

Investing in Triple-Net, Leased Investments

An Overview

Michael Shields, CCIM
Apartment / Investment Broker
408-354-7470

Description

A fee simple, commercial investment with minimal or no management responsibilities

- Wholly owned or shared interest
 - Title to land, improvements & leasehold interests
- Typically retail, office, or medical properties
- Various types of tenants
 - “Credit-worthy” to high risk “Mom & Pops”
- Various Types of Leases
 - Lease determines involvement & influences value
- Values from \$1M to \$10M+

Property & Tenant Types

- Retail
 - From Wal-mart to “Mom’s Mart”
 - National corps., Franchise operators, Small Bus.
 - Walgreens, Advance Auto, Starbucks, Burger King, Kindercare, etc.
- Office
 - National, Regional, Local Business of all types
- Medical
 - National or Regional firms near med-centers

Lease Types

- “Net-Net-Net” (NNN) vs. “NN” vs. “N”
 - Included: Prop. Taxes, Insurance, Op/exps.
 - Typically NOT included:
 - Roof, Shell, Asphalt
 - Negotiated: TI’s to Termination – *Everything*
- Negotiated by Dev/owner & tenant
- New owner *assumes* leasehold interest
- ***NO SAY IN BUSINESS OPERATIONS***

Examples



- Walgreens
- Pomona, CA
- \$8,200,000
- 6.00% Cap Rate
- \$492,000 NOI
- 17 years remaining w/ options



- Jiffy Lube
- Newport News, VA
- \$1,228,850
- 7.80% Cap Rate
- \$95,256 NOI
- 13 years remaining, w/ options



- Starbucks / Quiznos
- Patterson, CA
- \$2,360,000
- 5.37% Cap Rate
- \$126,814 NOI
- Annual or term increases
- 8 years remaining w/ options

Advantages

- “No” (minimal) management responsibilities
- Steady, “reliable” cash flow
- Lease guaranteed by corporation
- Income regardless of vacancy or economy
- Location independent

Disadvantages

Risk vs. Reward

- Appreciation may be less with “flat” lease
- Income may not pace inflation w/ flat lease
- Strong tenants often have favorable leases
 - Exercise of lease termination clauses
 - Exercise / non-exercise of renewal options
- Weaker tenants have higher bankruptcy rates

Ideal Investors

- “Income sensitive” investors
- “Hassle-free” (low mgt. oriented) investors
- “Passive growth” phase investors
- “Legacy” investors (will to heirs)

Locating a Property

1. Commercial Websites
 - Loopnet.com
 - Propertyline.com
 - CCIM.net
2. Commercial Brokerage sites
3. Broker mailings
4. Broker phone calls
or
5. Work with a qualified commercial broker

Financial Analysis

Cash Flow After Tax

Potential Rental Income (PRI)
+ Other income (affected by vacancy)
- Vacancy & credit losses
<hr/>
Effective rental income
+ Other income (not affected by vacancy)
<hr/>
Gross Operating Income
- Operating Expenses
<hr/>
Net Operating Income (NOI)
- Annual Debt Service (ADS)
<hr/>
Cash Flow Before Tax (CFBT)
- Tax Liability
<hr/>
Cash Flow After Tax (CFAT)
<hr/>

Calculating Tax Liability

Tax Liability

NOI

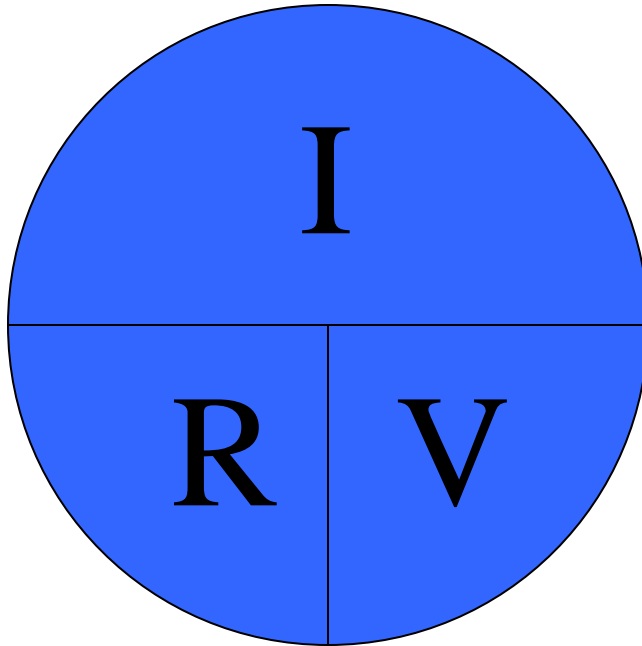
- Interest
 - Depreciation
-

RE Taxable Income

x Marginal Tax Rate

Tax Liability (savings)

Capitalization Rate



$$\frac{\text{NOI}}{\text{Price}} = \text{Cap Rate}$$

V = Investment Value (Price)

I = First year NOI

R = Overall Cap Rate

Direct Capitalization is a process of converting a stream of future income into a present value by dividing a future income amount by a cap rate.

Internal Rate of Return

N	\$
0	<Initial Investment>
1	Annual CFAT
2	Annual CFAT
3	Annual CFAT
4	Annual CFAT + SPAT

$$i = \text{IRR}$$

IRR or Yield = The rate earned by each dollar for each year that the dollar remains invested.

Financial Analysis Software

- Argus Edge / Argus
www.argussoftware.com
- Planease
www.planease.com
- CCIM Spreadsheet
michael.shields@svn.com

Purchasing Protocol

1. “Subject to inspection”
2. LOI first, then written contract
3. Contract Type
4. Legal review: Contracts, Clauses & Addend.
5. Due Diligence
6. Renegotiation

Protocol (continued)

7. Remove physical contingencies
8. Increase of deposit
9. Remove financing & appraisal contingencies
10. May or may not ***“Go Hard”***
11. COE time

Due Diligence

1. Geographic Analysis
2. Research Lessee's financial condition
3. Inspect location books & records
4. Property
5. Lease Analysis
6. Property Tax Reassessment

Geographic Analysis

- Population growth pattern (US Census)
- Demographic Analysis
- Income Analysis (current & projected)
- Crime Analysis
- Drive area with knowledgeable broker

Inspecting Books & Records

- Accounting records or tax returns
- Rent role & deposits
- Copies of tenant & non-tenant leases
- Tenant Estoppel Certificates
- Permits & Building plans (if new)
- Receipts for capital improvements
- Guarantees & warranties

Property Inspection

- Walk-through
- Roof
- Professional Property inspection (?)
- Termite/water inspection (?)
- Phase One Environmental
- Other inspections as needed
- Zoning verification

Lease Analysis

- Lease Abstract
 - Rent, Bumps, Terms,
 - Renewal Options
 - Responsibilities
 - Termination clauses
- Broker vs. Legal Review

Acquisition Steps

- Have funds available, Be Ready to Go
- Choose Acquisition team
 - Broker, Attorney, CPA, Inspectors
- Search BEFORE COE for downleg
 - Adhere to 1031 exchange timelines
 - Reverse exchange
- Tie-up 2-3, due diligence, then choose
- Release with valid reason

Relax & Enjoy the Income!

