Enjoy a "New Lease" on Life
With Commercial Real Estate – Part I
By Cherif Medawar

Commercial real estate is a great investment choice - even for beginners - and Cherif Medawar tells you why. Here's a simple strategy you can use to transition from residential to commercial…

Imagine owning a multi-million dollar building… leased by a national tenant with investment-grade credit… who makes improvements to your property on their own dime… who signs a 10 to 25 year lease where they agree to pay ALL your taxes, insurance, maintenance, and utilities. Plus, your tenant's lease payments not only GO UP every single year, but they are GUARANTEED by the parent company for the full lease term — even if the local branch (your tenant) doesn't do well or closes!

Say hello to the typical tenant who signs a triple-net lease on an office, retail, or industrial building. Triple net leases are not only common in commercial real estate, they are expected. "Triple net" refers to the fact that the tenant pays your taxes, maintenance, and insurance. And after those three are paid for - truthfully - what else is there?

According to Cherif Medawar, an investor who owns hundreds of millions of dollars of commercial real estate, investors who put together triple net deals like this can essentially sit back and enjoy stable income streams -just like the one in this scenario - for life.

Medawar insists there is never a bad time to purchase commercial real estate, but it appears now may be even better than most. And the numbers back it up.

The average yield on net-leased property rose six basis points to 7.6 percent in the fourth quarter of 2007, according to the latest report from PricewaterhouseCoopers. And although growth has been relatively stagnant in some regions during the country's economic downswing, the latest Standard & Poor's Commercial Real Estate Indices indicate that prices are up 3.6 percent nationwide versus May 2007.

In addition, many users of space are selling their property and then leasing it back as a way to raise cash. For instance, Pep Boys finished a sale and leaseback of 23 stores in April for $74 million. And SunTrust Banks raised $736 million over the past six months by dispatching 433 branches encompassing more than 2.2 million square feet of space. What does this mean for real estate investors? It means it's a great time to purchase commercial properties.

But that's not the only factor that has significantly increased the amount of great deals on the market. Until recently, soaring prices in the residential market fueled speculators to dump residential properties and swap into commercial real estate as a way of deferring taxes (via 1031 exchanges). This activity drove much of the commercial sales volume and often prompted multiple bids on properties. Not anymore. Today there are many motivated sellers out there - and they aren't afraid to give concessions.

Amidst this changing, yet appealing commercial market, *Growing Wealth* caught up with Medawar at one of his homes (in Santa Clara California). In this exclusive interview, *Growing Wealth* gets his take on the current economy, what strategies he favors, and what advice he has for investors who are new to commercial real estate or thinking about getting involved.

QUESTION: I've heard you state several times that although you've owned both residential and commercial real estate, that you actually prefer commercial. Why is that?

A. There are several reasons:

- With your average residential property — whether it's a condo, apartment building, or single-family home or duplex — the rent is quoted monthly or weekly. In commercial, the rent is quoted annually. That's right…commercial tenants stay for ***years***.
- Another difference is the leases. Residential leases are short term: usually twelve months or less. The leases in commercial are not only long-term (as in 10 to 25 years), but they have what are called escalations. This means every year or every five years they go up a specific amount (usually a percentage).
- In residential, the tenants have little interest in maintaining or improving your property. In commercial, you have tenants with an interest in making the property look good. After all, they have a vested interest in this location that they will be spending so much time in. Heck, I just had a commercial tenant repaint my entire building! It was not in the contract or anything. They just wanted to make it look better.
- In residential, the tenants call you for every little thing. Commercial tenants will only call you for big issues, if they ever call you at all. In most of my contracts, for instance, the tenant takes care of any roof *improvements*. I will take care of the roof *replacement*.
- In residential, you have areas of rent control. Rent control is to ensure landlords are not taking advantage of anyone. In commercial, there's no limit to what you can charge a tenant. Your earning potential is what you make it — and I'll give you another example to prove it. In some of my leases, not only do I receive a base monthly rent, but I collect a percentage of the tenant's gross sales if they exceed an agreed-upon threshold. Now that's investing!

QUESTION: In today's prevailing market conditions we've seen bankruptcies, stricter lending, and store closings. What bearing does that have on commercial investors?

A. Truthfully, it has NO bearing in my opinion. It will only affect you if you let it.

Occasionally you'll see a retailer file for bankruptcy. But it's important to know that filing for bankruptcy is one thing, and leaving a space (or not paying rent) is another thing entirely. For instance, Eddie Bauer filed for bankruptcy, but they still occupy many of their stores where they continue to make their lease payments and sell merchandise.

The banks in this economy have tightened up. They don't want to take risks. They're being very careful. All this is true. But what ARE they loaning against? They're loaning against commercial real estate because that's where the money is. People are leaving homes and moving out of single family houses, but they have to live somewhere. That's why apartment ***occupancy*** rates have moved up tremendously in many markets. Consequently, ***vacancy*** rates are down, which makes apartment buildings more valuable.

As far as store closings, many big tenants are closing shop, that's true. You have Starbucks closing 600 locations, but those were locations they signed five year leases on (with the option to renew every five years), so they were simply not renewing the leases on these stores.

The key is to focus on tenants that prosper in this economy. For instance, many fast food places are doing very well, because people simply are not going to full service restaurants or eating four course dinners as they were a couple of years ago. So bring in tenants such as Pizza Hut, Subway, McDonalds, Burger King, and Taco Bell. All these guys are expanding. Subway needs some 1,500 new locations, and they have taken deposits from franchisees who want to secure their own stores. ***To be continued next month.***

A self-made multimillionaire and owner of commercial properties across the United States and its territories, Cherif Medawar spent nearly 20 years developing the strategies and tactics that the Institute of Commercial Real Estate (ICRE) uses to empower its members to become owners of commercial real estate.

ICRE was founded by renowned real estate investor Mr. Medawar with a mission to bring the wealth-building potential of commercial property to anyone who wants to tap its power to produce income.

His 12 steps become easier the more you take them - they make you richer the less you do. No matter how profitable your current properties already are, we encourage you to come hear him speak. Let your money start working for you… and let it begin doing so at the Apartment Owners Association Trade Show and Educational Conference in Long Beach next month!