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Investing In Industrial Properties

If you haven't considered industrial properties as an investment vehicle, it may be time to take a look. Warehouse and distribution (W&D) properties are of interest because their standard layout suits a wide range of users, in contrast to specialized manufacturing facilities. Industrial properties look good for the following reasons:

- The market for industrial property is doing well with vacancy rates nationwide below those of other commercial buildings.
- There is a shift in the location and nature of demand, caused by changing technology and trade patterns, that will present investment opportunities.
- Institutional investors who have portfolios that are light in industrial assets are acquiring W&D properties for diversification.

With any kind of investment, of course, there are always risks. The most significant is the potential for rapid functional or geographic obsolescence. Because of this, investors must carefully analyze factors such as location, construction, ceiling height, and the number and location of docks, as well as other factors.

The Healthy Property

The turndown in real estate did not affect industrial property as much as other properties because this property did not encourage speculative building; as much as 30% of the cost of W&D properties is in nondepreciable land, so they held limited appeal for tax-motivated investors. Foreign investors have largely avoided the W&D sector because it lacks the "trophy quality" that makes offices, hotels, and resorts attractive. As a result, warehouse development was driven more by demand than by capital seeking an outlet. Also the size of the properties discouraged many institutional

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investors who prefer to invest in larger properties than the typical $1 million to $10 million W&D property.

Choosing The Investment

Choosing the right property may be a little more difficult. Certain factors may be driving the W&D market toward greater efficiency, changing how and where business will be done:

- **Inventory control systems.** Computerization and new techniques such as bar coding can insure faster and more reliable deliveries from shipper to destination. Combined with just-in-time systems, it reduces inventory and space requirements.
- **Automated space.** Using robots in W&D facilities will grow over time, encouraging more efficient use of space.
- **Regulations.** With the trend toward deregulation during the past decades, there has been a reduction in delivery costs by trucks and planes, causing a shift away from rail and water. This widens the possible locations for W&D facilities and encourages the construction of fewer and larger facilities. Since trucks and planes speed deliveries, the amount of inventory stored and the space needed can be reduced.

Investment in W&D facilities must be very carefully thought out because of the conflicting needs for greater demand for space while using existing space more efficiently. ❏

"Green" Buildings Bring Profits

Any savings in expenses that have already been budgeted can be turned into spendable income. One expense that can be controlled to some degree is the energy used for lighting and for air conditioning. The emphasis today is on "green" buildings. A truly green building must be built from the ground up. However, much can be done on an existing building.

Lighting the office space uses a high percentage of electrical energy. In addition, the lighting can generate excess heat that needs to be cooled by an air conditioning system. Up to 60% of the electricity used in a building can be used by lighting and cooling. Bills for lighting the building can amount to about half of the original cost of the building during its lifetime.

Changes To Save Energy

It is much easier to effect savings in lighting when building the new structure, with plans in advance for energy conservation. With the existing building, the same ideas for savings will be a little more difficult, but will pay off in the future. Some are as easy as changing bulbs. Others may need wiring changes and are a little more expensive. All should pay for themselves in a short time. Here are a few of these changes.

- Improved bulbs and fluorescent tubes.
- Improved lighting controls, reflectors and spacing of the light fixtures.
- Microelectric sensors that measure sunlight and sense people entering and leaving rooms can cut the use of lighting drastically.
- Individuals in offices can cut usage comfortably by using desk lamps (with special low-usage fluorescent bulbs) instead of overhead lights.

Heating and Air Conditioning

Keeping a building cool in warmer weather can save enormously on energy. Windows in offices or lobbies and halls of apartments can be glazed with low emulsive film. This transparent film will not interfere with the views from windows, but can reduce the ultraviolet rays from sunlight. Interiors can stay from 30 to 50 percent cooler.

Consider the savings that can be utilized from the installation of an energy management and control system (EMCS). The EMCS automatically controls the ventilation, heating and air conditioning systems in a building. EMCS can be as simple as individual point-of-use timers to very sophisticated microprocessor-based systems controlling the whole building. ❏

Partners Making A Tax-Free Exchange Of Partnership Property

There are many limited partnerships that own rental property. Suppose a real estate limited partnership plans to sell rental property of the partnership to a third party and one or more of the partners wants to defer tax through a tax-free exchange (rather than receiving cash for their partnership interests). It is important that the proper procedure be followed so that an actual exchange takes place between the partners seeking a tax-free exchange and the third party. The partners desiring the exchange will have to follow these rules:

- Each partner seeking a tax-free exchange receives a distribution from the partnership by way of a deed of an undivided interest in the partnership property.
- The partner then identifies property he wishes to receive in exchange, and the property is purchased by the third party.
- The third party then exchanges this property for an undivided interest of the partner seeking the exchange.

In a 1989 Tax court decision, a tax-free exchange was lost because Chase (the partner seeking the exchange) failed to observe a few simple requirements. (Chase, 92 TC 874 (1989).

The requirements were as follows:

- The deed to Chase from the partnership of his undivided interest was not recorded.
- Since the partnership agreement barred distribution of property other than cash to the limited partners, this provision had to be waived by the partnership. However, no evidence was presented of such waiver.
- There was no evidence that Chase negotiated on his own behalf.
- During the time that Chase supposedly was the owner of the undivided interest in the partnership property, he received no rental income or credit from the partnership for rental income it received on his behalf. ❑

Reviewing Overdue Rents

A critical indicator of a management company's success is their effectiveness in controlling overdue rents. A well-run property should not have chronically delinquent tenants. However, when delinquency does occur, immediate action must be taken. A list of all delinquent rents must be prepared showing all tenants who have not paid. or for those who have partially paid rents and other monies due. In addition, a delinquency report recording the manner and date of all collection attempts should be prepared.

When initial notification of the delinquency does not help, the property manager should review the lease's termination rights and consider possible legal action against the tenant. Should a delinquent tenant suddenly vacate the premises, late charges and legal fees should be deducted from the security deposit.

Finally, if repeated notices and personal visits by the property manager fail to remedy the delinquency, the manager should contact legal counsel, research relevant state and local laws, and prepare to file eviction proceedings for nonpayment of rent.

The Legal Action

Each month, the property manager should review the delinquency report outlining all telephone calls, personal visits, notices, and other actions taken in an effort to collect the rent. This report, along with the tenant ledger, will help determine what legal action, if any, should be taken against each delinquent tenant.

Tenants who generally pay rent on time should be granted an extended grace period in which to pay. In many cases, the initiation of legal action will induce habitual late payers to remit rent monies owed; however, eviction procedures should begin immediately for tenants who are suspected of moving, as well as for those who continue to refuse to pay. Copies of the tenant's lease and the tenant ledger should be forwarded to the attorney, who can then begin legal action. ❑

Pre-Leasing To Secure Construction Financing

There are some indications that banks will be making some loans on real estate during this year. Even if they do, the borrower will have to have documentation on everything. Loan application must be perfect.

Whether it's a new office building, industrial warehouse, retail shopping center, or high-rise residential apartment building, investors and lenders increasingly demand to see a substantial portion pre-leased before they are willing to put up construction money.

Purely speculative construction projects are rare in today's real estate market. "With vacancy rates as high as they are, people are reluctant to invest in buildings that haven't got good strong prospects for leasing," said one builder. Another developer was saying virtually the same thing: "the old days when (developers and investors) would go in and spec a building really are gone. Now developers and investors expect to have a tenant going in and taking away some of the risk." The trend away from speculative building without pre-leasing is having a profound impact.

Build-To-Suit Projects

The decline (and in some section of the U.S., the demise) of speculative building is being replaced by an increase (and in some sections of the U.S., a surge) in build-to-suit projects. That's because build-to-suit is a process in which the owner (or main tenant) is going to get exactly what he needs in the most expeditious manner. One design/build firm said "Built-to-suit has become more popular because of its cost-effectiveness." ❑

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. ❑