization. If a building has very distinctive architectural features rather than a plain exterior, some investors feel that the property has a greater investment potential.

Functional changes and mechanical replacements can reduce costs in an old building and increase efficiency. Wiring will usually need to be replaced to provide safety for modern electrical and computer equipment. Old heating systems will usually be inefficient and cause high maintenance costs, and should be replaced. An example of a mechanical replacement would be a change from an old slow electric elevator to a new high-speed model (often done by simply changing motor and electronic controls).

Aesthetic improvements are the sprucing up of the property and can usually be done at a relatively little cost. When an investor is looking for a quick resale, this type of improvement may be done rather than some of the others. Cleaning up the property, inside and outside, installing new lighting and repainting the building can be enough sometimes to make a quick, small profit.

Why Modernize?

When an investor is looking for the proper investment, older apartment buildings in good neighborhoods often look better for a long-term commitment than new construction. When a property is modernized, rents can be raised substantially and, if the work can be done without disturbing the existing tenants, the investor will not have the expense of carrying the property as he would in new construction. The investor would also hope that most of the existing tenants would stay and pay the increased rents, so the costs related to acquiring new tenants, as would be needed with a new construction, would be avoided.

Finally, the overall costs may be less. Although the price of the property may be high in relation to the current rents, the final cost after modernization may be far less than the cost of new construction. With this lower cost, the investor may be able to charge lower rents than new buildings nearby, putting him into a very competitive position.

When The Property Is Unproductive

Unproductive properties can present opportunities for big profits. When a building is bringing in little or no income because obsolescence or because of changes in the neighborhood that have made the location unsuitable for the original use of the building, converting to a new use can make a new profitable income stream. As an example, a movie theatre in an area converted to industrial might be changed to a factory or warehouse. Some neighborhoods have changed from warehousing and factory areas to residential. A factory building that is no longer being used could be converted to a residential condominium project, a small shopping complex, or an office building.

Don’t overlook properties that are still productive, but may have a much greater potential after a conversion. A chocolate factory was converted to a shopping center on the west coast. Movie theatres have been converted to supermarkets. Garages have been converted to condominium parking buildings. Seeing potential profits in older buildings takes imagination.

Give our office a call if you see a building that has potential for another use. ❑

Tailoring A Management Plan

Real estate investments can be set up to generate one or more types of returns:

- Cash flow to owners (yield or return on investment).
- Appreciation of owner's capital (capital appreciation).
- Shelter of cash flow and/or other income from taxation (tax benefits).
- Preservation of capital (safety).

Once the owner specifies the type(s) of return desired, the mix of returns, and expected timing, the property manager can develop an appropriate management plan. Planning, with its resulting control, is the foundation of effective property management.

If, for example, the owner wants to maximize cash flow for a two-year period, the property manager would probably plan to defer as much maintenance and repair as possible. Considering the short time period, the manager can reasonably assess that deferring certain maintenance and repair would have only a limited effect on the property's resale value. If, instead, the property is expected to be held over a long term, the property manager would probably design a strong preventive maintenance program and give corrective maintenance high priority, thus preventing significant deterioration of the investment over time. ❑

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. ❑

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