



## MODULE 19

# Business of Buildings & Ownership

Commercial real estate is a dynamic and essential sector that creates a conducive environment for businesses to operate, and promotes urban growth & the well-being of communities.

In today's economies, it plays a vital role by promoting economic activity, generating wealth, and contributing to the overall development of communities.

POWERED BY





# Key Takeaways From This Module



## Guiding Questions

- What is Commercial Real Estate (CRE) and why is it important?
- What is the Purchase Process?
- What risks should you look out for when purchasing?
- What are appraisals and inspections? How do they play a role in CRE?
- What is homeowners and renters insurance? How are they different?
- Why would you become a Real Estate Investor?



## Enduring Understandings

- Risks associated with CRE investments include vacancy, market, and tenant credit risks.
- Appraisals and inspections are important for determining a property's value and identifying any risks.
- Why is insurance important to either a homeowner, or a renter.
- The significance of investments, and what benefits/incentives there are for Real Estate Investors.

# Leasing Basics of CRE



**Leasing is another term for renting a space**, and it plays a huge role in the economy, particularly leasing Commercial Real Estate (CRE).

CRE allows businesses to invest in their company, rather than a physical store, however, different kinds of commercial real estate are used for various reasons and cater for particular tenants.

## Three Key Basic Components

### Lease Terms

Lease terms specify the specifics of the arrangement, such as the length of the lease, the amount of the rent, the frequency of payments, and any other rules that regulate the tenant-landlord relationship.

### Legal and Financial Obligations

Both landlords and renters must be aware of the contractual duties, both legal and financial. This includes obligations for upkeep, repairs, insurance, utilities, and taxes on the property.

### Use of Premises

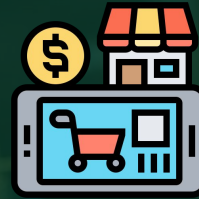
The tenant must operate within the scope of the commercial space allowed and within local zoning laws. This provision safeguards the property's value, stops unlawful activity, and promotes goodwill between the renter and the neighborhood.

# Four Main Types of Commercial Properties



## Office

Commercial buildings designed for company activities, ranging from small individual offices to large multi-story complexes.



## Retail

Retail premises are commercial buildings created particularly for companies that offer products or services to customers directly, such as strip malls and retail centers.



## Industrial

Commercial buildings known as industrial properties are utilized for manufacturing, production, storage, or distribution operations.



## Multifamily

Multifamily properties are residential structures with multiple residential units. These properties provide numerous rental apartments inside the same structure.



# The Purchase Process



## Due Diligence

To **guarantee that the investment is in line with the buyer's goals**, a thorough examination and evaluation of the property's state, financial performance, legal status, and other pertinent elements must be made.



## Financing

The next step involves **obtaining the financials needed for the transaction to be completed**. Traditional mortgages, business loans, private funding, or even a combination of diverse sources are all possibilities within CRE financing.



## Closing

Closing indicates that the **transaction has been completed, and the buyer has acquired ownership of the property**. To guarantee a seamless and legal transaction, it is essential to work with knowledge experts including real estate agents & attorneys.

# Real Estate Investment Trusts (REITs)



**REITs** are investment vehicles that **own, manage, or finance real estate holdings**. They manage these holdings and rent them to tenants, which provides a form of passive income.

Many REITs are publicly-traded so that stock investors can receive exposure to commercial real estate.

- Investors can **buy real estate assets without personally owning and managing them** through REITs.
- They offer a way for individuals with relatively small amounts of money to **invest in real estate without the need to buy and manage properties directly**.
- They are often listed on major stock exchanges, accessible to both individual and institutional investors.
- There are different types of REITs, including **equity REITs** that own and manage real properties, **mortgage REITs** that finance real estate, and **hybrid REITs** that combine both equity and mortgage strategies.

# What are the Risks?



## 1. Market Risk

- Potential financial losses due to market fluctuations.
- Includes interest rates, exchange rates, commodity prices, and market sentiment.

## 2. Credit Risk

- Risk of financial loss from borrower or counterparty defaults.
- Concerns timely repayment of loans, interest, or credit obligations.

## 3. Operational Risk

- Risk of financial loss arising from internal processes, systems, or human errors.
- Includes failures in operations, technology, fraud, or employee mistakes.



# The Impact Supply & Demand in Real Estate



**“Supply & Demand”** is a commonly used term to explain certain phenomena occurring in our everyday lives: the greater the demand, the greater the price, and the lower supply, the higher the price.

“Supply” concerns the amount of a specific good or service, whereas “demand” expresses the need of this good or service.

## Real World Application

As an example, let's take gasoline. When the demand for gasoline is high (people need gasoline), but the supply is low (there is a shortage of gasoline), the gasoline price will experience a steady raise in its price.



## A Direct Ratio

When there is a **greater demand**, there is a **greater price**.

### THINK ABOUT IT:

*How can Supply & Demand explain why limited edition sneakers, art, and trading cards are so expensive?*



# So, How Does this Apply to Real Estate?



So, in terms of real estate, when there is a **high demand of certain properties**, they will be **subject to higher prices**, as the supply will be lower. In turn, this affects other aspects of the economy, as when there is a **high demand for assets** such as houses, the supply decreases, causing an **influx of price for materials and inventory** needed to make these assets in the first place.

# Market Cycles & Timing



**Market cycles are the repetitive patterns of ups and downs** in the market over time, which produce rising and falling asset prices depending upon the stage of the cycle.

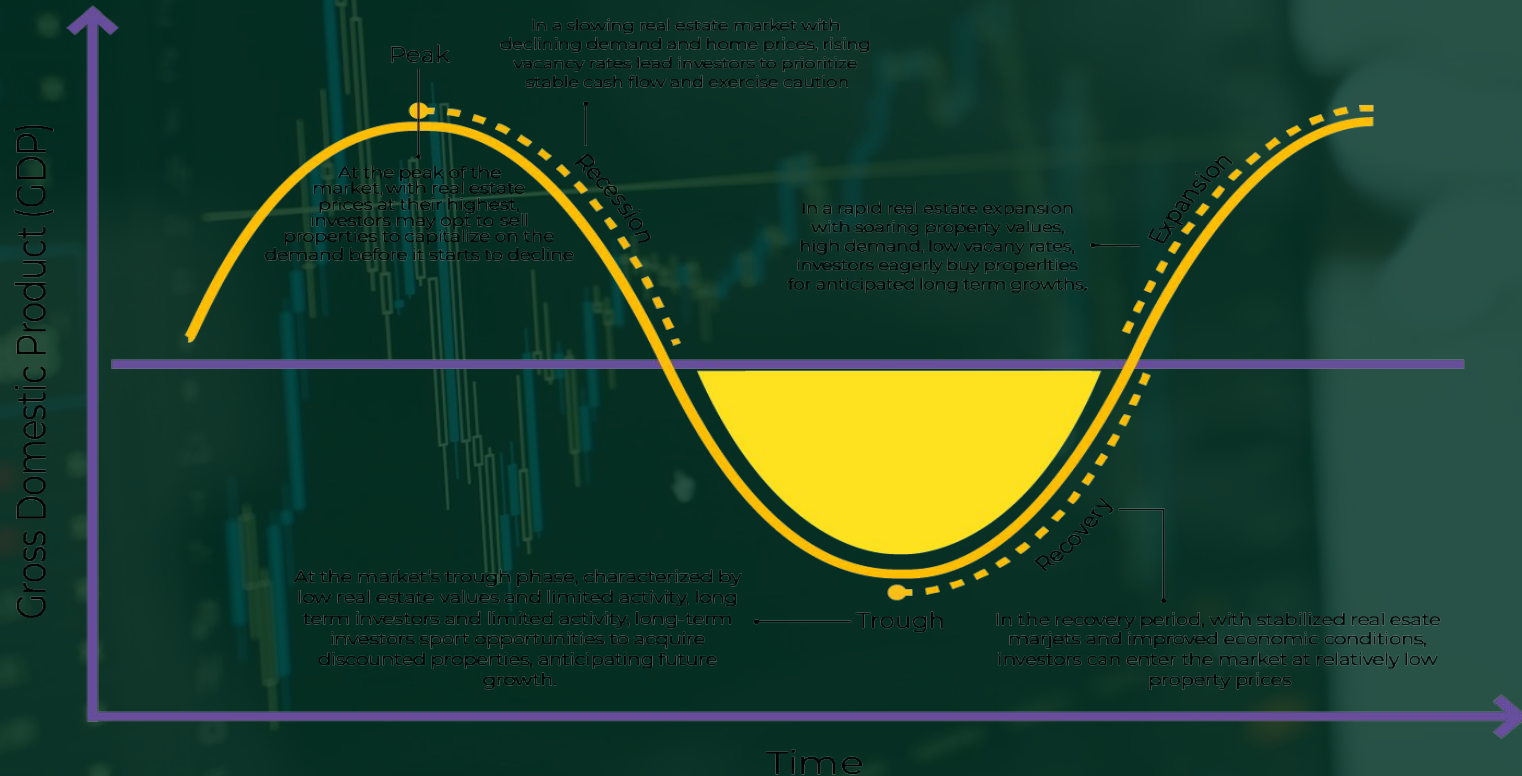
- These stages are actually characterized by phases, including **expansion**, **peak**, **contraction**, and **trough**.
- Each phase has distinct trends and characteristics.
- Making smart choices when it comes to commercial real estate investments - or any investment for that matter - requires an understanding of **market cycles**.
- These cycles enable investors to foresee changes in the market and modify their plans as necessary.



# Market Cycles & Timing



## Business Cycle



# Real Estate During Economic Downturns



**When the overall economy faces a time of recession or contraction, the real estate market suffers.** Economic activity slows down, unemployment rates increase, and consumer confidence plummets during these downturns, which **lowers demand for real estate assets.**

## Three Key Features

- **Reduced Demand:** As a result of weaker consumer confidence and a decline in purchasing, economic downturns cause demand for both residential and commercial buildings to decline.
- **Falling Property Values:** Property values tend to diminish as a result of falling demand and waning buyer interest, which has an effect on owners' equity and market valuations as a whole.
- **Increased Vacancy Rates:** In times of economic difficulty, businesses may downsize or close, increasing vacancy rates in commercial properties like offices and retail stores.



# Why do the Federal Reserve & Interest Rates Matter?



**The Federal Reserve is the bank of all banks, it controls the interest rates that commercial banks sets for consumers**



## **Higher Interest Rates**

Makes mortgages & general loans more expensive for business and consumers

The price of customer goods remains unchanged ( slowing down inflation ) and household spendings decreases.



## **Lower Interest Rates**

Encourages borrowing and investing for both businesses and consumers, stimulating economic growth.

Increases the price of consumer goods therefore increasing inflation rate.

**NOTE:** Depending on the Interest Rate that the Federal Reserve sets, inflation can be rapid or gradual, playing a key role of importance to the nation's economy.



# Figuring Out How Much Your Property Is Worth



# Neighborhood Analysis



**A NEIGHBORHOOD ANALYSIS** is a specific type of report where real estate investors are able to calculate the expectations for a possible investment within a property.

Some characteristics that can be observed are the...



**Location**



**Crime Rate**



**Education Quality  
& School Districts**



**Population**

# Property Evaluation



**AFTER** knowing what to look for specifically, **the property must be appraised** or evaluated to allow investors, or potential buyers, to see the full condition of the asset. This can help them see if the **price listed is adequate** in terms of the condition of the market!

The person conducting the evaluation should consider many things, including:



**Noise Levels**



**Size & Quality**



**Accessibility**



**Parking**



# Appraisals



Appraisals determine the **fair market value of a commercial property**, providing investors, lenders, and sellers with a **reliable basis for pricing decisions**.

- They are conducted by licensed appraisers using thorough analysis and data, and are crucial for buyers, sellers, lenders, and investors.
- These appraisals help set asking prices, negotiate terms, and assess investment returns and risks.
- Appraisals are objective assessments performed by qualified appraisers.
- Appraisals help reduce risks by preventing overpaying or underestimating property values.



# Inspections



Inspections **identify any existing or potential issues** that may impact the property's value or safety.

- These evaluations include detailed examinations of the building's foundation, **electrical systems, plumbing, HVAC, and other essential components.**
- Inspections help buyers make informed decisions by highlighting any necessary repairs or maintenance requirements.
- Sellers can benefit from inspections as they provide **opportunities to address issues** before listing properties, **potentially increasing its appeal** to potential buyers.
- Lenders may also request inspections that ensure that the property meets safety and maintenance standards, **safeguarding their investments.**

# Key Takeaways From This Module



## CORE & FUNDAMENTALS

- CRE focuses on location, cash flow, and lease terms to ensure a successful investment.
- CRE investments risks include changes in market conditions, rising interest rates, and financial loss for significant property value growth.
- When focusing on supply & demand, there is a direct relationship between demand and pricing, which affects the entire economic sector.

## APPLIED KNOWLEDGE

- Understanding the risks while purchasing have an impact on the effectiveness and worth of real estate
- Market cycles play an important role while making smart choices when it comes to CRE.
- Understanding that with higher demand, comes with higher prices, for example, assets such as land, etc.

## RELEVANCE FOR YOU

- Appraisals and inspections in CRE can determine property value, assess condition, mitigate risks, and many more.
- The purchase process is essential in enabling investors to make well-informed decisions that align with their investment goals.
- When looking for a house or place of residency, you should look at the surrounding areas, and the condition of the environment.

