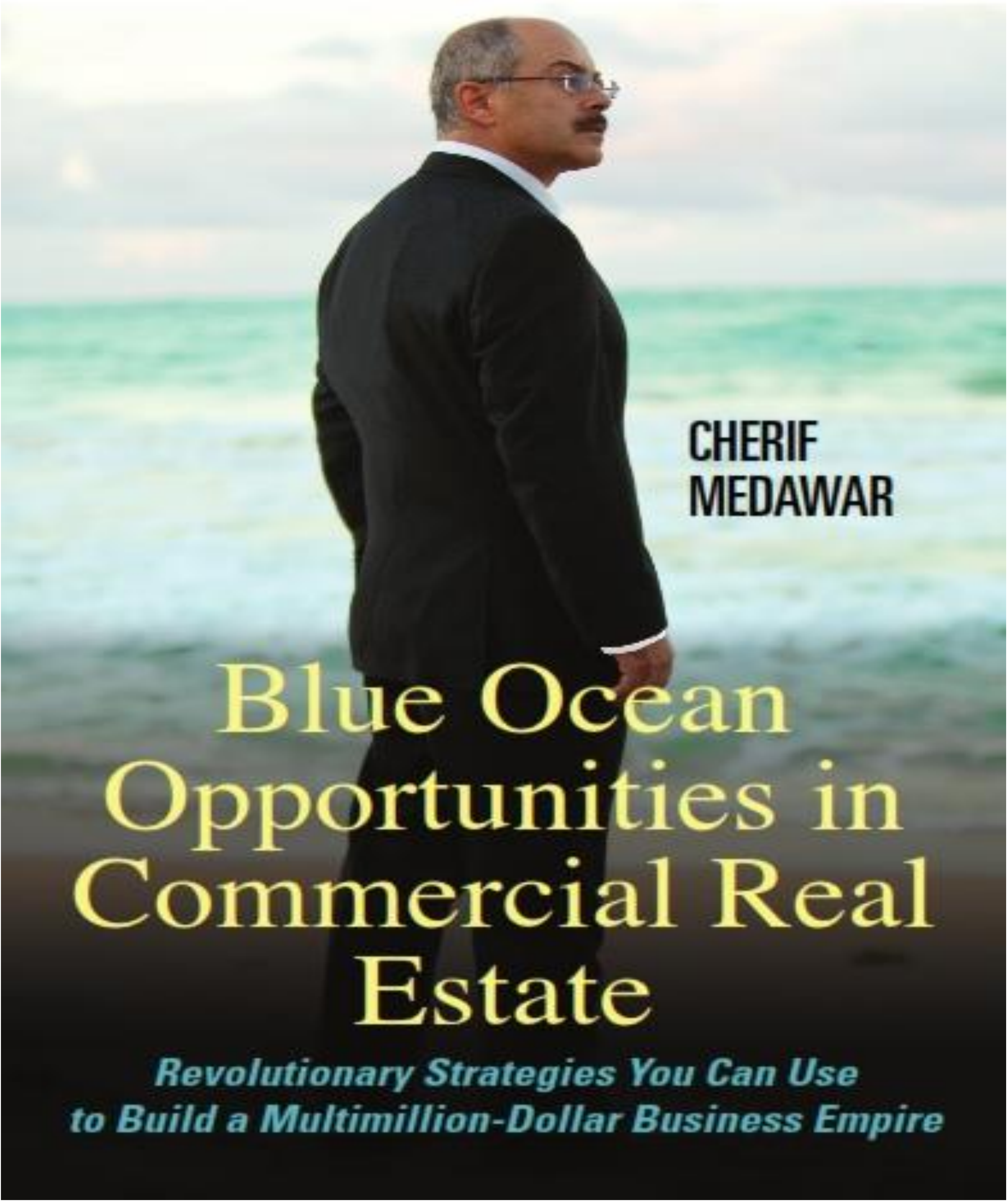
Inside: A Patented System for Buying and Selling Properties . . . Anywhere in the World



CHERIF MEDAWAR

Blue Ocean Opportunities in Commercial Real Estate

Revolutionary Strategies You Can Use to Build a Multimillion-Dollar Business Empire

Blue Occean Opportunities

in

Commercial Real Estate

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Blue Ocean Opportunities in Commercial Real Estate

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This book is dedicated to
my wife and kids… I do what I do for you.

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Introduction: This is How Fortunes are Made

I want to congratulate you on the decision to purchase this book. You are about to enter the exciting world of commercial real estate—a blue ocean that can literally make every financial dream you have come true.

We all deserve the opportunity to reach our ultimate potential. To have lasting wealth, plus the time to enjoy it.

I have built Cherif Medawar Real Estate Investing (CMREI) to help people like you take the same wealth-building path I have taken personally. I promise you—without hesitation—that my strategies work. In a little over 10 years, I went from being a typical manager at a typical company … to being a private investor with a net worth in the tens of millions and growing monthly.

I've been on both sides of the coin: working 80 hours a week for my money, and having my money work overtime for me. Trust me, you want the latter.

There was a time when I had only a few dollars and owned no real estate at all. I worked around the clock for the next promotion and a higher executive position.

Today, I own millions of dollars of commercial real estate. I have a large portfolio with properties all over the United States. At the writing of this book, I am actively running CMREI … I have a family of three I love spending time with … I teach seminars all over North America on a monthly (sometimes weekly) basis … and I am managing more than $50 million worth of property.

Oh yes, and I continue to buy commercial property. Every year I add to my holdings.

I am also one of the largest holders of small, historic commercial real estate in the United States and its territories. I'm extremely proud of that because proper development and management of historic property helps preserve our country's character and heritage. It is my hope that at some point in your investing career, you will consider owning commercial historic property in your community and preserving its legacy.

I tell you all of this to show you how owning the right commercial properties can give you more income than you ever dreamed—plus, as I said, the time to enjoy it.

I love teaching people how to invest in commercial real estate and have even created business models for my students and members to invest directly with me in both commercial and residential opportunities. This lets my students put their money alongside mine if they choose to do so. It also gives them an opportunity to earn while they learn.

As you'll read about shortly, I was fortunate enough to work for one of the most successful men in the world for eight years. One of the things I had to learn was how to trade on the stock market. I became very good at it. In time, I wrote a book called *Conquer Wall Street* that was published in 1998.

When the book finally caught on, I started hearing from people who wanted training. I taught for a while, and I enjoyed teaching people about the stock market; but deep down I wanted to show them how to make money in real estate. After all, I was making my biggest money in commercial real estate. It is easier, faster, and more solid.

There's no doubt that real estate requires more work up front than trading stocks. But to make money trading stocks, you must do it *every single day*. This isn't your father's stock market. It never will be again. The market volatility created by today's computer-dominated trading has rendered "buying and holding" a thing of the past. If you're going to put money into stocks or options, you must be active. Even if you find a stock market strategy that works for you, it's not nearly a sure thing. Losing trades are not just inevitable … for most people they are the norm.

Even professional traders admit they have losing trades almost half the time. The way they make money is by cutting their losses quickly and letting their winners run.

But if you do your due diligence, it's hard to lose money in real estate. Cash flow is king … especially passive cash flow. And if you do make a mistake in real estate, time alone will correct it for you.

That's what this book is about. I'm going to cover as much as I can about my techniques for wealth and commercial real estate in general. I'll start with the basics and move into things a little more complicated. For demonstration purposes, I will tell you about the deals I've done and the properties I own. As you'll see, I have earned the right to tell you what I'm going to tell you.

I will talk about specific locations and transactions … I'll talk about formulas and terminology … and if you are a beginner, I'll show you three important things. You'll see how to:

1. Start with income-producing property to get into commercial real estate.
2. Purchase commercial property with zero money down.
3. Get into *big* commercial deals—either in time, or right out of the gate.

And once you get to the level of doing really large deals, you'll find out there is a lot *less* competition, there is a lot *more* money, and there is wealth beyond your wildest dreams. Your competition is often groups of entities, and making a decision takes them forever. You don't need a management team to run your commercial properties. I can beat every REIT (real estate investment trust) and limited liability company (LLC) out there because most of them have hundreds of people and lots of bureaucracy.

As an individual, I can make decisions quickly. As I said, I manage a portfolio of more than $50 million worth of high-cash-flowing commercial property without a single management company. The key is to develop a few trustworthy, competent people on the ground so you can manage any real estate asset (or business) from a distance. After I show you how, you'll be able to do the same.

You just need to change your current way of thinking.

By the end of this book you will feel comfortable and confident enough to go out there and make things happen. And if you purchased this book because you were curious about commercial but you still just want to do residential, listen to the principles. There are some universal principles for real estate that apply to any type of real estate, anywhere in the world, at almost anytime, and I'm going to stress these. However, I know you'll be convinced that commercial is better by the time you finish.

Global investing

With the exception of a few of the tax strategies, all of these commercial real estate principles can be applied globally. What you do in the United States, you can practically replicate in Canada. You can also do it in Latin America with small nuances that can work to your advantage.

Many people ask me, Cherif, can I do this in Europe? China? Russia? Yes, yes and yes. If you want to invest globally, you can do so. One of my favorite countries to invest in is Mexico. The hotel investments there are phenomenal. My wife is originally from Cancun, Mexico, so I have always looked at Latin America. My mom is from France, so I have always looked at Europe. My father is from Egypt. Suffice it to say, I'm very interested in global property.

But let me be clear: All roads eventually bring you back to the United States. We live on the best shores in the world, so you don't need to go to another country. You can make billions right here without complicating your life. But if you complicate it a little, you may make even *more* money.

Blue ocean opportunities

You may be wondering about the title of this book. Let me explain. Since early history, oceangoing ships have been known as "blue water" or "blue ocean" vessels. These terms still endure today.

Blue water is safe and deep. In blue water, you won't run aground. In fact, a captain of any sizable ship knows to steer for blue water. Blue water is well away from reefs and shoals. It's far from turbulent, dangerous tides. It's where smooth sailing happens. If a storm should appear, a blue ocean vessel can weather it on the open sea and not be threatened by a rocky shoreline or blown onto a reef. In blue water, there's little threat of colliding with another vessel. And the occasional pirate ship can be outmaneuvered, outrun, or even outgunned if necessary.

In their popular business book *Blue Ocean Strategy*, authors W. Chan Kim and Renée Mauborgne talk about red oceans. A red ocean is defined as the markets where 99 percent of the world's people compete. A red ocean is already inundated with ships … it's a dangerous area where people are fighting for every penny they can get. They are blowing each other's ships to bits for a shrinking amount of loot. Products become commodities, and cutthroat competition turns the ocean bloody. Hence the term red oceans.

A blue ocean is an open marketplace where the water isn't bloodstained. There are fewer shallow areas and lower concentrations of predators. You have little, if any, competition.

Blue oceans are out there. In fact, the world has more blue oceans than red. But most people think they have to invest in a red ocean because that's all they know. I'm here to show you that you don't.

With commercial real estate, I'm about to give you a newly designed ship that will take you out of the red oceans you've known all your life and put you in your own blue ocean. You'll no longer be shore bound. You can roam the open seas and find opportunities you had no idea existed. And you'll never want to go back.

Blue ocean business models

Blue ocean opportunities can also be the development of new business models. A blue ocean is the wider, deeper potential of market space that is not yet explored. Blue oceans contain loads of potential and rapid success.

At the end of this book, you can read about the six business models I've developed for my students. In each of these business models (**Chapter 16: Paying It Forward**), I have structured several paths that create strong positioning to make it difficult for potential competitors to gain market share and take business away from me.

I have also structured the opportunities to be flexible so my students can:

1. Join me in my endeavors to benefit from my experience, contacts, resources, and results. They can do that by investing directly with me.
2. Copy me and duplicate my work for themselves as individuals. They can do that by attending my training events that I personally teach.
3. Create their own structures, as I have, to benefit a group of individuals who will join them in their endeavors instead of competing with them.

These blue ocean opportunities have been tested and proven to create success on many levels for all involved. When you finish Chapter 16, you may also want to get involved.

Failures are important

Here's something different about this book. Most books, seminars, and even business schools focus only on success stories. I will not only talk about positive experiences and success stories, I will also discuss frustrations and failures. I think there is much to be learned from failures—perhaps even more than from successes. So I will show you not just what to do, but what *not* to do. It's important to avoid the fatal mistakes that can kill your net worth and your cash flow.

My biggest influence is Warren Buffett. I love reading about him and listening to what he has to say. Ironically, his focus is the stock market and my focus is commercial real estate. Why is that ironic? Because they say if Warren Buffett had used leverage as he could have in real estate, he would've been a *trillionaire,* not a *billionaire*. But he doesn't use debt or leverage; he uses the equities market (almost all cash). We're going to use leverage (wisely) by tapping into the debt market. If you want to get wealthy faster, you don't want to use *equities and cash* … you want to use *debt and leverage.*

After all, is it easier to find $1 million cash in your couch cushions, or to take out a loan of $1 million? Obviously, a loan (debt) is easier. You can literally walk into a bank as a stranger and say, "Listen, I would like to buy this commercial property," and if the numbers will make sense, the bank will be ecstatic.

Why? Because they are not looking at you and your income as much as they are looking at the property and its tenants and revenue. That's what makes commercial real estate different from every other investment out there—and such an exciting business to be in.

D-C-B-A: My formula for learning

I want to tell you about a sort of "formula for learning" that I use in my training events. This very simple formula for learning has helped me to learn a lot of things very fast in terms of business, management, real estate, and equities trading.

I call it the D-C-B-A method.

D is for defining the words: Have you ever come to the end of a paragraph and realized you did not understand a word you just read? It happens. And it usually happens because there is a word somewhere in that paragraph that you misunderstood. But if you go back and find the word and define it in the context it is in, and read the paragraph again, it's like a light coming on. Using this concept helped me study, learn, and quickly understand three different languages.

Understanding the definition of words is by far the most important thing when you embark on a new area of study. You have to understand the definition of each word. So when I start going into terms like "triple net" and "leaseback," I will make every effort to define these words as I go. I don't want you to go on without understanding every single word you read. There is also a glossary in the back of this book. Use it when necessary. And as you understand the words, you will have absolute clarity and be able to move forward with a lot more certainty.

So the "D" in D-C-B-A is for **defining** the terminology in a particular industry.

The "C" stands for **concept**. This is where I explain the big picture and what we are trying to accomplish.

The "B" is the **business model**. As you will see, I am a big believer in setting up business models to evaluate and execute any opportunity. By definition, a business model is specific steps you can follow to consistently and predictably achieve certain results within a small variation. This makes it easy to replicate your strategies once they are successful. I'm going to introduce you to my business model for investing in commercial real estate. It's called the FACTS system, and you will learn about it in detail in this book.

The "A" stands for **application**. You must apply and take action using the business model for success.

Internet resources

In today's Internet age, many aspects of investing are easier than they used to be. Branches of government, real estate associations, brokers, and all kinds of real estate professionals and organizations have a web presence. This puts some of the information you need at your fingertips.

Accordingly, I mention helpful web resources in the book where appropriate. When I do, I have specifically designated them as web addresses by underlining them. I encourage you to check out these Internet resources as needed.

Progress on a gradient scale

As you read this book, I'm going to try to deliver the information on a gradient scale. Not a *gradual* scale, a *gradient* scale. The word gradient means as soon as you master a part, you go to the next one and build on it, then to the next one and so on. That's why I encourage you not to skip chapters. By the end of this book, you will know more than most licensed real estate agents or brokers who have been in the business for years but have continued doing things the same way over and over.

How can this be? Well, the fact of the matter is, commercial real estate is simple—but it's not easy. A lot of real estate agents and brokers in residential would love to go into commercial, but it's intimidating for them because there is no training. There is no formal training for commercial real estate investing that an individual can take into the market and really make it happen. That's why I wrote this book. And that's why I have CMREI.com. It offers formal, structured education on commercial real estate investing for people who want to change their lives.

What do you want from commercial real estate?

As you begin this book, you've got to figure out what you want to accomplish through your investing … and what you have to start with. Maybe you have cash. Maybe you don't. Maybe you need cash flow.

Maybe you don't. Maybe you're paying a lot of taxes, and you want to get tax deductions so you can net more cash. Perhaps you want to build assets by acquiring properties so you can preserve your wealth.

You can do all of these, because real estate offers you the end goal of:

1. Preserving your money in safely growing assets.
2. Receiving reliable, increasing cash flow.
3. Living a simple, hassle-free life.
4. Passing it all on smoothly (mostly tax-free) to your loved ones or a favorite cause.

As you read this book, your job is to identify which strategies you identify with *now*. That means figuring out your comfort zone, identifying what you want to focus on, and determining how much time you have to devote to this. Because if you make time, investing in properties out of state may make sense for you. But if you don't have much time, you need to initially focus on properties in your city, or in another market relatively close by.

You also have to consider how much time you have for investing when deciding what strategies to use. You don't want to buy an eight-unit apartment building if you don't even have the time to spend an evening with your spouse. You need to be realistic. Maybe you need to choose a different type of property, and I'll be covering that, too. You'll find what fits your style and what fits your life.

As you grow, you'll be able to do more. And if you *know yourself*, you'll understand how to start on a gradient scale and move up to wealth beyond your wildest dreams. You will start by pushing yourself outside your comfort zone to expand personally and financially. It is almost always scary and uncomfortable at first, but if you stay the course, your momentum will carry you and you will achieve your goal.

I will show you the type of properties you can buy and have almost nothing to worry about. Whether it's a terrorist attack, interest rate changes, or even economic disaster, you will still get paid. And I'll show you how to hold onto these properties with guarantees from the biggest banks and largest corporations in the world.

Do you have a financial statement?

You also need to have a firm grasp on your financial situation. To do this, you should have a financial statement. A financial statement is what the bank will ask you for as soon as you talk about commercial real estate. They want to know what assets you own and what debts you owe. Because even though they are mostly interested in the property (as I mentioned), you are the one who will be receiving the money.

What's on your financial statement may affect your ability to qualify for a certain type of loan. When banks loan to people, there are two types of loans. There is a *recourse loan*, which means that if something happens they can take the property back *and* go after your other assets as well. On recourse loans, they get a guarantee from you personally.

The second type is a *non-recourse loan*. If something happens that causes you to default, they just take the property. They can't touch any of your other assets. You can literally walk away. A non-recourse loan is great, but the criteria to qualify are difficult. They may ask you to put 35 percent down and they will want the property to cash flow very high. It's easier said than done.

Nothing beats real estate assets

There are three types of assets in the United States. They are:

1. Paper assets, such as stocks, bonds and certificates.
2. Business assets.
3. Real estate assets.

Of these three, the most valuable are real estate assets. Why? Because paper assets, unless they are government bonds, have no guaranteed return.

As for businesses, they require a lot of work. Usually you have to be present physically, you have to manage them day in and day out, and you have to have a good system in place. And, sadly, it is very hard to pass a business along to the next generation.

Real estate is the greatest asset because it gives you a lot of advantages. Say you have a house worth a million dollars and you owe $700,000 on it. That $700,000 is a liability. If that house is all you own, what's your net worth? Answer: $300,000. So it stands to reason that the more assets you have, the more eventual net worth you will gain. So the idea is to have as many good assets as possible.

The problem with that is if you're buying residential real estate anywhere in the United States today, you're running the risk of having big liabilities and no positive cash flow. So you'll be getting a big risk, big liability, big problem, big headache, and big exposure. I like to buy and sell residential properties, but it involves too much work, risk, and high taxes. Plus, you could be considered a dealer.

However, when you get into commercial real estate, and you set up properties with guaranteed revenue, you want the *maximum* amount of debt you can safely borrow. By prudently maximizing your properties' debt, you'll maximize the amount of cash you can keep in reserves. That is, if you locked in a low interest rate and you have a high rental income with yearly escalations.

What is your definition of multiple streams of income?

Let's talk about your income. You may have income from a job and/or you may have income from something else like a home business. I recently met a guy who told me, "I work at Sun Microsystems during the week. On the weekends, I am a photographer. I put my ads on Craigslist and on eBay and people call me to do photography. I also sell cars part-time. I buy them, fix them up a little, and put them on street corners and sell them."

I was astounded by this. He was running in five different directions! And I told him so.

"Well, I believe in multiple streams of income," he explained.

"So do I," I said. "But let me tell you about my definition of multiple streams of income."

My definition is not to have too many jobs, too many things to do, or too many things keeping you running around. It's simply to have several properties producing guaranteed revenue. *That* is multiple streams of income.

Because if you understand how to do commercial real estate and have the right properties with the right revenue, it's like you have several jobs that are paying you every month without fail … except these jobs do not complain, call in sick, or hassle you. They do not ask for a raise—instead, they give you a raise every year from the increasing revenue. And the second you die, they pass on to your kids, who will continue enjoying the same benefits.

And if your kids are starting to get crazy tattoos and unusual body piercings, and letting their pants hang down, and you're not sure where their minds are going, you can even manage your money long after you're gone. Did you know that? Heck, John Paul Getty is *still* controlling his money, and he's been dead for years.

You can put your property or your money in a trust and decree that your kids can never sell it—that they can only live off the income it produces based on certain conditions. You can specify exactly how much they get and how often. You can even reward them from the grave: *If my kids accomplish (this), they can get some money, and if they do (that), they can get more*. It's great.

Step back and gain perspective

During the last several years of my career in the hotel business, when I was a consultant, I would hold a two-hour training each Thursday for the executives and staff members. We would spend one hour on business principles and how to run hotels more effectively. Then we would spend one hour on real estate or stock market investing.

These mini-trainings changed the lives of the hotel staff. These were W-2 employees who generally lived paycheck to paycheck and thought no further than getting a small raise every year. Elevating their thinking, and giving them new hopes and goals, changed their productivity and morale tremendously.

It really showed me how much an individual's vocation impacts his or her entire life. People are happier at home with their family … they are better with customers … and they are more creative in general. In 2000, this particular Embassy Suites hotel I was running for Hilton scored the highest "team opinion" when we surveyed all the hotels across the country. On the surveys, employees indicated they felt respected, responsible, trained and in control, and that they understood exactly what they were being asked to do.

I believe everything happens for a reason. In hindsight, these Thursday meetings were the unofficial start of my training career. I was developing a skill I would need later. Obviously there was no cost or charge to train my staff, but it really was satisfying to make such a difference in people's lives. I began to recognize and believe that God puts me in different places to positively impact the people around me by teaching them strategies for financial and even personal success. I have a passion for disseminating information to other people and transforming their lives. I help them gain a perspective they've never had before.

When I look around today, I can't believe how hard people work to make wealth happen for them. The idea is to step back. To work smart, not hard. To get outside the problem and look at it, study it and decide on the best course of action. You see, people get completely consumed by their jobs. If I casually bump into someone in an organization and ask, "Hey, what's your goal?" He or she will say, "My goal is to train the new employee, talk to my boss, re-do the budget for my department. …"

And I just want to shout, "Stop it!"

They are clearly inside their problems and need to step back from them. If you own commercial real estate the way I'm going to teach you, your investment will bring you more income than your job. And it won't consume you like a job will. You'll have more perspective on life.

When was the last time you cried tears of joy?

When you start doing real estate and making money, you will encounter an excitement—a high—you've never felt. Now, I'm not an emotional guy, but I remember when my daughter was born in early 2006 and my son was born at the end of 2007. Those were the best moments of my life—incredible, emotional moments.

But the same year my daughter was born, another incredible moment happened. I'd been eagerly expecting a phone call back from the Puma Corporation for them to agree to lease a property from me for eight years at $15,000 a month. Getting $15,000 per month would give me incredible cash flow because my payment on the property was less than $10,000. But I didn't know yet what they were thinking. Puma finally called, and I answered the phone, praying they would agree to $15,000 per month.

Do you know what they offered? Puma proposed to lease the property from me for 10 years at $20,000. That's more than $10,000 positive cash flow per month on *one* property! When I hung up the phone, I nearly broke down and cried. It's easy to get emotional about money because I know how it will impact my life and that of my loved ones.

And this is not about being selfish or greedy. Even if you want to give your money away, you can't be charitable unless you are profitable. Making money is an extension of your spiritual existence.

I promise you the cash flow you can make in commercial real estate is worth getting emotional over. Bringing in $10,000 a month pure profit *from one building* will do that to you. And as you put these strategies into practice, I guarantee there's a Puma deal for you out there. Just keep reading.

How would you like to have too much equity?

When you have revenue, you're going to have expenses. That's just the way it is. In business, you have expenses. With a job, you have expenses. So it stands to reason that if you have a building, you will have expenses. But when you have commercial real estate, the idea is to *pass along the expenses to the tenant.*

This is not unusual … in fact, it's actually commonplace.

Consider the building that Puma leases from me. They pay me $20,000 a month. And my payment is $10,000 (I'm rounding the numbers here). But guess who pays for the property taxes, property insurance, property maintenance, and the utilities? They do! It's called a triple net lease (NNN). It's net of the taxes, insurance, and other expenses (liabilities) on the building.

How do you like that? All of a sudden I've got net income, but I have no expenses.

And that building that I originally thought I was going to rent for $15,000—and now is rented for $20,000—does it have a higher value? You bet it does. I increased my asset value because *the revenue from a commercial property is what dictates its value*. Not its age. Not its location. Not the beautiful arched windows. None of that. It's the revenue and the quality of the tenant. As you increase the revenue, you increase the asset value.

And if the revenue is high, guaranteed, and triple net—and the rent is backed by a company (like Puma) that is publicly traded and/or is very strong financially—then you have an asset that *immediately* increases in value. Now all of a sudden you rented it for more than you expected, and the value (just for the sake of conversation) jumps to $4 million. But meanwhile, your debt is still the same.

There are the times I can't sleep at night because I have *too much equity* in a property. And I don't like to have equity in my properties. I like to refinance and cash out. What do I care if I have higher liability? I care about the positive cash flow that is increasing year after year … while the debt amount is decreasing … while inflation is making the building more valuable since the replacement cost is higher over time … while the value of my debt goes lower since money's purchasing power decreases. It is a phenomenal way to compound your returns with safety. If and when I refinance and cash out, I have the perfect setup for endless streams of income with infinite rates of return. On top of all that, I'm often not *personally* liable for the loans.

You can easily see why commercial real estate gets me excited. And I'm about to share things with you no one ever has before. So let's not delay any longer. Congratulations again on your decision to purchase this book.

Chapter 1:
The Chance of a Lifetime

I was born in Cairo, Egypt. As I was growing up, my parents enrolled me in the Jesuit school, which ran from 8 a.m. to 6 p.m. This Catholic school had a very intensive curriculum.

My dad is a Catholic Egyptian—the minority of minorities in Egypt—and my mom is from France. That mixed background gives me a bit of an advantage. I learned to respect and appreciate different cultures and points of views. But I always knew what I wanted to do from a very young age.

When you were growing up, you probably wanted to be a fireman, ballerina, movie star, police officer, astronaut, pop star, or professional athlete. Most kids do. Not me.

When I was little, my best memories were in hotels. Every time we had a fun family event or my parents wanted to celebrate something, they would take us to a hotel. So I associated hotels with fun and excitement and figured all hotel managers must live the good life. They sit around enjoying all these exotic foods, fun friends and great amenities. I thought that's what people did in hotels.

Consequently, I wanted to be a hotel manager.

As a result, I talked my dad into sending me to hospitality school in Switzerland, where there was a program that would allow me to finish the four-year curriculum in three years. I wanted to do this because it was a tough class and I was in a hurry. Nothing has changed as far as my sense of urgency. I think that's helped me in my business life a great deal.

I ended up finishing the four years of hotel school in 27 months and moved to the United States. I started out in Seattle and then quickly moved to Los Angeles, where I started working as a management trainee at the Century Plaza Hotel while taking business administration classes at UCLA.

The Century Plaza Hotel was a Westin (at this writing it is a Hyatt Hotel), and it was one of the best in the world. You've probably heard of it. All the movie stars book rooms there, and even the president of the United States stays there when he's on the West Coast. So it was the elite of the elite. And I worked very hard, literally around the clock.

Both my parents and the Jesuit school had instilled a tremendous work ethic and high discipline in me. So I was really on a mission to do something big with my life. I was on track for that. It was all mapped out in front of me.

But one evening my life changed forever.

A hotel guest that I knew by face but not by name approached me in the lobby and said, "Cherif, every time I come here I see you working at 6 a.m. in the restaurant, then at 3 p.m. you go to the front desk, then at 10 at night I see you with the night auditor. This is crazy. What in the world are you doing?"

"Well," I replied proudly, "do you see this golden name badge? I'm a management trainee, and they told me that if I put in 10 years of hard work, I can become a general manager by the time I'm 30!"

He sized me up for a moment. “Listen. I can tell you’re a hard worker and a fast learner. You always have a smile, and you are running around with enthusiasm and energy. I’ve talked to other people about you. They say you aren’t easygoing, but you are a good person to work with and they enjoy your leadership. Leave this corporate structure behind. I want you to come work for me.”

“What do you do?” I asked.

He said, “I am in real estate. Commercial real estate. I have properties around the world and I need an honest, intelligent, hard-working person like you to travel and get things done for me.”

“But I don’t know anything about real estate,” I told him.

He gripped me by my shoulder and said: “You are the right person. What I will show you, you will never see or experience in any university in the world, not even Harvard. I know that because I am a graduate of Harvard with two degrees. So just say *yes*.”

I was fascinated by his presence and vision. So I put my faith in God and myself and moved forward. I said yes.

As it turned out, this gentleman’s name was Edmond Baysari. And he was—and still is—one of the wealthiest men in the world. He has commercial property holdings all over the world, including resorts, timeshares, shopping malls, and even a chateau in France.

And here I was, only 22 years old, being offered the privilege and opportunity of working for this man.

He interviewed me, of course. In fact, he flew me to New York and we talked for two-and-a-half days. I was very impressed with his candor, integrity and observations. But above all, I was amazed by his intelligence and integrity. He told the truth, and that boggled people’s minds. It was amazing to see him negotiate or organize his thoughts and present his opinions.

Looking back, the scary part is that I almost said no to him. But sometimes you have to make a change and take a risk. Some people resist change and want routine. Frankly, that’s impossible. The people who don’t embrace change and learn to adjust end up being very dissatisfied or even miserable. You have to listen to your intuition. It will tell you when something is right for you, and when something is wrong.

My intuition told me to take this risk. Everyone needs a mentor, and I was fortunate to find Edmond Baysari.

This “chance” meeting was a perfect example of what I call “Be-Do-Have.” To succeed, you have to understand the “Be-Do-Have” of life. You must:

- **Be** at the right place at the right time.
- **Do** the right thing in the right way.
- **Have** the right results for the right reasons.

There may be a high degree of luck for this to happen once. But what if we look at it in a different way and agree that it is not luck—that it’s a matter of choice and creation? Can we then create our own Be-Do-Have and become successful?

I think you can by:

- **Being** where you are but making it the right place and making now the right time.

- **Doing** the right thing (whatever you can) in the right way (the best way you can) to cause an effect.
- **Having** the right results (executing your plan) and having the right reasons (honor, profitability, growth).

For you to create the Be-Do-Have for your own long-term success, you must:

- **Be** the right person (interested, willing, able and committed).
- **Do** the right things (by taking the necessary massive action and understanding the price you must pay).
- **Have** the right people around you to grow with you.

I was at the right place at the right time, doing the right thing in the right way, having the right results for the right reasons. Mr. Baysari saw that and realized I was right person who could do the right things for him with the right people.

Mr. Baysari is a well-known businessman. In fact, Harvard Business School called him the man with two brains. There are books written about him in the United States and Europe. He is now in his late 70s, but despite his phenomenal success and incredible wealth, he continues to be a very private person.

After accepting the job, I found myself reporting to a man with a billion-dollar net worth at a very young age. Once I started working for him, my learning curve increased dramatically. Mr. Baysari told me what I needed to do and asked me to be resourceful in getting it done. That's how my education in commercial real estate began.

We traveled to Chicago, Los Angeles, San Francisco, the Caribbean, Paris and other parts of Europe. I had to quickly understand people and finance. I learned the world of high finance and real estate, how to trade in the stock market, how businesses work, and how to make millions with commercial properties.

Most importantly, I learned that there are sound investing principles that apply anywhere on Earth. And that based on the proper formulas, one could be faster at thinking, deciding and executing. Mr. Baysari expected a lot of me, and I pushed myself to the highest level of performance that's humanly possible. It was a test of intellect, will and emotion.

It was incredible exposure to a different way of high-level thinking. But it wasn't as glamorous as you may think, I assure you. It was a lot of hard work around the clock. Every night, I would lay my clothes out beside the bed in case I had to jump into them in a hurry. Next, I would arrange a dozen or so file folders on the desk so they were within reach.

Many times, Mr. Baysari would call me at 3 in the morning and I had to be ready with the numbers. We were usually in different time zones, but it didn't matter what time it was. I had to be ready at a moment's notice to tell him why expenses were up … or revenues were down … or something had changed in one of his many businesses.

When the phone would ring, I would turn on the light, pick up the phone, and grab whichever file folder I needed to answer his questions.

I was on my game all the time. It made me mentally sharp. And my mind became accustomed to compartmentalizing. After all, I was in charge of dozens of properties, stock option trades, and businesses at any one time. But it made me a better trader, investor and businessman, that's for sure.

I learned the techniques and methods of commercial real estate, plus the financial secrets that make huge wealth possible in a compressed period of time. I learned how to acquire properties … how real estate deals are structured … how taxes are saved … and how billions are made.

It was the chance of a lifetime. I benefitted from it greatly. And soon, so will you—without having to spend years of your life learning it.

Chapter 2:
What Took You So Long?

I worked for Mr. Baysari for eight years. And after awhile, I realized that if he was making money doing this, maybe I could do it the same way. Maybe I could make just a *fraction* of the money he was making.

I owed so much to this man. Yes, I'd devoted eight years of working around the clock to him—and I was leaving with very little money—but I'd received more in return. I'd received the education of a lifetime. And my mind had expanded in both knowledge and capacity.

I was nervous to tell Mr. Baysari I was leaving. I put it off for weeks. But one day after flying back from a transaction I did for him in the Caribbean, the time seemed right and I brought it up.

"Mr. Baysari, I've really enjoyed working for you. But I'm thinking I will make a move and try doing some things on my own. I've learned a lot from you, and I think by combining some of these things with what I already know, I can do well for myself. Is that okay if I leave you?"

That may not be exactly how I phrased it, to be honest. I was nervous, so I don't remember my words precisely. But I do remember his.

He remained silent a few seconds, and then he said, "It took you eight years. Why so long?"

Bewildered, I asked, "What do you mean?"

"I mean, what took you so long?" he repeated. "It's been eight years and you're just now figuring out that you can go out and make a lot of money like I do—that you can do this on your own? You're a smart guy, Cherif. That's why I hired you. But I've been waiting for this day. It's about time."

"Is that a compliment?" I asked him.

"Cherif, you labeled yourself as a hotel manager, so you stayed with hotels. Then you labeled yourself as my right-hand man, so you stayed with me for eight years. Now you've labeled yourself as an investor and a free being, so you are ready to grow. I know you're going to accomplish a lot on your own. But from now on, always be careful how you label yourself."

In hindsight, Mr. Baysari likely only expected me to work for him for two or three years. And why wouldn't he? Most people probably would have taken off after learning the basics of what he does. Eight years was a bonus for him. But I wanted to learn and test and create new formulas, and he allowed me a lot of room to perform. Everyone moves at his own pace. I encourage you to do the same … but you must also push yourself, or life will cave in on you.

So in 1989, I returned to California and went to work as a manager/consultant for Hilton Hotels. But this time around, I had a new perspective. I looked at everything differently. I had more to offer.

Something else was different, too. I didn't spend 80 hours a week working for my employer. I started doing real estate while I worked in the hotel business. I invested in both residential and commercial real estate, and I got very good at both. I traded in the stock market and created small business ventures on the side.

I started to formulate my strategies

It was at this point that I began to put into words why commercial real estate is so incredible … why it's such a blue ocean opportunity. At its foundation, commercial gives you the six most important things you need for financial freedom. Subconsciously, I knew these things from the previous eight years of experience. But until now, I hadn't had time to verbalize them.

One night I took out a sheet of paper and wrote them down. The list I wrote in 1989 is the same one I teach today.

All six were truths I learned when working for Mr. Baysari. To my knowledge, they don't exist in anything else but commercial real estate. Now I offer them to you:

1. **Increasing long-term income streams**

   Commercial real estate has increasing long-term income streams. Remember how I mentioned in the **Introduction** that if you have rental income, the lease is written with an increase in it? These increases are called escalations.

   Let's say you purchase a building on a busy street, and now you're going to lease it. So you put up the For Lease sign and somebody calls you and says, "Hi, I'm from Verizon Wireless. We saw your location at 123 Elm Street. It's a pretty busy street, and we would like to put a Verizon store there because there is enough parking right in front. What are you asking?"

   Now, when you quote commercial real estate, you don't quote it per month or per unit. You quote it per square foot. So this building is 5,000 square feet, and you're going to say, "I rent this property at $30 a square foot." That is *per year*, by the way; you're giving them an annual quote.

   So if you're charging $30 per square foot and the property is 5,000 square feet, how much is your income? Answer: $150,000 a year. And if you divide that by 12 months, how much do you get per month? Answer: $12,500.

   Now how did you know to quote that amount? How did you arrive at that number? You quoted that because next-door, or across the street, other building owners are leasing for $28 to $32 per square foot. See how it works? You have to know what's listed and what other people are paying.

   You'll find this information from talking to brokers and from researching for yourself what's on the market. (A little later I will talk more about how to find what's on the market.)

   In the lease it will say: *This lease will have a 3 percent escalation*. This is very common in commercial real estate. In fact, it's expected. What's a 3 percent increase of $150,000 for the next year? That's a $4,500 increase—so for the second year, the lease will be $154,500. And you have not done anything; you're just the owner. You just look good. You wake up in the morning, and you have money coming in—$12,000 a month plus. That's $400 per day. And if it's free and clear, that's even better.

   Why would I want it free and clear? *Because I would like to borrow against it.* I'd like to pull money out of the property. And fortunately for me, I have the income guaranteed by Verizon Wireless, a billion-dollar company. In fact, the paperwork will say, "This lease is guaranteed by the *mother company*."

Here is the point: You have the property, you know how to quote the rent, you know the lease has escalations, and you tell them, “This is going to be a triple-net lease.” That means Verizon is responsible for the maintenance, taxes, and insurance. *You* are responsible for collecting the money. Sound like a sweet deal? It is!

The question people often ask me is why doesn’t Verizon buy the building? It’s a very good question, and one I’ve posed to numerous tenants over the years. The answer? Because they are not in the business of real estate—they are in the communications business. *We* are in the real estate business, you and I.

That’s how every single one of these big companies plays the game. All of them focus on their business and lease the real estate from commercial landlords like us.

2. **Increased asset value over the years**

Now that the lease we just talked about increases by $4,500 a year, does that revenue increase affect your property value? You bet. So let’s say that next-door there’s an empty lot, and somebody wants to put an AT&T Wireless store there. Is the cost of construction less today than it will be 10 years from now? Yes. Does this dictate that the property value will increase? Of course. The cost of living is higher.

In addition, the rent increases annually, and since the formula is all based on revenue, the value of the property increases. So the asset value will increase over the years as you hold that property with a good lease and a good tenant. One of the best things you can do in life is make sure you have an asset that keeps increasing in value in order to keep up with and even surpass inflation.

Commercial can do that.

3. **Maximum tax write-offs**

In addition, you can depreciate the value of the property over a period of time. Depreciation is when you take the value of the building and deduct it from your taxes over 39 years. (The formula is 39 years for commercial property and 27.5 years for residential property.)

For example, let’s say the entire property is worth $1.5 million. The land is assessed at $500,000 (which is pretty high, but let’s use this figure just for the sake of conversation), and the actual “improvements” (the building itself) is assessed at $1 million.

Simply take $1 million and divide by 39, which equals $25,641.03. That is the depreciation. Every single year, you can write off $25,641.03 of the income you brought in. It’s like telling the IRS that you did not get that money—except it’s completely legal. It’s written off. It doesn’t get any better than this.

4. **Ease of holding and managing**

Let’s look at this scenario from a management perspective. Verizon is leasing your building and sending you a check for $12,500 per month. Will that be easy to manage? Yes. What kinds of calls are you going to get? None.

Most leases you give tenants will dictate that you, as the owner, are in charge of the structure. If there are any problems with the integrity of the structure itself, such as the roof, you will have to fix it. This is common.

For just such an occasion, you should keep what are called *cash reserves*. This is why I said earlier that it's important to have cash available at all times. Cash flow is good, but it won't help you on a dark day—or on a day when you wrote a lease that says *every* roof problem is your problem. You are going to have to have some cash.

But what if you don't have cash? What if that roof is going to cost you $35,000 and you don't have it? In that case, you go to the bank and say, "Mr. Banker, here is my lease with Verizon, a billion-dollar company. They are leasing my space for 10 years. I've got a problem with the roof and I have a bid here for $35,000."

Will they give me a credit line for $35,000 against that building? You bet they will! The banker will say, "Yes, please sit down over here. Are you comfortable? Can I take your coat? Would you like some coffee while you're waiting?" That's when the bank starts romancing you. Because they would *love* to put their money with your property.

So when you get your monthly check, you should put aside some cash reserves for that particular building. Usually cash reserves are 2 percent to 3 percent of the gross income you receive. On the building we're discussing, you should keep $3,000 to $4,000 in reserve every year in case you need to change or replace something as determined by your lease.

You don't need a management team to tell you this. You can hold and manage your own commercial properties without hiring management. After all, how often does the roof need replacing?

That's exactly the way I do it. I don't spend a lot of time managing my properties. I just collect. Some tenants do a direct deposit into my bank account. Some like to send a check, so I do have to actually go out and deposit the check. So if you want to hire a manager to deposit your checks because you are traveling the world with your family, maybe you should consider that.

Otherwise, you can manage properties yourself. You'll make much bigger profits this way. There's no reason to have a middleman.

I'll give you an example: For my properties in Puerto Rico, I have a very competent, trustworthy person who can handle emergencies: My brother Mauricio. If I'm in California, in Mexico, or teaching a seminar somewhere, he does what needs to be done when I'm not there.

The bottom line: You can manage every commercial property you own from a distance.

5. **Decreased exposure to liability**

We live in the most litigious society on Earth. Everyone wants to sue someone. Those who can, *do.* Those who can't, *sue*. So you need to reduce your exposure to lawsuits.

For decreased exposure, you can put the Verizon store into an entity such as a land trust, an LLC, or a C corporation. Once you do that, what is your liability? Are you exposed to getting sued? Let's take a look.

If somebody slips and falls in front of my Verizon building, first they have to sue Verizon. Then if they want to sue me, they'll have to go through the insurance company. Next, they'll see that the property has a lot of debt, because I love debt. (And you will, too, when you're finished reading this book.) After all that, if they still want to come after me, they'll see the property is held by an LLC. Needless to say, they are not going to get too far.

But let's say they do. If they are actually able to sue me and they win, they'll likely never collect because I may not be willing to disburse funds through my LLC. The goal of the game is to *never* keep your commercial properties in your own name—typically they should be in an LLC, a land trust, or a C corporation.

I'm not an attorney or a CPA, but I have hired the best in the world. Just to talk to Ernst & Young, they had to check my background for two weeks. What were they checking? I have no idea. But they do this to all their clients.

Then I had to pay a $15,000 retainer just so I could sit down with them. It was a pretty steep amount. But that's the team I wanted. I wanted the international division of Ernst & Young to handle my affairs because I have properties in the United States and all over the world. I want to know what the deal is when I'm in Puerto Rico—which is a U.S. territory—versus Florida, North Carolina, California, and other places. There could be some nuances, especially since I have some historic buildings.

So I hire the best. But when you're getting started, just hire a CPA with clients who are investing in real estate. You can check out *Yahoo!,* local classified ads or the Yellow Pages, or get referrals from other investors. Then when you call their offices you can say, "Listen, do you have clients that are in commercial real estate? You do? OK, I would like to interview you. …"

In short, you need people who have been dealing with these concepts, so every time you ask them a question, they don't have to research the answer for 15 minutes. (We'll talk more about asset protection in **Chapter 14: Protecting Your Assets**).

6. **Ease of pass-through**

Ease of pass-through means it's easy to bequeath property to your heirs upon your death. Compared with a business, real estate is *much* easier to pass on. Statistically, the best businesses in the country will only be passed on three times. When Bill Gates retired, you didn't hear about his kids running Microsoft, did you? No, because it's publicly traded. The day he took Microsoft public, that ended the possibility that it could be a family-run business.

As I mentioned in the **Introduction**, you can control how your assets pass through to your loves ones even after you are dead and gone. One of my buildings in Puerto Rico has Coach as the tenant. That building is a cash cow for me and has never caused me a single hassle. Coach is one of the biggest retail tenants in the world. Women absolutely love Coach purses. Accordingly, I want to bequeath it to my daughter. I'm sure she'll love their purses when she's old enough to carry one.

In my will, I can put:

Erica is to inherit the Coach building (at such and such address) *if she*:

- Finishes college with a minimum of a four-year degree.
- Has a prenuptial agreement when she gets married.
- Has a postnuptial agreement as well.

- Marries a guy who is not a loser.

Obviously the last one is a joke, but you get the picture. Erica will have to live her life intelligently and responsibly if she wants to inherit and keep the building.

I want to will the building that has Puma as the tenant to my son. Puma is also a cash cow for me because the company makes massive amounts of money, so my lease is backed by a corporate guarantee worth more than $200 million.

In my will, I have something like:

Max shall inherit the Puma building (at such and such address). All the income shall be his to use the way he wants *if he:*

- Finishes college with a minimum of a four-year degree.
- Has a prenuptial agreement when he gets married.
- Has a postnuptial agreement as well.
- Removes his tattoos.

Actually, Max is only five years old, so the only tattoos he has are temporary Disney tattoos for children. But you get my point. I want Max to earn his inheritance by living his life in what I consider to be the right way. If you have young children who will be inheriting your assets, you should stipulate in your will the things that are important to you.

Pass on your assets with no taxes

When you pass away, you want the transition to be as smooth as possible. If your spouse needs to step in and is not familiar with your real estate investments, he or she should be able to take over without too much difficulty. And guess what? There is something called a stepped-up basis in the tax law.

Let's say I buy a building for $350,000. My tax basis in the property is equal to its cost, $350,000. On the day I die, the building's value is $1 million. As ownership of the building passes to my daughter, her tax basis in the building will be $1 million.

But if I'd given her the property before my death, she would have received a carryover (instead of stepped-up) basis, which would be $350,000.

Because of this provision, any appreciation in the property that occurred during my lifetime will never be taxed! It's an incredible incentive for you and me to keep appreciated property until we die. Then, when our kids inherit it, they will enjoy the stepped-up tax basis.

A brush with death

We're all going to die someday. That's why you have to arrange your affairs as if you could leave at a moment's notice. You must work on developing a lifestyle whereby your physical presence is not necessary. That way you can die at any time without having to worry about the people you are leaving behind. The importance of this concept hit me like a ton of bricks back on May 23, 2007.

As you may have realized by now, I travel a lot by plane. And for anyone who flies often, it can become boring. That's how it was on this particular morning as I was taking a flight out of Dallas, Texas, to San Juan, Puerto Rico. It was a relatively short, routine flight I'd taken dozens of times.

But while this flight was short, it would be anything but routine.

We had just taken off and cleared the tree line when the right engine literally exploded in the air. It rocked the plane, billowing out a stream of smoke and fire behind us.

But it wasn't the plane that was making the deafening noise. It was the passengers. If you want to hear fear—if you want to hear people scream at the top of their lungs like you've never heard before—experience a near-death incident in an airplane. Adults and kids were screaming, the plane was bouncing around, and we could see the ground coming at us. Strangers who had never met one another were hugging and comforting each other. All around the plane, everyone was crying and praying out loud in many languages.

It was a moment that made me realize that although I have conducted my life in a way that gives me peace of mind, if I wasn't set up right—if my financial dealings were not set up correctly—it would not be fair to my family. When danger like that confronts you head-on, all you can think of is the people who love you. My mom, my dad, my daughter who was a year old at the time, and my wife who was four months pregnant with our son. *What are they going to tell my kids? What's going to happen if I'm suddenly gone?* All of this flashed through my mind in an instant. It was almost too much to bear.

But the pilot was phenomenal—he got the other engine going and we managed to turn around and land at full speed. As we were landing, fire trucks and ambulances with people wearing special gear were beside us on the runway. Some passengers were screaming in Spanish, "Fuego, fuego (fire)!"

Even as we touched down, the other passengers on the plane were still hysterical. But during this time, all I kept thinking was, "Why am I doing this? Why am I traveling all over to buy more buildings? Why am I making all this money? Is it for me? For the kids? For the love of the game?"

I didn't have all the answers at that moment. But it really made me look at my life and do some introspection. I realize now that sometimes you start living right when you face death. Fortunately, I am set up correctly now, so if something happens to me it will not cause chaos for my loved ones. All my assets will pass through to them easily.

In addition, all my trainings have since been captured on video and placed on my website at www.CMREI.com. These are hundreds of hours of education from real estate to mortgage notes to trading the stock market to business management.

But what about *your* loved ones? Don't wait until you have a similar experience or it may be too late for you. Do it now.

Chapter 3:
Types of Real Estate and How to Value It

I often get the question, "What's the difference between a broker and a real estate agent?" Someone once joked that the difference is about "3 percent." But no, that's not the answer.

The answer is pretty simple. The broker is the one who has experience and has a license that allows him or her to *hire* real estate agents. Usually real estate agents have to be in business a couple of years before they can apply for a broker's license—unless they have a four-year degree, in which case they can apply immediately.

So real estate agents work under brokers. That's the main difference. In the commercial real estate business, there is a national designation called CCIM, which stands for Certified Commercial Investment Member. People with this certification are considered experts because of their experience and their CCIM education in everything from financial analysis to ethics involving commercial real estate deals. Very few people have the CCIM designation. If you are working with a broker, it's better to have one with a CCIM designation.

I've done a lot of deals with real estate agents and brokers, and some are fantastic. If I am looking at a building on a certain street, and I'm not so sure what the tenant is renting it for, I can pull out my cell phone and call the commercial real estate department of a big company like Colliers, C.B. Richards, or Coldwell Banker.

"Hi, my name is Cherif Medawar. I am on University Avenue in Palo Alto and I see a building for sale. I would like to know how much it is selling for. Could you tell me?"

And they'll say, "Well, it's (X) million and (Y) square feet."

"Can you tell me how much they are paying right next-door?"

And they'll say something like, "The statistic on that street is $50 per square foot a year. We even have tenants right across the street who pay $65 because they have (this) and (that)."

Now you have the statistics, you know how much it is per square foot, you know what's happening in the neighborhood, and you can start figuring out if you've found a deal.

In addition, a lot of times a commercial deal is not put on the MLS or Multiple Listing Service. Oftentimes the owner will call the broker and say, "Listen I don't want to put a sign outside. I have a very important tenant who is not going to like it if I put up a For Sale sign outside the building. If you know of some serious buyers, I'd like to talk to them. I'll give you whatever, a 5 percent or 6 percent commission."

And that broker will earn the commission. That little phone call could be worth hundreds of thousands of dollars to you: "Hey listen, I've got a person retiring. He wants out and he's going to sell. …"

Now you step in. The moral? Build a rapport with brokers and agents. Make sure you take care of them. They'll bring you deals.

A traditional transaction

Before we start talking about valuing real estate, let's look at what is involved in a traditional transaction. You typically have a buyer, a seller, brokers, appraisers, bankers, contractors, tenants, insurance agents, escrow and title company officers, and tax assessors.

Who in this group would like the property to be valued really high? The tax assessor? Not so much. Generally speaking, tax assessors are usually the ones who assess it the lowest.

Obviously the seller wants it to be appraised high. The bank also wants it to appraise high. If you're going to buy it at $1.8 million, and borrow money from the bank to do it, they hope it appraises even higher than that. A higher appraisal give them a comfort zone—a margin of safety.

How about the brokers? Do they want it to appraise higher? Of course they do. The more it sells for, the bigger their commission.

Let's say you are the buyer. You are not the owner yet, but you just made an offer of $1.8 million. In addition, you just made a phone call to Verizon's real estate division and asked, "Would you like a building in Santa Clara? I'm involved with a building on Elm Street."

And they said, "Yes, we need a store in that location, provided it's no bigger than 5,000 square feet and no smaller than 3,500 square feet."

What an exciting moment! You found a building for sale, you made a call and found a tenant, and all of a sudden you say, "Now I can afford this." So now you need to go put it under contract. But you think it will appraise at $1.8 million. Do you want it to appraise at $1.8 million or maybe at $1.9 million?

Well, if the numbers make sense, and if you are going to be able to borrow and have a positive cash flow on top of it, why not try to get it appraised higher? If you are going to pay cash, you want it to appraise low, but savvy investors borrow. And if you aren't borrowing, then start from this point forward. You want to keep your cash.

At this point, you'll find out almost everybody is aligned for the property to appraise higher except the appraiser. Why? Because the appraiser has to be cautious. He has a reputation at stake. The appraiser is a person who has to make sure the numbers make sense—that the property is falling into the right price range.

Switching roles to understand a seller's mentality

Let's switch roles and say you are the seller. If you are selling a property, the person more important than you is the buyer. I have actually bought properties for more than they appraised for—do you know why? Because in one situation the property was on a busy street, and as I drove by I could see the potential to put a single tenant with a triple net lease in the building, which was leased at the time to a single person for an antique store paying only $3,500 a month rent.

The property appraised at about $500,000. And I went to the owner and said, "I want to buy your building."

He replied, "I don't want to sell."

So I upped the ante by proposing, "I'll give you $50,000 over appraisal."

He looked at me for a few seconds and said, "Done."

Here's why I did that. I knew as soon as I put in a tenant such as Verizon Wireless and the property went up to $1.5 million, I would make a million dollars. So that's what I did. I bought it, refinanced, and cashed out half a million dollars over my original $100,000 down payment

You can't find another investment like this. Commercial real estate is king! If you can show me something better than this, I'll be there. But it simply doesn't exist. And opportunities like this are everywhere.

Plus, property owners don't always know the value or cash flow opportunities their properties hold. They are usually so caught up in the minutiae of their lives, they are ignorant of the potential. But if you understand the area and the numbers, you can see what they can't.

Let's review the scenario in a little more detail. You have a single location on a busy street and you see the current renter is paying very little. The person is running a small business that's not going anywhere. He or she has a lease and wants to get out of it. But the lease does not expire for three years, and the owner won't let the tenant out.

You go in and tell the owner, "I want to buy it." And because of the revenue, it appraises low. Because remember, the value of commercial property is based on the revenue; if the revenue is low, it appraises low.

At this point, are you willing to pay more than the appraised value if you are going to put in a better tenant who pays more? Yes, definitely. Are you starting to see the formula? I hope so.

Here's a hurdle you might have to overcome, however. When you get the property, and you change the tenant, you may have some holding time after you close, before you start receiving rent. Can you afford the holding time? Maybe you can, maybe you can't.

If you can't, simply get a partner. And when you present this to the partner, you say, "Look, here's what I've got. I have a property with current revenue of $3,500, and when you look down the street you see there is a Cingular store and they are paying $35 per square foot per year. We can make this building bring in $12,000 per month. Do you want to get in with me? Because I have it under contract and if you don't, I'm going to go talk to somebody else." And people will listen.

The fact is you'll be amazed how many people in our country have retirement accounts with $300,000, $500,000 or more. They can borrow a lot of money or even roll over their company 401(k) if they want out of the rat race.

The best way out of the rat race is through commercial real estate. Not by wishing, not through fantasies, not by working around the clock like I used to do, and certainly not by having three or four jobs. The best way out is through commercial real estate.

A "creative" transaction

We've established that in a traditional transaction there is a seller and there is a buyer. The seller has a real estate agent or a commercial broker, and the buyer can go directly to that agent or use his or her own agent. That's the customary way to do it. If the two sides talk and they are in agreement, the buyer can send a letter of intent (LOI) in writing.

Then they are going to "open escrow" with a contract and have what is called the due diligence period, when the buyer arranges an inspection, an appraisal and the financing. Finally, the buyer and seller go to the closing. That's a *traditional transaction.*

Let's look at what's involved in a *creative transaction*. The creative or nontraditional way is when the buyer and seller work with each other directly. Believe it or not, this is actually more common in commercial real estate than in residential real estate. Especially in an unstable economy.

Let's stick with the scenario I used previously. I approach the seller and say, "Hi, my name is Cherif Medawar. I'm very interested in talking to you about your property located at 123 Elm Street. … Yes, that tenant where you have an antique shop there? I'd like to buy it."

But the gentleman tells me his property is not for sale. So I come back with, "Let's have it appraised. I am willing to pay a little more than appraisal."

Now he's interested. So he says, "Really? Will you pay me 10 percent more than appraisal?"

You reply, "I think I can commit to that."

Now, what if he asks you *why?* What's your answer? Personally, I like to answer that without lying because I don't like to lie. I want you to do business and sleep at night—sleep a full eight hours. So you tell him, "You know, I think the property has some potential. I still need to look into it, but I've got some money and I'm willing to pay a little bit more. I'm trying to make a decision pretty quick because I'm looking into other properties."

See how you positioned him now? You weren't specific, but you weren't untruthful. You got him excited and you *always* mention the competition. Make people compete to have your business even when you want their business. Never be loyal with any one bank, appraiser, contractor, or tenant before you check with somebody else first just to compare—because sometimes loyalty is not reciprocated.

To illustrate this point, I once was doing business with a bank in the Caribbean. I did one deal with them, then a second, and a third. But one day I thought, "Wait a minute. I'm going to them without checking with others." And one thing that made me curious was they always greeted me with a big smile, and the smile just kept getting bigger.

So I checked with another bank and they said, "We can beat them by .75 percent." Do you know what .75 percent is on a loan of $8 million or $9 million? About $1,800 a month! You can buy a brand-new Lexus with that. The lesson here is: Have the banks compete.

So a creative transaction allows you to "deal directly." To cut out the middleman. This is how I usually do business and how I recommend you do it as well.

Property valuation

Let's look at how to value property. Appraisers are stuck, and I'm going to tell you to leave them stuck. Let them keep their narrow minds; it works to our advantage, with all due respect to appraisers. Appraisers work with three methods or approaches to appraising a property's value. These include:

1. **Comparable sales approach.** Appraisers typically use this method for residential property. The bank's primary focus for residential properties is comparable sales. They want to see what sold in the area compared with the property you're buying. And they sometimes make the mistake of

looking at commercial real estate using this approach—but not often. As a matter of fact, commercial real estate is a whole different division of a bank. I challenge you to walk into Wells Fargo tomorrow and tell the loan officer, “Hi, I'd like to buy a commercial building.” They're going to tell you it's another division that deals with that, and here's the person you need to contact. And it’s usually not even in the bank. It's often a whole different division that handles it for an entire area or region.

2. **Revenue approach.** They usually use this method for commercial property. If a property is making $100,000 in revenue and it sold for $1 million, then if this other one is making $100,000 it should also be valued at $1 million. Your primary focus is to find out what the revenue is today versus what the revenue could be tomorrow. You are going to purchase the property based on what the revenue is today, but the value tomorrow is what you will make it. And if you can't make it, but you know it can be made, put it under contract and show it to other investors.

3. **Replacement value approach.** This method is usually used for insurance purposes, and it applies to all kinds of properties. Replacement value says, “If this property is demolished, destroyed, or completely gone, how much would it take per square foot to build a similar one?” If it will cost $100 per square foot to rebuild, and this property has 10,000 square feet, then the property is worth $1 million. Insurance companies often use this approach and will want a copy of your appraisal to determine the replacement cost.

We’re going to talk about a fourth method in **Chapter 5: Highest and Best Use: The Concept That Will Make You Millions!** My method. But for now, just know that these three valuation methods are why virtually no one else makes the kind of money my students and I do in real estate. They have limited their thinking.

I’m not completely discounting the three approaches for valuing property. They all have their place and exist for a reason. For example, the comparable sales approach works fine for residential. But it’s time for you to graduate from residential. And we’ll begin by looking at how to rezone residential to commercial.

Rezoning residential to commercial

Find a single-family home on a busy street. Go to the city planning office. Talk to them about rezoning the property into office space. My students do this successfully all the time in cities around the country. Why? Because single-family homes on busy streets are very desirable as office space—but not very desirable as homes.

Once it is approved, not only will you get better financing for that property, you’ll have better cash flow—and you can actually lease it for more per square foot.

Attorneys, doctors, insurance companies, and other professionals are interested in the location because they want the busy traffic, they want to put up signs, and they want to pull people in off the street.

The next step: Residential income-producing properties

Residential income properties are the next logical step as you move toward big-time commercial. These are the duplex, the three-plex, and the four-plex. A four-plex is either four units next to each other or two units underneath with two on top. Now the beauty about doing a duplex, three-plex, or four-plex is that you qualify for a residential loan, yet it's an income-producing property.

Let me repeat that. When you are purchasing a duplex, three-plex or four-plex, your loan is a *residential* loan as long as you're living there. That means the terms are better, with less down payment, a longer term, and easier qualifying requirements. You can live on one side and rent the other. That's a very good way to start with income-producing property.

Here's an example. You go to the bank and tell them you're earning a salary of $80,000 a year and you're buying a three-plex, where you plan to live in one of the units.

Then they will say, "You can put in a lower down payment because you're going to live in one of the units. And how much are the other two units renting for?"

Let's say a thousand a month. "Oh, a thousand a month? That means you don't make $80,000 a year, you make $80,000 a year plus $12,000,plus $12,000. That's an extra $24,000, minus a 5 percent vacancy factor. Well, now you are making over $100,000 and you can qualify for the loan."

So they actually add the property income to your income, and that helps you qualify.

Potential condo conversion

Let's say you want to convert the four-plex into four separate condo units and sell them. It's usually just a matter of going down to the city planning office and getting approval. But what if the city planning office does not want you to convert them? No problem. You can make it *tenants in common.* The city can't stop you from doing that.

You can go to an attorney with a drawing showing that this will be one property with four different owners—each one will own a portion. Ownership will be defined by Unit 1-A, 1-B, 2-A, and 2-B. Pretty simple.

By making it tenants in common you don't have to get the city's permission; you bypass the city altogether. We'll talk more about this later.

More about apartments

Let's say you have an apartment building you are considering buying, and the appraiser is comparing it to another one and telling you, "Look, you have eight units here and they have eight units. These properties are the same."

But you notice that the mix of units he is comparing it to is two-bedroom, one-bath; the one you are buying is two-bedroom, two-bath. Which one has a better mix of units? Your mix of units is way better than the other one.

So you point that out to the appraiser. You point it out to the bank. When you sell an apartment building, you say, "This is a $2.4 million building. It's $300,000 per unit, with eight units." Quote it per unit with a vacancy factor of the typical 5 percent. If it has a high vacancy rate, such as 20 percent, is that a potential opportunity for you? Yes it is, if you actually know how to promote the property and get some tenants.

In apartments, a lease is usually monthly, 12 months at a time. Do you want to rent to people 12 months at a time, or do you want to rent to corporations 10 years at a time? See the difference? That's why I'm not so crazy about apartments. But there is money to be made in apartments. It even spreads out your risk.

For instance, if you have an apartment building with eight units, and one tenant leaves, you still have seven units rented. Your building is less than 13 percent vacant. That’s better than if you have a single-family home rented and the tenant leaves. In that case, your house is 100 percent vacant.

The problem with apartment buildings is you can't pass on the expenses. The expenses are high, insurance is high, and maintenance is high. Apartments have extensive management, but large properties may let you afford to pay for that management. So as I have repeated, I am not crazy about apartment buildings. Nevertheless, I have made money on apartment buildings. In today’s market, sellers are desperate to get out.

It also depends on your location. A lot of people have been very successful buying apartment buildings in Texas, a huge, centralized location with plenty of businesses and corporate offices. In Texas and Colorado, you can get a lot of good deals.

Commercial has tremendous flexibility

A guy once sold me a building but wanted to stay in it to lease the office space. He needed cash. It was a great arrangement for both of us. He sold me the building and stayed as my tenant. The building contained a Chinese restaurant on the first floor with office space upstairs—a set-up called *mixed-use*.

There is so much flexibility in commercial. For instance, you can buy the whole building or just a floor. You can buy just a section on the floor or one office by itself. You can buy just the office and rent it. And if you are in business, you can buy an office and rent it from yourself. You can even get a better loan when you tell the bank that you are the owner/user.

By the way, a low-rise is one to seven stories. A midrise is eight to 24 stories. A high-rise is 25 stories or more. Of course, bigger is better. I like to get as big as I can. If you get a big office building, let's say 25 stories tall, you can separate the floors and sell each floor to tenants. And if you sell half of it, this will likely pay off your loan—and you’ll own the rest of the building free and clear. Isn’t that nice?

Maybe you own two of them free and clear. If that’s the case, get a credit line on those two. Now you actually have less to worry about, you have more money out, and you are able to work with all the profits. The rest is all positive cash flow for you.

A quick bit about air rights

Since we’re talking about tall buildings, now is a good time to discuss air rights. Whenever I do seminars in New York, I get a lot of questions about this.

Let’s say you own a well-positioned building and you want to increase the income you get from it. You are creative because you read my book or you came to one of my seminars. So you go out and find a company that will put a big billboard on the side of your building. Let’s say it’s Guess jeans, Tanqueray gin, or Chanel perfume. They are going to pay you $60,000 a year just to use the billboard to advertise. And they want to lease it for two years.

But let’s say the deal comes with a condition. Tanqueray tells you, “We're going to put the billboard up, but we need to make sure the building next-door doesn't build upwards, blocking the view. Then we’d be stuck with a billboard no one would see. And it would cost us money to remove the sign.”

They just want assurances that you own the air rights to the building next door. This is very common.

So you contact the owner of the other building and say, “I don't want you to build anything up there, and to ensure you don’t, I would like to purchase your air rights.”

They weren’t going to build anyway, so they say, “Okay, we will sell you the air rights for $50,000.” Would you pay $50,000 once to make 60,000 a year for several years? I guarantee you would! This is just a great example of how commercial real estate allows you to work smarter instead of harder.

More about air rights

Generally speaking, owning or renting land or a building gives one the right to use and develop the air rights. Air rights are one of the distinct three interests in a property—they can be bought, sold, leased, and transferred like the other two types of rights, which are *mineral* and *surface*.

Retail space with multiple tenants

The Verizon building we talked about earlier is an example of a single-tenant building. But you can also have a multi-tenant building. You see those everywhere. You might have a Seven-11 and a cellular phone company. Or a Seven-11, a laundromat, and a Subway sandwich shop. Those are multi-tenants.

You’re familiar with strip centers, malls and outlets. These are all multi-tenant retail buildings. Leases on these should be three years at the very minimum. If you have a lease that’s less than three years, the bank doesn't even consider it a lease.

Why do that when you can have a lease for five, 10 or 15 years—which big companies will gladly sign? They have a huge stake in this too, remember. If you are a big company, you want to establish your presence in the community and stay in one spot as long as possible.

Verizon doesn't want to leave; they want to be in business for a long time. Starbucks signs leases for 25 years. How would you like to have a company like Starbucks paying your lease?

How to spot good locations

Consider a strip of retail stores along a street with one unit on the corner that borders on a very busy street. All of the stores are doing good business. But the corner unit has much more exposure. That particular store is *way* more valuable than the one next-door.

The store next-door could lease for $30 per square foot and the corner location could be $35 per square foot. But they can appraise for almost the same. They are both rented at maybe $30 per square foot at this time. But you know something the original owner does not. You know something the appraiser doesn’t take into consideration. You know something the real estate agent didn't think about. And if you think I'm exaggerating, consider this. That measly $5 difference in price per square foot is almost a 20 percent difference in revenue, which results in a 20 percent increase in property value. That 20 percent can be yours.

Be observant: Notice the mix of tenants

I was vacationing in the Caribbean, and I came off the cruise ship and walked down the street, looking at the stores. Jewelry store … jewelry store … jewelry store … café … jewelry store … jewelry store … jewelry store. …

What's that café doing in the middle? I asked myself. That little café was selling sandwiches, but it was the business itself that was being sandwiched … in between a bunch of jewelry stores.

Do you think that café was paying high rent? Of course it was. And the owners couldn't afford it. Do you think someone could have bought that building and put a jewelry company there to create competition? A new tenant, such as Pacific Jewelers, Diamonds International or Colombian Emeralds?

Well someone did buy it … me! And I made a killing with that one deal just by looking at the mix of tenants.

What is a business cluster?

It's common to think similar businesses don't want to be anywhere close to each other. The opposite, in fact, is usually true.

Winemakers know the best wine starts with grapevines that were planted just close enough together to be forced to compete for nutrients in the soil. Stress causes the plants to put more energy into their reproductive processes, increasing the quantity and quality of the grapes.

Competing businesses located together in what are known as business clusters also have better results. Numerous studies show that on average, a business located in a cluster has a stronger growth and survival rate than those located outside it. The retailers feed off of the overall increased traffic, so everyone benefits. You often see this with fast food restaurants, jewelry stores, banks, clothing outlets, and furniture stores. In some areas, you can find entire streets of a particular type of retail tenant.

So first I got the building under contract. Then I went to him and said, "Hello, Mr. Tenant. I'm going to buy the building. If you want to lease, why don't you lease over there next to Starbucks, where there's a lot of traffic? If I get you off the lease sooner, will you be happy?"

He said, "Yes, space there would be better."

So I asked him, "How much deposit do you have? I will give you one more month free and you can keep your deposit."

He said, "In full?"

I said, "Yes, keep everything … just leave."

He left and he's happy. He's next to Starbucks. He's paying less rent. I bought the place and I got Colombian Emeralds to come look. The daughter of the owner flew out to check the location, and she leased the space for 15 years without batting an eye. We also agreed to a 10-year lease renewal with 3.5 percent escalations. She didn't even ask, she just said yes to everything I proposed.

It looked like this:

- The lease we agreed on is guaranteed by their entire network of stores.
- Escalations are 3.5 percent. (Asking for 3 percent is more customary.)
- It's triple net—they pay for everything except major structural issues.

There was very little negotiation. Later I thought to myself, "I should've asked for more!"

Types of commercial property

There are 12 kinds of commercial property that are worth considering if you're going to invest. I could write an entire book about each different type. If you want to focus on just one or two types, I encourage you to go to CMREI.com and register as an Elite member. Purchase one of my 12 DVDs, or get the whole set at a tremendous discount. These trainings go into detail on each commercial property type I discuss and provide you with the highest level of education you can get from the comfort of home.

1) Apartment buildings

If you're one of those people who would rather put your foot in the pool instead of doing a jackknife off the diving board into the deep end, let's get back to how you can graduate slowly from residential to commercial. The next step up the ladder from residential is apartment buildings with five units or more.

I'm not a big fan of apartment buildings because I don't like managing them. If I'm going to manage, I'd rather manage hotels. It's a lot more profitable. But apartment buildings are a big part of the business, and they can be very profitable for you. I'm not saying I haven't done them. I have.

And the beauty of having experience with apartments is that now you can tell the bank, "Look, I had a four-plex." That proves to them that you have experience with income-producing property. And now that you have experience, you qualify for the loan. Another benefit of apartment buildings is that you can do them nationwide. And the bigger the building, the easier it is to sustain the expenses of management.

2) Retail

Let's begin by looking at retail property. This book is primarily focused on retail. If you've ever been to one of my events, you know that my favorite type of commercial real estate is retail. I love it because I can work once and get paid over and over.

Retail properties are like the Puma store I mentioned, a 7-Eleven convenience store, or a company selling men's suits or ladies' bags. Those are retail buildings.

The risk is low because you can find national retailers to be your tenants. They'll provide you with rent guarantees. My favorite is the corporate guarantee. Think about having the mother company of a billion-dollar corporation guarantee your lease for 10, 20, or even 30 years. Talk about sleeping well at night!

Retail tenants sign triple-net leases almost exclusively. That means your tenant pays for the property taxes, insurance, maintenance, and utilities. That means as a retail landlord, you pay for almost nothing. All of a sudden you've got income, but no expenses.

Imagine the pride you'll feel when driving by the shopping center you own with a long-term national tenant … and the satisfaction you'll feel knowing that tenant holds a triple-net lease.

Retail properties are great, whether it's a single tenant or multi-tenant property such as a mini mall, strip mall with anchor tenant, or power mall with multiple anchor tenants. Why? Because consumers love to shop. That's why it doesn't matter where the market is going … when you have a good location and the right tenant, both you and your tenant will prosper.

3) Storage facilities

Have you ever considered a storage facility? Most storage facilities worldwide are located in the United States. That's because Americans have an incredible fascination with *stuff*! Even though Americans are transient by nature, they still want to maintain their personal possessions.

In addition, more people are renting homes today because of the recession. The burst of the housing bubble has made storage facilities more popular than ever.

A TV show called *Storage Wars* follows people as they sort through repossessed storage units. These fortune hunters are part gamblers and part detectives, and they find everything from coffins to comic books. The show is entertaining, but it completely misses the point. The "storage war" has already been won. And the winner is the savvy investor who owns the storage facility itself, not the one buying other people's left-behind junk. That investor can be you.

The fact is storage is the fastest-growing U.S. commercial real estate sector in the past 30 years. If you've ever wanted to invest in commercial, this is a largely recession-resistant opportunity with huge income potential. Here's why:

- Personal storage business has increased 65 percent in the past 15 years.
- Storage units are not expensive to build, maintain or manage.
- One in every 17 Americans rented one in 1995; one in every 10 rent one today.
- "Evicting" a non-paying tenant is easy, and you can even make money auctioning off what's left in the unit.
- Storage facilities offer many additional income opportunities for you.

If you want to own commercial real estate in a niche that's trending up, this could be a good time to cash in with a storage facility.

4) Hospitality

As you know, I got my start in the hotel business. That means I know quite a bit about hospitality real estate. Right this second, there is a huge vacancy in the commercial real estate market: A vacancy for investors just like you to come in and buy inexpensive hospitality properties and turn them into money.

As Americans began to travel again, hospitality profits are starting to climb. And despite the still-sluggish economy, the growing demand for business and leisure travel is expected to push prices higher.

It's important to know that hospitality real estate isn't just hotels and motels. It also includes resorts, marinas, condotels, executive apartments, hostels, bed and breakfasts, and extended-stay properties. Sometimes you can even combine them.

With hotels and motels, location and management contracts are important. Sometimes you can purchase a hotel property that already has a management contract with, say, Hilton or Days Inn. And they manage it for you. It makes your life a lot easier to have professional management.

Not only does this make it easy to manage, but when you are considering purchasing one, the company will give you a detailed profit and loss report (called a P&L statement). This lets you look at the deferred maintenance. Assuming there is deferred maintenance from the previous owner, since there usually is, you and Hilton will have to come to an agreement on what they will pay to fix and what you will fix.

Once you identify a deal with potential, the fun part begins. You bring in your knowledge, ambition and ingenuity and turn an underachiever into a goldmine.

For starters, you can begin profiting from any leftover inventory. Empty rooms are a waste. There are ways to fill them.

Then get to work increasing occupancy levels. Many hospitality property owners have *no clue* how to increase occupancy. They simply turn on the VACANCY sign.

In my Hospitality DVDs on CMREI.com I give you specifics on how to increase occupancy. To give you an idea, here are just three ways:

1. Connect to local businesses for special volume discounts.
2. If you have a resort, you can work with airlines to offer special deals.
3. Work with your competitors during peak periods.

Once you boost your occupancy, you can raise the value of your asset even higher. That means it’s time to maximize your revenue centers. In the industry, this is measured by RevPAR (revenue per available room).

There are large opportunities for income increases if you know the business. For instance, if you know how to manage a hotel or even an apartment building, and you can cut expenses by 5 percent and increase revenue by 5 percent, your cash flow just increased by 10 percent. And again, that means the value of the building increases by 10 percent.

If you bought the building for $5 million, a 10 percent increase in value is half a million dollars. Is half a million dollars worth six months of work? That's why there is a lot of money in hotels, motels and apartment buildings if you know what you're doing and want to focus on it. Because now it’s a business, not just real estate.

One additional strategy is to take a hotel/motel to its highest and best use by converting it to senior housing or assisted living. The potential for senior housing is tremendous and is getting ready to explode.

5) Senior housing and assisted living

Have you ever wished you could get in at the start of a trend and make a fortune from it? Right now, there is a can’t-miss trend that’s just getting started. And it’s going to continue for decades to come, no matter how the economy is doing.

Our country’s senior population is exploding as Baby Boomers hit retirement, and these residents need places to live. The demand for assisted living properties is going through the roof. Owning a retirement center or assisted living facility can be incredibly gratifying. You are providing a comfortable living for seniors in a pleasant environment—and bringing in significant monthly cash flow on the building. And right now—and for the foreseeable future—the supply for senior housing is dwindling and demand is spiking.

What kind of property do you want to own? With senior housing and assisted living, you aren’t just locked into one type of property. Some seniors prefer to live in communities where they are active and fully self-sufficient. On the other hand, elderly citizens sometimes need more care. Nursing homes can provide medical assistance and medication with doctors/nurses on staff. The shortage of every type of these is acute, and demand will only grow as our nation ages.

One downside is higher liability, so your insurance costs will be more. But so what? This is your chance to offer high-demand commercial real estate, and there are many creative ways to provide it. For instance, residential can be rezoned into senior housing—sometimes you don't even need to rezone—and hotels/motels can easily be converted.

The great thing about commercial real estate is that you provide the property for a business. And whether it's senior housing that's full of plush amenities or assisted living with no amenities, I suggest that you don't run the business itself. Just manage the real estate and collect your checks.

There are thousands of senior healthcare franchises that will be more than happy to lease your facility from you. You just get it ready for them. Right this second, nonprofit 501(c)(3)s, municipally owned facilities, and for-profit corporations need:

- Continuing-care retirement communities (CCRCs)
- Senior housing and independent living
- Assisted living
- Memory care
- Skilled nursing facilities, or nursing homes
- Transitional-care living

And no matter what the economy does, demand is only going to grow. It's your chance to be at the forefront of an emerging commercial real estate trend. And it doesn't matter what the economy does—no one can stop the aging of our population.

If you need further proof, consider these five trends in senior care:

1. One of every eight Americans is 65 or older. By 2030, it will be one out of every five.
2. About 80 percent of seniors currently have at least one chronic health condition, and 50 percent have at least two.
3. Currently, 1 million residents live in 36,000 facilities throughout the nation. Industry analysts project resident capacity to double by 2030.
4. Elderly care is experiencing substantial annual growth. By 2014, an 83 percent increase is predicted in government spending alone.
5. As seniors increase at a 2.3 percent rate, the number of family members available to care for them will go up only 0.8 percent.

Financing is another reason to get excited about this sector. Funding from the government is the cheapest and most attractive vehicle for senior housing. In fact, government financing has taken on even greater importance with recent changes in the Section 202 reform bill.

HUD is the dominant source of government financing available to you. It will lend for both construction and permanent loans. HUD offers favorable lending terms, including 35- or 40-year terms for senior housing. Additionally, they provide nonrecourse financing, up to 85 percent or 95 percent loan-to-value, at favorable interest rates.

Government grants, which you don't have to re-pay, are also available for the right project.

6) Raw land development

I'm not very fond of developing raw land. It involves a lot of headaches and can be incredibly risky. To convert raw land into something useful, you must get a parcel of property "construction-ready." You have to deal with permits and regulations. However, there's no denying that by doing this, you are adding tremendous value to the land. And you haven't even begun construction yet.

The key is to find the land's highest and best use. The highest and best use of land is simply deciding what type of building you'll be putting on it.

Is its best use housing? Commercial? Farming? Once you decide, you can work with the local municipality. Most cities are anxious to work with you because they want to grow. And you will be making the land more valuable and useful for a community.

But again … land development is not easy. The key is to get creative and engage the city to help you. To finance the project, you can issue bonds through the city where you will be building. This is how cities grow, neighborhoods evolve, and you make money.

You've likely heard the phrase, "If you build it, they will come." But in land development investors will come to you even if you *don't* build.

You see, after you purchase raw land, you don't need to build *anything*. You can just get the land construction-ready for someone else. Permits, regulations, zoning, surveying, subdividing and annexing are all part of this process. Perhaps you even go the extra mile by draining, filling, leveling, paving or installing the utilities. That's up to you and your vision for the property.

At this point, you can use one of three strategies:

1. **Flip the land.** Simply sell it to someone with an idea for construction.
2. **Do a joint venture.** Find a person or firm with money to fund it and another with the skills to develop it. After you do one successful joint venture, you can do it again and again with the same people.
3. **Begin building.** Follow through on your original construction plans.

The point is, you don't have to build to make money. You can do the initial legwork, sell the parcel, and take your profits.

It can be tremendously rewarding—and there's nothing like starting with a blank canvas—but there can be significant risk involved. One way to minimize the risk is to have an absorption study done. An absorption study will show you how quickly you can lease or sell your buildings once they are complete.

But if you have no experience, I don't recommend you jump right into full-on land development. In fact, I don't recommend it at all unless it's something you're just really passionate about. There are just too many buildings that have already been built that afford you plenty of ways to make money.

7) Eco-friendly

It doesn't matter what kind of commercial real estate you own. The eco-friendliness of your building needs to be considered. I identify "eco-friendly" as a *type* of commercial real estate, but it could just as easily be considered a *strategy* to apply to any type.

Being able to advertise your office, retail or apartment building as "green" attracts tenants. That's because they know waste is discouraged. Old building components are preserved and recycled, rather than discarded. Green buildings or rehabs are built with long-lasting materials that require low maintenance. They also contain energy-conscious materials such as recycled components and those with low toxicity to the environment.

While these choices may be more expensive initially, as a commercial investor, you will reap profits over the long term in cost savings and efficiencies in maintenance. Plus you'll rent your property quicker. New or retrofitted buildings are attractive to tenants because:

- Workers log fewer sick days, and employers receive fewer "sick building" complaints.
- Conservation and environmental awareness are trending up and are on everyone's mind.
- The cost savings in utilities can possibly be passed on to your tenants.

There are also tax incentives if you modify your property to meet certain qualifications. Those who make modifications seeking approval or a certain status from the Leadership in Energy and Environmental Design (LEED) program may also qualify for significant tax bonuses and incentives as well. This is especially true if you own larger buildings because you have more to offer by making environment-friendly modifications to them.

There is also a tax credit, commonly called the Commercial Building Tax Deduction, of up to $1.80 per square foot for commercial building owners who adhere to certain standards. To receive the credit, you must save at least half of the heating, cooling, ventilation, water heating and interior lighting energy cost of your building.

There is also a $.60 per square foot tax credit in place if you make improvements to one of your three building systems and improve the efficiency of the building. The percentages vary, but it involves reducing total heating, cooling, ventilation, water heating and interior lighting energy. Visit www.EnergyStar.gov for more information.

"Green" is here to stay. And where it makes financial sense, it's a great thing.

8) Office buildings

Office space is defined as real estate where commercial or government business is conducted. The premises may be used up to 24 hours a day, but people do not sleep at the property. There are different classes of office buildings, rated by the Building Owners and Managers Association: Class A, Class B, and Class C. Buildings with Class A space charge higher rents because the space is more desirable, with high-end décor, prestigious locations, and better views. Class C space is more no-frills and aimed at tenants who want a lower-than average rent. Class B, of course, falls somewhere in between.

As always, the big money is in taking your property to its highest and best use. This maximizes the value of your investment, immediately earning you a huge chunk of equity. A few of those techniques include adding:

- Executive suites: corporate living area, meeting room/office
- Office suites: rented for meetings and conferences
- A day-care center or gym
- Solar on the roof
- Green building components
- Restaurant (Class A), deli (Class B), or vending machines (Class C)
- Billboard/ads

- Paid/valet parking
- Record retention service
- Computer backup and Wi-Fi

Believe it or not, now is a good time to find favorable deals on office buildings and lease them for positive cash flow. Several industries are expanding and need desirable, well-managed office space. Financial services, insurance, and real estate companies account for roughly 22 percent of all U.S. office space occupancies, the largest segment in the entire office sector. Service companies, including those in technology, take the second spot at 14 percent.

Do you have financial services, insurance, real estate, and technology companies where you live? Of course you do!

And that's not all. Poorly managed properties are easy to find. You can get these buildings inexpensively and quickly turn around their performance, thus increasing their value. When you combine these dynamics with an approaching office sector rebound, you have a formula for serious profit potential.

Executive offices are very big right now. A lot of people don't want to pay rent—they want to buy. So get a building and sell executive offices to them at a profit.

Right now, where I live in Silicon Valley, you can get some fairly good deals with office buildings. But you have to know about the different classes. Class C properties are often run-down and not up-to-date. Class B properties are okay, but they're often a little bit removed from the "main drag," so to speak—the area where you find the most activity. Then you have Class A buildings. These are in the best locations, are the most updated, and attract the best tenants.

Let's say tomorrow you are driving on the freeway and you see a building with a big sign that says "For Sale." And you see another building a little further back, but it's a little bigger and a little better. And it says, "Great deal, must sell."

You go and take a look at both and you find out they're both almost the same price. The one off the freeway is a little bigger, however. It's just not as conspicuous to passers-by. Which one do you think has the potential to make you more money? The bigger one, or the one on the freeway?

The answer is: The bigger one. Can you put a sign on top? It's a possibility. So you put it under contract and say in the contract, "Condition of purchase: City planning and zoning office to approve signage changes required by new owner." And then you simply go to the city and ask..

If city planning/zoning agrees—or if they say yes, but limit the size of the signage—you still have a building and you can increase its revenue. And if you increase its revenue, it increases in value. If you increase its value, do you sell it? No, refinance and keep it. I recommend you never sell unless your money can be used for something bigger or better that will increase faster.

Use "the flinch" when negotiating

Early in my career, I was selling a duplex. I listed it for sale with flexible terms but left the price off the ad so it would fit into three lines of newsprint. The price I wanted was $300,000. A guy who was interested called me and we agree to meet at the property. After looking it over, he said, "We checked the comparable sales and we are going to make you one offer. Take it or leave it."

"Okay," I said. "Go ahead."

"I'll pay you $325,000."

His offer caught me off guard and I flinched. In fact, I was so surprised, I repeated his offer out loud: "$325,000?"

But what he did next threw me off even more.

"All right, I will make it $335,000. But that's the highest I can go. Final offer," he stated emphatically.

I have been flinching ever since. After all, I made $10,000 more just for being surprised! Now I act surprised all the time. And not just with real estate. When I go to Starbucks and they give me the price for coffee, I flinch. It's a running joke we have. (It does not work at Starbucks, by the way.)

I even learned how to "flinch" when I'm on the phone with a real estate agent. I just do it verbally with an audible "ahhhh." Or I just say, "Oh my God, so much?" From there, you can go back and forth and hopefully negotiate a better deal for yourself. Because even when people tell you they are at the maximum range of their offer, they rarely are quoting their highest figure.

There are even degrees for the flinch. My wife is very shy and not overly dramatic. It took me a long time to persuade her just to try doing the **simple flinch**. The simple flinch is just a little facial twitch that shows the other party you aren't 100 percent pleased with the offer you just heard.

I'm trying to move her up to the **disoriented flinch**. This is the one that makes you look so disoriented by the current proposal that you can't even think straight.

But the ultimate is the **painful flinch**. This is for serious negotiations only. The goal of the painful flinch is to use an angry facial expression, cock your head to the side, and make it look like the other party has literally insulted you with the latest offer.

Let's say someone makes you an offer of $790,000 on a building you're selling. And you are delighted with that price. But you have to flinch. "790! What?" Treat it like it's an insult.

Then you pause. You wait. The pressure is on the other person, and he'll usually respond by saying something like, "Well, you see, I'm offering you 790 because, well, I tell you what… 795."

You just made $5,000 for flinching.

But let's look at it in reverse. At some point you will have the flinch done to you. How do you respond when the other party is doing the flinching? Let's say you are the one making the offer at $790,000. And the person flinches at you.

"$790,000?" he says.

So you say, "I knew you'd be surprised. It's a great offer, isn't it?"

I just used this tactic when buying a three-story office building. The seller wanted $2.8 million. I walked in and said, "Hi, thank you for coming. Why don't we go over to that café where we can sit down and talk?"

Well, this guy was a big developer, and he said, "No, make me the offer right here, right now."

I said, “$2,550,000.”

“$2,550,000?!” he snorted.

“You are happily surprised aren’t you?” and I put on a big smile. “So let’s go have lunch and celebrate.”

He looked at me like I had lost my mind. But he didn’t say no. Instead he said, “Let me think for a moment.”

I’m only good at the flinch, not great. But all you need to be is average to make millions in commercial real estate. I can't tell you how much extra money I have made by just flinching. It’s not hypnotism or a Jedi mind trick. You’re just using a negotiating tactic to find the maximum of the other party’s price range. But you must train yourself to do it no matter what kind of offer you get.

9) Mobile home and RV parks

One often-overlooked type of commercial real estate is mobile home and RV parks. For some investors, these may not seem particularly glamorous. But those who own these types of real estate and manage them correctly are more than happy to keep this property type a secret—and have all the profits to themselves.

A mobile home park is a subdivision of plots designed for sitting mobile/manufactured homes. For your tenants, it’s a great alternative to owning a home or even renting an apartment.

As the owner of the park, you rent plots to the mobile home owners, giving them a sense of ownership. Typically, they own the mobile home, but not the land. In exchange for their rent, the residents get access to utilities and amenities.

RV facilities and campgrounds are different from mobile home parks. Travelers generally park their RVs for a few days or weeks as opposed to setting up a permanent residence.

Between the two, mobile home parks are generally better moneymakers. You can typically enjoy a cap rate of 7 percent to 13 percent. Plus, defaults are currently lower for people buying manufactured/mobile homes.

And not every mobile home park is the same. As an owner, you can have specialized parks that cater to low-income buyers, vacationers, and even retirees. As the demand for senior housing soars, there will be incredible opportunity in mobile homes.

You can customize your park to people on vacation or “snowbirds” who only live there half the year. Some parks even convert their spaces to a timeshare-type ownership.

Amenities vary as well. They are a great way to add value to your community and attract more tenants and might include these:

- Swimming pool
- Clubhouse and game room
- Shuffleboard court
- Tennis court

Specialized financing is available for this property type. For example, the Department of Agriculture offers very attractive financing in rural areas. Creative financing is also common in mobile home park purchases.

This is one of the best-kept secrets in commercial real estate. And just as I touched on with senior care, this sector is a trend on the rise. With families downsizing (mobile/manufactured home parks) and baby boomers retiring (RV parks/campgrounds), you could do very well in this niche if you were so inclined.

10) Parking garages

There's only so much space in the city. This creates demand for additional parking. But there are parking challenges in the suburbs, too. Suburban office buildings, hospitals and medical plazas also have parking issues.

Welcome to the world of parking garages, a very unique niche of commercial real estate. Consider that:

- There are 240 million cars registered in the United States. Paid parking is a huge business.
- Buying and selling parking spaces is relatively simple and hassle-free.
- Maintaining parking garages is easy.
- Operating parking garages can be done through third-party companies.
- Eviction is easy; delinquent leasers are simply not permitted access.
- Paid parking is a great way to use land and produce cash flow until it is time to develop, such as in a downtown location.
- Many cities are eliminating the minimum required number of parking spaces for condominium developments to promote mass transit—which boosts parking leases and sales.

Added revenue potential is almost unlimited. There are dozens of ways to increase the value of your parking garage investment. Here are some examples of how you can take your asset to its highest and best use:

- Secure corporate parking accounts.
- Combine monthly parking with daily/weekly.
- Offer auto detailing and/or oil change services.
- Install automated parking.
- Add a deli or convenience store.
- Install vending machines.
- Offer car condos for sale or lease.
- Charge customers for advertising signage.
- Offer bicycle rental.
- Install accommodations for electric cars.

This is an investment I recommend you absolutely hire someone to manage. Simply choose a management company to operate everything and handle all the day-to-day hassles for you. A parking garage is the ultimate commercial property for an absentee owner. Many parking garage owners just use remote surveillance over the Internet if they want to check in on their investment from afar.

11) Gas stations

Americans love convenience. They will even pay extra for it. One of our biggest conveniences is self-serve gasoline. And because Americans love their cars, they will readily pay whatever you are charging at the pump.

But the best part about owning a gas station is not refueling the cars. It's about refueling the people inside them.

You see, gas stations are a retail facility ownership opportunity where you can make money in all sorts of ways. For instance, your gas station can also be complemented with additional profit centers such as advertising, ATMs, a car wash, detailing, a convenience store, and other uses.

When you own a gas station, you can contract out the different services to third parties and handle your real estate from a distance. Here are some ideas you could do with a gas station:

- Lease to a large oil company.
- Lease the convenience store.
- Advertise for others and make that a profit center.
- Lease and then sublease (sandwich leasing).

When it comes to a gas station, the key is to work *on* your business, not *in* your business. Once you get it set up, and perhaps scale it larger, you'll make money from the cash flow and the upside. Then it's up to you to decide whether to hold onto it for cash flow or sell it for a nice payday.

12) Warehouse and industrial

A lot of people make good money in this sector. This unique property type is defined by commercial buildings that are used for the production, storage, import/export, or distribution of goods. Quite often, warehouses and industrial buildings contain loading docks, high roofs and reinforced floors to facilitate manufacturing and distribution.

Industrial property and warehouses sell and lease *per foot*. It's user-specific. If Sun Microsystems wants to have an assembly line somewhere next to the airport, that's a warehouse. You can buy it and lease it to the company. Size is important. The potential tenant will tell you, "We need 50,000 square feet (or whatever it is)."

And the beautiful part about industrial is your tenants will do practically everything to get the property ready. The tenants will come in and fix the building, take care of the roof, and put up signs. If they want to alter it, *they* get the permission from the city. Not you.

Large manufacturing works very well. With long-term users, the tenants pay for most of the modifications. They literally take the building as is, where is and do everything. All they might ask of you is to sign off on any requirements by the city, since you're the owner.

You'll need to take several things into consideration when investing in this property type, such as:

1. Location to specific areas and natural resources
2. Proximity to importers/exporters
3. Governing laws for protection and waste
4. Nearby highways, airports and rail systems

Ponder this: What about warehouses and small businesses? Suppose someone wants to run his own business like the gentleman I talked to with the laundromat. Can he buy a building like the Verizon building and put his laundromat in it? Of course he can. Now he creates a corporation for the business that pays for the LLC that owns the building. So you can have your own business *and* your own building.

But you could also go the other way and put the building far away from retail areas. Frequently, undesirable areas can be great for this type of property. Noisy traffic areas, airport flight paths, and remote locations that aren't ideal for housing, retail, office or hospitality are perfect for warehouse and industrial buildings.

There is also quite a bit of flexibility if you want to modify this property type. Because industrial buildings and warehouses have simple, inexpensive construction, you can convert their use easily. And maintenance? It's practically non-existent. What's to maintain?

But if that's a concern, you can even find tenants who will sign triple-net leases and do the maintenance themselves.

Here are other reasons this property type is desirable:

- Triple-net leases with escalations are common.
- You can often find large tenants who will give you corporate rent guarantees.
- You can lease an industrial park for a long term.
- Use some of the space for your business and rent out the rest.
- It's easy for you to manage from a distance.
- It can be easily converted to retail, an exhibition center, a flea market or numerous other uses that would make sense..
- There are frequently local and state tax benefits for businesses using warehouses.
- Purchase isn't necessary. You can lease and sublease in a sandwich lease.
- You can build very inexpensively using steel structures, and even buy prefabricated warehouses

Imagine having a triple-net investment with no maintenance hassles that you can manage from a distance with a stable, long-term tenant who even gives you a rent guarantee.

Just one building like this can make a huge difference in your finances. One deal could set you free. But what if you had two, three or four?

There are a dozen different types of commercial real estate. It's all around you. And you can create financial magic with any of these.

I used to get specific questions from students about specific property types. That's why I created a training called the Commercial Real Estate Roundtable (CRERT). The training format was very different from anything I'd ever done. I held a roundtable discussion and invited students of mine with experience in different property types to join me, along with some rookies..

Interactive learning

I've always tried to incorporate activities into my trainings. The Roundtable event was the ultimate interactive learning. Instead of just being given the information, attendees researched some of the steps online. It really helped each student/investor learn more about the investing process, and we all benefitted as a result.

Present at the meeting were investors representing apartment buildings, gas stations, retail centers, hotels, office buildings, mobile homes parks, and assisted living facilities. For three days, I led the discussion while we covered all 12 types of commercial real estate in a roundtable forum. The result was productive and enlightening.

12 property types

1. Apartment buildings: duplex, triplex, four-plex and large multifamily
2. Storage facilities: personal belongings, business, boats, RVs
3. Hospitality: hotels, motels, resorts, marinas, timeshare
4. Land development
5. Eco-friendly commercial real estate
6. Retail: strip malls, single tenant, shopping malls
7. Office: executive, medical, government
8. Senior housing and assisted living facilities
9. Mobile homes parks and RV facilities
10. Warehouses and industrial
11. Parking garages
12. Gas stations

I got such great feedback on the event that I started holding one every month around the country. If you'd like to purchase the training on DVD, or attend the event in person, visit CMREI.com. These 12 stand-alone DVDs provide you with the highest level of training you can get from the comfort of home. Each DVD is professionally produced, and provides advanced-level training for every identifiable commercial property type.

Imagine the wealth of knowledge you will possess after learning about every single type of commercial real estate. No one has ever put together education like this. I encourage you to check it out. It will greatly supplement the commercial real estate foundation you are getting from this book.

Chapter 4:
How to Produce an Immediate Profit

In Chapter 5, you are going to see why I make so much money in commercial. I use a concept called "highest and best use." But there are important things we need to cover here in Chapter 4 first.

After all, when it comes to making money in commercial real estate, some strategies take a while to turn a profit. Appreciation takes time. Getting rid of a tenant for a better one sometimes takes time. Other techniques take varying amounts of time depending on the particulars of a deal.

But you don't always have to wait to work your financial magic on a property. Let me introduce you to several strategies for increasing value and locking in serious profits that can happen rather quickly.

Buy below market value

The No. 1 way to make money with commercial—or residential, for that matter—is to get a property below market value. If the area is selling at "$X," buy it below that price.

For instance, let's say we have a bunch of similar buildings in the same area and one is a 20-unit apartment building that's selling for $4 million. And let's say we have another 20 units selling for $4 million next to it, and another 20 units across the street for the same amount. So the whole area has plenty of apartment buildings and the seller tells you, "Listen, I'm going to retire. I don't need the headaches anymore. My building has a couple of vacancies and there are a couple of repairs needed. I want to sell it—make me an offer."

So you start by making him an offer at $3.5 million. And he responds with, "I'll take it if you can close quickly." Now, that's an acquisition below market price. Does it happen every day? Not necessarily. When you're in the market making offers, will it happen to you? You bet.

You know you're getting a good deal on residential real estate if you use the same concept. You have comparable homes selling for $400,000, but you buy from a desperate seller who wants out at $350,000. You just got a property below market value.

Now when you write a contract to purchase commercial property, they will check the revenue of other comparable buildings. So you'll get a sales comparison showing (per square foot) how much others are selling for. (Hopefully, this number will show that yours is a little bit better price.) If you don't have the down payment needed to purchase, you can always assign the deal to somebody else.

Let's say an investor friend we'll call Brenda tells you, "I've got some money. I'm looking for an apartment building with potential." And you say, "Brenda, I've got a deal under contract for $3.5 million. The whole area here just sold recently for $4 million. I'll assign it to you." Brenda will likely give you $50,000 or $100,000 for that assignment.

Did she get a good deal at $3.6 million? Absolutely.

What if at some point the seller realizes, "That's funny, I wrote the contract with you but she's going to be the one buying it." Can he change his mind? No. He signed, he accepted certain terms and conditions—

and he has to move forward and make it happen. So as you can see, you have many powerful options when you get a deal below market value.

Obtain the best long-term financing

Want to know another good strategy to make money? Obtain a good loan and patiently wait for appreciation to take its course and positively impact the property value. There's nothing complicated about this. It's just taking advantage of long-term appreciation.

Let's say you did not find a $3.5 million property. You just bought one at $4 million while the one next-door is also selling for $4 million. But you got financing so sweet, that instead of 15 or 20 years, you got financing for 30 years on this apartment building when they usually lend for a *maximum* of 25 years.

It's a local lender, and they want to get more aggressive in that neighborhood because it's close to the college and they are willing to go 30 years when all the others banks are at 25. That's a bank that has a special program. So you get the loan with a lower down payment, they allow the seller to carry back a note, and they fix the interest rate for the first 10 years. And do you know what you do with commercial residential real estate and apartment buildings? You increase the rent.

Do tenants expect the rent to increase every year? Yes, they do. And if you don't increase the rent by 3 percent for one of the tenants because you're afraid, are you losing money? Yes. Can you make it up next year by increasing it 6 percent? You may, but it will likely upset the tenant.

But if you raise the rent by a steady 3 percent, you are happy, the tenants are content, and you are meeting their expectations. Financing a property well and holding onto it is one of the best strategies to make money long-term.

Three additional points

I want to mention three other important things to consider when valuing property to make serious money. These also highlight why commercial is better than residential. You should also pay attention to:

- Current inventory vs. local demand.
- Market trend direction.
- Property evaluation.

Current inventory vs. local demand

You should always consider a property's history of days on market (DOM). Let's look at a residential scenario, and I will round the numbers. I had a student who recently sent me an email that read, "Cherif, I found this property for $400,000. Houses similar to this one, in the same subdivision, sold for $480,000 to $490,000. This property appraised a few months ago at $480,000. The guy wants to sell at 400,000. Should I buy it?"

I wrote back, "What are you going to do with it?"

He said, "I want to sell it quickly."

"Give me the ZIP code."

The house was in a small subdivision in Riverside, Calif. A private owner was selling it. He was desperate and wanted out. And the student is telling me he wanted to buy it because it was $80,000 below-market. Yet when I looked at the inventory, there were many properties for sale in the area, and they were all around $400,000. Most of the sellers were willing to discount.

So when a new buyer comes in, like this student, and he wants to turn around and sell it quickly, he has to offer creative financing and easy terms to attract buyers. But too much inventory affects the value. That's the first step to disaster for residential real estate. The sellers play the game like a Mexican standoff. And someone always panics and shoots first.

One will become desperate enough to drop his price. So when this student takes advantage of this and buys now at $400,000, the sale will show up in the MLS. Now these three remaining sellers say, "Oh my God, I'd better sell fast; I'll drop my price to $390,000."

Then the next seller says, "I'm really going to lose everything. I'll go $380,000."

And the real estate agent is going to tell this person, "Listen you need to sell fast. I need to make my commission. You need to sell quickly. The guy right next-door to you just sold, so you need to talk to your wife and you need to make a decision. You guys need to bail out. I'll get the most I can for it at this point."

Meanwhile, you finish fixing up the property, and when you go to sell it, you find out that everything there has dropped in price.

But let's change the scenario. What if there had been nothing else for sale in that neighborhood? What if that area has limited inventory, and you pay $400,000 and you want to put it up for sale at $500,000 with easy terms? The people looking in the neighborhood need to find a house. When they see your sign or they see your ad, they come running. Now they are bidding against each other. Local demand and inventory are key.

Apartment buildings that are for sale fall under the same scenario. If there are too many apartment buildings, somebody is going to have to drop the price. So if there are many sales in your area, here is what you should do. Submit the offer to three or four properties simultaneously with a cover sheet on each one that says, "This offer is submitted simultaneously with several other offers. After the first offer is accepted, all other offers will be hereby rescinded."

Now you've created a frenzy with the sellers. And the Mexican standoff ends when the most desperate seller accepts. But remember: I'm not buying commercial property to sell it—I'm buying it to find tenants, lease it, appraise it, and refinance it. Do you see the point now? You can use this to your advantage when it's commercial. But it can work to your disadvantage if it's residential.

Market trend direction

You always want to know what's happening to the market trend. (One thing I discuss on CMREI.com is market trends.) You want to know what is happening in the short-term versus long-term. What are the expectations? Is there a good market here for apartment buildings? Are there a lot of vacancy signs? Are people moving out because they lost their jobs or got laid off?

If the interest rate is going up, the value of income-producing property rises because fewer people can afford to finance their own home—more people want to rent. And if more people want to rent, you raise the rental revenue. And when your rental revenue goes up, the value of your building goes up.

So now that the rental revenue for your building is going up and the actual demand for rentals is increasing, the value is increasing. When you have apartment buildings and the interest rate increases, it works to your advantage. But it works to the disadvantage of the residential real estate market.

So why should you want to be in commercial? Because when the market goes up you make money, when the market goes down you make money, and when the market stays the same you make money. When you wake up, you're making money. When you go to sleep, you're making money. When you die, God forbid, you'll still be making money.

Property evaluation

What is the potential of property in a particular location? That's what is called an "improvement *pro forma*." What are you looking for? You want a property that is going to be able to make money when you have it at the highest and best use. Can you change that café to a jewelry store? Can you change the antique shop to a Verizon store? Can you change a few features and get Puma as a tenant instead of a little guy selling rugs?

A couple of years ago I was at a getaway called Olympia Resort, just having a conversation with a nice gentleman I met there. He was telling me about a city called Oconomowoc, Wis. Oconomowoc is in Waukesha County—a very nice place with a lot of lakes. This guy had a property on a small street in a small town with a lot of little stores. And Wal-Mart was coming in.

He told me, "I was very disappointed because I had my shop and the building next-door. I rented one and I put my business in the other. I've been here for 20 years. Wal-Mart came in and killed me. All these big players are coming in and killing us."

"How big is the space here?" I asked. He told me the space of both stores together was 15,000 square feet. So I said, "I know tenants who will come and rent 15,000 square feet."

"What kind of tenant would take that?" he asked.

I replied, "The big companies you are complaining about!"

"You are kidding me!"

"No, I'm not," I told him. "There is a company called Guitar Center. They would love to come to the Midwest. I know the broker because I was talking to him about leasing another place that I have."

So he called the broker and the broker said, "Send me pictures, send me this, send me that." Then they got an OK from the city to break the wall in the middle. Guitar Center came in and signed a lease for $15,000 a month.

In his 20 years of business, this guy never saw $15,000 in one month. Now he sits home and laughs about the big companies, which he previously thought had yanked him out of a job. Today his job is to travel the world with his wife or stay home and go fishing in the lakes of Oconomowoc.

Now don't get me wrong. I'm not telling you not to work. Just work on something that makes sense. As a matter of fact, life is most wonderful when you find something worth working hard for. Work smart, *then* work hard. The potential of a property is the biggest challenge and the biggest opportunity in real estate. And once you crack that code, you will understand when and where to spend your time, effort and money.

Increasing value with a renovation

I had a three-bedroom, one-bath in Burlingame, Calif., that was selling for about $700,000. Yet a four-bedroom, two-bath in Burlingame sells for a little less than $1 million. (It's the same in other parts of the country, including Santa Monica, Miami and other nice areas.)

Now, if you take a three-bedroom, one-bath and add a master bedroom/bath, the property becomes a four-bedroom, two-bath. But more importantly, it becomes more valuable. And it costs about $100,000 to add a master bedroom/bath. Is that too much money? Let's look.

Say I have holding costs and closing costs equal to $50,000. That means your total investment is $850,000—yet your property will be worth close to $1 million. Is it worth working four or five months to make $150,000?

A contractor told me about one of these deals on a street called Hunt Drive in Burlingame. I went to city planning and I asked, "Can I add a master bedroom?"

They said, "Yes. You just need to submit these plans and get that permit,"

It sounded great, and then I realized I didn't want to deal with all the plans, permits and construction. So I called around and found a contractor who would partner up with me. I said, "Look, if you add the master bedroom at your cost, I'll make the payments in the meantime—then we'll sell it and split the profits."

When I first called him, he said it was going to take four months and cost $100,000. Well, I got him to finish the job in two months and we each walked away with about $80,000. How would you like to earn $80,000 in a little over two months?

Split the lot

Since we're still talking about residential, here's a highest and best use strategy to consider for single-family homes. A student in Orlando came to my seminar and listened to me. She told me, "I've got a lakefront property on a large lot that I paid $700,000 for. I'm barely making the payments. It's just too much work for me. I'm working two jobs and I'm afraid to lose the property because it's beautiful and it was my dream home."

I asked her, "Can you live with half the size of the lot?" She replied that she could. So I suggested, "Go to the city planning office and ask them if you can split it into two lots."

They said yes and she sold one side, as an empty lot, for $700,000.

Even if she'd only sold the land for $350,000, she would still have a lakefront property with a building. So her side could be worth, what? $500,000? Can she now refinance it and cash out some money? Or have a credit line just in case she wants to do other things? Sure she can. So the next time you see a large lot, start thinking creatively.

Rezone residential into commercial

This technique is so good I want to cover it again. To rezone a property, you simply need to go to the city planning office where the property is located. And then ask. It's no major deal. You don't have to have a genius IQ or be a certain height or weight. You don’t have to know somebody. You don't have to lift anything. Just go there and talk to them. Anyone can do this. *Including you.*

Remember the property I mentioned earlier that was on the corner of a busy street? Once I put it under contract, I went to city planning. I took a number, stood in line, and they called me.

So I stepped up and said, “Hi, I have a property under contract, it's on the corner of McGee Avenue and Scott Boulevard.”

The guy looked it up and said, “Okay, what do you want to do?”

I said, “I need to know if I can rezone it from single-family residential to office space commercial.” He was gone 45 minutes and then he came back and said, “Yes you can rezone it because you have enough parking spaces on the side.”

That was an exciting moment for me. I had delayed the closing as long as I could. I bought it at full market value for $550,000. Then I got it rezoned and it appraised at $715,000. So I called the Realtor and said, “Yes, we are closing!”

While we were waiting to close, I immediately put a sign out by the busy street. Farmers Insurance Co. wanted to put its sign there ... so did some massage therapists … and a dentist.

Note: Think about it … the Realtors couldn't sell this house for the life of them because there was so much traffic. When you walk onto the property, there's nothing but traffic; when you wake up in the morning, you can’t relax. As a residence, it was not very appealing. But as an office building—as a business—it’s ideal.

When I closed, I bought it for $650,000 and got $100,000 cash at closing. It appraised for $715,000. *All because I rezoned.*

So you just need to think and look. There is a condition worse than blindness—and that’s looking at one thing but seeing something else. That condition occurs to those who are untrained, unqualified, and only have a dream. But reality is right in front of them, and it’s sweeter than any dream. They just refuse to see it.

Here’s an example: I saw a house across the street after I purchased this property. It was an identical home built by the same builder 60 years earlier. And I went to the owner and tried to buy it from him, but he did not want to sell. He had renters paying him $2,000 a month while I was across the street making a $4,800 positive cash flow. And you know why he didn't want to sell? Because, he said, “Property is increasing in value in California. In 10 years, it's going to double.”

My goodness, in four months he could make $200,000. But he wanted to wait 10 years. Do you see how his thinking was untrained? He was going to hold that house, experience a bunch of headaches, and work harder instead of smarter. You’ll encounter people like that. And you can't change them.

I ended up leasing my space to attorneys. Three divorce lawyers wanted to put up a sign and have a big space for their practice. As you can imagine, divorce lawyers do very well in California.

I almost purchased the one across the street, too. I was going to rent to this matchmaking service called Great Expectations. I figured they’d meet and get married through Great Expectations … and since there is a 50 percent chance of divorce, then they could go to the lawyers across the street. I'd be helping both businesses. My tenants would love me.

Conversions into condos

We talked about this before, but I want to give more examples. A student of mine in Modesto, Calif., bought a four-plex for market value at $900,000. Once she heard all my ideas for improving value, she sent me an email. It said, "Cherif, I took your advice. I went to city planning and zoning, showed them the apartment, and they allowed me to split the utilities. I split the utilities—so now the water, electric, and gas meters have all been separated. It cost me about $8,000 or $9,000. But each unit has its own meter. Then we submitted the paperwork and now, instead of one deed, I have four separate deeds. I have four condominiums that I can sell separately."

With the condominiums separated, she was able to sell them with easy terms at $500,000 each. That was a pretty nice deal for her.

She sent me a follow-up email. It said, "Cherif, this is great! The entire process took me six months. I'm going to sell it for $2 million, pay off my $900,000 debt plus the cost of conversion, pay whatever taxes I have to, and walk away with $1 million profit!"

The tax on this (after a year) will be 15 percent in capital gains. But I knew she was semi-retired. I figured she and her husband could live in one and keep another one to rent right next-door.

So I responded by saying, "That would be great, but I'll tell you what's even better. Why not sell the two units upstairs, keep one, and rent the fourth? Would that make sense for you and your husband?"

She responded, "That's a great idea. I'm giving the two people upstairs easy terms—I'm going to carry a note. They got a loan to cash me out, which pays off all my debt. At that point, I'll have a condo rented free and clear, bringing me income to pay for all of my basic expenses, car insurance, electric, telephone, etc." It was a great scenario for her.

But here's what ended up happening: They lived in one, rented the other, and got a credit line on the other two. Getting a credit line (home equity line of credit) is not as easy as it was five or 10 years ago. But you can still get one with enough equity. Anyway, her unit is worth $500,000 and the other is worth $500,000. She secured a credit line for 800,000.

Then she went out and found a property with a desperate seller who said, "Listen, my property is worth $900,000. I need $850,000 and I'm out."

"I tell you what," she said. "I will write you a check and in four days I can close, but the check has to be for $800,000. I don't have to go to banks. I don't have to get appraisals. I don't have to get anything. I'll give you $800,000 and you can be free of your problem."

Do you think that seller took her seriously when she said that? See how you can get a better deal when you have cash?

Note: You'll notice that many of my real-life examples of residential real estate conversions are from California, but you can apply these strategies anywhere in the country … the Midwest, the South, and the Northeast.

Creative thinking can make you money in any situation

A student of mine bought a three-plex close to Market Street in San Francisco for $700,000. It was a pretty good deal when he bought it—was actually a steal of a deal. But he was too anxious and did not do his due diligence before buying. He bought it based on one requirement: to be able to split it into condos.

Due diligence

This is the period after you sign a contract when you do your homework to see if what you think you can do is going to be approved and can be done.

But when my student with the three-plex went to the city planning office, they said, “Sir, you are dreaming. We will not give you the OK to put condos here.”

He was very disheartened and sent me an email saying, “Cherif, I am very frustrated. The broker told me I could do whatever I wanted with this property. Can I sue the broker or the city?”

I said, “Don't sue anybody. Why spend the negative energy? Think creatively. There is something called tenants in common (TIC). Go to a real estate attorney to write the paperwork for you—and the paperwork will allow you to own the property like a company that has shares you can sell separately.”

Here’s what it looks like: Your first buyer goes to the bank and buys Unit 3A. Your second buyer goes to her bank and buys Unit 2A. Your third buyer purchases Unit 1A. They don't have anything to do with each other—they just go and get the paperwork from your attorney that specifies which unit they’re buying.

There are specific banks that do these loans. In today’s economy, I encourage people to work with a smaller community bank that feels more comfortable lending locally.

Any one of those buyers can sell his or her unit separately. There are also some association fees, just like condos charge, for work that has to be done on the common areas. The value of TICs is typically 15 percent to 20 percent less than condos.

As condos, they were going to sell at $400,000 each. As TICs, he could sell them at roughly $350,000 each. This is still a great return. Selling two of them pays off the loan. The third one is totally free and clear.

If you were the one doing this, you could sell two and keep one. Or you could sell three and get some money. If you purposely took longer than a year to complete the process and sell them, your capital gains taxes would be lower because your profits would be considered long-term capital gains.

Let’s keep thinking creatively. Let’s say one of the units had a tenant in it and you couldn’t remove the tenant because the property is in a zoned area where the tenants have rights. It is rent-controlled. Can you go to the tenant and say “Listen, I'm going to give you $10,000 if you leave”? Would that give him or her incentive to leave? Absolutely. Just work with the profits from the deal.

You can say, “I'll pay you the $10,000 from escrow as soon as I sell the last unit.” And your attorney will charge you a couple thousand dollars to specify what you are doing with this tenant in the contract.

Changing TICs into condos

Even if you purchase a building as tenants in common, you should keep going to the city asking, “When are you going to change the zoning?”

Why do this? Because cities change plans occasionally, and they usually change their zoning when they do so. If you go to them with a zoning request for an apartment building that they want to turn into condos, they may say no. But eventually they may say something like, “Yes, we have had a lot of complaints, it's getting too expensive. In order to make more affordable housing, we are going to let you change to condos provided you make two of the units Section 8.”

In case you are not familiar, Section 8 is a housing assistance program for lower-income families. So in this scenario, you would be helping some people and making money at the same time. What a great deal.

Adding value to apartment buildings

Just like adding value to a smaller multi-family building, you can add value to apartments by converting them into condos and TICs. There is more money required, that's all. Instead of making $350,000, maybe you make as much as $3.5 million. It's the same work, but a bigger deal—and consequently, a bigger payday for you.

It’s easier to make money when you have money. Especially if you are trained. If you have money but you have no training, you and your money may soon be parted. That’s one reason I started Cherif Medawar Real Estate Investing (CMREI). To train those who have money—*and* those who don’t.

So as you build your way there, you can do it with condos. Improvements are usually based on location, so you want to ask yourself, “What should I improve on this apartment building? Can I add another section? Can I improve the size, change the layout, or improve the amenities? Can I change the unit mix?”

A student of mine bought an eight-unit apartment building and changed it into six units. This is called **changing the unit mix**. He made them larger units and rented them furnished as executive offices. But he didn't want to sell the units or split them into condos because he didn’t want the hassles. He just went and got an architect, submitted the improvements to the city, got a contractor, and started breaking down walls. The whole thing only took a few months. And the units are gorgeous.

Now he is leasing it and making a very nice positive cash flow. He could take out a credit line against it, but he doesn't need it. He could sell it for a lot of money, but he doesn’t want it. He just loves the positive cash flow—relaxing with his wife and kids, enjoying life.

This example is not a typical strategy to use for apartments. Usually investors focus on decreasing the vacancy factor and increasing the rental revenue. If you learn how to do that, you are going to be able to make a lot of money. But with apartment buildings, it’s easier said than done.

I’ve found that the difficulty with apartment buildings is that instead of corporations, you’re dealing with individuals—and that means people problems. I once closed on a six-unit apartment building in Sunnyvale. I bought it, closed, and had a flight that afternoon to go do a seminar.

As soon as I landed and turned it on, my phone started buzzing a hole in my pocket. *My goodness*, I thought, *there must be a family emergency*. I pulled it out and saw I had three messages. I had just come out of the gate, so I was walking through the airport listening to my voicemail as a soap opera unfolded over my phone.

The first message was a guy from one of the upstairs apartments. He said, "I just received the letter that you are the new owner. I want you to know I went to the laundry and my quarters are stuck. I need to know what you're going to do about my wet clothes."

I thought, "Wet clothes? Stuck quarters? Holy cow! I have to call him back immediately."

So I saved that message and went to the next one. This one was from a lady downstairs. She said, "I want you to know that the people upstairs keep moving the table and it's really annoying. I know they have kids, but this lady is mad at me and I think they are doing it on purpose!"

I saved that call and said to myself, "Moving tables? Quarreling tenants? If the third call is from a tenant, this thing is *sold*! I want out!"

Fortunately, the third call was not from a tenant, but I ended up selling it anyway. But get this: I ended up selling it **at the same price I bought it for—*and walked away with a profit***. That's right. I bought it for $1.28 million and sold it for the same amount. In another chapter, I'll show you how to buy and sell commercial property back-to-back—at the same price—and make money.

Get your rent … guaranteed

The value of a commercial property is based on the revenue, so you want to increase the revenue if you can. But in addition to increasing it, you want that revenue to be safer. And nothing is safer than a written guarantee.

When you lease your property to a company, some will give you a guarantee that you'll receive the rent even if that particular location, branch, or franchise can't pay it. There are different types of guarantees. There are ***personal guarantees***. The company CEO can sign, which means he/she is personally guaranteeing that the rent will be paid according to the lease.

Or there are the kind I personally prefer, ***corporate guarantees,*** which you can get if you renting to big companies. Think about having a billion-dollar corporation guarantee your lease. A corporate guarantee is based on the network of stores or factories they have nationwide. Talk about sleeping well at night.

You can also have what is called an ***insurance bond***. In other words, get your commercial tenants to obtain bond insurance so that if they can't pay the rent, the insurance will pay for six months. That gives you enough time to get them out and get new tenants in.

Lastly, there's what's called a ***letter of credit*** that is guaranteed by the bank.

Types of rent guarantees

1. Personal
2. Corporate
3. Insurance (bond)
4. Bank (letter of credit)

I was doing a deal in Arizona. This company had bought a Phoenix University building and was changing it into an office building with a spa downstairs. The company was going to sell it to me and have me lease it back to the company. I would receive very good income on it. I checked and found that the owners had bought it for $6 million. They wanted to sell it to me for $9 million—a good profit for them. They proposed to lease it back from me for $900,000 a year, which would be a 10 percent capitalization rate.

So they would be making me a higher rent payment, but the profits from the business would allow them to afford it. Meanwhile, they would use their $3 million profit to expand their business by purchasing other buildings—one in Mesa and one in Phoenix. They would do the exact same thing with the other two buildings—and offered to sell them to me as well. (They even had future plans to buy buildings in Scottsdale, Ariz.; Washington state; and Oregon.)

I was game, but I needed protection. So I told them, "I need a guarantee on your income. You're about to get $3 million and I'm going to have a big debt of maybe $8 million. I want to make sure I'm going to get paid, and I don't want your personal guarantee."

I didn't want a corporate guarantee either because they were the corporation. I would have accepted an insurance bond, but they had not been in business long enough to get bond insurance.

So they got a letter of credit from Wells Fargo Bank. Unfortunately, Wells Fargo Bank did not want to give the letter of credit I wanted. I wanted a guaranteed letter of credit for two years. Why? Because the building was big, and if they didn't pay me, I was going to have to get another big tenant or a bunch of small ones. Plus, it would have taken me awhile to rent all this office space because it was out in Timbuktu.

Now if Wells Fargo had said, "Yes, we are going to give you a letter of credit for two years for this tenant," I would have bought it with my eyes closed.

After all, the numbers were beautiful:

- My payment would be approximately $720,000.
- The income would be $900,000.
- I would make $180,000 a year of pure profit by just owning the building.
- I was getting in with very little money out of my pocket.
- The lease was going to be 15 years with 3.5 percent annual escalations.

This was going to be sweet deal. But I'm not reckless. I always want margins of safety. And in this case, safety meant I had to have the right guarantee. And without that two-year letter of credit, I passed on it.

Measuring ethics

Many investors would have gotten overly excited about that deal. And that's where you can go wrong. People can take advantage of you if they are bigger, better, smarter, or unethical. And you know what? I believe you can ***measure ethics***.

You see, some people are ethical up to, say, $100,000. But when they have the opportunity to make $105,000 on a deal, they will steal. They can't resist lying, cheating or stealing once they cross a certain threshold.

I'll use someone everyone knows as an example: Steve Jobs. Steve Jobs was an honest guy—a smart guy. He is one of the greatest legacies in history when it comes to impacting people with technology. He was incredible.

But one time Apple gave him $80 million worth of stock options. He realized if he backdated them by just two weeks, they would be worth $84 million. So he backdated the option two weeks to make an extra

$4 million. He didn't need the money. He would not even notice the difference. But he couldn't resist. So can we measure Steve Jobs' ethical threshold? Sure … it was anything over $8 million.

Why am I telling you this? Because you'll see it in commercial real estate. And you need to be careful. Some people may not be able to resist faking the numbers when they see dollar signs.

So let's say a building has $800,000 in revenue, and it's worth $8 million. But if it's producing $900,000 of revenue, then it's worth $9 million. Perhaps that extra $1 million crosses the threshold that will make an ethical person suddenly deceitful.

The next thing you know, normally honest people are trying to fake the numbers by not disclosing all the expenses to you. Would not disclosing the true expenses show better revenue? Of course. And you can get stuck with a bad deal because their ethical threshold was at half a million, but they stand to make a million dollars from their lies. You see, if the property had the potential to make a half-million, they would have been honest. But at a million dollars … they couldn't resist.

You will be tempted one day

Believe it or not, it is customary in Mexico for the seller to record the selling price of a property *far lower* than it actually is. For example, I was set to buy a building in Cancun from an attorney (who actually teaches law!) in Mexico City. It was a $525,000 transaction. But when he sent me the details, it read *property shall be recorded at $190,000.*

I called him back and said, "I'm buying it at $525,000. Remember?"

He said, "Yes, but this is going to save you on yearly taxes."

I replied, "Sir, I don't like to do anything unusual—and I don't want to do anything fraudulent."

He laughed and explained, "It's customary in Mexico."

So I called another attorney in Mexico and he agreed, "Yes, that's customary in Mexico," and went on to explain to me how this is done all the time.

Well you know what? I was tempted, but I turned down the deal because I want to be able to sleep at night. And I don't want to spend the rest of my life in jail … especially a Mexican jail.

The reason I tell you this is because you will be tempted one day. You will be tempted to lie. You will be tempted to avoid this or hide that because doing so can make you more money. Don't go down that path. If you walk solid and do things right, you won't have to worry that something you've done is coming back to bite you. The fact is, no amount of money beats sleeping well at night.

How do you protect yourself? With guarantees, with verification of where the revenue is coming from, and from doing your due diligence. That's why I like big companies. Because Puma, Coach, Adidas, Sunglass Hut, Michael's, Starbucks, Verizon, Cingular and others don't have time to play games. These are big corporations, and they say, "Here are the numbers, here's the lease, here's the guarantee, here's the whole thing. Let's get this done."

You can then go forward and buy the building because you have a high degree of safety and you have long-term income. Plus you have periodic escalations. And that is the key to commercial real estate. Higher, safer, and longer—with periodic increases. The asset increases in value, the revenue increases in value, you can protect yourself, have tax deductions, and have something to pass on to your kids. You've got it all.

Chapter 5:
Highest and Best Use:
The Concept That Will Make You Millions!

If I had to pick the most important chapter in this book, this would be it. If you master the techniques and secrets I give you in this chapter, you will master creating wealth in commercial real estate.

I'll be showing you how to find and create a better use for any property you are considering—in other words, how to make sure it reaches its money-making potential. There are 12 strategies I use to accomplish this, and we'll take a look at each of them in this chapter.

Remember in a previous chapter when we talked about the three traditional ways of valuing property? Here they are again:

1. Comparable sales approach (residential)
2. Income approach (commercial)
3. Replacement value approach (insurance purposes)

Those are the three approaches taken by appraisers to determine the value of property. But I'm going to give you a fourth way to value property. **And it is one of the biggest keys to making money with my system. It's called *highest and best use*!**

Finding the highest and best use of a property is to maximize its income … to realize its potential. When looking at commercial real estate, you must always be thinking: What is this property's *potential*?

Remember the little antique shop I wanted to put under contract and rent to Verizon instead? That is a good example of finding a higher and better use for a building. It is the key to commercial real estate. Once you understand the concept of bringing a property to a higher and better use, you have cracked the code with a master key that opens the door to any financial future you desire.

1. Expanding

Expansion is a great technique. Remember the earlier example of the three-bedroom, one-bath home where we added a master bedroom? What if I were to use the same concept with a commercial property?

Let's say you own a commercial property and you have a potential tenant who says, "We really like the space. We like the building, and the large parking lot, and the fact that you have gates outside here. But we need extra space for our trucks to park and unload their refrigeration units. If you don't have it, we can't lease from you … plus there is another building that does have it."

Now you need to think. Can you expand the building to add an extra warehouse in the back for their trucks to park? Say you can build it for $100 per square foot, and you'll be renting it for $30 per square foot. That means in a little over three years, you'll have a 100 percent return. Plus you'll be keeping the building forever. Expansion makes a lot of sense in this case, doesn't it?

How do you put the numbers together? How much will it cost you to build per square foot? How much will be your income per square foot? The formula is simple: If your income per square foot is $20 and it's going to cost you $100 per square foot to build the addition, then it will take you five years to break even.

That's not just good, it's outstanding. Why? Because the minute you build it and rent it, you can tell the bank, "Mr. Banker, I've got this property rented and it's bringing me [X] income. Cash me out." Maybe it cost you $250,000 to build—but after the tenant is in, you can probably sell it for $350,000.

2. Splitting

One seller I talked to had a huge jewelry store in the Caribbean. He wanted to sell the building to me for $10 million. The space was all open, though, and I kept thinking, "Who is going to rent here?"

Finally, I realized I could split the property so that when people walk in, there are separate sections with different vendors. I could bring in big companies that want to display, such as Rolex or Swatch, and lease these sections like booths or pods.

This deal was complicated. But it was a great deal, so I took it anyway and started getting these tenants in to set up their pods. After I bought it from the guy, we started splitting it up, and one of the tenants offered to buy the whole thing from me. I don't usually sell my properties, but I was more interested in another deal right down the street where there were two buildings next to each other.

So I sold it to him. It was a good deal, and I rolled my money over to the other project. I did it using a 1031 exchange where you don't have to pay taxes. I'll talk about 1031 exchanges in the chapter on tax advantages.

3. Rezoning

I have made a *ton* of money over the years simply by rezoning a property. You can, too. This strategy is worth your time if you find a property that's a good candidate for it. Rezoning commercial real estate is extremely powerful.

Can you rezone, say, a motel to a medical facility? Yes you can. Just go and ask. You don't *get* if you don't *ask*.

What if they tell you that you can't rezone? In that case, you just won't do the deal. Make rezoning one of the contingencies of closing. Then go do your due diligence *before* you buy. You check with the county and then make the purchase. Whatever you do, don't buy and *then* check.

4. Converting

You can convert all sorts of buildings into another type of commercial property, if it makes sense. I once paid $2.6 million for a single building that had two apartments on the second floor and a big commercial space (4,000 square feet) on the ground floor.

I converted each unit into separate office condos. The downstairs space alone was worth $2.4 million plus (a 10 percent cap). I rented the downstairs to Tommy Hilfiger, a stylish men's retailer for $240,000 a year—pretty good income.

I then sold one of the second-floor condos for $735,000, which made the closest comparable sale for the other apartment, which I still owned, the same amount of money. This $735,000 I received from the sale recouped all my down payment and then some.

So I spent $400,000 to get into the deal, and quickly pulled out $735,000 by selling one of the apartment/condos. Meanwhile, I still owned the other apartment, and the downstairs space was bringing in $240,000 a year for me. Are you excited about conversions now?

5. Changing the use

Changing the use of a building can make all the difference. How do you do this? You change the use when your property goes from selling antiques to selling Verizon wireless equipment … or from being a motel to a medical building.

I once found a Kmart property on the Internet that had a huge 110,000-square-foot facility. It was north of Kansas City, and the owners wanted to sell it.

I didn't want to buy it because Kmart was going to be leaving in two years and I figured I'd have to split it into smaller places to sell or rent it. The area was growing about 10 miles north and 10 miles south of that area. This specific strip mall area was dying. So the trend was down.

But I kept the phone number because I hoped one day they might sell it very cheap. I figured, "I'm going to keep checking. Maybe I'll just steal that thing."

And then one day I called and the broker told me it had sold. I said, "How? This thing has been on the market for a year, and every time I called, you said it was still there."

He said, "We sold it to a company who is going to use it for a warehouse. They have trucks that come off the freeway, and they need to park the truck somewhere, so they are going to change the use. They are going to remove the retail, so Kmart is out, and are going to actually drive the trucks in and park them inside so they don't need to lock them up."

So they changed the use. Anyone could have bought that building, changed it from retail to warehousing, and presented it to this trucking company. They move their stuff all over the country and they needed storage. They wanted 25 years, it was a guaranteed lease, and now they are storing their trucks in it.

I could have made a lot of money if I'd thought of that.

As you can see, changing use is very, very profitable once you are able to do it. During the stock market downturn a few years ago in Silicon Valley, there were a lot of empty buildings. The high-tech people left, and you could have gotten into the market by changing the use and improving the buildings. There are a lot of opportunities for those who are creative.

But you know what happens? A lot of the properties that are very large are owned by big companies that require a committee of 10 just to make a decision. So these companies foolishly hold onto properties that are vacant. The other owners are lazy, wealthy people who inherited their money. If their building is vacant, they think to themselves, "I don't need it, I'm already making $100,000 a month." They likely wouldn't notice the difference in their financial situation whether they rented it or not.

6. Changing the layout

As I mentioned previously, you can change a property's layout and make a lot of money. For instance, you can do it like the gentleman who changed the eight-unit apartment into six executive offices. He changed the use *and* the layout.

You could also take a motel and change it into medical spaces. In doing this, you can change the layout of the building to give practitioners more space for their medical equipment. As you can see, oftentimes you can combine several of these 12 techniques. I do that a lot, and I encourage you to experiment with that as well.

7. Updating, upgrading and remodeling

Can you take a building—any building—and update it? Yes. Does it increase the value? Absolutely. As you know, I have a building that is leased to Coach. Coach is a great company, and I have a long-term lease with them. But let's say one day they decide to leave. And let's say another retailer is coming in to sell clothing out of that store. It would not be unusual for them to want to remodel the entire space.

Usually one of two things will happen:

1. I will have to pay to remodel it in order to attract the clothing company,.
2. I will tell them, "Look, I'm going to give you three months' free rent. You remodel it the way you want."

Knowing me so far, what do you think I will do? I'm going to give them three months free. Why? Because it's less work. I'm not lazy. I just like to do what I do. It's like this guy told me once, "I'm not a perfectionist, I just like things my way."

This is the same thing. When a company comes in and wants to remodel the space, the conversation usually goes like this: "Listen, Cherif, you do the work. Here is the architect design. We need our clothing racks to be like this and we need this type of lighting. Here is the contractor you can hire, and the architect will monitor the work. We will take it as soon as it's ready. Or, instead of one month's free rent, give us three months' free rent, and we will do the work ourselves. Which would you prefer?"

I'll say, "Take three months free. Let's start the rent on this date. Here's the contract. You sign it and give me the guarantee."

Now, do you think I write the contract? No, I have an attorney write it. Do I know what the attorney is writing? Yes. I'm going to monitor what the attorney does, because the best attorneys in the world are dealing with 10 to 15 contracts a day. Monitor them—it's your business. So I call the attorney and I tell her, "Klio, maybe we need to get the security deposit."

And she says, "No Cherif, you don't need it, this is a publicly traded company."

"OK, Klio, how about we say that it may be four months or three months … whichever is sooner by the time they get their permits and licenses?"

She says, "You're right, let's change this to three months because that's what you agreed on."

Good attorneys are not going to miss much, but there is no such thing as boilerplate contracts. The attorneys I use actually write contracts for national tenants. This works to my advantage, because they understand things from the tenant's perspective.

8. Changing tenants

Changing tenants can make a big difference. Why do I change tenants? Just to work? No, I do it to increase the rental revenue. I took an antique store out and put in Verizon. I took the café out and put in a jewelry store. Improve the tenant, improve the revenue.

9. Changing terms

I once bought a building two years from the expiration of the tenant's lease. And when the lease expired, the tenant had no option to renew. So that tenant's lease was coming to an end. I paid a lot of money for the building, and I knew they were doing a lot of sales. And in the lease it said, *six months before the expiration date, you must call the landlord and notify them to discuss terms if you want to renew*. But they didn't have an option. They had to *discuss the lease terms*.

Option to renew

This is the length of time the tenant has a right to extend the lease. For example, a tenant can have a lease for 10 years with an option to renew for five. Or a tenant can have a lease for five years with an option to renew for five—then an option to renew for another five. Or a tenant could not have the option to renew a lease at all.

So when the tenants from the previous example called me, they said, "We understand you are the new owner. We've been sending you the checks on time. We do very good business here and would like to renew."

I said, "Okay, but under different terms. You will have to pay triple net."

Changing to triple net means they will now pay the taxes, insurance, maintenance—and, of course, all their utilities. This means more positive cash flow for me … and less hassles.

They said, "But the building needs some repairs. We talked to the old owner about it, but he didn't fix it."

What does that tell you? The owner did not fix anything and yet they were *still* paying rent. Do they love this space or what?

"Okay, what do you need?" I asked.

"We need $50,000 to repair these things. And we will do all the work."

"I'll tell you what," I responded. "I'm changing your rent. It's going to go up, and I'm going to ask you to pay me increases—not every five years—but *every* year. Annual escalations. You'll pay triple net and I'm going to give you three months free. You also pay to fix the roof."

They said they would take care of everything. I am drawing up the contract with them as I write this. It's beautiful. I bought it because the lease was going to expire. I wanted to change the terms. Is that pretty powerful stuff, or what?

Let's talk globally

If I purchase a building in the United States, I have to live with the lease terms that have already been established with the previous owner. But in other parts of the world such as Europe, the Caribbean, and

Guam, I can change the terms if I buy the building and the lease has five years or less left on it. For example, let's say a gentleman named Jeff owns the building and he has a lease with ABC Company. But all of a sudden he sells it to me. As soon as I close on it, I can change the terms—even if they signed the lease with Jeff.

Maybe I think the rent was too low; maybe I think ABC Company was taking advantage of Jeff. Or maybe it was pretty reasonable revenue when he started, but 15 years later it looks pretty low compared to the rest of the market. That's what happens with these long-term leases sometimes. So now they have to adjust to me. And if I buy it, I can go in and say, "Listen, I'm the new owner. I don't have to live by the old contract you had with Jeff. Your new contract is $3,000 more per month." Boom! I just increased the value of that property.

My only caveat is this: Don't try to take advantage of people. Don't try to put them in a situation where it's unfair to them. It's always best to have good rapport with your tenants because it's almost like a partnership relationship; you want them to like you, and you want to like them. Plus, you want their business to thrive. Then if something goes wrong, they will work with you. They're all individuals, just like you.

10. Increase the tax advantages

As I mentioned, you can sell the land and lease it back to yourself. It's all just paperwork. A CPA and an attorney can set this up for you once you explain that you want to separate the land from the building and lease it back.

Passing on the tax burden

As the owner, you don't want to pay for taxes and insurance. You want the tenant to pay for those things..

Here's a nuance of the law in California, where I live. Let's say you bought a building 10 years ago for $1 million. You leased it to a company for 20 years. You have a triple net lease with them, so they are paying for taxes, insurance, maintenance and, of course, utilities. The taxes on that building are about 1.15 percent, but let's round it to 1 percent. By law, you can only increase the rent 2 percent a year because of Proposition 13.

So right now, the property is likely worth $3 million, maybe more. This is a commercial building and rent has been increasing each year. They are leasing it for 20 years, and now the first 10 years have passed. You decide you want to sell it. You call me up and say, "Cherif, come buy this building from me."

I look at the rental revenue. The rental revenue has gone higher over the years. It appraises at $3 million, the bank is giving me a good loan, and I like the property—so we transfer ownership from you to me. What happens to the tax now? When the property changed ownership, the building got reassessed at $3 million. Perhaps the tax was $10,000 a year, but now it's $30,000. Who is going to pay the $20,000 difference? Me, you, or the tenant? Unfortunately for him, the tenant will.

You'll find that large corporations have attorneys who are unaware of this nuance in the California law. Why? Because most attorneys for the big corporations are located in New York. In fact, in six or seven out of 10 deals that I do with retail and warehouses, the attorneys are in New York.

So sometimes they make a mistake and overlook this. If you're buying a building that has an existing tenant, pay attention to the contract. It may say something to the effect of, *If the seller sells to a new buyer* *in the state of California, based on the location, the new buyer …* or maybe it will say, *The seller will have to adjust or pay a portion of the rent (or triple net) so the tax portion will remain at no more than X*.

You don't want to get stuck with that. I'm not sure of the law in other states, so you need to be aware of this. So always have the existing lease on any property you're buying—not just in California—reviewed by an attorney for clauses like this. You don't want to make what should be the tenant's problem into your problem.

Use a corporation to avoid the issue

Here's how you can sell the building without affecting anybody. If you are selling the building to me, you can transfer the ownership in a corporation. So the corporation owns the building, and the assets of the corporation are the building. The building increased in value to $3 million. But you are not going to sell me the building; you are going to sell me the corporation. And since I am just buying a corporation, the tax does not change.

Check with a qualified CPA to walk you through how this works.

11. Adding other income

In my recent Commercial Real Estate Roundtable training, we covered hundreds of ideas for adding other income and otherwise taking a property to its highest and best use. I'll talk more about the roundtable in a future chapter.

One of my favorite strategies is putting up a billboard. Can this make you money? You bet. A friend of mine who is a doctor just dabbles in real estate. He owns a little duplex, and as the street got busier, he decided to make it offices. Downstairs he's got a little dentist office and upstairs is an engineer's office. I came by one day to see it and I said, "This is beautiful. You have a lot of traffic. See these buildings down here? Why don't you put up a little advertisement upstairs? You know—a billboard?"

"My goodness," he replied. "I never thought of that."

Well he did it, and guess what? That little idea made him $24,000 a year.

You'd be surprised how many additional income opportunities like this are open to you. A word of advice, however: Always check with your local municipality on its specific rules for things like billboards *before* you put them up. In these situations, it's better to ask for permission than forgiveness. You don't want to have to take something down because the city didn't give you permission first.

Antennas

When I was a hotel manager, I had many companies asking me whether they could put an antenna on top of my hotel. I said, "Yes, but you are going to have to lease the space. You are going to have to pay $400 a month."

When you have an apartment building or some other big building overlooking the freeway, and they want to put antennas up for cell phones, is that good? Absolutely. The higher the building, the more they'll want put an antenna on top. Antennas make a lot of money for building owners—it's pure profit, no expenses.

In California, my brother had a big property on a hill and someone wanted to put to up antennas. It paid him $700 extra per month, and he didn’t have to do anything. My building can look like a porcupine for all I care. I’ll put up all the antennas I can get!

12. Buying more properties to add critical mass or value

Not long ago, my brother and I found a deal in San Pedro, Calif. San Pedro is growing like crazy because it's a big port in Southern California. We found a sweet building on a busy street corner. But it only had a little alley for parking. It was so bad, in fact, that if you parked one car and another came behind it, they both had to back up. It was ridiculous.

But they wanted to sell it for just $600,000, which was a steal because you could rent it for $5,000 a month. So we went to the guy next-door and asked him how much he would sell for. He wanted $1.8 million, and he knew he could get it because he had a big parking lot.

So we thanked him for his time and instead talked to the couple who owned the residential property behind the building we wanted. My brother asked them if they wanted to sell. They said, “Well, we are thinking about it. We don't know. We have to talk to a Realtor.”

We told them to get it appraised, and whatever price came back from the appraisal, we’d give them $50,000 more. Not a bad deal for them, right? We ended up purchasing that house from them for $500,000, which was ridiculously expensive. The thing was a dump (pardon the expression). But it didn’t matter because after we closed on it, we flattened it. And guess what we put back there? Parking spaces.

Now it's a great spot and everyone likes it. We lease it to a coffee company called Coffee Beans and they even have a drive-through. We put up a sign: *Parking in rear*. People see the sign out front and go park in the back. It’s a beautiful situation.

We paid a little over $1 million for the two properties. To demolish the house and remove the debris was another $150,000. Now our investment is worth $1.8 million. That’s half a million dollars in profit.

Chapter 6:
Why Profiting from Commercial is Easier

It's easier to make money in commercial real estate. There's no doubt about it. In this chapter, I'm going to step back a bit and focus on the fundamentals of why it's easier. We're going to strengthen your educational foundation.

One reason it's easier is because commercial real estate investors are more sophisticated, and creativity is not unusual. For instance, you can call a commercial real estate seller and say, "Listen, your asking price is $1 million. The bank will only give me $800,000. All I have is $100,000. Can I owe you the $100,000 difference?"

And they may say, "Okay, I will carry the note—but no longer than three years."

Then you might say, "Okay, can you carry the note for three years, but let me make the payments all the way at the end? I want to spend all my money renovating the property."

He or she will like that because you're putting down $100,000 and spending more money renovating the property. That means the $100,000 note you owe will be on a property that is increasing in value.

Cash flow is what matters

Warren Buffet says most people invest by looking in the rearview mirror. People do this in real estate, too. If I'm in residential real estate, I don't care where the market is going … I don't care where it's been … all I care about is where it is today. That's because I'm buying and flipping. I'm purchasing below market value, making improvements, and then selling for slightly more. I'm in and out.

In commercial, it doesn't matter where the market stands. What matters are the numbers on the specific commercial building I'm buying. I'm not buying it on speculation … I'm buying it for its future streams of income. Cash flow is what matters. Not a property's value. Not how the market is doing as a whole.

You can't go wrong if you have a strong commercial tenant with a long-term lease who will bring you good cash flow. *You will always go wrong* if you are buying a property (commercial or residential) because you are counting on the market to go up. Don't get me wrong: Appreciation is nice. But counting on appreciation is speculation.

Investing is cash flow. And cash flow is king.

There's a longer due diligence period

The due diligence period is longer in commercial real estate than in residential. That's because the inspection period is longer and the process of getting appraisals is longer. That allows you time to:

- Get a partner.
- Find somebody you can assign the contract to.
- Find a buyer and close (you often have 45 to 60 days and sometimes even longer).

In a residential contract, the owners want you to close in as little as 30 to 35 days. But having a longer time to close works to your advantage. It allows you to put together longer leases with large corporations that have escalations and guarantees. And that's exactly what you want.

Subleasing is common

Remember our little antique store with $3,500 a month rent? In that case, you wanted them out so you could buy the building and lease it for, let's say, $10,000 per month. You wanted to rent to a better tenant. That antique store didn’t fit on that street and the tenants wanted out, but the owner didn’t want to let them leave because they still had three more years until the lease expired.

You came in and wanted to buy the building so you could lease it to a bigger company. But what if the owner had told you, “I don't want to sell the building?”

That’s always possible, isn’t it? \In that case, what about subleasing? Subleasing has made me a lot of money.

Faced with this, you would go to the owner and say, “You don't want to sell? Then I would like to lease it at $5,000 a month.”

Is that owner excited about receiving $5,000 from you instead of $3,500 from his current tenant? Yes, because he's going to make $1,500 more per month. He’s foaming at the mouth.

And the current tenant is happy because he will now be released from the lease. When you write the lease, simply make sure your attorney includes a paragraph that says that the new tenant (that’s you) *has the right to sublease this space without any landlord/owner consent*. That means you are going to pay the owner $5,000/month, but you can bring in another tenant of your choosing and sublease the space.

Now you can go get a company as a tenant and have control over the building. You pay the owner $5,000 a month, collect $10,000 a month from the new tenant, and pocket the difference. It's called a sandwich lease.

Just last night I pulled up at a Kinko's and it had a big sign that said *Sublease*. You’ll see this all the time. The owner of this strip mall has leased this space to a tenant, and that tenant has to pay the owner. But Kinko’s needs to move, for whatever reason. They are probably relocating, couldn't pay, or are expanding to a bigger space. However, they are still responsible for the lease—so they need to find another tenant to take their place.

If the tenants can sublease the space for more money than they are paying, then *they* pocket the difference. It’s a good deal for them. But the landlord/owner is still making money either way. Everyone wins with subleasing.

As you get into the business, I encourage you to network with potential tenants. Keep the lines of communication open. You never know when you are going to find a deal just like this. And if you know how fast a national tenant is looking to expand—and *where* it wants to expand—you simply become a matchmaker. Match the tenant with the space by doing a sublease … and become filthy rich in the process.

So don’t forget this strategy. Especially when an owner won’t sell a building to you. Leasing and subleasing could be an opportunity for you because the deals are bigger, the sums of money are larger, and if the spread is even $1,000 a month, that’s $12,000 a year you didn’t have before.

Value is based on cash flow, not comps

Let’s say a commercial property has been bringing in a net of $100,000. If the property brings in an extra $10,000 this year, is it worth more? Absolutely. Remember: The value of commercial real estate is determined from its revenue. But it does not work like this in residential.

Imagine you have an ocean-view home worth $1.5 million. This value is based on the comparable sales—which means the house next door probably sold for $1.5 million, the one across the street for $1.6 million, the one on the other side for $1.4 million. So in that neighborhood, it's worth $1.5 million.

The property has a tenant who pays $3,500 a month. (This is typical in California, by the way.) If that tenant leaves and you don't get $3,500 a month anymore, is the home still worth $1.5 million? Yes it is, because its value is based on comparable sales. It's whatever is selling in the neighborhood.

But wait. What if you find new tenants who are willing to pay $4,500 a month because their company is footing the bill? Is the house priced differently? No, because its value is still based on comparable sales.

This is one reason it’s so hard to make a lot of money in residential real estate: Unless you have cash on the side, bought the house from a desperate seller for $1.3 million, or did something else magical, how are you supposed to increase its value?

You can’t.

Now let’s talk about commercial. Let’s say I have an everyday commercial property. I have no ocean view. No sea breezes blowing across the porch. I just have a good location on a busy street that’s rented for $10,000 a month. Then my tenant leaves. Doesn’t the building have less value? You bet! It's vacant, so it's worth less because it's a problem. Nobody wants to come in and start looking for tenants, so it's valued at less. But say I buy it vacant and then find a tenant who will sign a 10-year lease for $10,000 a month with regular increases. See how the value increases? It's based on the revenue. Every year when the rent goes up, the value goes up.

If I have a great lease with a written guarantee and 3 percent escalations. God forbid something happens, like a terrorist attack—do I still get my money? What if the city decides to put down new asphalt, resulting in half the street being closed for construction? If that puts a big dent in my tenant’s sales for the next couple of months, do I still get my money? By now you know the answer. It's their problem and they are big companies. I'm not leasing to mom-and-pop shops. Neither should you.

And what about the building’s value? If the rent has now escalated to $12,000, does the value of the building increase? By now you know the answer to that, too. In commercial real estate, value is strictly dictated by revenue.

I have students who started in commercial real estate by buying small. One woman, an executive in New Jersey, started by purchasing one little office condo in Orlando, Fla., for $75,000. It's only about 4,500 square feet. But it brings her $7,500 a year and the tenants pay for utilities, taxes, insurance, and everything. She got a very nice loan on it and she's getting positive cash flow. That was a great way for her to start.

Now she wants to do as many as she can. She's going to buy more in the same building. And as she grows little by little, one day she will likely own an entire office building.

Calculations are done *before* the offer

In commercial real estate, most calculations of value and potential increases of income are done before you spend a dime. You can figure out rent rates by looking at similar properties nearby. Let's say a 10,000-square-foot space is renting for $500,000 a month. You're going to buy the building next-door and it is 5,000 square feet. So if 10,000 square feet rents for $500,000 a month, 5,000 square feet should rent for approximately $250,000 a month. Follow me?

Once you figure out what your income will be, you call the bank and ask about a loan. "Well, we can give you a 25-year loan at 7 percent, but you have to put (so much) down." Then you can go on calculator.com or another free website, click "Mortgage," enter the numbers, and the picture becomes clear.

At this point you can say to yourself, "My payment will be $4,000 and my income will be $5,000. That's $1,000 a month. So if I put down $100,000 and make $1,000 a month, then in 12 months I will make $12,000."

Is $12,000 a year on a $100,000 down payment a good number? That's a 12 percent cash-on-cash return. That's beautiful.

So we've determined you'll be receiving $12,000 a year, plus all the tax deductions, plus the escalations, plus the increase in value because of the escalations. At that point you can refinance and cash out $100,000 in a couple of years. Now the numbers start getting exciting!

It's important to let the numbers speak for themselves. Don't try to convince yourself. Answer some basic questions: Is it going to cash flow? Is it going to have net value? If I put any money in, will I get some money out? If I get a partner and he or she puts some money in, will we both be able to make money?

It's easier to get partners

Speaking of partners, it's easier to get partners in commercial real estate because all you need to do is show them that the numbers are good. You are not looking for a property they are going to fall in love with.

In a seminar the other day, a student asked me, "Do you physically look at the property?" He was getting the point. You may just look at the numbers and they'll make sense.

The billionaire investor I worked for all those years, Mr. Baysari, could literally look at the numbers on hotels and say, "Okay, if the hotel is worth so much, it's netting so much, let's go ahead and buy it." He didn't have to see it.

Physical inspections

Personally, I like to see properties before I purchase. I mentioned how Mr. Baysari would purchase hotels sight unseen. With hotels, that may work. But it's different when you're actually trying to buy a commercial building. Although you could, I don't encourage you ever purchase a building without seeing it first.

For instance, you may need to have it cleaned up or have work done in order to lease to specific tenants. Plus, you want to make sure that this is the right building for them, that there are no extra leaks you have to disclose, or other problems you need to explain.

Let's say you want to get me in on a partnership. And you send me an email and say, "Cherif, I found a small property that Cingular Wireless is interested in leasing. I already talked to them. I have a deal under contract. I have 45 days remaining for due diligence and inspections. Cingular is willing to pay $6,000 per month easily. Once we purchase it, the loan will be about $3,500. There is a lot of profit here—are you interested in being a partner? Or would you even be interested in buying it?"

Once you explain the numbers, I'm going to know whether I'm in or out. Looking at the property becomes secondary now. This is why it's easier to get partners for commercial real estate deals.

Wait until I cover syndications in a future chapter. Syndications are when you put people together to buy large deals that require a lot of money. The good news? Everyone can also make a lot of money. This simply doesn't happen in residential.

There are more government programs available

Every single time you are looking to buy a property—especially apartment buildings—call the county and city to ask if they have any special programs. You may be surprised.

Some time ago, I was doing a deal in San Jose, Calif., and they had a Section 8 program. Section 8 will guarantee your rent if you get a qualifying tenant. The market was hot, so landlords were not renting to anyone who had a low income like Section 8 tenants. When I called, the city told me, "We have a whole list of people. You should come in and talk to us."

Come to find out, they had a program where I could rehab the entire apartment building and have tax credits. Not just tax avoidance. Not just tax deductions. Tax *credits*.

Let's say you spend $100,000 rehabbing the apartment building. When it's time for you to file your taxes, you owe $25,000. You could take the $100,000 tax credit and defer your taxes for at least four years.

It was an incredible program. But the city needed housing, so they offered it. Always ask the city if they have any special programs. You will be amazed how many times they have something that will benefit you as an investor.

More on Section 8

The Section 8 program is the federal government's major program for assisting low-income families, the elderly, and people with disabilities in affording decent, safe, and sanitary housing in the private market. Section 8 is administered in your area by your Public Housing Agency (PHA). The PHA receives federal funds from the U.S. Department of Housing and Urban Development (HUD) to administer Section 8.

The great thing about Section 8 is that the government sends you a check for its portion of the rent by the third day of each month. It will continue to do so as long as your tenant remains eligible for Section 8 and your unit meets the Section 8 program standards. You are responsible for collecting the tenant portion of the rent each month.

There are no limits on commercial borrowing

Let's look at residential lending limits versus commercial lending limits. When you walk into a bank to borrow for a residential property versus a commercial property, there is a big difference. The difference is that with residential property, you are limited as to how much you can borrow. This limitation is based on how much debt you have, how much investment income you earn, and how much you're paid in wages from your job if you are employed.

For instance, World Savings Bank, which was acquired by Wachovia and is now part of Wells Fargo, had a rule in California that no one can have more than $1 million in residential loans. They don't want to risk the exposure. So if you went into Wells Fargo, the last time I checked, and the house you wanted was worth $1.5 million, the loan officer would probably tell you that you'd have to put down $500,000.

But that's typical. For instance, Washington Mutual, now part of Chase, had a rule that it would not give you more than three residential loans simultaneously in one 12-month period. So if you are wealthy and have good credit and a good job, too bad.

The bank will tell you, "You already have two properties. After the third one, we cannot loan to you anymore within this calendar year." That's a bit of a problem for an active residential real estate investor, don't you think?

Now let's talk about commercial. For commercial property, when you apply for a loan at the bank, they'll pull your credit but they won't ever see the other commercial properties you have. Why? Because a commercial loan—as long as you do the loan through an EIN number for a corporation or LLC—is *not reflected on your credit report.* So how many commercial properties can you buy? As many as you want.

Other reasons why commercial is easier

Here are some other reasons making money in commercial is so easy. Some of these we've touched on, others we haven't:

- There is less risk in commercial real estate. If you have an apartment building and one tenant leaves, it doesn't hurt you nearly as much as if you were renting out a single-family house.

- It's easier to afford management if you need it—especially when you already have positive cash flow on the building.

- You can be more resilient to changes in economic trends with commercial property because it really doesn't matter what the economy does. Your focus is on finding *one tenant* for *one building* in *one location*. And when the economy swings, you focus on the businesses that are flourishing, not the ones that are struggling.

- It's a safer, more dependable, long-term investment. When you are getting rent that's guaranteed, for a longer lease term, it's much safer than a wishy-washy tenant occupying a single-family home.

- There is less competition in commercial. For one thing, few people know it. Even fewer understand it. Those who do understand it only stick to one type of investment because they are narrow-minded. If you are determined to succeed, you can go out there and walk your way to wealth by remaining open-minded to all possibilities and being creative where others get frustrated.

After reading this chapter, I hope you see why it is easier to make money in commercial real estate. I don't want to talk down about residential investing—after all, I used to do it—but the commercial strategies I'm teaching you are the reason the wealthy become wealthier and the poor run around in circles.

There's nothing that says you can't go out and buy a strip center or single-tenant building tomorrow. You know enough already. But most people are hesitant.

I would encourage you to start with residential if that's what you're comfortable with and walk your way into income-producing properties. Then get into apartment buildings or units that you can split and sell quickly or convert. Then get into big commercial deals. If you want to start with commercial right away, no problem. Put one under contract and assign the contract.

Know the FACTS

During the course of my career, I have been personally involved in dozens of different businesses, more than a thousand real estate deals, thousands of stock market trades, and numerous other endeavors. Most of the time I've been successful. A few times I have failed.

But no matter the outcome of a particular business, deal, or trade, I always learned from it. If it was a success, I took note. If it was a failure, I *really* paid attention.

But I've never lost money on a real estate deal. Not once. I know it's easy for me to write that in this book and never have to prove it. But I keep every file from every property I've ever owned, so I have the backup to prove it. I believe in transparency with my students. And when I present an exciting success I've had, I routinely show my students my bank statements or wire transfers. It helps to prove what I'm saying and show what is possible.

I don't say any of this to brag. On the contrary, I tell you that I have never failed in real estate to show you how easy it is once you know what you're doing. The reason I've never lost money is because of the thought processes and business models I've developed when it comes to evaluating opportunities.

The best investors—whether they succeed in stocks, real estate, or other types of endeavors—have a business model. They may have it written down, or it may just exist in their head. But I assure you they have a formula they've acquired over time.

The FACTS system

When I first started training people in the early 2000s, I noticed my students wanted to follow my investing model, the one I'd perfected. They didn't just want strategies and techniques; they wanted the recipe—an exact list of my ingredients for success. So I captured my formula for commercial real estate with the FACTS system**.** FACTS is an acronym that stands for:

Find
Analyze
Control
Time
Strategize

FACTS is relatively straightforward. First you have to ***find*** the property and a good tenant for it. Then you must ***analyze*** the deal to see if it meets your investment criteria. You get ***control*** of the deal by putting the property under contract. Then you ***time*** the process because you may want to purchase, assign, or get a partner. Finally, you need to ***strategize*** how you will manage the property profitably and take it to its highest and best use.

All of my trainings are structured around the FACTS system. All my students use it. It is so good, and so thorough, I actually patented it. In the next five chapters, you will see how to invest according to the FACTS system—the proven business model that has made me millions in the last 20 years. Here's what it looks like:

- **F**ind the deal—Locating a deal and then finding great tenants for the property.
- **A**nalyze and calculate—Analyzing the trend for the area and calculating the actual numbers on the deal.

- **C**ontrol the deal—Negotiating and Controlling a deal is done with the correct paperwork … the letter of intent, the contract, an effective lease, or maybe even an option contract.
- **T**ime the due diligence and financing—Inspecting the property and raising or acquiring the funds to purchase it.
- **S**trategize—Managing the property profitably and then taking it to its highest and best use, where you earn the big money.

Chapter 7:
Find the Deal

Let's begin with the first step in FACTS: ***Finding the deal***.

There seems to be a story behind how I find each opportunity. Some could say it's luck, but it's part of the process. First of all, I know from experience that when it comes to good opportunities, you can either pursue them or attract them.

If I look at advertisements online, call the phone numbers I see on For Sale signs, and go to auctions and bid on properties, then I am pursuing opportunities. This can eventually get me good deals. But invariably the better opportunities come when you attract the sellers or their agents. So I keep the word out with brokers, owners, landlords, tenants and others, and I make sure everyone knows that I am looking to buy a specific type of property.

I put signs on my existing properties that clearly read: "I buy commercial properties, all cash." I put ads online, and if I get anxious for a good deal, I place ads in newspapers. Most people search online nowadays, and there are actually websites that cater to each type of commercial property.

I am always looking for a good deal, whether it comes through a broker or a directly from a seller. These signs, advertisements, and efforts attract people who have a need to sell, and they bring the opportunities to me.

Situations that create opportunity

In order to find opportunities, let's talk about situations that give people motivation to get rid of properties. Most of these could apply to residential as well as commercial real estate. But think about commercial real estate as you read this. Here are some of the situations:

1. People problems
2. Property problems
3. Location problems
4. Lawsuits
5. Changing of bank financing terms
6. Little or no equity
7. Growing or changing investment direction
8. Other reasons

People problems

First you have people problems, such as the loss of a job. When people lose a job and they have a property they were counting on to supplement their income, all of a sudden they have a big problem. They might not be able to keep the property because of the reduction in their cash flow. If there is equity in the property, they may want—or need—to sell. This presents an opportunity for you to help somebody *and* make some money.

Other people problems include divorce, illness, and probate. All of these can lead to motivated sellers. You’ll also find sellers who become too old to maintain a property, especially with apartment buildings.

Many investors started with small buildings when they were younger, and they grew into big apartment buildings they no longer want to manage. If they don't want to give it to a management company to control, they end up selling the property. And because the baby boomers are starting to retire, the next few years are going to be the perfect time to find these properties.

There is a lot of wealth in the United States held by individuals who look just like you and me. Many of them own apartment buildings. They started small and grew, but somehow their business mentality never grew with their assets.

You can tell when you talk to somebody whether he or she has a small mentality. Recently I was touring a property with an older gentleman, and he was telling me, “We used to pay $57 a month per unit for the trash service. They’ve now increased it to $59. Unbelievable.”

Two dollars a month per unit was such a drama to this man that he was obsessing over it while we were touring the building. Wow. Some of these retiring people value money so much that you can start at a low offer and work your way up slowly because they expect that. So when you’re dealing with big commercial properties, recognize when owners still have a small mentality and you can use it to your advantage during negotiations.

For the past two years, many of my best deals on big commercial properties involved owners who were retiring. Many of them were wealthy, but for whatever reason, their kids were not interested in the property.

Often you may be able to work a deal if the retiring owner wants to sell but also is interested in continuing to earn income on the property. In that case, you can tell the seller, “Listen, instead of giving you a $200,000 down payment, can I give you $100,000 and owe you $100,000? I will pay you 8 percent interest.”

You get the owner to carry a note for part of the down payment. It's a $100,000 promissory note—basically a second mortgage. This way you get to keep more of your cash and you don't have to fork out the big money.

As you can tell, I feel very strongly that having cash reserves is important. Here’s why: If something happens, you now have the cash to solve the problem, fix the property, or even maintain a negative cash flow until you get new tenants in. You can even give tenants an incentive of three months’ free rent for signing a lease, and you don’t have to worry. When you secure an anchor tenant and the big payments start rolling in, you can pay off everybody by refinancing and cashing out your equity. Now everybody's happy.

Property problems

What about property problems such as management issues? These create motivated sellers, too. Maybe the property is hard to manage because you have to collect rent with a machine gun. That’s not the type of property I want to be involved in. But believe it or not, I know people who get involved in properties like this and make money.

Three or four years ago there was a young lady from Seattle, Wash., who was showing me pictures of the properties she started with. They were terrible, dilapidated properties in horrible neighborhoods next to the "U District."

She told me, "I go and buy up these properties—then I call the city and get approval to rent them as Section 8 properties." That's not unusual. But what really stunned me was when she said, "Even murderers need a place to live."

More on Section 8
Section 8 is a pretty simple program that involves the city paying rent to you, the landlord. Contrary to popular opinion, the property doesn't have to be located in a war zone. And the tenants aren't bad people, as is sometimes implied. You just have to rent to a lower-income individual who the government has qualified—maybe a single parent, someone with a disability, or a veteran. City inspectors come and look at your unit(s). If they approve, they have a list of tenants. How would you like the government to pay you the rent? And help a low-income family with a place to live at the same time?

Simply call the city and say you are going to buy an apartment building and would like to know about the Section 8 program. The person from the city will say, "Okay, you are in Atlanta, Georgia—for a two-bedroom, one-bath, we pay $880 a month. For a three-bedroom, two-bath, we pay $1,200 a month." Once you start calculating, your decision often looks something like this: *Do I want to get $1,200 a month guaranteed by the government, or do I want $1,500 from somebody who's going to tell me a story every other month about not being able to make the rent?*

Just be sure—given the fragile economic state of some municipalities—that you are aware of the city's current financial condition. Get a written guarantee that you'll be paid.

Now, the woman who said she rented to "murderers" was half-joking. She just happened to specialize in a more dangerous mix of tenants who qualified for Section 8 housing in her area. But when she came to my seminar, she decided to change her strategy. She realized she could split these buildings into condos and sell them for more. She did it and walked away a millionaire after less than three years of hard work.

Location problems

One common location problem occurs when the area around the property is changing. Does this create an opportunity for you and a problem for somebody holding the property? Absolutely. The direction and the trend of an area can work to your advantage and to the disadvantage of the owner because most owners are not creative. For people to think creatively, they have to have one of three things:

1. A lot of experience.
2. A lot of training.
3. A keen sense of observation.

Most people don't have any of these, and that's an advantage for you. After reading this book, you will have at least one of these—if not more.

Let me give you an example. Every time I am in my car driving from Point A to Point B, I'm looking at what is happening in different areas. Which tenants are coming in? Which tenants are leaving? What is the city doing with that corner lot? You can see trends and identify opportunities much easier when you observe. Knowledge is instinctive and based on observation.

When I am in the mall, I go in and I ask the staff about any new brand that just opened. I ask, Who is the main company? How are you doing? Do you know whether the corporate office wants to expand? I remember the first time I saw Juicy Couture. I never guessed it was a part of the Liz Claiborne company. By simply chatting with the staff, I got some important data I couldn't have gotten anywhere else.

Yet many thousands of people walk and drive by the same stores without thinking about this background information. They have a consumer mentality, while I think like an investor. This comes with training, experience and a keen sense of observation.

Lawsuits
Sometimes people involved in a lawsuit want to sell their property quickly. This is very common. After all, we live in the most litigious society on earth. Defendants often want to settle everything and get rid of their assets. This can create very motivated sellers.

One of the best deals I've made came to me through an appraiser who met me in the street and mentioned that since I am always looking for a good deal, I should consider looking at a property he had in mind. He not only gave me the address, but he put me in touch with the owners, who needed money because they were in a lawsuit and wanted to settle. They needed some cash and were willing to discount one of their properties.

Changing of bank financing terms
Have you ever had a variable interest rate mortgage that increased in payment? Many homeowners have, but it happens in commercial real estate, too. Imagine owning a large apartment building where your payment is fixed for five or 10 years and your rate is switched to variable. If your rent didn't increase, but your mortgage rate did, you may not be able to afford it anymore. If you find people who just had a change in bank financing terms, this could be a powerful motivator for them to cash out and be rid of the property.

Little or no equity
Consider a situation where people have purchased a building without too much equity to begin with. Then perhaps the market changes or perhaps they lose tenants, so the property is valued at less. You can get it at a bargain, rent it, and increase the value.

Growing or changing investment direction

One day my attorney called me said, "Listen, I have a client who has a furniture business. It's not doing well, so he wants to sell his apartment building. Then he can take the money and try to improve his business. I would like to do the deal, and I want you to be involved as a part owner. Can you involve me as an equity partner?"

First of all, I am not in the furniture business. Maybe the guy had a phenomenal strategy, but I don't know how he can sell more furniture by putting more money into it when people are simply not buying homes right now. But I am not here to critique or educate the guy—I am here to make money.

So I told my attorney, "Sure I can. Tell me about the deal."

He said, "Cherif, if we can close fast, the guy will sell the building to us for $900,000. We can segregate it. The units can be converted into condos, and each condo will sell for $300,000. So the building will be worth $2.7 million!"

Can you see why my lawyer wants me to be his partner?

"I can get an architect to partner with us and bring his expertise to help us with the conversion," he continued. "The architect will require $90,000."

"Do you know the architect?"

"Yes," he replied.

"Add him as a partner, then."

I like lawyers—I even have family members who are lawyers. But the truth of the matter is that lawyers are trained to think negatively. You typically go to them so they can tell you why you should *not* do a deal. And I know that if you and I shake hands and agree on a deal, and I tell you, "Have your lawyer call my lawyer," that deal is never going to happen.

There's a book called *The Terrible Truth about Lawyers* written by Mark H. McCormack. He's the same author who wrote *What They Don't Teach You at Harvard Business School*. The book about lawyers is invaluable because he is a lawyer. And he essentially says in the book, "My only job is to protect my clients."

That's why it's almost impossible to have two lawyers agree unless you, as business people, have already agreed on the key points. So as you go forward in commercial real estate, remember to have your lawyer(s) protect you and do the basic contracts, but not keep your deals from happening.

On the real estate deal with my attorney, I was putting nothing into it. I was just showing up as a face to say, "Yes, my name is Cherif. Yes, I am the borrower. Yes, I have experience in commercial real estate."

Then I simply signed the bank note—and it was a sweet deal with the bank. The bank said they would give us the loan for $900,000, plus a $300,000 credit line for remodeling. Why? Because they could see that the actual value of the building was a lot higher than $900,000. It's not very often that banks get extravagant with their money, but having the right deal makes a lot of difference.

So you can see why it's good to have attorneys, to talk to them periodically, and tell them you're in the market for new property deals. Attorneys see people all the time who are losing jobs, involved in lawsuits, getting divorced, in probate, have illness and problems with medical bills, and in all sorts of other situations. Attorneys can bring you some deals if you cut them in on the action. As long as they disclose and everything is on the up and up, you can both make money.

In this case, my attorney found a furniture store owner who wanted to change his investment direction. And we were very happy to oblige!

Other reasons

Now that I've covered situations that give people motivation to get rid of properties, I hope you see how to find opportunities. But before we leave this topic, here are a few other reasons why people become motivated to sell:

- **Unwanted inheritance**. People inherit real estate all the time. When it comes to commercial real estate, often they don't know what to do with the building, especially if they have never dealt with commercial property
- **Overleveraged situations.** When people get into properties that they can't afford, you can go in and use your creativity to put it under contract, and either assign it or make the purchase happen.
- **Business issues:** Many commercial property managers are not good business people, and they fail miserably in running the operation. This could reduce the value of the real state in an unfair way.
- **Bankruptcy.** Once people are overwhelmed with financial problems, they choose to file for bankruptcy and often they start liquidating their real estate holdings either before or right after they talk to attorneys. They end up selling without much negotiation or resistance.
- **Insolvency.** When people are upside down, meaning they owe more than their property is worth—or, or worst yet, they have a huge negative cash flow—they can get a short sale arranged with the bank, and the new buyer can have a property with great cash flow … at a much lower price.

Places to find opportunity

Now that we've talked about *why* people become motivated to sell, let's look at *where* you can find them. Some of these places include:

1. Commercial real estate websites
2. Commercial real estate companies
3. Auction houses
4. Attorneys
5. Newspaper ads
6. Courthouses
7. Government sites
8. Bank foreclosures
9. Title companies
10. Your own ads, letters, and contacts
11. Your own observations

Commercial real estate websites
The best website for commercial real estate in the United States is loopnet.com. It's free. You can pay a membership fee and get more data on properties if you want. But the basic information is free. You can enter search criteria such as *apartment building, Atlanta, Georgia, 50 units or more* and click "Enter." And it's going to come back with everything for sale that meets those criteria.

When you start looking at properties, any type, you can search for what's called "net leased." This is another term for triple net. If you go on loopnet.com and you check "net leased" and enter "Florida," it gives you all the net leased properties in Florida.

One interesting thing about commercial is that the marketplace for commercial real estate is still in the dark ages. There aren't resources out there like there are for residential. Loopnet is the primary site for commercial real estate, but it's just one resource. Residential has dozens of sites like LoopNet. A very structured marketplace exists for residential real estate.

The fact that commercial is unstructured is better for you. With the techniques I teach, you can go out and take advantage of the marketplace because now you know where and what to do.

A powerful networking resource

When you become a member of CMREI.com, we offer a members-only Forum that allows you to network with other CMREI members. This is where you can post your questions, comments, and actual deals. In addition to listing your deals, you are welcome to use this as an "online classifieds" forum for anything real estate-related. Many of our members use the Forum to find investors and list what kinds of properties they are seeking. We encourage you to do the same.

Let's say an investor lists on the Forum that he is looking for an apartment building for up to $6 million, high vacancy is OK, poor condition is acceptable, it can be anywhere on the West Coast, and it must be close to a university. Now let's say you find a building that fits those criteria but you don't own it. You can go get it under contract. And during your due diligence, you can contact the investor and say, "Listen, I have a building that's just what you're looking for, come and take a look." If the investor likes it, you can assign it to him or her and make money. It's a great resource for the seller, the buyer, and everyone involved.

I'll give you an example of the difference between commercial and residential. If you are selling residential real estate, you can just put a sign outside your house that says *For Sale by Owner*. But commercial is typically a little bit more difficult. I can't put a *For Sale* sign outside one of my buildings where I have a tenant like Burberry. Why? Because Burberry Group (LSE: BRBY) is a very prestigious, publicly traded company. It is a British luxury fashion house that manufactures clothing, fragrance, and fashion accessories.

Putting a sign up like that would be a disaster for Burberry. Imagine a first-class retail store with a big *For Sale* sign in front that reads *Please contact Cherif Medawar*. They would be on the phone with me in seconds asking me to take it down.

But if I go to a web site like CMREI.com or loopnet.com, where I can put pictures of my property, I'll sell it in no time. It's good for me. It's good for my buyer. And it won't upset the tenant.

Commercial real estate companies

If you go to ColdwellBanker.com you will see a section that says "commercial." Click it and select what city and state you want. It's kind of fun because you get to see properties anywhere. Sometimes they show what is for sale around the world.

For example, if you're interested in Florida because you like to go there on vacation, you can look for properties you might like to own there. You can select "net leased" if you want triple net properties, or you can select "Florida" and "4-plex" to see what's available. If you don't like Florida, you can look at apartment buildings in Texas or Arizona.

In addition to Coldwell Banker's website, you can go to colliers.com (Colliers International), cbre.com (CB Richard Ellis), or marcusmillichap.com (Marcus & Millichap). These are all websites of commercial brokers, and they can tell you about recent sales, available properties, and square footage. You can also let them know what you're seeking. You get to work with the actual commercial real estate brokers and talk to them.

I have tenants on Market Street in San Francisco. I have good rapport with them. Someone from their real estate department called me and asked if I had anything in Fort Lauderdale, Fla. "We need something on Las Olas Boulevard," she said. That is one of the best calls you can get. They just call you out of the blue and ask if you have any anything.

"Yes, I may have something," I told her. Did I? No, not yet. But I don't need to fly to Fort Lauderdale. Not when I can pick up the phone and call the brokers on Las Olas Boulevard. How do I do that? I go online. I do a search for "Las Olas Blvd" and "real estate firms" and call.

"Can I have the number for your commercial real estate division and the person who deals with it? His name is Peter? Okay. Yes, please transfer me to him. Hi, Peter, I'm looking for something on Las Olas Boulevard. Yes, I'm very interested in buying the property. Nobody wants to sell? Does anybody want to lease?" So I started exploring whether I could lease or sublease and simply took it from there.

One day a young lady called me and said, "My name is Rachel. I see a sign here that says you are looking to rent 4,000 square feet to a national tenant. I have a national tenant that would be interested in renting from you. Will you give me a finder's fee?"

I said, "Yes ma'am, I certainly would. Why don't we meet?"

When she showed up at my office, she was wearing very casual clothes—a swimsuit with a little tank top. She walked in, introduced herself, and told me she was a journalist. I asked her, "You are going to rent a space that costs like $20,000 a month? That's $240,000 a year, you know. I need a 10-year lease, so that's $2.4 million for the lease."

She replied, "Yes, how much will you give me for finding a tenant?" I said, "If you can do that, I will give you $10,000 right now."

She said, "Okay, can I use your phone?"

I said, "You don't even have a phone? All right, use this phone." And as God is my witness, this girl picked up the phone and made a phone call to American Apparel. She was talking to them right in front of me, and the whole time I was thinking, "This is a prank—I must be on 'Candid Camera' or something."

They said, "We need some pictures of the property and we need them immediately." So I sent the pictures, and two days later they sent an architect and a whole team from New York. (It seems like everyone has a branch in New York when it comes to commercial). They are a very dynamic company; they moved so fast. They looked at whatever they needed to, and we finished the deal in less than 30 days. Finished *everything*. They had the store plan, the design—the whole thing was signed, leased, and delivered. I gave them three months' free rent and everything was done. They were very nice people to work with.

And you know what? Rachel made $10,000 and she didn't even have a real estate license or anything. It just so happened that they were looking in that location and she knew some key people there. I was really happy for her. As you can see, opportunity is clearly out there.

Selling commercial real estate

This chapter is about finding deals, but when you become a seller of commercial real estate, you should think about the process in reverse. If you want to sell a property or assign a deal you can list it on commercial websites such as Craigslist.com or loopnet.com. And once you put your property listing up there—with pictures and a description—you will get calls.

If you are in a hurry to sell, you can contact commercial real estate companies or list your property in an auction. You may not need to discount it—just let the auction house sell it for a fee. So as you read all the techniques in this chapter for buying commercial real estate, think of them as if you were a seller as well.

Auction houses

Look at the ads auction houses put in *The Wall Street Journal*. They'll tell you, for example, that an auction will be held in South Carolina—then you can find out how much properties sell for there. You can find out what's going up for auction in Texas, New York, Illinois, Nevada … wherever it is you live. And when there is an auction, just go. Show up and listen. Commercial auctions are very interesting. You can see who is bidding and who is buying. If a private investor shows up at an auction, do you think they have cash? Would that be a good contact for you to make so when you have a good deal you can call them? If you see a guy actively bidding, give him your business card, get his, and ask him, "What are you looking for?"

And he'll reply with something like, "I'm looking for apartment buildings west of the Mississippi. I want 40 percent vacancy. In fact, I want a lot of problems because I have a whole team I need to put to work."

Tell him you'll be in touch. Now you've found a buyer who is active.

Auctions are very important. Auction houses are very important. When you find an auction listed in *The Wall Street Journal*, call and ask if the auction house has a website. Sign up on the website to be on their list so they can e-mail you. When you get their emails, you can look at what's for sale to get a better understanding of the market.

If you are focused on, say, California, Florida, or Texas, and you get an email about a 50-unit apartment building in Texas with 40 percent vacancy that's selling for $1.8 million, and another with 160 units that's selling for $1.6 million, you can do some investigating.

So get on the mailing list of auction houses. You'll start to understand the market as you see what's selling in an area.

Attorneys

I already talked about attorneys, so I don't want to harp on it too much. Real estate attorneys know what's going on and the changes that are happening in the market. For this reason, they can give you some valuable insight. After all, they make money by getting clients. So if they see you are in the business, they will talk to you.

It's not uncommon for an attorney to tell you, "Listen, I know somebody who is interested in selling, but please call me when you put the contract together." Is that fair? Of course it is. You scratch my back, I'll scratch yours.

If an attorney makes $200 to $300 an hour, he or she is worth every penny. Out of the entire team you work with, they get paid the least—but in my opinion they are the most valuable and could have the most impact.

Newspaper ads

Some people place ads to sell privately owned properties. Real estate investment trusts or REITS are made up of investors who pool their money in the stock market and often put their buildings up for sale through newspaper ads. Sometimes commercial brokers will also put ads in the paper. Heck, this is how some real estate agents make deals. They put themselves where the deals are, where the money is, and where the money is going. You don't need a license for that. Just put yourself in the right place. You find out who is coming and who is going. These are big companies. Get them the right location, get them the right deal, and you'll get paid.

Courthouses

If you are still physically going to the courthouse to look for real estate deals, you are behind the times. You don't have to do that anymore. You can go online to access the records of just about any courthouse these days. In California, you can go to Maricopa County, Santa Clara County, Los Angeles County, and the others and get information online. Find out who is defaulting on taxes. Big commercial buildings that haven't had their taxes paid will have a tax lien. Sometimes you can pay the tax lien, get a superior position, and even get the property.

You can also find out who is getting notices of eviction. If you see an apartment building where the owner of the building is trying to evict people, would that be a good owner to contact? Is that a weak moment for him or her—are they vulnerable at that time? Absolutely. By looking at courthouse records online, you can find a lot of deals out there.

Government sites

Don't expect to see beautiful apartment buildings and retail properties foreclosed on by the U.S. Department of Housing and Urban Development, Fannie Mae, Freddie Mac, or the Internal Revenue Service. These are usually foreclosed on for some bad reason. Maybe a property has a lot of vacancy, no one's been maintaining it, somebody inherited it and didn't make the payments, or some other issue is in play. As you move up in your business and you create wealth for yourself, you can start looking into auctions and government sites to get these properties. And when you turn them around, the impact (profit) can be half a million dollars or more in a few months. Then you can refinance and cash out and keep the properties. Here are some government sites:

- HUD is www.HUD.gov.
- The U.S. Marshals Service is www.USMarshals.gov.
- Go to www.IRS.gov for the Internal Revenue Service and click on the menu where it says "properties for sale." Then under "Type" you can enter "Commercial."

Bank foreclosures

Unlike residential bank foreclosures, a commercial bank foreclosure is handled by an entirely separate department within the bank. You can call the commercial division and tell them you would like to have a list of foreclosures on commercial.

Last month, I happened to be in a bank in the Caribbean. They have what's called a private banking division where they can make you very high interest, so I figured I could park some money there until I did another transaction. I was sitting with the banker filling out some papers for something completely unrelated to commercial real estate. But I'm always thinking, so I said, "By the way, Michelle, do you have a foreclosure division? You do? Can I have the list of foreclosed properties?"

She said, "Yes, you can go online. Here's the address."

REOs and NPAs

Two acronyms you should know are REO and NPA. REO stands for "Real estate owned," which is a banking term for the properties they own. NPA stands for "Non-performing assets"—assets for which the loan is not being paid. Not surprisingly, the department at a bank that deals with these will often be called the REO Division or the NPA Division. You will be talking with this division, so just be aware of the terminology.

So I went online and started looking. Huge empty warehouses were $1.2 million. At that size, the replacement value alone would cost $2.4 million. In other words, if you built one next-door it would cost you twice as much. And the bank wanted to get rid of them. They don't like to hold commercial property because it involves maintaining tenants, getting the right people in, and other action on their part. When they get a commercial property, it's usually vacant, and filling a vacant property is not their business. Lending is their business—not real estate.

Title companies

It's good to have rapport with title companies. Sometimes a title company will see a deal fall through at the last minute. And you can tell them, "When you're doing commercial transactions, please let me know if any deals fall through. Or if you hear of any good deals, please let me know."

In my lifetime I've gotten two deals through title companies where somebody was trying to sell the property fast, it fell out of escrow, and they asked the title company if they knew anyone who would step in and buy it. They said, "We have somebody who was going to sell an apartment building and the deal fell through. Can you step in? They will give you a very good deal."

I practically *ran* over. They had everything done, everything ready. All I had to do was call my bank.

Let's contrast this to residential real estate, which is what you may be more familiar with. When you go to buy a residential property, you have to show the seller that you are preapproved by a bank. But when you buy commercial property there is no such thing as a preapproval. Why? Because the bank's not going to preapprove *you*, the bank is going to preapprove the *property*. It's an income-producing property. *Your* income doesn't matter; it's the *property's* income that's important.

So I walked into the title company and asked for the numbers on the property. Then I sent them to my bank to see whether the property qualified. It was that simple.

So keep communication open with title companies. That call from the title company was one of the sweetest calls I ever answered.

Your own ads, letters, and contacts

Why not place your own ads? Why not do a mass mailing campaign to owners of commercial real estate? It's different from residential because a commercial real estate owner responds and reacts differently than a private owner who is losing a home. A private owner losing a home feels emotional and insecure, whereas a commercial real estate owner is receiving a private letter saying, "I'm interested in buying buildings in your area. I understand you own an apartment building (or a retail building). Will you please contact me?"

Commercial real estate owners will call because they are curious. They want to know what you do and how you do it. Most of the private sellers I get for my deals are people I have contacted and said, "I know you don't have a *For Sale* sign, but you have a building I am interested in buying." And as I mentioned earlier, I tell them I am buying it because I see the potential with the building.

Your own observations

In 1999 when I was consulting with Hilton Hotels, they were opening an Embassy Suites Hotel and Casino in Puerto Rico. They asked me to go down and help solve some challenges they were having as they opened the hotel.

I flew to San Juan. As you probably know, Puerto Rico is a U.S. territory in the Caribbean and an absolutely beautiful place to live or visit.

I worked long hours trying to solve some of the problems we were having. After I'd been there about a month, one of the managers asked me if I'd like to join him on an afternoon trip to an area called Old San Juan. I desperately needed to get out of the hotel for a few hours, so I rode with him.

"This is an historic area," he told me as we drove through. "With lots of historic buildings. There are some benefits to investing in historic buildings."

Not only were there historic buildings about, but I could see that this was the location where all the cruise ships arrived. There were lots of tourists walking around sightseeing and shopping. It was an exciting location, and it looked like it had potential. So I enjoyed the afternoon in Old San Juan and filed it away in my memory.

But no experience you have or person you meet is a chance encounter. They are all meaningful—even if it's not readily apparent why at the time.

Several years later, I left the hospitality business entirely to invest full time in commercial real estate. I was evaluating properties in California, Arizona, and Florida, but something kept pulling at me. I knew what it was. It was Puerto Rico.

I decided to trust my instincts. I went to Old San Juan and found a deal that made sense. It was two commercial properties downstairs, with an apartment on top. As I calculated the numbers, I determined that the downstairs portion—when rented out properly—would pay for the entire building if I got the right tenants.

I immediately bought the building and started rehabbing it using a credit line. After I fixed it up, I realized that if I put one of my own businesses downstairs, I could refinance it and pull 90 percent of the value out. This way it would be like only putting 10 percent down. The reason I could this was because one of my businesses would be using the building—thus, the financing was similar to an owner/user SBA loan.

This was my first major commercial deal. I did the entire thing myself. And when I refinanced it, I pulled out all the money I put into it, put some money in my pocket, and still had the building pay for itself.

I used the upstairs space as a home office of sorts. Now I had a "home base" location in the Caribbean and started looking at more deals there. I started doing bigger deals and eventually owned entire streets in Old San Juan.

Most of my buildings are right in front of the piers where the cruise ships arrive. I was able to attract the biggest retailers in the world as thousands of people pass by and subsequently shop in my buildings.

The bottom line? Deals are everywhere. As soon as you adopt the right mindset and start researching, you will see potential goldmines everywhere you look. By using the ideas in this chapter, you will find all the leads you will ever need.

Finding tenants

We've talked extensively about finding deals. But once you see a property with potential, you must also find a tenant.

For my students who are just getting started, I sometimes recommend they work with tenant brokers. But whether you work with a tenant broker or directly with a tenant, you'll need to create a file on your property. As part of this file, you should have:

- An email introducing yourself and your property.
- Pictures of the property.
- Specs on the property.
- Information about the immediate area and neighboring tenants.

Through CMREI, we provide a Tenant List to our student members. This list contains the names and phone numbers of hundreds of top national retailers around the country. But more importantly, *it has the specific person to contact in the leasing department.*

Let's say you find a nice building, or space in a building, on a street that has clothing stores. In that case, you'll want to contact the top apparel retailers that aren't represented nearby. They could include TJ Maxx, Gap, Ross, The Limited, Burlington, Foot Locker, Dress Barn, American Eagle, Ann Taylor, Abercrombie and Fitch, or dozens of others.

From there, it's simple. Either use our Tenant List or do an Internet search for the company's corporate location. With some searching, you can usually find this information online. Armed with a number and maybe a name, call the company's headquarters and ask for the real estate department. It can also be called the leasing department or real estate division. The real estate department will usually have brokers that work for the company.

Even in a poor economy there are growing companies. And they want to expand their chain of stores.

Consider a company like Guess Jeans. They have 347 stores worldwide and corporate offices in New York and Los Angeles. Their management team may want to expand by 20 locations this year. If they have two brokers in their real estate department, the company's executives are basically telling them, "We need 20 more stores. Find us the hottest and best locations right now."

So those two brokers are scrambling and feverishly trying to find new or up-and-coming locations. Once you reach one of those two individuals, say something like:

"Hello, my name is Cherif Medawar. I have a property located on Market Street in San Francisco. The property is about 3,000 square feet. Across the street is a company called Aldo. Right next to them is Puma. I noticed Guess Jeans doesn't have a presence in the area. I'd like to know if you would be interested in knowing more about this space."

From there, the conversation can go one of three ways:

1. "No thank you, we are not expanding at this time (or are not interested in that market)."
2. "We are not currently making any moves, but please send us the information. We may be opening some new stores or relocating a store into that market later this year."
3. "Yes, we are looking for a store in Santa Clara," *or* "Yes, we're looking in Fremont and we may want to look at your building, too. Can you send us pictures of the outside? Do you have any statistics on the sales next-door?"

If you get answer #3 (or even #2), it is time to spring into action. If you have not bought the building yet, go ask the seller to give you some pictures of the inside. You'll also need to take pictures of the outside, of the street both ways, and send them specifications on the property size, location, parking situation, etc.

With this information in hand, you can send it to prospective tenants and speak to them intelligently about the property.

And when you are talking to brokers, it's important to remember that they work for that company. It doesn't matter whether it's a retail, warehousing, manufacturing, or medical company, they will have to present a case to company executives at some point. They'll have to go to a board or committee and say, "I found an opportunity on Market Street in San Francisco. Here are a couple of pictures. There is busy traffic and ample parking." You want to equip brokers with everything they need to present that opportunity for you.

If potential tenants tell you what they want, go find it

A couple years ago, I was buying an international building. I called three companies as potential tenants before I bought it. Each one reacted differently.

The first one said, "Send us the information—we will let you know." The second one was Victoria's Secret. They said, "We are not interested in expanding internationally at this time. We don't want to go outside of the U.S. We are expanding so fast domestically, we can't even control what we have here."

The third company was Aldo, a Canadian corporation that owns and operates a worldwide chain of shoe and accessory stores. They gave me a rundown of what they typically look for and then said, "We are not looking right now, but we'll call you back next week and let you know when we will be looking."

They never called me back. But a couple of years later—long after I had leased that particular building—I heard from Aldo out of the blue. They had kept my contact information because that's important in their business. When you start reaching out to potential tenants, they'll keep your information on file. Likewise, you should keep track of the building specs they require in case you should come across something that meets their criteria.

When I answered the phone, a familiar voice said, "Hi, my name is Trent. I am a broker with Aldo. You called us a couple of years ago and we are very interested to know if you still have a location available."

I would have liked to have leased to them back when I first contacted them. And I was a little irked that he was finally getting around to calling me. But of course I didn't tell him that. Instead I said, "Yes, let me make sure I remember the numbers you needed: You were looking for 7,000 square feet and a 10-year lease. Is that correct? Okay I'll get back to you."

Now I had a big-time national tenant telling me exactly what they wanted. Is that a great phone call to get? You bet! And why did they call me? Was it just because I called them? No, it was because I called and I had a specific location in mind for them.

As a result, I took a trip to the area where they were looking to expand. And I simply began doing a little information gathering. I was looking for anyone who had a 7,000-square-foot property for sale.

But the point I'm trying to make is that *this deal came from a tenant to me, not from me to a tenant.* And as you do your homework, as you build momentum, the commercial deals will come to you. If a national tenant contacts you, and you don't have a building that's what they're looking for, so what? They don't know that. Tell them you'll get back to them. Then go out and get one under contract to buy or lease … fly the tenant out to see it … and then get the financing based on the rent you'll be receiving.

Show up and good things will happen

Woody Allen once said, "Ninety percent of life is just showing up." If you are sitting home watching TV, what will come to you? Nothing! I always tell people it's very hard to not be rich in this country. You have to be lazy and unwilling to look. People in our country watch too much TV. It's killing the American Dream. It's not what television makes you do that's bad. It's what it doesn't allow you to do. But when you get off the couch and quit watching TV, good things happen. When you make a little effort, life meets you halfway.

When I got started, it was as though I was going up the stairs one step at a time. Then, because I kept "showing up," all of a sudden I found myself on an escalator one day … going up rapidly.

As you move forward, life comes closer. If you sit lethargically, life moves farther away. Just by making a phone call two years ago, I started things moving in the right direction. By making a small change today, you'll begin moving in the right direction. Things will happen slowly at first, and then one day you'll find yourself deep in the blue ocean.

Chapter 8:
Analyze and Calculate

Let's continue with the FACTS. *Analyzing the deal* represents the *A.* It's important to analyze the numbers and make sure the amount the property will bring you is significantly higher than your payment on it.

When analyzing a deal, there are three ways you can make money. You want to buy a property:

1. Below market value.
2. With great numbers (its income).
3. With potential for improvement.

Any deal you do must have at least one of these. It's even better to have two or all three. Let's take an in-depth look at each.

1. Below market value

We talked about this technique a little already in **Chapter 4: How to Produce an Immediate Profit.** When analyzing a deal, the first thing you should do is look to see if the deal is below market value. We've already established that the value of commercial property is based upon its income. However, even in commercial you can use comparable sales numbers to guide you.

Is an apartment building, retail space, warehouse, or medical building lower than its market value based on comps? Perhaps there is a similar one that sold nearby where a buyer paid more. Although a bank will not loan to you based on comparable sales, sometimes you can tell a lot by looking at them.

You can also look at a property's *replacement cost* as a good indicator of its value. Remember when I told you the bank had a big warehouse they wanted to sell for $1.2 million? I calculated that building a similar structure would cost me nearly double the price, or $2.4 million.

2. Great numbers

Another effective way to identify a good deal is to find a property with great numbers. Look at the income on the property. Is it cash-flowing well?

Let's say you're analyzing a single-tenant retail space. The building has ample parking and the tenant happens to be Kentucky Fried Chicken (KFC). The building is cash-flowing at $100,000 a year and they want to sell it for $1 million. You like the cash flow. The numbers make sense because the income is good. You like the fact that for a $1 million investment you will make $100,000. That's a 10 percent cap rate. Once you've established that the numbers are good, start moving forward.

3. Potential for improvement

What if the building is making $100,000 and they want $2 million? Now the cap rate is just 5 percent, so the numbers are not as exciting. Let's say the McDonald's building across the street recently sold for $2 million. So the comparable sales are the same.

If we look at the replacement value, let's say it would cost me less than $2 million to replace it. So it would cost me less, but maybe I can't find any other lots nearby to build a KFC.

Well, what about the potential for improvement? Let's say the lot is huge, most of it is vacant, and all they need are [X] number of parking spaces. Maybe you can put a single-tenant building on the unused portion and lease it to Verizon Wireless. Maybe you can put a Coffee Bean there and have a drive-through. Now you're seeing the potential. And a building's potential is limited only by your imagination.

Maybe you can put a billboard sign on the side if the city has no problem with that. Maybe you can put in some stairs and lease an office on the second floor. Once you have some drawings and submit the changes, you can get a construction loan and make payments in stages. Stage one: Get the drawing approved and pay for the contractor to start; Stage two: build; Stage three: finalize.

Let's go with adding the upstairs office. How much will it cost you to build this? We'll say it's going to cost you $500,000 for everything—that even includes delays in the payments because of slow construction. If you get the whole thing financed, let's say you'll have additional income of $50,000. With $100,000 of income, it was worth $2 million. With an additional $50,000 of income, you can get another million for it, for a total of $3 million.

Always try to have no down payment

When purchasing property, I always try to get a zero down payment—even when I have money. Why? Because I have the same investing mentality—now that I have millions—as I did when I started with nothing. If a down payment is required, I want to refinance, split the building, sell parts of it—basically do anything I can to cash out my money and keep the rest free and clear. If I get my initial investment back, the rest is just free income for me. I suggest you adopt the same mentality. You'll sleep *much* better.

Okay, follow me here as I bring this in for a landing: If you paid $2 million for the building … and it's costing you $500,000 for the new construction … and the building is now worth $3 million … you've just made half a million dollars! But at this point, that money is in equity. So do you want to sell it? Take all the money and run? No. Now you want to refinance it and cash out *some* money. And after a year or two, maybe the rental income has escalated to $110,000. Now the value of just the KFC is $2.2 million. So split the building, sell the KFC, and keep the office. Now it's all income to you because you owe nothing.

Analyzing the numbers

Some people are under the misconception that commercial real estate is confusing or difficult. It's not. Here are a handful of key indicators you can analyze to tell whether you should make an offer:

- Price
- Current income vs. potential income
- Vacancy
- Operating expenses
- Net operating income (NOI)
- Capitalization rate (cap rate)
- Financing and debt coverage
- Cash-on-cash return
- Return on equity (ROE)
- Return per square foot
- Return against alternative investments

Let’s look at each one individually.

Price

What is the price of the property? Do they want $1 million or $2 million? We talked about using comparable sales or replacement cost to compare prices. Don’t spend a lot of time analyzing this. After some experience, you will be able to tell at a glance if it’s worth pursuing. And price is the first indicator of whether you should dig deeper or not.

Current income vs. potential income

Let’s say the current income is $100,000, but the Kentucky Fried Chicken lease is expiring next year. If they are making a killing and doing very well, do you think they are going to want to renew the lease? Of course. And if you buy the property right now at $2 million—and you know that the McDonald's across the street is paying $200,000 a year—can you increase the lease when it expires? Maybe not to $200,000, but you can certainly increase it.

Maybe the lease is not going to expire for a few years, but you could still make some money by purchasing the property and keeping it as is. Then, with expansion, there is potential for a future income of 1.5 to two times higher.

Potential income is the key. What do you need to do to the property to realize the increased income?

The great thing about the potential for income is you don’t need to find a motivated seller. Just knowing that you will increase the income is enough. But what if the seller *is* motivated? Now you’ll make money coming in, you’ll make money staying, and you’ll make money when you improve the property. What a trifecta.

Vacancy

Vacancy is an estimated loss in rental income due to property vacancies and nonpayment of rent. On retail properties and warehouses, you have virtually zero vacancy. If the lease is for 10 years, then you know it's not going to be vacant for 10 years.

On apartment buildings, you do have a vacancy factor, and it’s usually calculated at 5 percent.

I talked to a gentleman who had an apartment building in Palo Alto, and he told me, “I’ve been renting my apartment building for five years and never had vacancy. I'll show you the paperwork. Not one unit vacant.” And it was a 20- or 30-unit building.

So I replied, “You have a problem.”

“What do you mean?” he asked.

“If you don't have vacancy, your rents are too low. You must not be increasing the rent,” I explained.

“But I like my tenants,” he replied.

“Well, I *love* my tenants, but I built increases into the lease as standard.”

He didn’t like that answer, but he knew it was true.

Back when I did residential, I was trying to keep tenants long-term and I told them, “I would like you to sign for three years of rent.”

And they all said, “No, three years is too long. You could jack up the rent, we won’t be able to leave, and we’ll be stuck.”

I said, “Listen, I’ll put it in writing that if you stay with me for five years, I'll give you no increases the first year, an increase the second year, no increase the third year.” I tried to work it out so the building still increased in value but I still had good income and good tenants, and everyone was happy.

But I was still unsuccessful with these buildings because it required a lot of management. Some investors hire management companies, but you can have problems with management companies, too.

Once I had a vacant commercial unit that wasn’t renting—and on a whim I decided to see how they were managing my building. So I called the management company acting like I was a potential tenant who saw the sign. “Hi, I saw the sign outside. I'd like to know how much the rent is and what the configuration is.”

And as God is my witness, the guy on the phone gave me the information of *another* property on *another* street close to my property. They were pushing another building instead of mine—even to callers who were interested in my building. He started trying to convince me that the other property had a better layout, better parking, and other benefits. Why? Maybe they were favoring that landlord over me, I don’t know.

I said, “No, I'm calling about the one on this street.”

And he kept on, “The other one will be better for you … yada yada yada.”

So I told him, “I hate to play games with you, but I am Cherif Medawar, the owner of the building. You are trying to push another building on me when you should be doing your job.”

And do you know what his response was after I told him how they were doing me wrong? He said, “You cannot get out of the contract for another three months.”

That was his response. Do you think I got out of the contract? Absolutely. That's when a lawyer can come in handy.

Getting tough

Anyone who knows me will tell you I am a nice guy. But in business you can't *always* be nice. When you need to handle a problem, you should always start nice, but you have to know how to be tough. Wars are not won with kindness and diplomacy—they are won with force and intelligence.

When you see Donald Trump, does he smile and say, “I want to thank you all for coming,” or does he come in like somebody just stepped on his toe? He comes out upset at the world. Why? Because he's constantly battling. He's got American Express leasing a whole floor from him. Citigroup’s leasing another floor. They want to negotiate this, they’re demanding that. He’s got to deal with attorneys and other negative forces against him all day, every day.

You don’t have to walk around with a ticked-off attitude like Donald Trump, but on occasion, you’ll have to get tough like he does.

I told the lawyer, “I'd like you to send out a letter immediately. Fax it to them, send me a copy, and tell them I want out or I'm going to sue.” Would I have sued? Maybe not, but it got their attention. And I got out of the contract.

Net operating income

With any property you examine, you want to determine the net operating income. You get this by subtracting the operating expenses from the property’s income.

If you have income, you must subtract the vacancy—usually calculated at 5 percent. You could even tell the bank that your building—like the gentleman’s apartment building I mentioned earlier—has never had a vacancy. But the bank is still going to calculate a 5 percent vacancy. That's standard.

Capitalization rate

Capitalization rate (also referred to as cap rate or cap) is the most important number I want you to understand. To help you remember it, I’m going to give you an unusual definition you won't find in any other book. Here’s my definition: *Cap rate is the return you’ll get on the money you invest.* In other words, if you buy a building with cash, the cap rate is how much return that will bring you.

If you pay $1 million for that Kentucky Fried Chicken, and the property's net operating income is $100,000, the property has a 10 percent cap.

Here’s another example. Say you look at a property in Arizona, and you ask, “How much is this building making and how much are you asking?”

They tell you, “This building is making $50,000. And we want $1 million for it.”

What's the cap on that property? It would be $50,000 divided by $1 million. So the cap would be 5 percent.

You can also work the formula in reverse to find out what the purchase price should be. If you are an owner in Michigan and you have a property that makes $100,000 in income, how much do you think it's valued at next to this one that just sold for $1 million?

Here’s how to figure it out: NOI ÷ cap rate = building value.

So $100,000, divided by 5 percent, for a purchase price of $2 million.

Let's say you’re buying something in Texas and they tell you it's a 10 percent cap. That means if you buy the building with all cash, it is going to make you 10 percent. Not so difficult, right? If you buy a building and your loan has a mortgage interest rate of 7 percent, but the building makes you 10 percent, that’s a sweet deal. The bank is charging you 7 percent and the building is giving you 10 percent. Let me see… get 10 percent, pay 7 percent ... I’ll buy every property in the country at that rate! What about you?

So in commercial, the key question is always: What is the cap? The cap will differ in each area. If you have cash and you are buying property in California, you will generally have a cap between 5 percent and

7 percent. That means if the building makes $50,000 to $70,000 a year, it's going to sell for around $1 million.

But in Texas, parts of the Midwest, and the Carolinas, a property that makes $50,000 will sell for only $500,000. So clearly you can make a lot more money outside of California. Why do you suppose this is the case? I'll tell you. Because there's a large population and a limited amount of land.

Go to an area like San Francisco and look for a building near Pier 39—you couldn't pay someone enough for one of those. They don't want to sell because they're making so much money. They have small places and they rent them very high. And if they do sell them, the buyer will only get a cap rate of maybe 5 percent. But wait. If you are borrowing at 7 percent and the income is only 5 percent, you'd be upside down. So who buys these? I'll tell you. Very wealthy people who have extra cash and think of their finances a little differently.

Here's what I mean. Imagine you own a huge company and you are making millions a year. And you need to invest and grow. Do you want to put your $2 million in the bank and make 5 percent, or should you buy a single store location at Pier 39 in San Francisco? Which is better? A 5 percent cap rate with a triple net lease? Or putting that $2 million in the bank at 5 percent and earning $50,000 a year?

Personally, I would buy the real estate. And here's why: On a triple net lease, the tenant is paying the insurance, taxes, and maintenance. In the meantime, the income from this building keeps increasing at 3 percent every year. After 10 years, the rental income has become, let's say, $60,000 a year. Based on the formula, that $10,000 income increase makes the property worth another $200,000.

Meanwhile, inflation is eating up the value of your money in the bank at 3 percent a year. So your 5 percent is really more like 2 percent. However, you are also getting taxed on that money. So you're really not making anything; your money is essentially devaluing over the years.

The moral of the story: Commercial real estate is nearly always the better investment.

Financing and debt coverage

A bank is going to loan you money based on something called the debt coverage ratio (DCR). Remember, commercial is not like residential, where the bank gives you a free approval letter to buy a property. They're going to want to see the income of the building. And they want to see that the income will cover the debt, which is represented in the debt coverage ratio. So the DCR is a ratio of the income versus the debt.

Let's look at the DCR in action. The income of a building is $12,500 per month, or $150,000 a year. The debt payment on the loan the bank is thinking about giving you will be $8,200 per month, or nearly $100,000 a year. So if your income is $150,000 and your debt payment is $100,000, that is a DCR of 1.5.

Here's another example. Say the property income is $120,000 and the debt is $100,000. What is the debt ratio? It is 1.2.

What if the income is $100,000 and the debt is $100,000? The DCR is 1.0. If the bank calculated your DCR at 1.0, what are they likely going to ask you to do? Put more money down.

If Bank A wants your DCR to be 1.3, make sure you tell them, "Bank B is only requiring a DCR of 1.2." You don't go to one bank to get a loan; you have to ask two or three banks. Make the banks compete.

Special government programs have lower requirements

Banks typically want your DCR to be at least 1.2, which is the industry rule of thumb. That means for every $120,000 in annual income, you have no more than a $100,000 annual payment.

But sometimes banks will have special programs, more or less “sponsored” by the government. These government programs can help you a lot, because they agree to back a certain percentage of the bank’s loan. This allows the bank to be more aggressive in specific locations, such as Florida or New York, for specific projects. And that means they’ll accept a lower DCR for you.

Let’s analyze the purpose of the DCR. Why do banks want you to have more in income than in payments? Because if something happens and you stop paying them, they need to know there will be enough income to cover their investment.

One time I was working on a deal and the bank told me, “You can buy this property with 20 percent down, but we need a DCR of 1.2.” I knew the property would make me $120,000, so that meant my total payments could not exceed $100,000.

So I asked them what my yearly payment would be. “Well, your annual payment will be $110,000.” The ratio was almost 1.1. Not good enough.

I tried to negotiate by asking, “Can you live with a debt coverage ratio of 1.1?” But they stood firm on requiring 1.2.

At that point, I showed them how experienced I was. I told them how I would be changing the tenant and improving things. This is where experience will make things easier for you. When I showed them this, they said, “Oh, you’ve done this before? Can you show us?” After they saw everything I was going to do, they said, “Okay, we will work with you.”

So I just had one question. “Instead of 25 years, can you spread the loan out over 30 years? Give me a little longer term?”

And just like that—with one creative question—I got the building. Oh, they hemmed and hawed a little, but it was a stable building with a good tenant, so they finally agreed. Thank goodness I asked them if they could give me a longer term. Why? Because that 30-year term dropped my annual payment to $100,000. And that building is going to make me millions.

You don’t get if you don’t ask

Banks don't like to amortize loans for more than 25 years on commercial deals, but I have gotten loans up to 40 years in length, just by asking. It helps when you can ease their fears by showing them your experience, but you’ll never get anything without asking.

One time I was trying to buy a building through World Savings Bank (now Wells Fargo). My payment to them was about $90,000 a year. But I had the seller carry a note, and my payment to the seller was $15,000 a year. The bank told me, “When we calculate the DCR, we include your payment to us *and* your payment to the seller.” And if you combined both payments, as they were doing, my DCR was too low.

So the banker informed me, “We can't let the seller carry a note; we want you to put down a cash payment because we don't want you to have payments that mess up your debt coverage ratio.” I was disappointed, and I didn’t want to take up any more of his time. He told me he was buried in paperwork. And he literally was—I could barely see the guy over the papers on his desk.

So I stood up to leave, but I didn’t want to walk away. I was trying to be creative. I had to find something. We were literally at the door and I said, “How about if I don't have to make payments to the seller?” “What do you mean?” he asked.

“What if I make the payment to you and I arrange to have the seller get a balloon payment in two years?” So we went back and sat down. The banker finally agreed, “Well, if the seller will accept one full payment in three years, we can go ahead and give you the loan. So every year for the next three years you will owe him $15,000, and then you can refinance on the fourth year and pay him all the accrued in payments you have not made.”

So I called the seller and said, “Hi, I have good news and bad news.”

“What is the good news?” he asked.

“The good news is I'm buying the building.”

“What is the bad news?”

“The bad news is I can't give you monthly payments.”

“Why not?” he asked. “I wanted that positive cash flow.”

“Because the DCR will be different. It’s at about 1.1 and they want it to be at least 1.2,” I explained.

But he was a savvy person, so I said, “Look, I'm going to write the contract with you. We can go with this bank, but I promise you as soon as I finish the changes to the property, I'm going to pay off the note in six months. If I don't, you can increase the interest rate from 8 percent to 12 percent.”

He agreed that was fair and we made the deal happen.

Cash-on-cash return

It’s important to calculate your *return on cash*. Remember I said that if you paid $1 million *cash* for a building, you could make 7 percent, which is $70,000?

But what if you *borrowed* the money? Let’s say you only put $200,000 down and you borrowed $800,000 at a very favorable interest rate of 6.5 percent. The building is bringing in $16,000 annually. Now instead of the building making you 7 percent, your cash-on-cash return is 8 percent. (Divide $16,000 by $200,000.) Why? Because the bank is lending it to you at 6.5 percent, but the property is making you a 7 percent cap. That’s a nice tradeoff. You should *love* to borrow!

The problem comes when you have a property with equity and no access to that equity. Remember you want the cash out. You want the building to pay the bank and give you positive cash flow. You want the building to make you wealthy.

You can make 8 percent on your money. And if it’s a $1 million building, that’s $16,000 per year. That’s better than putting your money at risk elsewhere. The debt is getting paid down, and 10 years later the property has increased in value from $1 million to $1.4 million or $1.5 million. It's just a matter of time.

You acquire assets, the assets build equity, and the equity becomes cash. Or you can acquire the assets, improve them, and immediately turn them into equity so you can refinance and pull out your cash.

Return on equity

Since investing is about putting your money to work, it's important to know how your money will be used. Return on equity (ROE) gives you a good indication of how well a building will use your investment to generate a profit.

On Wall Street, ROE is particularly useful for the common-sense investor. It can help cut through the fluffed-up corporate statements that are churned out by most CEOs in their annual reports. So when they attempt to paint a pretty picture by saying that their company has "achieved record earnings," you can get a much more complete picture of the company's health by doing a quick computation of the return on equity.

Warren Buffett, one of the most successful investors in the world, said that getting higher earnings each year is an easy task. But it's ROE that will help you discern whether a company is actually putting its equity to good use for its shareholders.

For our use of ROE, let's say you find a deal. The seller tells you, "I need to sell this property right away. I don't want to pay real estate commission. I'll give it to you at $1 million if you close fast."

You buy the property for $1 million, but it's really worth $1.1 million. Let's say you put $200,000 down but the appraisal came in at $1.1 million. Your down payment was $200,000—and you instantly gained $100,000 in equity when you bought it—so you really have $300,000 in equity. You are making $16,000 a year. So take $16,000 and divide it by your $300,000 total equity. That equals your ROE.

Remember, the property is worth $1.1 million. So between your equity from the cash down payment and your instant equity when you bought, you have $300,000 in equity. So the $16,000 divided by the 200,000 is your return on cash (8 percent), and $16,000 divided by 300,000 is your return on equity (5.3 percent).

When you calculate ROE, remember that commercial properties are constantly going up in value. The beauty of this is that whether the interest rate goes up or the interest rate goes down, I don't care. The U.S. Federal Reserve chairman himself could come to me and whisper, "Cherif, the interest rate is going to go up."

And I would say, "Thank you, I appreciate you telling me, but I don't need to know."

Why? Because I already have fixed increases of 3 percent per year that are increasing the value of my building. And I have a 10-year fixed payment to the bank. The loan is guaranteed. I don't care what happens with the interest rate; I don't care what happens in the neighborhood—I know I'm going to make money in the long term. What happens in the short term doesn't matter to me. I'm already set for 10 years, 12 years, or whatever terms the leases spell out.

No matter what happens to the market, the increases in rent increase the equity. Next year your property will be worth $1.05 million, and you'll have $350,000 of equity. Year after year, the rent escalates and the equity increases. But after awhile you'll find out that you have a lot of equity—and you have good positive cash flow—but you continue to have a very low ROE.

So what should you do? Get credit lines from the bank or refinance and get some cash out. Some people tell me, “But I don't like to have too much debt.”

And I reply, “What makes you feel more secure? To have equity or to have *cash*?”

If I can get the cash out of a building, and have the rent make the payments for me, I want all the cash I can get. I will have a financial statement that will make the bank choke when I show up and say, “I've got so many millions here, I don't know what to do with them. So I am putting them in a CD with you. By the way, I'd like to buy this property.”

And the bank will tell me, “You don't need to use your cash. We would like to give you a CD for the cash. We will go ahead and give you a 100 percent loan.” That’s what happens when you build momentum.

But whenever I tell other investors that *on average I can get a 100 percent loan for 40 years,* they don't believe me. They have never seen it. Not even the biggest REITs in the United States can do that. But you can start having a return on cash and can tap into the return on equity once you:

- Build rapport with the banks.
- Make them compete.
- Show them what you are doing, including how you’re increasing values.
- Are getting the debt ratios right.

ROE vs. cash-on-cash

Consider a property that costs $100,000 and produces net income of $10,000 per year. If you purchased it for cash, your annual rate of return on the equity invested would be 10 percent ($10,000 income ÷ $100,000 equity). Assume instead that you borrow $75,000 at 6 percent ($4,500 interest) annually and make a down payment of $25,000.

Now your $10,000 income is reduced by the cost of financing to $5,500. The resulting return on equity invested is 22 percent ($5,500 ÷ $25,000 equity = .22 or 22 percent rate of return on equity). This is why you should borrow money to do your deals.

Return per square foot

You can actually calculate a property’s return per square foot. If a property has 10,000 square feet and it’s making $10,000, then 5,000 square feet should make you $5,000.

When you lease space to retail tenants, they usually calculate what their *rent* is going to be per square foot—but they sometimes also calculate their projected *sales* per square foot. Let’s say you’re talking to a company like Adidas and they’re asking you about your available space. The conversation will go something like this: “How much is it?” they’ll ask. “Because we need 10,000 square feet.”

“Well, it's 11,500 square feet.”

“That's great because we need extra storage space. So that will be wonderful. How much is the rent?”

“The rent is going to be $50 per square foot,” you tell them.

“Okay, let us make some phone calls and we will get back to you.”

Once they call you back, they’ll say something like, “Okay, we talked to some other tenants that we know in the area they said they are doing sales of $1,000 per square foot. We can easily pay you the $50 per square foot.”

Where did they get these numbers? Well, we have our formulas as investors. But tenants have their formulas too. And in this case, their statistics said that if Fossil, Puma, or Ross stores are selling “X” per square foot in this immediate area, that they will likely do “Y” in sales per square foot.

Return against alternative investments

What about your return compared to alternative investments? Should you put your money into this building and get 7 percent, or should you take the million dollars and put it into a CD at 6 percent?

For average people, alternative investments are always competing with real estate because average people don’t understand real estate very well. They don’t understand that once you get the property:

- The rent increases.
- Its value increases.
- The debt gets paid off.
- You have tax deductions.

They don't understand the incredible compounding effect that could be making them very wealthy in the long term. At this point in the book, you are no longer “the average person.” You understand all these things. You are developing an investor’s mindset. And if you use these concepts—and apply some creativity—you will be very wealthy in the short term *and* the long term.

There is no better alternative than commercial real estate.

Analyzing the costs

We’ve analyzed some key indicators and other numbers that are important. But there are a few other things you should know. Whenever you purchase property of any sort, there are always costs involved. They include:

1. Holding costs.
2. Financing costs.
3. Commission costs.
4. Repair costs.
5. Other costs.

Holding costs

You have to know what your holding costs are going to be. Essentially, holding costs are the costs you incur during the time you spend “holding” the property as you get it ready to rent (or sell). Holding costs can be taxes, insurance, and debt payments.

So ask yourself:

- How much will I spend before I can rent (or sell) the building?
- By the time I fix the building and get the tenant, what are my holding costs?

Financing costs

How much will it cost you to get the loan?

- How many points will it cost you?
- How much is the payment going to be?

You must also consider your closing costs. These can be considered part of the financing costs or broken out separately.

Commission costs

If there's a broker involved in getting you a tenant, that person is going to tell you, “We're going to get you a tenant that pays you $70,000 a year for 10 years. That's a $700,000 deal (or higher, depending on the lease).”

“Well, that sounds great,” you say. “But what's the commission?”

Because commission costs are the key. Usually brokers charge you 2 percent or 3 percent. If they are from New York, it seems to be 4 percent to 5 percent.

Repair costs

Do you need to repair the property? Can you pass on the repairs to someone else? This is *vitally* important when you are analyzing the numbers. Always try to have other people repair the property. If you are a contractor and you want to repair properties, you will lease them very fast; you'll even have multiple bids. But you’ll have to deal with the repair headaches.

Other costs

Other costs you can analyze include:

- **Conversion costs.** How much will it cost you to convert, split, or change a property in any way?

- **Attorney’s fees.** Your attorney will charge you to write the contract that changes the configuration. The attorney will also charge you fees to record documents and submit paperwork to the city on your behalf.

- **Resale or refinancing cost.** If you resell it or refinance a property, there will usually be fees involved. However, if you refinance with the same bank, they usually don't charge you points. Why? Because they don't want you to refinance with another bank. They want to keep your business.

Uncovering the true numbers

In some commercial deals, especially multi-unit properties, sellers will play with the expenses in order to make the property look more attractive. Here are several ways to uncover the real expenses:

- Do a *pro forma*. A *pro forma* is similar to a historical income statement, except it projects the future rather than tracking the past. *Pro forma* income statements are an important tool for planning future business operations. There are current numbers, and there is a *pro forma* that projects the numbers into the future.

  As part of the *pro forma,* you'll want to know something like, "If I increase the rent by $50 per unit, and there are 10 units, that's $6,000 per year more in rental income." But there are always expenses that will eat up some of that income increase. So you must factor the expenses into the *pro forma* as well.

- The best way to make sure you understand the numbers is to write the contract with a stipulation that you can monitor the business for 30 or 60 days. (This is done in business all the time.) Or you can lease the building with an option to buy.

  You might say, "Look, Mr. Seller, I'm serious about buying this, and I would love to give you a $50,000 earnest money deposit when I write the contract. But I'm going to give you $10,000 right now to have a lease with an option to buy so I can monitor the numbers for two months. I will be involved and see how things operate. And if everything looks good, then I will close."

  Then you can actually go in, see how the business is running, and have management/ownership coach you through the day-to-day operations. More importantly, you'll have more confidence and comfort in the numbers. If the numbers make sense at the end of "X" time period, then you can buy.

- If the property is managed by an actual management company you need to get the P&L from the management company. That will give you the true expenses because a management company doesn't have time to play games with the numbers like some sellers will.

- Any person who runs an income-producing property has to file taxes. In doing so, he or she has to show the income and expenses. And I guarantee that person puts *all* the expenses on the tax forms to get the maximum deduction. Just tell the seller that you want to see the last two years of tax records. This is a great resource for you to use to verify the numbers.

- You can get what's called estoppel certificates. Estoppel certificates (or estoppel letters, as they are also called) are very common in the sale of real estate. An estoppel is a document sent to a lender, a homeowners association, a city/municipality, or a tenant requesting a payoff of a mortgage, assessments or taxes due, or rental amounts due on a lease, in order to incorporate these amounts into the settlement statement for the buyer and seller of the real estate.

  In this case, the tenants would fill out the estoppel certificates to verify how much they pay their current landlord (the seller) in rent.

Don't get me wrong. I'm not trying to say you will be dealing with thieves or people who don't want to disclose things. But when you're buying a commercial property, the requirements for disclosure are not very strict.

In a residential property transaction, the seller must tell you everything. On commercial properties, the requirements are not the same. So you have to do a little more due diligence and be a little bit more cautious.

'Projected' numbers

When you look at real estate listed for sale on LoopNet or anywhere else, you should be familiar with the nuances of how brokers will list the properties. Often you'll see the "current income" versus the "market income" or "*pro forma*" income. Market income and *pro forma* are **projected numbers**. In other words, the listing is telling you what the owner is getting right now versus what you can expect to get when you become the owner.

I have yet to buy an apartment building where they didn't tell me that the income would be more when I bought it. This will undoubtedly happen to you. You go in to look at the apartment building and the broker, the real estate agent, or the sellers are telling you that you can raise the rent.

One time I was so irked I said, "No kidding, I can raise the rent and you couldn't? You are selling the property to me because I am that much smarter? Why didn't *you* raise the rent then?"

Recently I saw a property listing that gave the current income and then it said "*pro forma* expenses." Let me guess. Those projected expenses are lower than the current ones, am I right? It's pretty clever the way brokers think, but if you understand the terminology you can't fail. Just remember: All you want are current numbers.

You are essentially telling the seller: *I want to buy your current "problem" at a discount. Why?Because of the value. You see, the price is based on your* current *problems; your* current *situation. Never mind what I'm going to do to the property once I buy it. Maybe I'm going to increase the rent or I'm going to expand the property. That's none of your concern, Mr. Seller.*

Remember the dozens of opportunities you've had to get the property to its highest and best use? That's really the value, that's what you are buying.

So you don't want *pro forma* numbers. You need current income on an apartment building and current expenses, and then you need to *verify* the expenses. After seeing the numbers, if you are still not sure about everything, you may want a longer period of due diligence.

Let's say you need 90 days to make sure everything is OK. How do you write that in the contract? Whatever you do, don't say *I need 90 days to evaluate the deal*. That could discourage the seller. Write that you need 60 days, which is customary, and that you *have the right to extend for another 30 days*. That sounds much more reasonable.

However you do it, analyzing a deal in commercial real estate is about the numbers. By following the guidelines in this chapter and using your observation skills, you'll end up with only the deals that are profitable for you.

Chapter 9:
Control the Transaction

Controlling the transaction represents the *C* in FACTS. Once you find a property you're interested in, you need to set the wheels in motion. You need to control the transaction from the start.

And you do this by using the appropriate paperwork. Many people think commercial paperwork is complicated. This is not true. While there may be a few more documents involved in commercial transactions than there are in residential deals, they are not difficult to understand. The documents you need for purchasing a piece of commercial real estate are simply:

1. A letter of intent (LOI) to purchase when you are interested in buying the building.
2. A legally binding contract (purchase and sale agreement) when you're ready to commit to purchasing the building.

When you have a residential property, you're usually using some kind of standard contract. Those standard contracts have typical clauses protecting both the buyer and the seller for a certain amount of time. It's kind of a contingency period that allows time for getting a property inspection, a title report, a termite inspection, and an appraisal.

But when it comes to commercial real estate, instead of going right into a contract, it's usually a little different. Let's say you look on www.LoopNet.com and you find a property you are interested in. It's listed by some real estate broker named Christopher, so the first step you should take will be to send Christopher a letter of intent to purchase.

First things first

Many new investors find a property they are interested in that is already rented and immediately call the bank. Upon being asked how much they would loan on the property in question, the bank is going to want to see the leases before they can tell you. So send the seller an LOI so they can send you the leases. Then you can get the leases to the bank and start getting some real loan numbers.

The LOI is kind of an informal (yet still business-like) way to present or express your interest in buying the property under certain terms and conditions. It's like a preliminary starting point for negotiations. The LOI is not created to bind anybody; it's just there to express your interest in buying.

After receiving it, a seller will usually respond and you'll start some basic negotiations. From there, you will go into a due diligence period. Once you come to terms, you will sign a binding contract. So in commercial transactions, it's kind of a two-step process before you get to the actual binding contract.

The LOI to purchase

Some people trying to buy commercial properties incur costly legal expenses by getting attorneys to draw up contracts—but then they go through their due diligence and discover they don't want the deal because it didn't pass inspections anyway.

Why spend the money? Just do an LOI in order to agree on the basic bullet points of the deal, do your due diligence, get the inspections, get the title report, and see what paperwork they can show you on the property. Make sure everything passes the standards you need.

Putting information into the LOI

Let's pretend we are looking at an actual deal as we go through the items on an LOI. So for the purposes of this example, I'm going to pull an actual deal off of Loopnet.com as I write this.

Loopnet.com search criteria

Here I am at Loopnet.com. I'm ready to enter in my search criteria. The first thing I want to do is put in the area where I want to buy. So where am I looking? Well, in much of this book, I've talked about property in California, Texas, Florida, and the Northeast. So for this example, I'm going to go to the Midwest. I don't want my Midwestern readers to feel neglected. So how about Iowa? You can't get much more Midwest than that. The first thing I will do is enter Iowa into my search criteria.

Next, LoopNet asks me to specify the *property type*. We'll say retail. What about *property sub-type*? Let's look at shopping centers just for fun. What about *price*? Let's limit it to anything under $2 million. What about *property use*? Do I want investment property? Net leased property (net leased means triple net)? Vacant property? Owner-user property?

Let's choose owner-user property. So if I have a retail bicycle business and I am looking for a 3,000-square-foot store on a street with busy traffic to operate a retail store, I'm going to click on "owner-user" as criteria. In fact, you can be more specific by selecting *vacant* owner user.

There are many other search options such as by owner, building size, and lot size. But I'm going to leave the criteria I entered above—without entering anything else—and see what I get back. You can take time and experiment with the different search options on your own.

Selecting a property

LoopNet takes a few seconds and returns several properties from my search. The first one looks pretty good, so I'll select it.

It's called Cityview properties. Two neighborhood strip centers, well-maintained and highly visible on University Avenue. Sounds good. Both locations are being marketed together and total more than 24,000 square feet with a total price of $1.5 million. They can be sold separately. Both properties are 100 percent leased to long-term tenants. The cap rate listed is 8.5 percent.

One building is called Family Dollar Plaza because it has a Family Dollar store in it. Okay, Family Dollar is a good company and we can see that the lease is triple net, there's ample parking, and other details. But there's no cash flow information. Why didn't they provide the cash flow information?

Because it's triple net. It is a net lease investment. They've told me the cap I'll be making. So let's calculate the net cash flow. Remember this?

Building value (price) x cap rate = NOI

$1.5 million x 8.5% = $127,500

So the building is making $127,500 a year. That's your net operating income. We're going to need this information in a moment when we fill out the LOI.

Filling out the LOI

When you write an LOI to purchase commercial real estate, if the company is big enough, you can address it to the chief financial officer (CFO) of the company selling the property. If there is no CFO, you can send it to the president. If the company is using a real estate agent, you also need to send it to that person.

It should say something like this: *Mr. Jones, this letter of intent expresses purchaser interest in buying the property located at [address] under the following terms and conditions. However, this document does not create a binding agreement for purchaser or seller.*

From there, it's just filling in blanks. Let's take a look at what should be included in the LOI to purchase, item by item:

1. **Purchaser**
   Where it says "Purchaser," you put your name.

2. **Seller**
   Where it says "Seller," put the name of the seller. If there's an agent involved, he/she can tell you the correct spelling of the seller's name, LLC, or corporation that owns the building.

3. **Purchase price**
   In this case we are going to put the purchase price at $1.5 million. But sometimes you can use the LOI to negotiate a little bit, by offering a lower purchase price. In this example, we will be negotiating the cap rate.

4. **Cap rate**
   The listed cap rate is 8.5 percent. Do we want to offer them 8.5 percent? No, we want to have a better return. Let's ask for 9 percent. So we're negotiating with our LOI.

   I can call the broker and say, "Listen, Christopher, I know you are listing these two properties. I'm very interested in buying them and I'm going to send you a letter of intent. I'm going to call the bank right after I hang up with you. The bank has already received my financial statement; they just need the leases so they can verify them. By the way, do you think the sellers would take 9.25 percent?"

   And then Christopher, who is representing the company, may say, "Would they accept 9.25 percent? I doubt it. But you know what, send me the 9 percent and I will talk to them and see what I can do."

   That means he's going to try to get them to 9 percent and he will hopefully come back with 8.75 percent. But remember, he is representing them. So he might tell you, "No, you'd better put it at 8.75 percent. ..."

   And if that's the case, you say, "Listen, I'll tell you what. I'm going to go ahead and send you the LOI at 9 percent and then you can maybe counteroffer at 8.75 percent."

Why do this? Because if you start at 8.75 percent, it will *definitely* come back at 8.5 percent. See my point?

As the new owner, the amount of rent you will receive will be $127,500. You might be able to increase rents after you purchase, but that will have to wait for now. What you need to be concerned with now is putting 9 percent on the LOI. But wait a second. Remember our formula? If you change the cap rate, you also have to change the purchase price. We use the same formula we used previously to find the new purchase price. Remember? It looks like this:

NOI ÷ cap rate = building value (purchase price)

$127,500 ÷ 9% = $1,416,666

Now I've got a new purchase price to offer them. Because I don't want to pay $1.5 million and get 8.5 percent. I would like for whatever I pay to bring me 9 percent. Knowing that the net is $127,500, I divided that by .09 and it gives me the offering price I need to make: $1,416,000.

So the amount I'm going to offer them now is $1,416,000. The conversation goes like this, "Christopher, I'll tell you what. I only want to pay $1,416,000 because that's going to be a 9 percent cap. And I want my money invested at 9 percent. If not, I've got two other offers that I'm submitting in Kentucky and Wisconsin that will bring me this cap rate."

5. Earnest money

For earnest money, we're going to put down a $100,000 deposit—it will be due within 72 hours of the effective date of the purchase agreement. *Earnest money shall become non-refundable at the expiration of the inspection period.*

In other words, you're saying the earnest money is going to be so much and after a certain date you cannot get it back. (But if you purchase, it becomes part of the purchase price.)

Refunding earnest money

If you have to put up earnest money, it will be applied to the purchase price. But during the due diligence period, if for whatever reason you decide you don't want the property, you can get that money back. The LOI is a nonbinding agreement. No rights or obligations arise as a result of executing the LOI. However, if you wait until the due diligence period has passed, earnest money is non-refundable.

6. Inspection period

The next thing is what we call the inspection period. You're going to have a period of time to inspect the property—usually 30 to 45 days—sometimes even 60 days. It depends on the size and the complexity of the property.

In commercial real estate, 30 to 45 days is typical. In this case, we'll say *30 days from the date of receipt of requested due diligence documents*—including the seller's standard lease forms. He needs to send me the leases and anything else he has on the building so I can do my due diligence. Is it easy to do due diligence on a triple net building? Of course. Its triple net. Here is the lease, the guarantee of the lease, the escalations—it's all in the lease. They send you a packet and give you a title report showing you the trust it's in, along with its owners. You'll get expense reports and financials if available. There aren't any expenses in this example, though—remember, this building is triple net.

Read it yourself, but have somebody verify it. For one hour, an attorney will charge you a couple hundred dollars. This is money well spent. Hopefully, the attorney will just confirm your good judgment by saying, “Okay this is a very good master lease with Family Dollar … they have a thousand stores in the United States … it’s a pretty big company. …”

Sometimes sellers sell and lease back so then you can ask them for their extended lease form. Or if you’re going to purchase a vacant property, you’ll want the surveys, the environmental reports, the title report, and all the other things you need to make sure this is the right property for you.

7. Financing period

You can also add that you need time for the financing period. How much do you need? Well, we just requested 30 days for the inspection period. So I would add an additional *15 days from the date of expiration of inspection period.*

“Financing period” is customary, but not required

There may be no financing period needed if you’re ready to go and you’ve got the funds ready. If that’s the case, just put *Buyer has been granted approval by [name of bank]* on your letter of intent. I prefer asking for a financing period, even if I don’t need it, because it gives me more time to close.

So now you have 30 days to inspect the property and 15 extra days for the financing period. If you start the financing immediately (which you should), you’ll have 45 days to finance it.

Financing is not going to take that long but this will give you extra time. This way you can close in 20 days if you want to, but you’ll have 45. I suggest you close as late as you can. It's always better. And now you’ll be able to since *you* are controlling the transaction.

8. Closing date

Include a closing date in the LOI—a mutually agreed-upon date between purchaser and seller that’s no later than 10 days from the expiration of the financing period. With this, I just gave myself an extra 10 days. If you’re keeping score at home, that’s:

- 30 days for inspection.
- 15 for financing.
- An extra 10 to close.

So now I have 55 days. Not bad, huh? The fact is, it's not unusual to have 60 days total—it's very common. You’ve just got to hide it a little so as not to alarm the seller.

What is the best time to close?

When purchasing an apartment building, the best time to close is the beginning of the month. Why? Because by closing at the beginning of the month, you can collect all the rents that month as the owner. If the sellers want you to close in the middle or end of the month so they can collect the rents, make sure you negotiate with them and let them know they'll have to lower the price or give up something else in return.

9. **Closing costs**

You can also specify who is going to pay the closing costs. If you're unsure what is customary, simply put, *Purchaser and seller shall pay all closing costs in accordance with the traditions prevailing in the property's county.* Once I was doing a deal in Saint Croix and didn't know the usual way to pay for closing costs in the U.S. Virgin Islands. So I used the preceding phrase.

Closing costs are negotiable, however. For instance, you can say, *Purchaser and seller shall each bear its own attorney's expenses and shall split all closing costs.*

In this case, we're going to negotiate the closing costs. Did you know you can negotiate closing costs? Previously we tried to negotiate a 9 percent cap with the agent representing the seller. Let's say he counter offered with, "You know, the best we're going to do is 8.75 percent."

Then you can say, "Okay, I will take it at 8.75 percent, but have the seller pay all closing costs." Hopefully they will agree to that.

Negotiating rule

Remember this rule when negotiating: When someone asks something of you in a transaction, ask for something in return. They ask you, ask for something back. That's the way it works. Don't ever give up something for free in a negotiation.

10. **Financing contingency**

You can put a contingency on financing. Have it say something like, *This offer is contingent on obtaining financing terms acceptable to buyer.*

Sometimes the seller will push you to know what is deemed "acceptable" by you. Then you can tell them, "I don't want to pay more than 6¾ percent or 7 percent, and I don't want a loan for less than 20 years."

11. **Property condition**

You can also go into property condition. *Property shall be purchased as is.* Let's say you discussed that on the phone. They told you to put it in your LOI. Most sellers don't want to do any improvements before they sell. The seller wants to sell the property "as is," with no representations being made by him or her as to the property's condition.

Other conditions

- With regard to property inspections, you could add that *Buyer must approve all inspections prior to purchasing the property.*

- In the LOI, you also need to indicate when you will draw up a binding contract. You usually put, *Within 10 days of acceptance of this letter of intent, purchaser and seller shall enter into a binding contract. Seller agrees in good faith not to negotiate with any other parties during that time. Failure to reach an agreement will allow the seller to consider this agreement void and accept offers from other parties.*

- Here's one I frequently use: *Property must appraise at purchase price or higher*. This clause is useful when you will be buying a property for cash flow and not because it has potential improvements to increase its value.

  If you are purchasing a property that is not at its highest and best use, then you know you'll be increasing the value soon anyway. But if you are purchasing a property such as the one in the Family Dollar Plaza example to bring you solid cash flow and no headaches, this clause is important.

The purchase and sale agreement

At this point, you sent the letter of intent, you've done your due diligence, and you are in the process of securing financing. Most of the work is already done or being completed. If you still feel good about the deal, then let's secure it by entering into a formal contract with the seller.

You do this by using a "purchase and sale agreement," which is a contract. A purchase and sale agreement for commercial real estate is essentially the same as one for residential real estate. To make the agreement suit your purposes for a commercial transaction, simply include addenda specific to your commercial deal.

In your LOI you stated *Buyer and Seller to execute a binding purchase agreement within [X] business days from acceptance of LOI*. So if they accept your LOI, they'll usually start sending you the paperwork so you can actually write the contract with them.

The most important thing is to make sure what you want is put into the LOI, which will determine what goes into the contract. You then send the LOI to the attorney when you are ready to draw up the contract. After the attorney drafts the contract, you send the contract to escrow and give whoever is doing the closing, such as a title company or an attorney, whatever earnest money you owe.

Summary of paperwork

By using the LOI, you should be able to do your due diligence without any interference from the sellers. You just send it to them, they sign it and send it back to you, and you have now *informally* started the purchase process. Its purpose is to tie up the property somewhat, get the basic deal points agreed upon, and express your intent to purchase without putting together a formal, legally binding contract.

Only once you're satisfied with the building and the deal points outlined in the LOI should you enter into a binding contract, which you should have an attorney or an experienced broker draw up for you.

Steps of the FACTS should overlap

Sometimes students ask me which they should do first: Get the financing or find a tenant? The answer: Work on both of them at the same time. Juggling several steps of the FACTS system at once make for the most effective deals. After all, you'll need to find a tenant to secure the financing.

Using the option period to improve a property

When you want to show sellers you're serious, give them an earnest money deposit. I have a building right now I'm buying for $8.4 million. I met the sellers in the street and we greeted each other and shook hands. Then we went into the building, looked around, and walked up the stairs. I said, "Okay, here's my offer. What I'm going to do is give you a half a million up front for a lease option. …"

But before I could finish, he said, "Come with me." We walked next-door to Denny's and he picked up a napkin and wrote *Cherif Medawar will give the two sellers $500,000 up front. We will have a year and a half to close on the transaction.*

How would you like 18 months to work on a building and have an option to purchase it? An 18-month option lets you have the right to purchase and it buys you plenty of time. So you can use your money to fix the building and then get a loan for *more* money.

This way I can buy the building for $8.4 million and when I improve it for maybe $400,000, the property will be worth somewhere between $12 million and $15 million. In the meantime, I can upgrade the building, market it, find tenants, get a very good loan, and cash out my profit.

Sometimes if I need to sweeten the deal for a seller, I will give him the option *and* a monthly payment of such as $1,000. I don't make a habit of this, but I'll do it if the deal is good enough. Any way you slice it, $1,000 a month to the seller is much better than a monthly payment to the bank of $5,000.

The same strategy can be applied in residential

Let's say somebody is selling a house and it's completely trashed. It needs work. Let's say you agree on a purchase price with the seller of $250,000 and you tell him, "Look, I'll give you $10,000 to show you I'm serious with an option to buy, but I need to close in six months."

This way you get to keep the rest of your money now and spend it with a contractor fixing up the house. You spend $30,000 to improve it and raise its value to $330,000. You can get a loan from the bank for $330,000, cash out all your money on the investment, and own a nice property. You can live in it, rent it, sell it, or whatever you want to do from there.

The sellers are happy because:

- I give them some option money up front.
- I'm spending money improving *their* building.
- If I don't buy it, they not only keep my option money, but they keep the improvements I have done to the building.

I'm happy because:

- I have locked in a period of time for which I have the option to buy the building.
- I have locked in a purchase price.
- When and if I exercise my option, the seller has the obligation to sell the building to me.
- My money is being used not as cash down payment, but as improvement money so I can get a 100 percent loan.

Remember: The option ties up the property and locks in a price—but you lose the option if you don't buy it. If you do purchase it, the option will be credited toward purchasing the property.

Persuading the seller to give you an option

The difference between earnest money and an option deposit is that earnest money is *refundable* during the due diligence period. Option money is nonrefundable. So you can approach the seller like this: “Mr. Seller, would you like me to give you a refundable deposit or a nonrefundable deposit?”

What is he going to tell you? He’s going to say he wants a nonrefundable deposit, of course. So you respond with, “Okay, fine. Then I would like to close in six months instead of 60 days. But I'll give a $25,000 option deposit, and I’ll give you the money in advance.”

In this way, you are leveraging your money instead of shelling out more as a down payment. Always remember: Put down as little as you can up front. But you have to put down something for the option deposit to show them you have substance … that you are serious … and that you have some skin in the game. You can make millions using this strategy. It’s basically a no-money-down strategy for people who have money.

Getting paid on assignments

With an assignment, you get paid when the buyer actually purchases the property—at closing. The purchase price is paid at closing by the buyer (the assignee), money goes out to the seller, and the difference is your assignment fee.

People don't pay you for finding a deal; people pay you for finding a deal that they buy. They pay you for consummating the transaction.

Non-circumvention agreement

We’ve talked in detail about how to control the property by getting it under contract. But once you get it under contract, you may decide to *assign* it instead of *purchase* it. If you do, you must protect yourself because your buyers could technically go around you. In other words, they could be tempted to circumvent you by going behind your back and doing a deal directly with the seller. So even if you are dealing with honest people, don’t give them the chance to think dishonestly.

The way you do this is by having the buyers sign a non-circumvention agreement. This document simply states that they won’t bypass you. This tends to happen more in residential deals than commercial, but you still need to protect yourself by using this document.

Chapter 10:
Timing of Due Diligence and Financing

Timing of due diligence and financing represents the *T* in FACTS. This is a short chapter. That's because the timing of your transaction is similar to our previous chapter, controlling the transaction. Plus, all the numbers you need to analyze, which were discussed in Chapter 8, are the same numbers you will need to verify during your due diligence.

What is the definition of due diligence?

1. The care that reasonable people exercise to avoid harm to themselves.
2. Research and analysis of a property done in preparation for a business transaction.
3. Voluntary investigation of a business or person prior to signing a contract.

Obviously, your due diligence of any property must be done within a specific time frame. Your financing—whether it's hard money, private money, bank financing, or syndication—must also be in place by the time you close. Different strategies require different time frames. That's why this step in the FACTS system is represented by the word "Time."

Let's say you are planning to assign a deal. In that case, the financing of the real estate would not be your concern. But you would still need to be concerned with the timing. If you have it under contract, you have anywhere from 45 to 60 days to complete your due diligence. You can use some of that time to find another investor if you want to assign the deal.

Due diligence on expenses

Speaking of due diligence, I want to spend a moment on expenses. If you own a Kentucky Fried Chicken, you have no expenses. But if you own an apartment building, you have to find out the operating expenses.

Is that harder to figure out? Yes. Can they hide some expenses from you? Yes. You have to get professional appraisers, inspectors, and contractors to tell you if the boiler is old or if the roof needs repair.

I am an expert in the hotel business. I spent half my life running hotels on the East Coast, on the West Coast, in Europe, in Latin America, and in the Caribbean. I can tell you without a doubt: If you are going to buy a hotel, its *operating expenses* are critical. I can take hotels and improve their numbers tremendously; the profit will be phenomenal. You can learn to do the same. But you'll need to be familiar with operating costs.

STAR reports

A company called STR is probably the most well-known organization in providing market data to the worldwide hotel industry, most of which are delivered in its STAR reports. To see the numbers on occupancy, average daily rate, supply, demand, revenue, and other factors in the hospitality industry, go to www.STR.com.

As for operating expenses when it comes to hospitality real estate, storage facilities, office buildings, senior housing, apartment buildings, and others, ask the sellers how many maintenance calls they have logged in. If they tell you they don't have any maintenance calls, that they don't need to replace anything, they are hiding something. They just don't want to show you that the building has issues, leaks, or problems.

But they can't hide utilities. So ask them, "How much do you pay in electricity for the building?" They may say, "Well the average bill is $1,700 per month." Is that something you can verify? Yes.

So try to get as much information as possible. Ask questions such as, "How much do you typically spend on maintenance?"

"Maintenance is just $500 per month," the seller says.

"How much are your utility bills?"

"About $1,700 per month," he says.

After you've asked him everything you can think of, say, "Okay, please let me see the utility bills."

So you get the utility bills. What if you get them and you discover that the utility bills are $2,700 per month? If the seller lied on something you can verify, didn't he just lose all credibility on the other numbers … on the things it's harder to verify? You bet. Always ask for proof.

Back when I bought houses, I would knock on the door, take two steps back, and smile. It's the same for commercial. I smile. And when it comes to the numbers, I ask for them nicely. Because you know what? You can make millions without ever raising your voice.

But if somebody messes with you along the way, you need to know your rights and act decisively. *And you don't buy a property before you do your due diligence.* Look at the operating expenses you can verify. And for those you can't verify, always estimate slightly higher than what they are telling you. Tell them to show you the P&L (profit & loss) reports. If they have a management company running the property, that's even better, because a management company must do the numbers properly. Management companies are running a lot of properties so they are going to tell you the correct numbers.

Ask about these three things

Here's how you can tell if sellers are lying to you about their hotel or apartment building: If they say that maintenance is low, the roof is fine, and that they have no vacancies, don't trust them. At least one of those three items is usually an issue.

A tenant spills the beans

I was buying an apartment building one time and I told the seller I wanted to walk into some of the units. This is not an unusual request from a buyer, so he said yes. But beforehand, we agreed that I wouldn't talk to the tenants unless they started talking to me first. This, in turn, is not an unusual request from a seller. After all, he doesn't want to advertise the fact that he's going to sell the property.

"Who should I say you are?" the seller asked me.

"Just tell them I am an insurance person or something," I replied.

And to get us into the units, that's what he would tell the tenants … that I was with an insurance company. Well lo and behold, upon hearing this, one tenant said, "Oh man, we've got a problem with leaks in the roof." And he went on to tell me about all the issues with the roof.

I looked at the owner, and his face said it all. He was thinking, "Oh no, I just got caught. I wish this tenant would shut his yapper!"

So the owner muttered, "I've got some numbers for that I'm going to show you later."

And sure enough, when we got back to his office, there was another folder that he hadn't previously shown me. "This was something I should have taken care of," he admitted. "You are not going to see it on my tax returns. There are leaks in the roof, but you only need to patch it."

Where to get help with due diligence

For specific web resources and companies that will do your due diligence for you, I recommend going to CMREI.com and purchasing my Real Estate Roundtable Training DVDs. In there, I share specifics on where to go to get your due diligence—depending on what type of commercial real estate you are buying.

Get a rebate at closing

Sometimes you can *renegotiate the sales price* or *get a rebate at closing* based on what you find during your due diligence. Let's say you find a building that appraises at $1.4 million, but during inspection you found that the roof needs $40,000 of repairs.

You have a contract to buy it at $1.4 million. But that was before you discovered the roof leaks. So you can renegotiate the sale price or get a rebate at closing. The easiest thing to do is say, "Mr. Seller, I would like you to give me $40,000 cash back from the amount you're going to get at closing so I can fix the roof."

This is a negotiating tactic. You can use it when you're the buyer. It can also be used against you when you're the seller.

If you're the buyer, you can ask to get a little bit kicked back at the last minute before closing. The roof can just be an excuse. I've had people do it to me when I am selling a property. We'll be just days away from closing and they'll call and say, "You know what Mr. Medawar, we just found this water problem and it will require that we put in a new water meter for $3,000."

Now if I am selling a property and making $170,000, I'm going to give them the $3,000. Especially if they tell me it's a deal breaker. And I'll usually do it by giving them a cash rebate at closing.

Using partnerships when financing

Let's talk about financing. One option when financing is to do a partnership. A partnership will often allow you to time the transaction with more accuracy because you are not waiting on institutional money to be released for your closing. There are two types of partners/investors:

1. An **equity partner** wants to go in and make his money from the profit percentage of the deal.
2. A **debt partner** just wants to loan you the money for a percentage return.

No matter what types of partners you choose, they will become involved in the deal to some degree. However, there is a fundamental difference between equity and debt partners: Equity partners become true "partners" while debt partners become "creditors." Equity partners have a greater incentive to make the deal profitable, while a creditor is primarily concerned with receiving his money back with interest.

Debt partners	Equity partners
Become your "creditors"	Become your "partners"
Lower risk tolerance	Higher risk tolerance
Lower cost of capital	Higher cost of capital
Funding based on current cash flow	Funding based on expected future value
Periodic interest payments	No interest payments
Fixed maturity date	No maturity date
Take smaller amount of profits	Take larger amount of profits
Little involvement	Active involvement

Debt partners

Debt partners are usually conservative investors. And their money is guaranteed or secured as a first trust deed or a first mortgage against the property. So it's very safe for them.

A lot of potential debt partners will approach me and say, "I know you are good at commercial real estate. If you are going to buy a property, fix it up, and re-finance it—then let me give you the loan instead of you borrowing it from the bank. I'll charge you half a point less than what the bank will give you."

So if the bank tells me it's going to be 7 percent, my debt partner will loan me the money at 6.5 percent. Since I'll be fixing it up and refinancing, he'll get his money back within six months.

Equity partners

Equity partners are a little different. Potential equity partners will come to me and say, "You were going to put $100,000 down? How about I put $50,000 down and you put $50,000 down and we'll be equal partners?" So in this case we are going to be sharing the profits.

The best setup to structure an equity partnership is to use a limited liability company (LLC). And you can do it with one person or 10. With multiple members, each one of us could have a different percentage of ownership. One member might be in for $7,500, another for $15,000, and still one more for $50,000.
In addition, each member can use a different source of personal funds. For instance:

- One may use cash from a checking account.
- One may borrow money from a self-directed IRA.
- One may borrow money from a life insurance policy.

And when we sell the building or refinance it, everybody gets paid on a percentage basis.

I recommend avoiding hard money lenders

Hard money lenders are the people you borrow from when you can't borrow from the bank because you are bankrupt, you don't have enough money, or there is some other hardship reason. They will usually loan money to you at 12 percent to 18 percent interest. They ask you for two points up front (a point is a fee equal to 1 percent of the loan) and they charge you *a lot* of money.

They are called hard money lenders because it's hard money. And I should let you know that I have yet to meet one human being on planet Earth who ever made millions using hard money. However, I have met quite a few people who started with nothing, had the hard money letters stating that they would get the money, got the deals under contract, and assigned the contract.

I have also met people who have gotten residential properties that needed rehabbing, borrowed the hard money, spent a lot of money fixing up the property, sold it, paid off the hard money, and made some money. But at the end of that ordeal, they usually say, “Thank you God, I'll never borrow hard money again now that I have some money.”

So be very cautious when you borrow hard money. Some are in the business just to loan hard money for commercial properties. And most will give you only 65 percent to 70 percent loan to value. Let me give you an idea of how it works: Let’s say a property is worth $1 million. And you find a hard money lender who will give you a 70 percent loan to value. So if the value, based on its income, is $1 million, they are going to lend you $700,000. They’ll likely charge two points up front, so right away that is $14,000 (each point is 1 percent, and $7,000 x 2 = $14,000). In addition to this, they’ll charge you, say, 14 percent interest. Ouch.

Syndication is the answer

Later in this book, I will talk about the unbelievable power of syndication. Syndication is the “nothing down” strategy for today. If I’d used syndication early in my career, today I’d be a billionaire instead of a millionaire. That’s why I now offer an entire course on how to put together your own syndication. It’s not difficult, but lenders would like you to think it is. Once you understand how, you’ll never need to entertain the idea of using hard money again.

Here’s an idea: You can contact a hard money lender and say, “Hi, I am an investor. I'm looking for a deal. Have you had any defaults?” And do they have defaults? Yes. That's what they are in business for. Most of them are *expecting* the borrower to default so they can kick them out and get the deal for themselves. Some of them call it “loan to own.”

I’m making them sound very bad here, but let’s consider its history. Hard money lending used to be a business for the Mafia. Literally. Threatening debt collectors, breaking knees. And then it became “legitimized,” if you will. A lot of companies do it. As a matter of fact, a few of my students do it. Let me give you an example. …

He should have listened

A few years ago, I met this young guy, about 28 years old, who started his own company in Silicon Valley and walked away with $23 million. He had all this money and he was literally harassing me: “Cherif, can I fly with you? I'll pay you $50,000. Just let me spend a week with you.”

I kept saying, “Spend a week doing what? I don't do that much. I look on websites and I make offers by phone, I fax the documents, and then I show up. It doesn't require that much work. Come to one of my three-day trainings and you will learn how to do it.” (This was before I had written this book or I would have given him a copy.)

And he would always give an excuse like, “No, no, no. I don’t want to go to a seminar. I have to see it done in front of me. I need to have someone walk me through it.”

A little while later, he told me he’d found a way to make money with his $23 million. He was loaning cash to people. And people were calling him left and right. He's an individual; he had an attorney, and a title company, and an appraisal office, and he would loan them money. He would ask the borrowers, “You want $1 million? OK, the property had better be worth $1.2 million!” If it was worth $1 million, he would give you, say, $800,000. So he would give you a better spread than most hard money lenders.

He started bragging to me, “Look, Cherif, I just loan the money like a bank. People are paying me interest. I make the loan for six months and when they sell, I get paid. I'm happy with 12 percent.”

Well, guess what? When the market went down two years later, he was *not* happy. He had to foreclose on a lot of people. He was sending me emails like this: “Oh, Cherif, I wish I had listened to you. I should not have been in that business. I should have come to your seminar. I should have been in the commercial real estate business. I would have made a killing! My $23 million could have leveraged $100 million worth of property.”

And he was right. He likely would have been worth a quarter of a billion dollars if he just would have listened. But he's a high-tech person, and when he went and asked all the financial advisors about real estate, they told him, “It’s complicated. You cannot manage commercial real estate. You don’t want to get into that.”

They never told him that there is such a thing as triple net retail buildings he could lease to Wal-Mart or Walgreens with his money. They never told him these investments would cost him only 6 percent or 7 percent interest, while he sat at home getting tax deductions and making millions. They never told him that if he used leverage, put a little money down, and got big money from the bank, he could have $100 million in assets that he could turn into $200 million in 10 years. They didn’t tell him any of that because they didn’t know it themselves.

I knew. I tried to tell him. But he wouldn’t listen.

My point is that you now know it. You are learning it. Continue your education and put your knowledge to work … and soon you’ll have a net worth in the millions. By the time you finish this book, you will know enough to get started.

Walk your way to wealth

Do you want to know the secret to becoming wealthy? You just repeat the same successful formula over and over. It's not so difficult. The whole idea is to learn how to make your first million dollars. Just one. Then repeat it and repeat it—and as you grow and become successful, banks will want to throw money at you.

Look at their billboards on the street. Look at the ads. Look at all the people they employ. Banks need to loan money, and once they know you’re a successful investor—a proven commodity—they are very anxious to do business with you.

An interesting fact about banking

Did you know that if Bank A doesn't loan money fast enough—and Bank B does—that Bank B has the right to take some of the reserves from Bank A to loan to you? It’s true. The point is, both Bank A and

Bank B *want* to loan you money. Find a commercial property with good numbers and getting funding won't be a problem.

Let me tell you something very important. The size of a building doesn't matter. What matters is its cash flow. I'd rather have a small building that cash-flows nicely than a big building that barely breaks even. I would rather make a fair deal on a fantastic building than a fantastic deal on a fair building.

So how can you get started with this? Well, if you aren't comfortable jumping right into doing big retail deals, here's your plan: Get started doing a couple of smaller buildings. You can start with zero down and assign some deals. Then start buying duplexes, three-plexes, and four-plexes. Split them and sell them and make some money. Then go on to bigger deals and sell them and make *more* money. Now you can go get a foreclosed retail property with the money you have made. Get a small loan, make the payment, get a tenant in, and your profits start to skyrocket.

I'm always in a hurry. But that's just my nature. You don't have to be in a constant hurry to make a fortune in commercial real estate. You can just apply these principles and walk your way to wealth.

It takes a while at first, but if you build it the right way, you will make more money than your wildest dreams.

Chapter 11:
Strategize

Strategizing represents the *S* in FACTS. This is where you get into the big money. We've covered strategies to use here in previous chapters. Strategizing means taking a property and improving it or using it differently. It means adding new revenue centers such as antennas, advertisements, and changes to a property's layout.

This is probably the most in-depth part of the FACTS system simply because there are so many different ways to make money in commercial real estate. We've covered a bunch in previous chapters, but let's talk about a few we haven't covered.

Make millions as an owner-user

I want to give you a great strategy for somebody who owns a small business or is planning to start one. If you're the owner of a business who's actually going to buy a property and use it for that business, you can get very favorable financing with a U.S. Small Business Administration (SBA) loan.

A friend of mine named Andy used this strategy successfully after I told him about it. Let me demonstrate how it works using his story.

Andy had his eye on the perfect building for his pet shop/grooming business. It was just what he wanted, and the asking price was $1 million. But when he went to the bank, they said, "You need to put down 25 percent, which is $250,000. We'll finance you for $750,000."

After talking with me, he went back and told them, "I am going to be an owner-user. I would like to get an SBA loan."

The bank loves this. Why? Because he was going to operate his business there. And because now they could get him a 95 percent SBA loan. A 95 percent loan means they could give him a loan for $950,000. That made his down payment only $50,000. Once he got in, the money he saved on the down payment helped him reorganize and set up his business.

Six months later, he sent me an email. It said, "Cherif, I can't thank you enough. This has been great. We are doing very well; the business is making enough income to pay for the property, plus positive cash flow. The only problem is, I would love to expand but I don't have enough cash to do it."

Think about this: He bought it for $1 million. He is the tenant. If he pays himself rent at a 6 percent cap, which is standard in that area of Southern California, that means the rent is $5,000 per month. That's $60,000 a year in rent, which would make the building worth $1 million.

But because he is the owner *and* the tenant, he can charge himself a rent of whatever he likes. If he charges himself $9,00 a month in rent, that makes his building worth 50 percent more.

So I told him, "Don't make your building rent for $5,000 like the other buildings in that area. Increase your rental income so it increases the property value, and you can cash out half a million. When you increase your rent; just write it in the lease to yourself." His business was a C-corporation.

So instead of $60,000 a year in rent, he was now paying $90,000. That means now the building was worth $1.5 million.

I continued, “Put the property up for sale on LoopNet for $1.5 million at a 6 percent cap. Sell the property to an investor and lease it back from him.”

He sold the property and leased it back. And when he sold the property and paid off his loan, he got about $500,000 out.

Now he could expand to a new location. But here’s the beauty of it: He can do this again and again. Let's say he just does two more locations. Now his business is expanding. Pet Grooming has three locations and he's putting bigger down payments into the two others, he has better cash flow, and he's paying himself the rent. The building is owned by an LLC and the business is a C-corporation, and he is paying himself. He is paying no taxes. He is getting depreciation. He is using the business model together with the real estate model to grow very, very fast.

If you are currently—or soon expect to be—a small business owner, this can help you make millions very fast. And it can work whether you are a florist, a pet groomer, a dry cleaner, or whatever. By combining the business of real estate with your current small business, you can become a very quick millionaire.

Title I loans: How I financed my first deal ever

Let’s talk about Title I loans. These have been around for decades, but they've faded in and out of popularity over the years. Like U.S. Federal Housing Administration first mortgages, they're issued by private lenders and backed by government insurance that protects those lenders from losses. But *unlike* FHA mortgages, which help people purchase houses, Title I loans assist borrowers looking to upgrade properties they already own.

The advantages of Title I loans over conventional improvement loans include:

- Lower interest rates and fees because lenders can't charge more than five points.
- More lenient underwriting standards.
- No income limits on eligibility.
- Lower closing costs because no appraisal is required.
- Lower credit standards.
- Availability for homeowners with first and second mortgages.
- No equity requirement in the property.

Through Title I, you can get up to $25,000 for single-family home improvements over loan terms of as long as 20 years. The improvements can consist of just about anything except luxury items. New windows, air conditioning systems, storm shutters, or roof repairs all qualify—a new pool or hot tub doesn't. You usually have six months to get the work done, and then the lender inspects the results to make sure everything went OK.

When I resigned my position from Mr. Baysari back in the late 1980s, I ended up in Solano Beach, Calif. I needed a place to live, so I found a fantastic duplex on Lomas Santa Fe Drive. It even had an ocean view.

Well, the real estate agent said it was ocean view. The truth is, if you walked up the street and looked west, you could see a little blue dot. That blue dot was the Pacific. And in California that's considered “ocean view.”

I called the real estate agent and asked, “What's the best price I can get?”

He said, “Well, we had it at $325,900, but we can give it to you at $325,000.”

I said, “Come on. It's a busy street, it’s two units, and you can barely see the ocean. How much are the tenants paying for rent?”

He said, “Oh, $900 or so.”

So I said, “Can I send you an offer right now?”

“Sure, fax it to me.”

So I faxed him the offer at $295,000 and said I would not accept any counteroffers. I told him to accept by the next day at 4 p.m. or there was no need to respond.

I wasn't sure if I should buy this duplex, but I thought $295,000 would be a good deal. The property next-door had sold at $320,000, so I was thinking this would be a great deal for me as my first income-producing property. I planned to live on one side, since I was single at the time, and rent the other one.

The agent called me and said, “OK, they accepted $295,000. We just have to close quickly.”

So I called the bank and asked, “Do you have any special programs?” You should always ask about special programs.

“Yes,” they replied. “We have special programs if you live or work in the North County San Diego area. We have a program where if you buy a residential home, you can get a loan with only 5 percent down.”

Only 5 percent down! “Great! When can I come see you?”

They said, “Come in at 2 o'clock.”

This was all falling into place so easily. *I’ll be rich in no time*, I thought. So I left the hotel and went over to the bank. “Look,” I exclaimed, waving the contract. “I have an offer to buy this property and the seller has accepted my offer.”

The loan officer’s name was Kelly. I’ll never forget her. This first deal was very stressful for me, and she was extremely helpful. But what she said wasn’t music to my ears. “This is a duplex, Cherif. Not a single-family house. Since it is an investment property, we’re probably going to need 20 percent down.”

“Twenty percent down? I can’t afford that. Can’t you get me a loan with less down?” I pleaded.

She did a little checking and calculating. “Since this is a duplex, the best we can get you is 10 percent down.”

That was better, but 10 percent down on $300,000 was $30,000. I had $30,000, but it was all in the stock market. “I think I have the money,” I told her. “But it’s in the stock market.”

She said, “I’m sorry. That does not count as regular income.”

Now I started to sweat a little. The deal was falling apart. “But I have a job with income!”

“Yes, but it’s not enough.”

“I have bonuses,” I explained.

“We can't count on bonuses.”

“Well then, how can I qualify?” I probed earnestly. Even though this was my first deal, I knew from my experience with Mr. Baysari that if you just keep asking questions, you will eventually find a solution. You will find a way to make the deal happen. And sure enough, Kelly came through.

“Oh my God!” she exclaimed after a moment. “The rent on one side is $900 per month extra, right? So we can add about $11,000 to your income per year. That means you can qualify!”

“And because you're going to live on one side,” she continued, “We can give you a 5 percent down loan. If you can go ahead and put down the $15,000, we can make it happen.”

What a relief! What I hadn’t known is that when you buy income-producing property, like this duplex, the rental next-door—minus the vacancy factor—is added to your regular income. So now I qualified for a bigger loan. This was great news.

I immediately called the seller and asked if he could pay the closing costs. He said yes, up to so much. It turned out to be exactly what I could afford.

Now I needed to come up with $15,000. So I called Kelly back and said, “Do you care where the 5 percent comes from?”

She said, “No we don't.”

So the day before closing I went over to Union Bank and I handed them a bunch of credit cards. I told the representative, “Hi, I’d like to cash out $8,000 on this card; I’d like a cash advance of $5,000 on this one, and an advance of $2,000 on this one.”

In less than 15 minutes, I had cashed out $15,000 and walked out with a cashier’s check for the full amount. I’m not recommending you do this, by the way. But this was my first deal and I had to get creative to make it happen. But I had no liquid money to work with, so it was important that this be a “no money down” deal. And as you can see, it was.

The next day we closed and I got the keys to the property. I remember driving over and parking my car in the back. I walked in and looked around. It was two floors, 1,450 square feet, and it was mine.

I had already informed the tenant next door, in writing, that I was the new owner so he knew to pay me the rent. So far, so good.

The first monthly mortgage payment came. I opened it and thought, *OK, I can make that payment.*

Then the credit card bills came. I opened them and thought, *Ouch.* They were charging me 26 percent and 24 percent! These cash advance interest rates were unbelievable.

What am I going to do? I asked myself. *I'll have to get another job. Wait! I can't get another job! I'm already in the hotel 12 to 14 hours every day. What am I going to do?*

So I started calling banks. "Hi, I just bought a property for $295,000, but the one next-door sold for $320,000. …"

And they would say, "Sir, if next-door sold at $320,000 and you just bought yours for $295,000 then the value of the property next door is $295,000 now. You just changed the value of the market … your purchase dropped the values in the area."

"You've got to be kidding me. Well, can you loan me any money?"

"Loan you money on what?" they asked. "You only have $15,000 down. That's negligible. You have to have equity if you want a credit line."

I went to banker after banker. I was naïve. But I was learning. Today people ask me, "Cherif, how do you have so much knowledge?"

I tell them: If you want anything in life, you have to ask.

I was frustrated. But I kept asking. I had to because it came to the point where I couldn't make the credit card payments. It was looking more and more like I had bitten off more than I could chew when one day I was on the phone and an agent casually said to me, "Why don't you just apply for a Title I loan?"

"Come again?" I asked.

"A Title I loan. It's a special program from the government where you don't have to have any equity in the property. It is for single-family homes, duplexes, three-plexes, and four-plexes that need some remodeling. They will loan you the money and you pay it back in 15 years or so."

"Who can give me this loan?" I inquired.

"I don't know, try HUD."

"Thank you!"

Today you can simply go online, but at that time there was no Internet. So I found a number for HUD. Based on my area, they told me which banks was part of the program.

At that time I could get $17,500 for a duplex. I got the loan for $17,500 and paid off the credit cards. With the extra $2,500, I painted the fence and improved the landscaping. But the best part was that now I was able to cover my payment to the bank and my second mortgage of $17,500 to HUD.

Whew! My first deal was in the books! Or so I thought.

Six months later, the phone rang and a man said, "Hi, are you the owner of such and such property?"

"Yes, I am.

He said, “That’s wonderful. I am with HUD’s Title I division and I’d like to come over and see the work you've done on the house.”

“Work? What work? Why do I need to show you what I’ve done?”

“Because you borrowed money that we loan for people to actually *improve* their buildings. You signed documents saying you'd be using the funds to improve the building. We need to come with a checklist and make sure you have done the work.”

“Or what happens?” I asked timidly.

“Or you will have borrowed fraudulently and you can go to jail,” he replied.

I thought for a moment. “Have you ever been here before?” I inquired.

“No.”

“Then come on over,” I said. “How about Friday?”

So the gentleman from HUD showed up on Friday afternoon. I greeted him warmly and showed him around. The first thing I did was show him the landscaping… and the fence, of course. I was proud of that fence. “When I found this place, there was nothing here. But look at all these nice shrubs and plants. And take a look at this beautiful fence. I had it repainted!”

“Do you have receipts?”

“I have receipts for the paint,” I replied.

“Who did the work?”

“I did it myself.”

“Okay we can credit you for your hourly wage. How much do you make an hour?”

“I'm on salary as a hotel general manager, so I don’t make that much. But when I'm painting I charge a lot more.”

“Okay. How long did it take you?”

I told him and then added, “I’m a very slow painter.”

He looked doubtfully at me and then relented. “OK, I’ll give you an extra 15 hours.”

I was in luck because the property looked great. Plus, he had never seen it before. He took out his checklist and started marking things off with a pen. If I hadn’t improved the “curb appeal” of the duplex when I moved in, I don’t think I would have pulled it off. But he could see that I had put in some effort. Maybe not as much as he wanted, but it was enough.

As you can see, that first deal was quite a ride. I had to push through obstacle after obstacle to make it work. You'll face obstacles, too. Just keep persevering. Keep asking questions. If you do, your deals will fall into place.

The combination of using credit cards and getting a Title I loan was how I got that duplex. I hadn't planned on using either of those techniques when I first made that offer—especially the Title I loan. That was way before you could find everything so easily on the Internet.

Today you can do a lot more. And you don't have to hunt around like I did to find out what government programs are available. Once you understand how the program works, just work within its parameters. If the system is giving you money when you have no equity—use it! Why go for hard money when you can have the government helping you?

So if you're buying a fixer-upper of up to four units, and you're looking for money, check out Title I Loans from the FHA. You may be surprised by what is available.

203(k) loans

There is another FHA program called 203(k) loans. This program can help homeowners pay for a variety of home repairs and upgrades. It's basically a home improvement loan. These 203(k) loans range from $5,000 to $35,000 and cover all sorts of projects to rehabilitate and repair one- to four-unit properties. While the FHA does not directly dole out the money, it insures the loan in a partnership with a lender.

The HUD/FHA relationship

The Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development (HUD), administers various single-family mortgage insurance programs. These programs operate through FHA-approved lending institutions, which submit applications to have the property appraised and have the buyer's credit approved. These lenders fund the mortgage loans that the department insures. HUD does not make direct loans to help people buy houses.

Go the www.HUD.gov website and check out loan programs including Title I and 203(k). They are changing constantly, but these programs and others like them and are very powerful.

Local community programs

In the late 1980s, there was an area in West Palm Beach, Fla., where they cleaned out a drug-infested neighborhood. They boarded up the properties and arrested the drug dealers. It was major news, and as news spread, people started leaving the area.

So the city came up with a revitalization program that said if you come in as an investor or owner—and you improve a designated ZIP code area from this block to this block—we will give you a grant of $20,000. That's like $50,000 in today's money.

It was not complicated. You did the work, you sold it, and you made money. Investors were happy, the government was happy, and the neighborhood was happy. It improved the community. There are programs like this available in major cities today. And it is not difficult to make money with them. You just have to work within the parameters of the programs.

Zero down and below-market deals

Whether you have money or not, you should strive to do zero-down deals. Back when I had no money, I structured zero-down deals out of necessity. Today, I have plenty of money and can afford to pay whatever is required for a good deal. But I still try to make it a zero-down deal where I either put *no* money down, or I put *some* money down and I get it all back ASAP.

It’s also advantageous if you get a deal for less than it’s worth. If you can negotiate a deal for less than its market value, make sure you get it under contract. A below-market deal is easy to assign, whether it's a residential income-producing or commercial property.

But you don’t have to always assign these deals. Once you have a deal under contract, and you see it has potential, see if another investor is interested in partnering with you. “Look at this deal, Mr. Investor. I have it under contract. There's a café currently in there. I already talked to them. They are paying $3,500 a month, but they want to leave. The lease is up in three years, but they will leave right now if you give them their deposit back. They want out. And you can lease this thing for a minimum of $8,000 to $10,000 a month.”

Anyone would look at a deal like that. If you find you are confused about a deal—if you are not sure—let the numbers speak for themselves. The numbers will scream what you cannot say.

My first deal

As you read about previously, I didn't have money for my first property. I bought the duplex with money borrowed on credit cards and then got a Title I loan to pay off the balances. It was a zero-down deal. But in hindsight, there are endless ways I could have done it. I could have:

- Come in with a small down payment and had the seller carry back a note.
- Had the seller take an option and then I could have improved the property.
- Improved the income and then refinanced. From there I could have paid everybody off and walked away with some money.
- Refinanced, paid everyone off, and kept the building free and clear.
- Put the building under option in order to improve it—then sold a part or refinanced, paid off the seller who carried the note, and paid off the credit cards that carried charges for construction materials.

The idea is to get the deal, sell part, and keep the rest. Get your money back, but still keep the building. I like those a lot. They are some of the most profitable deals. You could:

- Get an apartment building or get a condo and sell it.
- Get a retail building, make it a condo, and sell it.
- Get a motel, make medical offices upstairs, and sell some offices, but keep the one downstairs.

All zero-down deals are very powerful. But you don’t have to be in a hurry. Only do the deals that make sense for you financially.

From strip malls to shopping malls to outlet malls

Just a few months ago, a student of mine talked to me about a North Carolina property for only $19,000. I can't even change a roof on one of my buildings for $19,000! But the important thing for you to realize is that there is room for you to do $19,000 deals, just as there is room for you to do $19 million deals.

The beauty of real estate is that it's loaded with Blue Ocean Opportunities. You can start wherever you want and walk your way to wealth. Don't overwhelm yourself. Just do one deal at a time:

- Let's say you started at $19,000. Then you became bigger. Soon you have $1 million in profit and cash. Can you still do one deal at a time? Yes.
- Next thing you know, it's a few years later and you have $10 million in cash. Can you still do one deal at a time? Yes.
- Before you know it, you have $100 million in cash. Can you still do one deal at a time? Yes. Just look for a bigger deal.

And if you want billion-dollar deals, go to Chicago. Or downtown San Francisco. Move at your own pace. Use the FACTS system I've given you in this book. You have the blueprint. Start with small properties; move on to *strip* malls, then *shopping* malls, then *outlet* malls. This is how you grow exponentially.

A Summary of the FACTS System

We've now covered each step of the FACTS system. Let me just give you a little more information to guide you as you use the FACTS. Once you've decided on a strategy, there are some basic, yet strategic questions you should ask yourself:

1. Who?
2. What?
3. When?
4. Why?
5. Where?
6. How?
7. How much?
8. What other options do I have?

I'm buying a building right now where I'll be paying $26,700 a month. I've decided to lease the building to Liz Claiborne. They're going to pay me $36,000, but because it's going to take four months, I need to be able to afford the holding costs.

We have a contract signed and they will do the work. It's going to cost me $26,700 for four months but then I'm going to start making $36,000—so I'll have $9,300 per month positive cash flow. What if I can't afford to wait four months? In that case, I would get a partner.

So as I complete this deal, let's use it as an example to answer each of the eight questions:

1. **Who?** Liz Claiborne.
2. **What?** My commercial space that's for lease.
3. **When?** They'll move in as tenants in four months.
4. **Why?** Because this tenant wants the location. And because the numbers will make a profit for me.
5. **Where?** This building happens to be in Puerto Rico.
6. **How?** We've signed the contract; they'll do all the build-out work.
7. **How much?** I'm going to have about $9,300 per month positive cash flow.
8. **What other options do I have?** Can I get another tenant besides Liz Claiborne? Will they be the fastest to come in? Can I get American Apparel—or maybe a jewelry store? Would they be interested in this location? The answer to all these questions in #8 is no. Other tenants I checked with want to wait six months and want to pay me less, so Liz Claiborne is the best option.

There you have it … the FACTS system. If you ever order educational DVDs from CMREI.com or decide to attend one my live seminars, you'll see that all of my trainings are structured around the FACTS system. I hope you'll make it the backbone of your investing strategy going forward.

Chapter 12:
Powerful Tax Advantages

Tax advantages are one of the best things you will enjoy as you buy property. For some reason, the government is generous when it comes to providing tax breaks on real estate.

With the information I'll give you in this book, you will be able to guide your CPA on tax issues. Why would you need to "guide" your own CPA? Because frankly, sometimes CPAs don't know. They usually deal with people asking for simple stuff.

However, when you get into real estate, it gets a little more advanced. When you get into commercial real estate it becomes *very* advanced. And lastly, global investing is *even more* advanced. You need attorneys who actually focus on it and study it so they're familiar with all of the complicated real estate tax codes.

Mr. Baysari was a wizard when it came to maximizing tax advantages. Since working for him, I have developed a true passion for cracking the U.S. tax code. People think I'm crazy, but I don't read fiction. I like reading the tax code. I enjoy looking for loopholes in the tax code and in real estate contracts.

Disclaimer:
I am not a tax attorney or CPA. I will explain as much as I can about how the tax system works and what's possible—but you'll need to consult with your own CPA.

Self-directed IRAs
It's important to remember that you can use a self-directed IRA and roll that money into commercial real estate investments. Once you've established a self-directed account, you can pay the earnest money (to purchase a property) with a check from your IRA. When the building sells, the money didn't come from you—it came from the IRA. Then the entire profit goes back into your IRA account and is tax-free. That can be a great way to grow your retirement nest egg—but more importantly, to avoid taxes.

To set up a self-directed IRA, you will need to find a reliable custodian. There are at least a dozen nationwide, but three I generally recommend when asked. I suggest you check out theentrustgroup.com (The Entrust Group), pensco.com (Pensco Trust Company), or sdiraservices.com (Self-Directed IRA Services). Self-Directed IRA Services is a subsidiary of Horizon Bank.

Tax-free profit
According to Internal Revenue Code (IRC) 121—which is a new tax-free capital gain exclusion that was introduced in 1997 by President Clinton—you can own a residential property and get up to $250,000 of capital gains profit tax-free when you sell it (if you lived in the property).

If you are married (i.e., filing your taxes jointly every year) you get up to $500,000 of tax-free profit as long as you lived in the property! So you can keep buying and selling and your profits will be tax-free—as long as you live in the property for at least two of the last five years. You don't even have to reinvest the money in real estate.

Internal Revenue Code (IRC) 121
According to the Taxpayer Relief Act of 1997, if the seller has owned and occupied the house for two of the previous five years, gains of up to $500,000 for couples and $250,000 for individuals are completely

exempted from taxation. This provision can be used once every two years. In effect you can buy a home, watch it appreciate for the two years you live in it, and sell it at a tax-free profit.

But what if it's not a single-family house? What if it's a duplex? Let's say you bought a duplex for $400,000. You're living in one side, renting the other side, and you just sold it two years later for $500,000. How will this work when you sell it? Simple. When you go to escrow they are going to ask you to fill out a form 1099 since you have lived in that property for at least two of the last five years. Since you lived on one side and rented the other it's really residential *and* investment property.

By purchasing it at $400,000 and selling it at $500,000 you have $100,000 in profit. Since it is a duplex, the profit is split in half, and $50,000 goes as primary residence *tax-free profit,* and $50,000 is *investment gain*. If it had been a single-family house, all $100,000 would be tax-free profit.

Buying and selling investment property

The rules are different when you actually buy a property and then sell it as an investment property. If you buy and sell it in less than 12 months (365 days or less), it is considered a *short-term gain,* meaning it is taxed as ordinary income based on your income tax bracket. In the state of California, you will pay, generally speaking, about 35 percent federal taxes and 10 percent additional for state taxes. (I guess they think it's a privilege to live in California!) So if you bought and sold quickly, your tax bill would be about 45 percent. That's a big one isn't it?

But it can save you money in taxes if you carry the note on your gain when you sell. Why? Because you haven't gotten paid yet. You will get it later when the buyers refinance and pay off your note. It could be very beneficial for you. By the way, if you bought and sold in states like Florida, Texas, Delaware, Washington (state), and Nevada, there are no state taxes due. In those states you just pay federal taxes.

What if you keep the property longer than one year before you sell it? It will now be taxed as *long-term capital gains*. And if you live in California, there will still be a 10 additional state tax. So it drops from 45 percent to 25 percent.

That's why:

- I may buy a property and carry the note when I sell it. That way I can get paid off later and avoid short-term capital gains.
- I may buy the property and let someone have a lease option to buy.
- I may buy the property and just rent it for a while—making my profit when I sell it at least 12 months from now.

The fact is, lots of real estate deals revolve around the tax code. Sometimes I will get a great deal simply by educating someone else on the tax code.

Recently I was at an auction and someone outbid me for a property I really wanted. I had the money but hadn't registered properly for the auction. Afterward I approached the man and told him, "I know you just bought the property. I was trying to bid on the same property, but you outbid me. I'd like to buy it from you. I'll give you $100,000 more for your profits. But that's all I can pay."

The man replied, "No, I want $200,000."

So I said, "I'll tell you what. Let me just close in a year because it's going to save you taxes."

I could tell right off that he wasn't really clear on this, so I started educating him and it worked to my advantage. Long-term gains make it more interesting for people—especially if you show them how you can save them big money. Check with your accountant for more information.

The depreciation tax benefit

What is depreciation? It's what you can write off as the property *decreases* in value. But the true beauty of depreciation is that it is really a phantom loss because real estate actually *increases* in value!

Let's say you own a three-plex and you live in one side and rent the other two units. If you bought the building at $300,000 and the land is worth $100,000, then the value of the improvements is $200,000.

Purchase price – land value = improvement value

$300,000 – $100,000 = $200,000

And because it's a three-plex, you will divide the value by three in order to find the depreciation amount per unit. That's $66,666.

Land Value ÷ # of Units = Depreciation per Unit

$200,000 ÷ 3 = $66,666

You cannot depreciate your own home. You can only depreciate your investment property. And two units of the three-plex qualify as investment property, $66,666 x 2 = $133,332. So we can depreciate $133,332, which is the investment portion. We depreciate this amount over 27.5 years, which is the depreciation schedule for residential. So even though your tri-plex is appreciating, on paper it is depreciating at a rate of $4,848.43 ($133,332 ÷ 27.5) per year. Isn't that great?

Now let's look at a commercial example. Let's say it is a commercial building with three office spaces. Since you obviously don't live in one, you can depreciate the whole building. If the value is $300,000 and the land is worth $100,000, then the office building is worth $200,000. The entire $200,000 will be depreciated over 39 years. (Remember: It's 39 years for commercial, 27.5 for residential.) That's a $5,128.21 write-off for 39 years.

Getting the maximum tax benefit

Let's say you have a retail, apartment, or office building. Do you know that you can not only depreciate the building, but that you can also depreciate the *chattels*? Chattels are movable personal items inside the building, such as furniture, refrigerators, microwaves (that aren't built-in), curtains, and office equipment—things that aren't permanently attached to the real estate.

Using a five- or seven-year depreciation period, you can depreciate chattels faster than the building itself because they typically have a shorter life span. This means you get your money back faster. Talk to your accountant about doing this to maximize your tax benefits.

Because it's considered residential, you can depreciate a four-plex over 27.5 years. But if you have five units or more, which would make it considered commercial, you can depreciate it over 39 years. Whichever it is, you can depreciate the chattels over a shorter period of time.

I mentioned a property earlier in the book that was $500,000 worth of land and $1 million worth of improvements. You bought the property for $1.5 million. You depreciated $25,000 worth of chattels in the first year. You depreciated $25,000 in the second year. That's $50,000 worth of depreciation. After subtracting two years worth of depreciation—at $25,000 each year—your cost basis went down by $50,000.

In the eyes of the tax code, you have now bought the property for $1.45 million. So if you turn around and sell it for $1.6 million, you now have $100,000 of profit plus $50,000 of what's called the *recapture of depreciation.*

It's better to depreciate everything and keep as much cash flow coming to you as possible. Take the maximum depreciation now and defer (or avoid) paying taxes on the property later.

Getting your maximum tax benefit is important. That's why I say you must ask an accountant or a CPA, "Do you have investors who are in the commercial real estate business?" Because the attorney, the broker, the CPA, the seller, the contractor … all these professionals have a job because you are buying real estate. They work for you.

And if they have a job, you'd better know how to employ them. You can't be sitting across from the CPA asking him or her, "So what should I do?"

Instead, you'd better be telling them, "Look, I know there is something called faster depreciation for something like five years instead of 39 on the refrigerator that I just bought. I paid $2,000 for this double door thing, and I need to depreciate it faster." You need to guide them; you need to tell them what you want to do. Make them figure out how from there.

Travel write-offs

If you buy a building in Dallas, can you write off the trip when you visit it? Yes, you are going there to look at the property. If you are looking at an apartment building in Switzerland, can you write off the trip? Yes, you are in the business; you have proof you are in the business.

You have to show proof that you went to Switzerland to look at an apartment building in Zürich. If ever asked about it, you would simply tell the IRS, "I made an offer, and they counteroffered. We did not come to terms."

How to avoid state taxes

Here's a hypothetical scenario for you. Let's say I sell a property in California for $100,000 and I carry a note on it. The buyer is going to pay me $10,000 a year, and I will unfortunately have to pay California state taxes.

Or will I?

What if I don't actually take the income in California? What if I sell the note to a corporation in Nevada, where there are no state taxes? And what if that Nevada Corporation happens to be mine?

What if I exchange the note for the certificate of ownership of the property? If it's an exchange, there are no taxes. The $100,000 note is no longer owed to me; it is owed to the ABC Corporation of Nevada. So I exchanged certificates of ownership.

Can I do this? Of course I can and so can you. And here's how it's done. I simply tell the people that owe me, "Listen, don't make the payments to me here in California. Send the payments to the ABC Corporation in Nevada."

And they'll often reply with something like, "So where do I send a check?"

And I tell them, "Just deposit the check to this bank account. Use a local branch here and say *for the benefit of [account number] for ABC Corporation of Nevada*."

So they deposit the money monthly. I can check online and see that they deposited the money, but the money is going to the benefit of the Nevada Corporation. Does Nevada have state taxes? Haven't I just benefited a little bit?

Am I able to avoid some taxes? Yes. Because I am an individual who lives in California with a Nevada Corporation as a separate entity.

You must check this one out with your CPA. I'm not telling you everybody can do it. But if you live in California or another state that has taxes, it's at least worth looking into. It's been a great strategy for me, I can tell you that. And it's all done legally, ethically, and totally aboveboard.

Avoiding state taxes with a Nevada corporation

If you make a profit of $100,000 in California, you're going to pay federal taxes *and* state taxes. But if the $100,000 is expenses going to Nevada, suddenly you have money that came in as *profit* but came out as *expenses*. California sees income and expenses. But the expenses went to Nevada. If the expenses come in as income to the Nevada Corporation you will pay federal taxes, but no state income taxes. Thus, you just saved 10 percent by paying the taxes in Nevada instead of California.

Avoid properties that aren't fee simple

It is very important to understand that you cannot depreciate land. You can only depreciate the building or improvements that are on the land. As a matter of fact, you can look on the Internet and find many listings specifying a "land lease." Sometimes you'll also hear it called "ground rent."

Both land lease and ground rent are the opposite of "fee simple." What does this mean? It means you can purchase the building but not the land. You can buy the building and depreciate it, but somebody else owns the land and will essentially charge you rent.

Let's say you are going to make $16,000 per month from a building, but you are going to have to pay monthly rent for the land because it is owned by Joe. Joe owns the land and Susie owns the building. Susie is selling the building and she specifies it's a land lease. Let's say it's a building leased to a national tire company. It's a triple net lease paying $16,000 per month including all expenses. This triple net is an *absolute* triple net; that means they pay for everything including the roof structure. You do nothing, you just collect money.

You call Susie and she tells you, "I am leasing it but I'll sell it to you for $16,000. I don't own the land." That means it is a land lease deal, so you say, "OK, what's the payment on the land?"

She says, "The payment is $4,000 on the land."

That means you are really going to be paying $12,000 now.

Now here's the question: When you see a deal like this, how many years do you pay $4,000? Let’s say it is a 20-year lease for the land, 20 years fixed, and it only increases every 10 years by 10 percent. Maybe those numbers make sense. At that rate, you would just be buying cash flow.

But what happens after 20 years? There’s no way to know for sure, but I’ll tell you what could happen: Joe could jack up the price like crazy. There’s nothing to stop him.

So I don't like land leases too much. Some people like land lease properties and tell me, “Cherif, if I buy the building I can depreciate the building. But I can’t depreciate the land. So I don't have to worry.” But I don’t agree. At some point you will be at the mercy of the owner of the land. That would be very worrisome to me.

You can’t depreciate land … or can you?

Technically, you can’t write off the land portion of your real estate. But I’ve found a way to do it, and this is why I recommend you always own the building and the land.

Here’s how I do it: First, I buy the building *and* the land. Then I separate the building from the land and form two separate entities. Then I sell the land to a C-corporation. For instance, I sell the land for $500,000 to a Nevada corporation. After selling it to my corporation, I lease it back to myself so I can have a write-off. By doing this, I have depreciation *and* tax write-offs to maximize all my profits.

Now, the building is bringing in $155,000 in income, and I have payments of, let’s say, $130,000. So I have a net positive cash flow of $25,000. But I have a tax write off of $25,641. In other words, the building is supposedly *decreasing* in value, while the building is actually *increasing* in value. Now, not only do you have *all* your money, it’s blessed by the U.S. tax code! This strategy has literally made me millions.

It brings tears to my eyes when I think how hard I used to work in the hotel business. Especially now that I know how much money there is out there in real estate. That’s why I teach people and why I wrote this book—to try to disseminate these incredible strategies so others can do it for themselves.

Nevada corporation

To take advantage of some of these strategies, you should consider setting up a Nevada corporation. You can pretty much do anything online nowadays, and setting up a Nevada corporation is no different. Anyone can do it. A great site to use is www.inc123.com. You can also search for “Nevada State Secretary,” hit search, and it will give you a site for the state secretary. Simply click the link from there and it’ll show you how to set up a Nevada corporation.

As you go through the process, it will ask you questions such as: *Who are the officers of the corporation?* I prefer to fill the role of every officer. I would suggest you do the same. For instance, I am the director, treasurer, president, and secretary of my Nevada Corporation. I am the four officers of the company. If I want to have a Board of Directors meeting, I just put mirrors up around the table.

So how does this work with me living in California? It’s simple. If you set up a Nevada corporation in Nevada and you want to do business using it in California, you must register through the state secretary in California. To do this, you pay about $800 a year in fees. If you keep the Nevada corporation, you’ll generally pay about $125 per year in fees in Nevada. But it can be worth it for the anonymity and to avoid state taxes.

You can avoid taxes with 1031 exchanges

You quickly learn how to avoid taxes when you are in commercial real estate. A lot of my students have been asking for more information on 1031 exchanges. They are very big right now. Here's how it works: When you sell a property and you don't need to cash out your money, you can exchange it into a bigger commercial property. You don't sell the property—you exchange it. This is called a 1031 exchange.

Let's say you bought an investment property for $1 million. If you kept it more than a year, you would only have to pay long-term capital gains, not short-term. So the taxes would be less. In this case, let's say you are selling it several years later. You have done some work on it, put in a new tenant, and appreciation has been good to you. It's now worth $2 million. But you don't want to pay taxes. You want to *defer* the taxes. You can do this using a 1031 exchange. You essentially sell the property to and then roll the money into another property by purchasing it.

It usually works like this: They give you 180 days to complete the 1031 transaction. The escrow office deals with a qualified intermediary, which is a third party, who gives you 45 days to identify one to three properties where you want to roll over your money. You then have 135 days to close, and 45 days + 135 days = 180 days or about six months. This is a great strategy if you don't want to pay taxes.

You may wonder how you can get your money out if you keep "rolling" it. Well let me ask you this: If you have a property that's worth $2 million now, can you refinance and cash out money? Yes you can. And when you refinance and cash out, that's borrowed money. It's nontaxable. Now you can roll the property into a bigger building with better income—and the tenants are paying for the money you just cashed out.

Let's say you just bought a property by taking a loan of $800,000. That was your debt. And over the next two years you split the units upstairs and converted them into condos. It's now worth $2 million. So you call the bank and say, "I'd like to re-appraise the property and refinance."

They say, "Okay, you've improved the building, you have some solid tenants, etc. We can cash you out at $1.8 million."

So you refinance and your new debt is now $1.8 million. Once you pay off the $800,000 there is an extra million dollars sitting in your bank account. That million dollars is tax-free. This is why I don't like to sell commercial property. In fact, I tell people to try to keep their properties forever. You buy them … improve them … refinance them … and cash out the money. The tenants are making your payments and you still have positive cash flow. Plus, you already got *more* than your money back out.

Rockefeller once said, "You play with pennies, you make pennies. You play with dollars you make dollars."

And that's the game. It has its own rules, and it's fun. It's a game with no opponents. Because you can help everybody win. And once you show them how they will win, you will win. Everyone is going to make money. The escrow person is going to make money, the intermediary is going to make money, and the new buyer is going to make money.

When I have a building I want to sell, I love getting a call where the broker or the buyer tells me, "Mr. Medawar, we are very interested in the building you want to sell. And the buyer is in a 1031 exchange situation."

Imagine you are in Vegas in front of a slot machine. That's the sound of money pouring out of it when you get that phone call.

Negotiating with people doing 1031s

Let me ask you something: Why is it easier to sell commercial buildings no matter what the market is doing? It's because:

- People don't want to pay taxes.
- People are always growing in commercial.

And when people start growing in commercial, they eventually have a huge tax liability. When they go to sell, they don't want to pay taxes. They want to roll the money over. But they only have 45 days to identify the property. So are they under financial and time pressures? Yes. Are they going to negotiate real hard? No.

That's when they tell me, "OK, we are very interested in the building. Can we see it tomorrow?"

And I say, "It would be better to see it at the end of the week." Now the sense of urgency is reversed. And one of the most powerful things—when it comes to negotiation—is time. One of the main reasons you can get stressed is time. Even kind, nice people will start to flip out when they're running out of time.

Try going to your job in the morning and getting stuck in traffic. Running late makes you arrive exhausted. You start fantasizing about quitting because the lack of time squeezes everything out of you. And people who don't want to pay taxes can run out of time if they don't do a 1031 exchange the right way. Then they call you to negotiate a deal quickly so they can close and avoid taxes. This is a win for you.

Remember it when negotiating and use it to your advantage.

Other ways to minimize or delay taxes

Here are several other ways to minimize or delay taxes. I'm not going to expand on any of them here. You can do your own research or check with your CPA for more information:

- You can lease the property so you can avoid some taxes.
- Give someone a wraparound mortgage when you sell.
- Use a seller carryback.
- Give a seller the money and carry your profits with a note so by the time you get your money, it is long-term capital gains.
- Get an option to purchase using an IRA. This way, when you actually sell the option you can avoid taxes. (And having an option to purchase later may help the seller avoid taxes.)
- Give someone an option for a year to delay the closing.

Difference between an assignment and simultaneous close

A student asked me the difference between an assignment and a simultaneous close. The difference is that the simultaneous close is closing two deals simultaneously. So you have to close on one deal and then *immediately* close on the second deal. It's also called a double closing or a "straw" close.

Sometimes a title company can play the "simultaneous close" game to get extra fees. For instance, a title company recently informed me, "Cherif, we understand you are going to assign this deal. What we are going to do is get $1.35 million from the first buyer, close with them, charge them the fees, and then we are going to charge you some fees as the seller. But since we do it simultaneously—as if you have just bought—you're also going to have to pay some fees as a purchaser."

So they were going to charge me as both a buyer and as a seller, and it was something like $8,000 in fees to do a simultaneous closing. So watch out for this.

Once you start doing transactions with a particular title company, you can ask the title officer, "Listen, I'm going to be doing an assignment—can you handle it?" Sometimes they'll say yes, and other times they'll tell you they have a specialist, but in another branch. "OK, then, call the other branch," you need to tell them. You want someone who knows what they are doing, uses the correct forms, and can handle your transaction easily.

At closing: Ask for a binder

What I'm about to tell you is going to save you tons of money at closing for the rest of your life. When you buy a building or a property that you are going to turn around and sell in less than two years, ask the title company to give you what's called a "binder." A binder will cost you an extra 10 percent up front—but when you sell the property, you will get what the new buyer has paid credited back to you. It can save you anywhere from $2,000 to $10,000 on closing cost back-to-back. But mark my words, *there won't be one person in the title company who will suggest this to you.*

The time to ask for this is when you go in to close and you get the title insurance and the paperwork. Let's say you're purchasing a property that you know you're going to turn around and sell within two years. When you come to the closing table, tell them, "By the way, I'd like a binder." You may pay 10 percent more when you buy, but you won't have to pay for all of the closing costs again when you sell.

Let's say your closing costs are going to be $8,000 when you buy and about $5,000 when you sell. With a binder, you'll pay $8,800 coming in and maybe $400 on the way out. That's a pretty sweet trade-off if you ask me.

Chapter 13:
Creative Ways to Share the Fun … and the Burden

Sometimes I meet people who tell me they want to cash in on the profits of commercial real estate but don't want to shoulder the entire burden themselves—whether that burden involves financial or administrative issues, due diligence and analysis, or just the legwork involved in making a deal happen.

There are several creative ways you can get others involved. It can help you share the burden and also share in the fun. After all, things are more gratifying when we share them with others … and that includes commercial real estate investing.

Use a limited liability company

One example is to use a limited liability company (LLC). I talked about this previously. Sometimes I may contact a potential partner and say "Look, I just found a building for $1 million that's worth a lot more than that. I want to purchase it, fix it up, and get a big tenant. The bank is going to ask me to make a small down payment. So let's set up an LLC and get 10 people involved."

Once we do that, each member will put in a certain amount. And every member has a different percentage of ownership depending on how much he or she put in.

In a scenario like this, I've done most of the work in finding the deal, signing the tenant, and managing the property. The other members just contribute money to the investment. So I would get a bigger percentage of ownership.

Tenants in common for a 1031 exchange

You could also set up a partial investment using tenants in common (TIC), which is something I've covered in previous chapters. For years, a lot of people were selling properties and found themselves holding $300,000 or less—but they didn't know *where* or *how* to roll it forward even if they identified another property. So in 2002, the government changed the laws for the benefit of small investors like you and me.

Now big companies—even Wells Fargo does this—are allowed to present a 1031 exchange investment opportunity to the public. They can pool the money and invest it into big buildings. And the investment must be offered as a TIC. Now the guy who just sold his property can roll his $300,000 into an $80 million building.

This is great for you and me. The advantage is you don't have to go find a property to do a 1031 exchange. You can do that 1031 exchange with a pool of other investors who are tenants in common, just like you. You have no hassles trying to find the property and you have no hassles with management.

Professional companies will manage them for you, although they will charge you a hefty management fee. So you will roll the money and make a hassle-free 6 percent. A lot of people love 1031 exchange opportunities, and why not? This makes the process much simpler for people who are looking to prevent a major tax hit.

A problem to avoid

Let's talk about an area to avoid where you could have problems. Let's say we have a partnership—an LLC with five members. And let’s say the LLC bought a building at $1 million, with each of us putting $200,000 into it. Meanwhile, we are making a lot of money with the building.

Suddenly, we decide to sell the building for $2 million. We are going to sell it and roll it into a bigger building. (Remember, for tax purposes, you have to roll it into a building of equal value or greater value.) We are all excited about buying this incredible new building. All of a sudden one of the five says, “You know what, guys? I don't want to roll my money forward. No 1031 exchange for me. I would like to cash out.”

Talk about disaster! This is where the intermediaries have the hardest time—when it comes to partnerships that go south and the group still wants to roll the money forward. It is very complicated and once happened to me. So be cautious.

If you are going to write a deal with somebody as a partner, don't do it just based on a handshake. Do it in writing. Pay a few hundred bucks for an attorney to put the correct language into the contract—clauses such as *In case of selling the property, we will roll the money at least once and then the partnership can liquidate* or *In case of selling, anyone who wants to liquidate shall be paid from the refinance of whatever is purchased.* The attorney will figure out all of the “what ifs” involved.

Real estate investment trusts

Real estate investment trusts (REITs) are organizations that form investment trusts using real estate property. They are regulated by the U.S. Securities and Exchange Commission (SEC) and are publicly traded on the stock market.

In this way, they can sell individual shares in the REIT. For instance, one share in a REIT may cost you $30. If you want to buy a thousand shares, that's $30,000. It's just like buying stock. The difference is that you are buying into an entity that manages hotels, buildings or large commercial properties of some kind.

REITs usually pay dividends. So if you bought the stock at $30—and let's say they pay 8 percent interest—you are getting a dividend. The dividend taxation is pretty low—about 15 percent—so you get no-hassle investing in companies that invest for you. It's like investing in the stock market, but your investment is related to real estate.

Personally, I don’t like REITs. The reason? Because I don't like *any* investment where I have no control. With a REIT, you can’t improve anything because you are not in control of anything. You just give them $30,000 and sit around and hope for a dividend. REITs are mainly for people who are retired and don’t want to manage their investments. A lot of people leave companies with big retirement funds and they don't know what to do with them.

The reason they don’t know is because they would never pay a penny for training or a seminar. They don't read books—they just watch TV. They can tell you what time every show is on and what’s happening on “The Bold and the Beautiful.” And they live their life like a soap opera. I suggest you go out there and make your own drama. Have your own adventure. Investing is a lot of fun, and it's a big world out there.

Instead of putting your money into a REIT, which is basically a public syndication, you can go out there and create your own private syndication.

Syndication: The power of group investing

Have you ever dreamed of having an endless supply of money to buy commercial (or even residential) real estate? Have you ever wanted to put together a group of investors to purchase property? Do you wish you could cash in on some of the bigger deals around you—but don't have the funds?

The way to do it is syndication. Syndication is nothing more than people pooling their money together to invest. I often refer to it as group investing. More money creates critical mass and power for everyone. It also results in less time wasted and more profit.

Do you know anyone who has an old IRA or 401(k)? Think they'd like to earn double-digit returns on an investment secured by real estate? You bet they would.

Find a few people like this, create a syndicate with their funds, and boom … now you're a major player. By grouping investors together after finding a great deal, you are now using other people's money to do the deal.

A good technique for commercial brokers

Syndication is also a great technique for commercial real estate brokers to use in this economy. For too many brokers, banks are not cooperating, appraisers are bringing values in lower, sellers are frustrated, and buyers are overwhelmed.

That's why hundreds of licensed brokers now consider syndication the best way to combat the current down market with hard-to-obtain bank loans.

If you are a broker, you can get paid three times:

1. You get an acquisition fee when you put the deal together.
2. You receive regular payments for managing the syndicate.
3. A few years later, you can sell a property again and earn a disposition fee.

In my opinion, syndication is the best way to capitalize on the low prices and huge potential that exists today in commercial real estate. At some point, properties will rebound in a big way. If you set up a syndicate now, you'll be positioned to ride the coattails of the escalating values.

Syndication is such an incredible technique for investors that I knew I needed to show people specifically how to do it. So in 2010 I started teaching people how to start their own syndication by grouping investors together and getting them into a commercial real estate opportunity. It's the same concept as raising money for any business venture. Doing partnerships, joint ventures, or larger-scale syndications is one of the best ways to get into big, profitable deals with less risk and more rewards.

Many attorneys and some of real estate "gurus" offer seminars on syndication. But attorneys don't want to teach you how they're done; they want to sell you on their services. In other words, they want you to pay them to set up yours and manage it for you. Likewise, some of the gurus make syndications seem complicated, thus scaring you into joining theirs … not starting your own.

The reality is that syndications are not complicated. That's why once a quarter I do a special event to train my student-investors on how to apply this unique and powerful method. I've now trained thousands on this strategy. At my syndication training events, I cover:

- Structuring a syndication.
- Finding investors and raising private equity.

- Understanding legal issues.
- Managing your syndications.
- Maximizing the tax benefits.
- Timing the process and cashing in.

The reasons to learn how to syndicate are obvious. First and foremost: Banks are currently asking for more than they previously have. They aren't requiring a 20 percent down payment … they want you to put down 40 percent or 45 percent! The answer to coming up with that kind of money is syndication. You find people with money, group them together, and suddenly you've got strength in numbers. Suddenly the real estate world opens up to you.

Very few people understand syndications. But the power of group investing is incredible. Unfortunately, if you go to an attorney, he or she is going to do it for you. And charge you a fortune. But you can do it yourself if you know how to set it up, file the proper paperwork with the Securities and Exchange Commission, and pool people's funds together. That's what I teach.

There are many creative strategies to purchasing property. This book is full of resourceful and innovative techniques that work. But forming a syndicate is the way to finance blockbuster deals and take your wealth to a high level very quickly. Syndication of the one thing I wish I'd known about when I was getting started.

The "nothing down" of today

In 1980, Robert Allen published one of the best-selling personal finance books of all time, *Nothing Down*. The book was successful because it captured, in one publication, all the no-money-down strategies residential investors used to do deals.

Syndication is the no-money-down strategy for today. It's one of the biggest keys to commercial success. With syndication, anyone can get started big and go bigger. I wish I had done syndication 20 years ago when I got started. If I had, I'd be a *billionaire* today instead of a *millionaire*.

Syndications are a topic unto themselves. I can't tell you everything you need to know here. If attending one of my syndication trainings is not convenient for you, you can purchase the training on DVD at CMREI.com.

No other training is so uniquely designed to put you in the driver's seat of the commercial real estate syndication process. I strongly encourage you to look into it. On the DVDs, I teach you everything you need. The DVD course has the exact same education and materials as my live syndication event.

I've even created a syndication that students like you can invest in alongside me. It's a unique fund called MIGSIF. MIGSIF is for high-net-worth student/investors seeking a large, no-risk commercial opportunity. You'll read more about it in **Chapter 16: Paying It Forward**.

You shouldn't do this alone

When it comes to success in any endeavor, no person is an island. You can't isolate yourself and expect to make it to the top. In any business, it's important to surround yourself with the right people. No one can create an empire without knowing how to work with others. Syndications are a perfect example of that.

Sometimes I see people who really want to create massive wealth but are difficult to work with. Not only can they not get along with others—they can't even get along with themselves.

How can you expect to be successful if you can't positively interact with those around you? If you surround yourself with competent people and treat them with respect, you can go as high as you want to go.

I'm not just advocating getting along with the people who can benefit you. I'm also a big believer in win-win solutions. As you grow with this business, you will have opportunities to take advantage of others … to stick it to the other guy.

But let me caution you: If the other side isn't winning, it's impossible for you to win. There is no reason to make any transaction adversarial. Whether you are dealing with a seller, buyer, tenant, or other real estate professional … always strive to make it a win-win.

If you leave some money on the table, they'll come back to do more deals with you. Karma is alive and well in this world. Strive for win-win solutions and you'll benefit in the long run.

It's been said that no one can climb a mountain alone. I've found that this is absolutely true. The person who steps on others during his climb to the top soon runs out of footholds.

But the person who reaches out and brings others up behind him will always have a strong support network on which to stand.

One of my greatest pleasures is seeing my students succeed. We have thousands of success stories. I love getting emails and phone calls from those I've trained. Not only does it give me satisfaction as a teacher, but it helps me learn new things as well. One week of my life is equal to a year of someone else's because I'm in constant communication with students. In other words, I get to see their experience as well. I constantly learn new ways of doing things and looking at things from them.

As you proceed in your endeavors, surround yourself with the right people. Give to them as they give to you. Together, you'll climb much higher than you'd ever make it alone. And the trip will be much more rewarding, I promise you.

Chapter 14:
Protecting Your Assets

Let's talk about protection. You need to protect yourself by putting your assets into entities. You have no personal liability if you use a C corporation, an S corporation, or a limited liability company.

I find people are all over the board when it comes to what they think they know about these three kinds of business entities. In fact, I could do an entire weekend event cleaning up people's preconceived notions about them. No matter what your previous education has been, let me summarize these three entities for you.

The limited liability company (LLC)

The S Corp and LLC are *tax-through* or *flow-through* entities. When using an S Corp or an LLC, you are taxed on the income from your job, any other earnings, plus whatever is in that entity.

So if you put a building in an LLC and subsequently sell it and make a profit, your personal tax return will include the profit you made from that deal, plus whatever income you had from your job. All this income is added up and you pay taxes on that. And if you have a loss, that loss will wipe out the income you have from the job and you may pay no taxes.

Meanwhile, you are protected.

Here's what I mean: Let's say you buy a building and put it into an LLC. If somebody slips and falls on that property and wants to sue you, that person can't get far. People can't go after your car, your other real estate, or anything you own personally. They can only go after what is in the LLC. That's why it's called *limited liability.*

If the debt is 100 percent of the property value, what can they get? There is no equity in the property. And they can't get anything outside the LLC. They are going to get *zero*.

Don't forget about insurance

Always have insurance on *every* building. No bank is going to give you a loan unless you have insurance. If you pay cash for a property, no lender will be there to require that you get it, but you should have it anyway. It's crazy not to pay $500 to $1,000 a year on a building worth $800,000 or more. So always get insurance—whatever the cost.

If you have insurance and somebody slips and falls, you have an extra layer of protection. Why? Because first the person will have to file a claim with your insurance company. The insurance company may decide to fight it or just pay it but will handle it either way. If the person wants to go over and above your insurance protection, he or she may decide to hire an attorney and sue for more. But there is nothing more to get if you have it in an LLC or an S corp.

Entities are a great form of protection, and they're simple and easy to set up. Let's say I have a project, and you want to come and do a partnership with me. In this case, I would use an LLC. In California it costs $800 to set up. I simply go to the Secretary of State website, fill out the form, pay the fees, and it's done. In 48 hours, I can have an LLC set up.

And between an LLC and an S Corp, I prefer the LLC. Why? Because if there are five people in the S corporation, the tax bill is divided equally when it comes. But with an LLC you can allocate the tax gains or losses however you want. You can tell the government which LLC members are taking a loss or gain. Maybe this year you want to have Fred take all of the tax loss. Or maybe Fred will take all the gain and the other members will not have any. With the LLC, you can separate it in any percentage you want. Your options are limitless.

Anonymity from a C Corp in Nevada

As I alluded to in the chapter on tax advantages, you do not have to live in Nevada to have a Nevada corporation. Anyone on Planet Earth can go online and set up a Nevada corporation, including non-U.S. citizens. And once it's set up, the Nevada corporation is a separate entity. It's like a separate individual who resides in Nevada.

Here’s a cool strategy that involves setting up a Nevada corporation. Let’s say you sold a property and carried a note on it. You could transfer the note to a C corporation in Nevada. But why would you do that?

Because while LLCs and S corps are under your name and Social Security number, a C Corp is separate from you. It has its own name, which you choose when you file for a federal tax ID number. You enjoy more anonymity.

Registered agent

When you set up a Nevada corporation, the state says you have to have what is called a registered agent, usually an attorney. So if there's anybody who wants to sue your corporation, serve you with a lawsuit, or ask you some type of question, it will go through the registered agent.

Managing your Nevada Corporation online

The only problem with a C corporation is you have more paperwork. You have to:

- Submit corporate filings.
- Show your meeting minutes.
- Update the information every year.
- Name your board of directors.

But Nevada has made it so easy now. Once you have it set up, just go online to www.nvsos.gov. Hit search and put in the name of the corporation. It shows that you are the director. It shows the date and information for renewal. Are there are any changes? *No.* Is it still the same directors? *Yes.* In case the director dies, what happens? *All voting shares go to surviving spouse and daughter.* Fees for renewal: $85. You pay with credit card, PayPal, or whatever. And you can deduct that payment on your taxes, of course.

Before the Internet, there used to be corporations telling you, “We can maintain the paperwork for you for a mere $1,200 a year.” Don’t fall for this. The Internet has made everything easier. You can do it yourself for $85 if you know how to read.

A C Corp offers power, anonymity, and protection

Let’s continue talking about C corporations. A C Corp is so powerful that it can even build credit. That’s right. After a couple years of showing income, you can start applying for credit cards, credit lines, and debit cards under your Nevada corporation. And it won’t show on your debt ratio because it's a separate entity.

Meanwhile, I am the director of the corporation; the shareholders are the owners of the corporation. The shareholders in a Nevada C Corp can be anonymous. In other words, you can list the name of the owner or you can leave it as “owner is a shareholder.” They don't need to know the identity of the owner. They just need the name of the director.

This would be like slipping and falling in a restaurant owned by TGIFriday’s. Are you going to sue the manager? The director of operations? The cook? The waitress? No, you're going to have to sue the company. It's the same with a building you have in a C corp. It's a very powerful layer of protection.

Here’s another powerful strategy to discourage people from suing you. Let’s say my property is worth $1 million—I owe $800,000 and have $200,000 equity. I can create a note for a $200,000 debt to my Nevada corporation. So I owe my Nevada corporation $200,000. If somebody slips and falls and then runs to an attorney, he or she is going to run a title report. The title report will show $800,000 is owed to bank, and $200,000 is owed to some company in Nevada.

As a result, the lawyer will tell the client, “Look, the building is worth a million, but the guy owes around a million. He owes $800,000 on a first and $200,000 to a second. What do you want to sue for? Forget this guy. You should move on; he owes money to some Nevada corporation.”

See how complicated you can make it for someone to sue you? One guy even asked me, “I have a divorce coming, how can I hide my assets?” Can you believe this? I told him to check into a Nevada corporation. It can be very hard to track the identity of the owner. (I’m not advocating that anyone do this, by the way.)

I know this section is a bit advanced, but one day you will be at a level where you can implement these strategies. The bottom line? The C corporation setup is pretty interesting, and the more you know about entity structures, the better off you are. All these layers of protection make it nearly impossible for somebody to pierce through.

Note: I would suggest you look at a Nevada corporation only when you grow to a level where it makes sense. Just make sure you check with an attorney before setting it up. It’s not something to spend time on if there is no need for it.

S corporations

In a previous chapter, I discussed how you can buy a house, live in it for two years (minimum), and then sell it and get the profit tax-free. Well, here’s a strategy that I guarantee you’ve never read anywhere else.

Let’s say you buy a principal residence, sell it for a profit two years later, and buy another principal residence with the money. Once you’ve lived in that one for two years, you sell it, take the profit and move again. But once you’re in the third property, your spouse tells you, “I am tired of doing this every two years. We’ve made a quarter of a million dollars, we are not paying taxes on it, and we have $700,000 cash in the bank. I love this house and I’m not moving again!”

Now you’ve hit a brick wall (unless you don’t value your marriage, of course). But let’s assume you do value your marriage and that you want to cash out the money in tax-free profit. I don’t blame you. So here’s what you do: You sell the property to your S corporation, which is you. Cash out the half-million tax-free and stay in the home. Isn’t that great? *God bless the United States of America!* If you understand commercial real estate, entity structures, and the tax laws, you can't go wrong.

Number of members in your corporation

If you are going to have members partner with you in an S Corp, it is limited to 75 people. A C Corp allows an *unlimited* number of shareholders.

An LLC also allows an *unlimited* number of members. You can put 10 people in it or one person—it’s up to you. If I'm going to do a project—and it's a $20 million to $30 million deal—I want to set up an LLC so I can add as many people as I want. I'm not going to limit myself to 75.

Here’s something else: With a corporation, members have to be U.S. residents. But in an LLC, members can be from other parts of the world. You can have members from Canada, Mexico, China, Japan, or anywhere you want.

Use one LLC for each property

The other day a student asked me, “Cherif, can I set up one LLC that will own *all* my buildings?”

If you did this, one LLC would have a lot of assets. What if somebody slips and falls? The whole idea of this setup is to *limit* your problems. If someone slips in Property A, that person can go after the assets in the LLC that owns Property A. But if you also have Property B and Property C in the same LLC, now those two properties have suddenly become vulnerable through no fault of their own. I highly suggest setting up a separate LLC for each property.

LLC distribution and dissolution

Let’s say I have a partner named Angela. We buy a building together, turn around and sell it for $100,000, and carry a note for five years. And the note is in the name of our LLC. We receive $10,000 a year, which is $832 every month (the monthly interest rate on the $100,000 note).

We have a bank account set up for our LLC. We’ve asked the sellers not to send us checks personally, but to deposit them in the bank account. Well, within that bank branch, we also have separate personal accounts. One for Angela and one for Cherif. When the $832 comes in, $416 immediately gets transferred into my bank account and $416 also goes into hers. Isn’t that a great way to track it?

At the end of the five years—when the sellers refinance to pay off the note—$50,000 comes to her and $50,000 comes to me. The LLC then dissolves itself. That's another advantage of the LLC—it serves its use for a finite period of time and then dissolves itself. No matter how you slice it or dice it, the LLC almost always ends up being the best option.

Filing taxes with an LLC

A corporation is a separate taxable entity. You have to file separate taxes for a C Corp or an S corp. It's almost like a separate person and you’re a director filing taxes for it. But with an LLC, you file your personal income taxes—and those of the LLC—together. It’s less hassle.

A living trust

Throughout this book, I have continued to teach you strategies (like the 1031 exchange tax strategy) where you can keep exchanging (or "rolling") your property into another one. Assuming you do this, you will likely keep growing, exchanging, and multiplying your profits for quite some time. Hopefully, you eventually grow a $100,000 personal net worth to $20 million, $100 million, or even $1 billion. That is the goal, right?

But something is eating at you and I know what it is because I hear this from students all the time. "Cherif, if I keep growing and deferring all this money, won't I one day have to pay the taxes on all of this profit?"

To answer this, let's look at a scenario. Perhaps you start with $100,000. And you've been rolling the money for years and now it's $200 million or $400 million. When you die, if you're not set up correctly, your beneficiaries will have to pay in the neighborhood of $150 million in taxes.

But the tax code tells us that we can set up what is called a *living trust* so that there will be no taxes when we die. Simply set up a living trust and you can roll all your properties into a living trust with the beneficiary being an LLC. Now if something happens to you, the members of the LLC (who in my case are my wife and kids) won't have to pay taxes. It gets inherited at a "stepped-up basis" to your loved ones.

If you die, the entity—which is worth $400 million—is passed on to your spouse or children. Only their cost basis is now $400 million. And since the IRS taxes us on the difference between the current value and the basis, when (if) they decide to sell, they'll pay no taxes.

Going "offshore"

Here's something else I sometimes get asked about. Should you go offshore for protection? Should you go offshore to avoid taxes?

In my opinion, no. We live on the best "shores" there are. People come from all over the world to invest in the United States. There's no reason to complicate it—and there's no reason to avoid taxes in a way that is questionable or suspicious. You don't want to evade taxes; you want to follow the law. Actually, scratch that. You want to *master* the law.

Leave the fiction in Hollywood

Some people ask me about pure trusts and other offshore setups you can supposedly use to protect yourself. Let me tell you: I'm familiar with all this stuff, and most of it is baloney. It's a figment of the imagination of Hollywood script writers.

You want to stay within U.S. shores and go to qualified attorneys who have experience. You want to make sure your CPAs and accountants understand what they are talking about. You want to use people who know how to structure your business right.

Don't get caught up in thinking there's some kind of magical protections or loopholes "offshore." There's not. That's just Hollywood fiction.

You can go to www.irs.gov and find out anything you want to know about taxes. Whenever the tax law changes, you want to be in tune to what's happening. You want to be on the mailing list for the newsletters that will announce changes in taxation. Because a small change in the tax code can make you millions in profits.

Chapter 15:
Ten Steps for Profitable Investing

I've given you all my commercial real estate formulas for success in this book. I've taken you from an introduction to commercial to how you can make millions with it. But I want to leave you with some last bits of wisdom. So here are some common-sense suggestions for success. I call them my 10 steps for really effective and profitable investing:

1. Know what your end goal is and make a daily effort to get there.
2. Acquire the knowledge and accept responsibility for the work.
3. Identify the team and tools and assess the price/budget that you will need to commit—as well as the time you will need to get there.
4. Your safety margin will always be in keeping your acquisition, maintenance, and improvement costs as low as possible.
5. Perform due diligence systematically and proficiently for each project before committing money to it. Follow it like a flight checklist.
6. Remember that barriers to entry and unique locations are an absolute advantage in the short and long run.
7. Balance your short-term thinking and actions to meet your long-term goals and ideals.
8. Know your exit while protecting yourself along the way.
9. Set up your business as if you will step away forever at a moment's notice.
10. Create win/win situations.

1. Know what your end goal is and make a daily effort to get there.

You have to identify your end goal and keep focused on it every day. If you don't have a goal, how are you going to get there?

In this book's **Introduction**, I began by suggesting that you should know "What you want from commercial real estate." It's like opening a map. As soon as you open a map, what's the first question you ask? *Where am I?* Okay, I am here. *Where am I going?* I'm going there.

You have to know where you are starting from financially and emotionally. What is your comfort zone, and what will you be going after? If you know where you are and where you want to go, now you have a plan.

2. Acquire the knowledge and accept responsibility for the work.

If you are out there trying to make a deal happen, you can't start blaming the spouse, the kids, or the computer when something goes wrong. You must accept responsibility. And you have to understand that you will make mistakes and there will be frustrations along the way.

For every deal I've made, I know I could make a better deal if I could go back and redo it. I could've squeezed more money out of it. I could've gotten a little bit more on the way out. With practically every single-family home I've sold, the people who bought it from me made money eventually. Am I upset? No, I'm happy for them.

Being fair

What you do comes back to you. And sometimes it's better to go to sleep knowing you didn't squeeze every penny out of the deal. It's not the end of the world. Make sure the deals are moving forward and that's more important than squeezing every deal. If you squeeze every penny out of every deal, you will do only two deals a year. Let it move forward without analyzing it to death and you will do 10 deals a year.

Sometimes your mind will play tricks on you. When you are trying to make a decision, you'll start hearing a voice that says, "Should I do this? Maybe I'd better not. Yes, I should. No, maybe I shouldn't."

Instead of letting the voices in your head talk to you, go back to the numbers and let the numbers talk to you. Look at the opportunity again. Drive by it. If it's exciting and you want to make an offer, ask them how long you have to answer them. Sleep on it. And before you sleep, think about it. You'll be amazed at what your subconscious mind can do.

3. **Identify the team and tools and assess the price/budget that you will need to commit—as well as the time you will need to get there.**

It's going to take time. You know the Chinese bamboo tree? It grows slowly for eight years, and then it shoots up all of a sudden. Abraham Lincoln once said, "If I had eight hours to chop down a tree, I'd spend six of them sharpening my axe." Isn't that an interesting concept?

Your life is like an airplane on a long runway. You keep picking up speed and you think it's never going to take off. And all of a sudden, it goes up. And when it does, it goes up so fast it takes your breath away—it just took a while to build momentum.

The *hardest* thing to do in the world of investing is to start. The *second-hardest* thing is to build momentum. And the *third-hardest* thing is—*watch this!*—to slow down. You see, once you get going, momentum can sustain you.

Reassessing your goals

Suppose your end goal is to have an income of $10,000 a month. That's a great goal, but you can do it so quickly in commercial that it may shock you. Now all of a sudden you have to reassess your goal. Why? Because you got there lightning quick—you just started this commercial stuff—and you still have energy. Besides, you're not just going to sit and watch TV. People like you—who read books like this—don't sit around and watch soap operas. So now maybe your goal becomes having income of $30,000 a month.

The momentum I'm riding just keeps building. I remember when my goal was to match the gross income I was making in the hotel business. Then boom! It happened very fast—within seven months.

So I said to myself, "Cherif, you need to make $15,000 a month." Boom! Again, it happened quickly. So I told myself, "Okay, $30,000 a month. That's a thousand dollars a day. I can live in a hotel in Paris and rent it." Boom, it happened. So I gave myself a final goal. "Okay, I'm going to get to $50,000 per month and then I will stop. That's it. I will spend my life donating my time and money and doing things for other people."

But the strangest thing happened. I fell in love with a woman, we got married, and I said, "You know what? The game is on now. Let's go for more money. Let's grow and take it to the next level. But the one thing I will do is share all of this knowledge with others."

That’s one reason I write books and teach. I enjoy it. But here’s another reason: If I cannot explain a concept to you, it's not because of a lack of words in our language. It's because I have not mastered the concept I'm trying to teach. So teaching is learning twice. Teaching is mastering the game. And I’m giving back all the while.

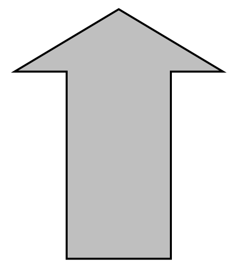
Teaching is my passion. I will always do it. I video every seminar and training event we do so one day my two young children can learn what I’ve been doing and see me at my best.

The Scale of Knowledge

I’d like to introduce you to a concept I call the Scale of Knowledge. During every seminar, students come up to me and say, “I didn't even know that I didn't know that stuff … because I didn't know it existed.” Prior to my seminar, they were at the bottom of the Scale of Knowledge. When they’re at the bottom, people don’t know what they don’t know (Level Five).

The 5 Levels of the Scale of Knowledge

1. I know it and can teach it for others to produce the right results.
2. I know it through experience and the right results.
3. I know about it (I have a theoretical understanding).
4. I know that I don’t know (I believe it’s worth pursuing).
5. I don’t know what I don’t know (I did not even know that stuff existed).



Once they know that stuff exists, they are aware that they don't know, and they may believe it is worth pursuing. That is a level above the bottom. (I call it Level Four.) Level Three is next, which is getting the theoretical understanding of what I am explaining. They get the concept. Level Two is when they go out and practice what they learned and gain firsthand experience through trial and error. Level One is the top level. This is where they have the formulas, practice and ability to guide another person who doesn’t even know what he/she doesn’t know.

I believe that training others is a great thing. The value of a human being is in direct relation to his/her willingness and ability to help others. There is no greater help than inspiring and empowering others to reach their potential.

People who understand the Scale of Knowledge can grow so fast because they recognize where they fall on the scale. But you don't know it until you are progressing … until you experience it and then teach others. And you're not going to experience it unless you take action.

With respect to commercial real estate investing, where were you on the Scale of Knowledge prior to reading this book? Where are you now?

Identify your team

It is *you* who determines the people you are going to work with ... the people who are on your team. How do you assess them? Answer: By evaluating their talents and temperaments. By asking questions.

For instance, my thought process goes something like this: “Deborah is constantly negative; she’s down on the emotional scale. Will she be good for my team? Rob is too laid back; he's not going to work hard for me. I don’t think he should be on my team. Chris is more energetic. He gives me ideas. He will be good for my team.”

My attorney is good for my team. Her name is Klio. I like her because when we talk about something tense, she doesn’t stress out. When she is stressed, however, she laughs. Aside from that, she's fast, she's efficient, she's pleasant, and she’s tough. But she doesn't have to be difficult. She is tough with a smile.

Lots of people have asked me to mentor them. I always decline, because I don’t have time. One lady came to me and said, “I am an interior decorator. I have contact with a furniture company and if you want to sell a property anywhere in the Bay Area, I can stage it for you.”

I said, “Stage it?”

She said, “Yes, I can put the furniture in and everything. And if you sell it for more than you thought, pay me a percentage of the difference. But teach me how you do things.”

So she wanted to give and get. I thought that was pretty fair, so I said, “Okay, I'm selling a condo right now in San Francisco. I'm going to slam-dunk $850,000.”

She said, “Cherif, I think you can get more than that.”

“But you don't even know the property,” I said skeptically.

“It doesn’t matter,” she replied confidently. “Will you give me 10 percent of anything you make over $850,000?”

“I'll give you 20 percent if you think ‘staging it’ can sell it for more,” I answered.

We had a deal. In order to avoid any misunderstanding, we put it in writing. We both worded the agreement and signed it. I gave her the address, and she went and staged it. She literally put the furniture in, placed decorative things around, and walked out. I put in ad in the paper and had an open house at 10 a.m. The property sold in one hour for $900,000. She got $10,000. I was happy for her and for me. Those are the kinds of people you want to have relationships with and consider part of your team.

Members of my team

There’s no way I could achieve what I have without the exceptional team of expert professionals who work with me. My properties in Puerto Rico are managed by my brother-in-law Mauricio. My training and investment company (CMREI) is managed by Ashlee. My real estate syndication is led by Nyle, who was also instrumental in creating the concept. My discount Note mortgage program is managed by Agustin.

These intelligent, ethical, and energetic individuals create an incredible synergy with me and add value to everyone involved. We help free each other up to focus on what each member does best, hence the tremendous success we’ve had in each business model. I handle the trading of the stock market directly as well as the teaching, and stay in constant contact with each member of the team—this keeps the momentum going and the profits growing.

As you proceed in your endeavors, surround yourself with the right people. Give to them as they give to you. Together, you'll climb much higher than you could ever make it alone. And the trip will be much more rewarding.

The price budget

My personal belief is that you want to make a profit at any cost. So if I have the money, I'm not going to set a budget—because a budget is limiting.

When I was in the hotel business, we were once in a big meeting with the Hilton corporate office and high-level executives. At the time, I was in charge of marketing for several hotels. I stood up and asked, “Why do we have a budget for marketing? Isn't that silly?”

“What do you mean?” they asked.

I said, “Let's say I put an ad in the paper. The ad costs me $10,000, but it brings me room and restaurant sales worth $50,000. Why am I limited with a budget of only $10,000 per month? Maybe we should put the budget at $100,000 so it will bring us half a million in sales.”

“No, no, no. We *have* to have a budget,” said all the executives. But they couldn’t tell me why. (And we weren’t limited by lack of funds.) They all had deep voices with spiffy suits. And when you have a deep voice and a corporate structure behind you, you are important stuff. Or so they thought.

You see, their collective thinking was boxed in by corporate structure. So they couldn't understand my point. If you have a budget, but you find out you are making a lot of money, then open it up. Start marketing more. If you're budgeting so much—because that's all the money you have—get a partner. Step back and look at the thing.

4. Your safety margin will always be in keeping your acquisition, maintenance and improvement costs as low as possible.

Remember when I talked about having a margin of safety? Don't do anything that makes you uncomfortable. Start by assigning deals. Start by getting deals under contract that you can get out of within 15, 21, or 30 days, for example. That's your safety margin.

If you *do* have money, go ahead and buy the building—just make sure you get it slightly below market. Lastly: Don't go crazy on the maintenance fees and expenses needed to improve it.

5. Perform due diligence systematically and proficiently for each project before committing money to it. Follow it like a flight checklist.

We talked about this, too. You need to see the lease on the building. You need to see the expenses. You need to see the financing. You need to *not* make a quick decision. This is all part of due diligence. You will never fail if you do your due diligence.

6. Remember that barriers to entry and unique locations are an absolute advantage in the short and long run.

Let me give you an example of this. Pier 39 in San Francisco has barriers to entry. What does that mean? It means not everybody can buy a building there. If you bought a building on Pier 39, that would be a great location. But buildings are very rarely ever for sale there. When they do go up for sale, the prices are incredibly steep. You need to be a savvy investor with a good team to get one of these deals.

Here are a few other locations that come to mind:

- Newport Beach, California. Right there on the strip.

- St. Thomas where the cruise ships arrive. There is a strip right there that has very valuable buildings.
- The Cayman Islands where the cruise ships arrive.
- Key West, Florida—there's a stretch of three streets that are very valuable.
- South Beach, Miami, especially Florida Beach Boulevard.
- Las Olas Boulevard in Fort Lauderdale.
- Worth Avenue in Palm Beach (sometimes called the "Rodeo Drive" of Florida).

These are just well-known examples off the top of my head. Clearly, there are many other unique locations that have barriers to entry. Generally speaking, the harder it is to get in for a building, the:

- More money you are going to make.
- More you are going to demand in leases.
- Better tenants you are going to get.
- More you can hold it long-term.

But if you can overcome the barriers to entry, and end up with a primo location, nothing that happens around you—short of a world collapse—can affect that investment.

7. Balance your short-term thinking and actions to meet your long-term goals and ideals.

Let's say you have a decision to make. You need to know whether the location you are looking at is a good one and if you should go forward with the deal. In the meantime, someone is telling you this, someone is telling you that. Don't listen to people who have no idea. Tell them to read this book if they don't get it.

Ask yourself, *does this align with my end goal? My end goal is to get to $10,000 a month in income*. Or, *My end goal is to have $100,000 a month. Will this add to that? No, this is going to be a hassle. So I'm not going to do it.*

Here's the bottom line: Balance what you're looking at short-term with whether or not it will help you achieve what you want long-term.

8. Know your exit while protecting yourself along the way.

This is an easy concept to understand, but not as simple in practice. Everything has to have an exit strategy. Yours might be, "I'm going to take this property, I'm going to put it under option, and after a year I'm going to refinance it. That's my exit and I'm going to keep it. Meanwhile, I'll put it in a living trust. That way if anything happens to me, it passes along to my kids."

That's an all-encompassing exit strategy. You must think of the "what ifs."

9. Set up your business as if you will step away forever at a moment's notice.

As I said earlier in the book, we're all going to go someday. The reality is that you could go at any time. So you need to be set up properly.

Once you own real estate or other significant assets, it's time to set up a living trust. In general, it's a one-time fee of $1,000 to $2,000. This will decrease your exposure, provide pass-through inheritance for your heirs, and prevent your estate from going through probate. Believe me, your loved ones will thank you for it.

10. Create win/win situations.

In his bestselling book, *The 7 Habits of Highly Effective People*, Stephen R. Covey recommends always seeking win/win solutions. I have found that this is the only way to be successful in the long run. Throughout this book, I have suggested negotiating tactics, and you should use every one of them to create profitable deals for yourself.

The problem I've found is that some people think about succeeding in negotiating in terms of the other party failing. In other words, if I win, you lose; or if you win, I lose.

A win/win situation sees life as a *cooperative* arena, not just a *competitive* one. Many people think in terms of either/or: *either* you're nice *or* you're tough. But in negotiations you need to be both. That's why I mentioned that you should always use a smile—until it's time to get tough.

Win/win negotiation finds a solution that is acceptable to both parties, and leaves both of you feeling that you've won, in some way, when the real estate transaction is over.

Commercial real estate has no equal

When you have more than a million dollars in the bank, most banks have what's called a private management account. You become a "special client" to them with special privileges. One of these benefits is having a team of attorneys and financial experts that will sit down with you and advise you how best to invest your money.

A few years ago, I sat down with six highly intelligent people from Wells Fargo. They told me, "You have a high net worth. So we want to help you protect and invest your money."

I said, "OK, what would you suggest?"

They replied, "Well, where are your financial weaknesses? Where are your liabilities and your risks?"

"You tell me," I replied. "I have triple-net tenants with high insurance on the buildings that have credit lines. I have positive cash flow and all my money sits cash**.** If the buildings burn or something tragic happens, they get paid by the insurance company.

"In addition, my tenants have provided me with guarantees. Each tenant—at a minimum—has a guarantee from an $800 million corporation behind it. The guarantee is with a mother company that has thousands of stores around the world. So they can't afford to *not* pay me rent. And they can't walk away. If they do, the banks will step in with the insurance bonds."

It went on like this—with me answering their questions—for more than an hour. At the end, their response was, "Wow. We have never had somebody with a business model like this." They were fascinated because they came into the meeting wanting to scare me. And now they were sitting there a little shocked, not sure what to say.

Here's the bottom line: Some of the best of the best minds in the world don't know this stuff. They don't know it's out there. But you're learning it. I hope you'll go out there and set up your business the same way. Nothing can beat it.

Now is the time to get started

Every day, you're going to have to force yourself to work this business. Whether it's looking at Loopnet, finding out what the brokers are listing, looking at the potential of properties, or asking people questions, you must make this a way of life. It's not something you "do on the side once in a while."

It's part of my life to look at and talk about real estate. It's part of my life to surround myself with people who are involved in real estate at every possible level. The people who are new in real estate—the students I teach—keep me grounded, keep me sharp, and remind me of the challenges involved. The investors I know who are heavy hitters remind me of the enormous potential that's out there.

But you have to understand what makes you happy. For most, it's not money—it's not anything like that. It's growing and giving back. Let me repeat a question one of my students asked me recently. The question was, "At what point, Cherif, do I know enough to start?"

My reply to him was, "You will never know enough to start."

That is my answer to you as well. If you realize you will *never* know it all, then you will begin. And you will learn more and more—moving forward one step at a time.

In the Bible, Moses and his people did not wait for the Red Sea to part before they crossed. They had faith. They took the first step and the sea parted. So take the first step, take the second step, and keep going. The sea will part for you, too.

Move not with speed, but with confidence.

Chapter 16:
Paying It Forward

Edmond Baysari changed my life. Working for him was not easy. But it was worth every minute. Before I left, I hugged him and told him so.

"Mr. Baysari, I can never thank you enough for what you've done for me. The knowledge I've acquired by working for you is beyond anything I ever could have learned on my own. It's beyond anything I could learn at any university. I am indebted to you for your generosity."

He accepted my gratitude because he knew that this foundation of knowledge would serve me well for the rest of my life. But before we parted ways for the last time, he had a very specific request.

We were at the airport. He had just arrived, and I was about to board a plane.

He said, "Cherif, you've done a good job for me these last eight years. I know you've been exposed to a lot. But now I need you to do me one more thing. When you go out there and succeed—and you will—I want you to share what you've learned with 10 other people. Then, if each of them shares what they know with 10 other people, the whole world will be a better place."

The man who had shared his knowledge so generously with me now wanted me to teach what I knew to others.

For a long time, I was in no position to teach anyone. My focus was on making a fortune for myself and furthering my education in the world of real estate. Through trial and error, I developed a proven formula for commercial investing. But Mr. Baysari's request was always in the back of my mind.

By this time, it was 1999. I was just 38 years old, but people would tell me that I knew so much it was like I was 68 years old. It was then I began to realize there are three different ways to calculate one's age:

1. **Chronological age—**This is your actual age in years. At 50, for instance, you will think, feel, look and act like most 50-year-old people. This has much to do with your genes. It is a number simply reflecting the years you've spent on Earth.

2. **Biological age—**This is the shape your spirit is in. At 50, you may look and feel 10 years younger. This has more to do with the way you live your life. Are you an ethical person who handles life with integrity? If you are passionate about what you do, you have an emotional balance to deal with the good and the bad. If you are physically active (with the right diet and exercise), that's a huge plus and there is no doubt you will live a healthier biological life than most other people in your age bracket. Your biological age is reflected in your health, peace of mind and happiness levels.

3. **Financial age—**This is the number that coincides with the sum result of your experiences, decisions, and ability to handle life. It has everything to do with your level of knowledge, the degree to which you seek and accept responsibility, and the level of control you have over your life. It is reflected by your assets' net worth, your cash flow level, the liquidity of your assets, and the amount of cash reserves you've built.

As I said in the **Introduction**, I am always in a hurry. I have an innate sense of urgency that works hugely to my advantage. I always act as if I have to take a flight the next day or the same day to just force myself to execute faster. (I often do have to take a flight within a day or two, so it is not hard to do.) Because of the fast track I've been on for more than three decades, my financial age has far surpassed my chronological age. I am 51 at the writing of this book, yet I feel 40 years young. However, my financial age is probably close to 300.

So I got married in January of 1999. I had published my book *Conquer Wall Street* in 1998 and it was finally catching on. In February of 1999, right after we came back from our honeymoon, I met a brilliant attorney by the name of Laurence Pino. Larry is an exceptional businessman and a genius in marketing. He was doing his own seminars, and teaching entrepreneurs how to profit in the cash flow industry.

After a brief meeting, he offered to turn my book into a seminar event, whereby he would handle the marketing and I could focus on the teaching. So in March of that year, I started teaching. My first opportunity was teaching classes on stock and options trading. I learned how to trade from Mr. Baysari, and it's something I still do very successfully. It requires very little time and can be done from anywhere. And I loved showing eager students how to master the skills and strategies I had developed.

My book was pulled from the online publishing/sales world and transformed into a series of live seminar events. We kept growing the securities training division, and it was a lot of fun. After one event, I was showing some attendees my trading account and how much I was making applying the simple strategies I was teaching them. This was typical. What wasn't typical was the conversation that ensued between Larry and me. Larry casually asked me what I did with all the money I was making in the equities market. I told him I put it into real estate because, "That's where the big money is."

He immediately wanted to see some backup. So I started showing him HUD-1 documents from my residential transactions, as well as purchase and refinancing paperwork from large commercial properties. As a result, Larry asked me if I'd speak for the new real estate division they were creating in his seminar company. I agreed.

Soon I was serving as an instructor with the Robert Allen Institute, a subsidiary of his company. The primary focus of Robert Allen's training events was residential investing. Many people—including me—have made a lot of money with single-family houses. I enjoyed speaking to classes of new real estate investors around the country, and I would even throw in some of my commercial techniques for the students in these events.

But deep down, my dream was to teach courses on *only* commercial real estate. I just didn't know if there were enough people out there who wanted to learn about this business.

You see, most real estate investors never venture away from single-family houses because they're afraid. Commercial real estate sounds scary, so they talk themselves out of it. People think commercial real estate is complicated and expensive.

I knew their fears were simply due to lack of knowledge and training—and it was costing them money. If I could just get a chance to show people what they were missing, I felt I could overcome their doubts and replace them with confidence.

Consider the simple concept of buying a commercial income-producing property for its future streams of income. With basic arithmetic, anyone can calculate (not speculate) what the returns would be on an income-producing property. Yet people were so desperate to make an instant change in their financial lives that they were trading stocks on companies they knew nothing about.

To add to my frustration, I found that no matter which strategies I taught in the stock market, many people wanted to do the trades their own way—especially when it came to options. In addition, most people did not have the emotional tenacity to endure a bad trade while strategically thinking of the steps to correct it. (In my trading, 50 percent of my profits come from *correcting* the trades. This is extremely profitable, and to this day I do not know anyone teaching it. It's mind-boggling to me.)

But in commercial real estate, one does not have to be overly smart or emotionally strong. All one has to do is follow a step-by-step progression of actions to conclude whether the property is a good deal or not, strictly based on actual facts and figures. And unlike the equities market (stocks and options), real estate is a leverage market (based on bank loans and debt).

Even the best stocks can't beat commercial real estate

It is a lot easier to borrow a million dollars on a good commercial building than to make a million dollars trading the stock market. If you are already rich and want to buy some valuable company stocks and wait for years, then why even try? Just buy Warren Buffett's stock, Berkshire Hathaway, perhaps the best stock in the world. Its trading symbol is BRK.A or BRK.B. Just remember, he pays no dividend. And trying to trade his stock is dangerous: It has fallen by 50 percent several times during its lifetime. So if you attempt to duplicate the leverage you can get in commercial real estate in the stock market by trading on margin, you will be wiped out sooner or later.

Incidentally, Warren Buffet announced a few years ago that his past performance is impossible to duplicate—even by him. So you see, all roads eventually lead you back to commercial real estate.

In 2007, I finally started teaching commercial real estate with the same seminar company. Larry made a commitment to me and I created the training materials. We offered a series of commercial real estate seminars under the name Institute of Commercial Real Estate (ICRE). We did them all over the country and attracted lots of ambitious students, both novice and advanced, plus many brokers from residential and commercial real estate. They all saw the power of owning commercial property.

There were many success stories. But the marketing company I was aligned with had spread itself too thin and was losing momentum overall. Plus, I wanted to be in charge of every speaking engagement, whether it was one of the free workshops, the multi-day training events, or the retreats.

In order to do that, I needed complete control. So in 2009 I formed my own company. I called it Cherif Medawar Real Estate Investing (CMREI). Now I could finally teach my successful stock and option strategies, my residential and commercial real estate programs, my discount mortgage notes, and several of my business strategies and proven formulas that work for executives as well as business owners and entrepreneurs. The response continues to be phenomenal, despite the instability of the economy.

What Is CMREI?

CMREI is an education and investment company. Under that umbrella, I am able to provide educational and academic services to local, regional and world communities. Our facilities include offices in Silicon Valley, the San Francisco Bay Area, the Los Angeles Area, Central Florida, and San Juan, Puerto Rico. These offices manage the training schedule and investment opportunities. For training, we use hotel conference rooms and actual on-site commercial buildings as our classrooms. We also have specially designated locations for wealth retreats. I personally teach and facilitate all of our live events. We do this across the country and even the world.

I think the popularity is because people don't want to just learn theory. They want to *apply* what they've learned and get results. From my vast experience in learning, investing and teaching, I can show virtually anyone with ambition how to be successful. We even expanded to a level where we have coaching programs for people in all walks of life who want to improve their business, trading and/or real estate investing.

At CMREI, we offer seminars, DVDs, retreats, mentorship, and even investment opportunities. Still, I am amazed at the variety of backgrounds of our investors, members and subscribers. They include investment bankers, executives, stay-at-home parents, retirees, students, small business owners, entrepreneurs, real estate agents and brokers, teachers, lawyers, CPAs, independent consultants and real estate investors.

CMREI provides each type of knowledge

In my experience, there are three types of knowledge. You can know something by:

1) Believing (When you hear something and think, "Yes this could be true" but have no evidence).
2) Understanding (When something is explained to you and you theoretically "get it").
3) Seeing and experiencing (When you go on location and see, feel, touch and go through the steps—plus, you practice a bit to get familiar with what to do when you are on your own, based on facts and figures).

The level of training and types of investments we provide attract some of the country's elite students. I am very proud of that because it pushes me to deliver the highest caliber of training available … training with substance and evidence of success like no other program offered today. I focus on getting students to take action and produce results. As of this writing, I have more than 1,000 video success stories on YouTube.com. To see them, just enter my name in the search window of YouTube.

In short, I created CMREI to capture a blue ocean for myself and my students. At the time, I saw that the real estate training world was shaken by Internet search engines and YouTube, but there was a major void. People wanted to learn and invest, but they could not get the proper training, coaching or guidance to get it done. Moreover, people needed the actual investments to ensure they would make money. CMREI filled that void by offering:

- Live training for individuals to learn directly from me, a real practitioner with proven results in residential and commercial real estate, as well as trading and business.
- Investments such as MIGSIF for accredited students, or the discounted notes for non-accredited students.
- An opportunity for beginners with no money to start by assigning notes and getting paid for each transaction.
- Special wealth retreats where I take students to a special location such as Puerto Rico—specifically Old San Juan where I own several commercial buildings next to the cruise ship docking areas. There, I demonstrate how I invest so they can duplicate what I have done in commercial real estate and syndication. Students can also attend the Cancun Inner Circle event, where I demonstrate how I trade the stocks and options markets successfully and set up business models that succeed no matter what happens to the economy.
- One-on-one coaching to assist students who need some hand-holding during a transaction or to get their next deal done. These one-on-ones can be held by phone or in the field and are based on my FACTS system.
- A website for students who want to become members and get the trainings online through videos, blogs, updates and a forum to communicate with others.

Through CMREI, I teach my students how to get rich, stay rich, and keep their money growing and compounding. There are six areas of study (opportunities) that I currently teach and help others to apply. I am constantly growing and adding value, but I refer to these six areas as my "business models." My students can either copy my business models and invest on their own or join me. For each of my six business models, I have one key person I rely on for the day-to-day specifics. This lets me manage them from a distance and continue creating new business models.

The six business models are described below:

1. Commercial Real Estate Investing

This is my first love and the subject of this book. In a nutshell, I find commercial properties with potential and put them under contract. Then I get national tenants to lease from me long-term, using a triple-net lease, with corporate guarantees. I get good deals by purchasing properties vacant, and their value goes up significantly as soon as the tenant signs the lease.

I hold a large portfolio of single-tenant buildings in the Caribbean and around the United States. In 2009, I actually started bringing small groups of students to my "vacation-like" investing territories in San Juan, Cancun, and Napa Valley for retreats.

I hold an intensive four-day retreat once per year at each location. I call these private trainings *Inner Circle Retreats*. They are limited to a maximum of 15 people and are open only to students who have the necessary prerequisite education (such as this book or one of my introductory seminars) under their belt. These events are focused on innovative ideas, advanced levels of learning, and rapid goal achievement.

These destination-training events take you out of the classroom and out of your comfort zone in order to open your mind for absorbing information. I go into tremendous detail on the investing and business principles you can use to accelerate your success anywhere in the world.

I have students who use my techniques in the United States, Malaysia, China, Canada and Mexico. It's an incredible thrill to show them firsthand—in a close, intimate setting—what I have done and how they can achieve the same success themselves quickly.

From the Inner Circle Retreats, some of my students have become my friends for life. My students also develop life-altering friendships and business relationships with each other. It's important that we have a little fun and get to know each other better. How can you not have fun discussing wealth on the soft, sandy beaches of Cancun, in the historic cobblestone streets of Old San Juan, or in the rich and lavish vineyards of Napa Valley?

2. Discount mortgage notes

CMREI isn't just about classroom education. I strongly believe you should *earn while you learn*. With that premise in mind, I recently capitalized on one of the amazing blue ocean opportunities that exist in today's residential real estate market: REOs.

I have been buying REO inventory from the largest national banks for pennies on the dollar because I purchase such large portfolios. I have created a business model that allows others to get into these properties … in a mini-bulk package of five or 10 … at substantial discounts.

I took the bank's "toxic assets" and presented them with the ultimate solution. I convinced them, along with their asset managers, to let me buy large quantities of their foreclosed properties on an "as is, where is" basis at a huge discount.

I deal directly with banks *after* they foreclose on properties and hold them as REOs (bank-owned or real estate owned inventory sitting in their non-performing assets department).

These properties are "Grade 2," meaning they needed some rehab, along with paying off code enforcement violations, utility liens, back taxes and other expenses to get them in sellable condition.

I buy these properties directly from the bank or their assigned asset managers. I then fix them and resell them by carrying the financing. I make sure the monthly payments—with principal, interest, property tax, and insurance (PITI)—are equal to or less than the neighborhood rent for similar homes. I carry the mortgage notes at 8 percent for a 30-year amortization. No pre-payment penalty.

The owner occupants who acquire these properties are usually people with steady jobs, but they often have bad credit. So the opportunity for them to get a home at the low current market values—along with an opportunity to rebuild their credit while accumulating equity through potential gain from the market recovery—is irresistible.

These end buyers must show two things:

1) Proof that they paid rent on time for almost two years.
2) Proof that they had income that was steady and reliable.

This program has allowed more than 1,200 families to get back into a decent home with affordable monthly payments. They get to build equity and stability in their lives. They also get to rebuild their credit. It is a unique niche at a unique time, and it restores the American dream. Everyone comes out ahead.

I then resell these mortgage notes at a huge discount to our student-investors. Student-investors who participate enjoy a good margin of profit and a high velocity of returns.

For example: A home we sell for $60,000 in Jacksonville, Florida at 8 percent for 30 years will have a principal and interest payment of $440 a month … or $5,280 a year. Such a note gets sold at almost 62.5 percent of its face value—making the student's investment less than $38,000 and bringing him/her a return of 14 percent secured against real estate. We even keep the deed and do not transfer it to the new homebuyers until they pay off the loan through payments (or refinance/resell after a few years).

Students learn how to:

- Analyze the value of each note.
- Buy it and keep it in their retirement account.
- Run it as business and not only make huge profits—but get a lot of tax deductions.
- Resell the notes for a huge profit along with the cash flow.

I even offer an opportunity to those who could not afford a $38,000 note to get into the program by purchasing a wholesale license and assigning my notes to other investors—getting paid on each note they assign.

I then take the licensees' opportunity to another level by holding a free presentation every other month. So all they have to do is bring their contacts/prospects to the presentation … I will do the sale, and if their prospects buy a few notes, the student gets paid $1,000 on each note. Any future purchases by their contact represent more money in their pocket as residual income. Eventually, they can earn enough to buy and sell their own notes.

Here are the blue ocean opportunities I've created with my discount mortgage note business model:

- My students can buy these notes at a discount and enjoy the safety and security of the real estate collateral along with a 12 percent return.
- My students can easily resell the notes at a lesser discount, say 10 percent, to other investors who like the security and cash flow of the discounted notes—especially after the notes are seasoned for a few months. This would make a nice cash flow for them, then a good cash out of several thousands when they resell the note for more money—making their yield close to 40 percent annualized.
- My students who cannot afford to buy them and keep them, or buy them and resell them, can just assign the notes to other investors and get paid a $1,000 assignment fee for each note. This program is called a license agreement, and it is a way to participate in the business with almost no money invested.
- Graduates of my Puerto Rico Wealth Retreat can use the notes to create their own syndication—getting paid not only from the assignment fee, but also from the cash flow produced by the notes.
- There is always the opportunity for my students to copy me and buy a bank-owned property directly and sell it by carrying the financing and keeping it or reselling it later.
- My students can do it on a large scale just like I am doing. This includes the possibility of creating syndication and having several investors pool their money to buy notes.

This is one of the easiest and least-expensive programs to get into in the United States. I continue to evolve and improve it. Hundreds of student-investors have made huge returns on these low-risk investments—all secured by real estate.

The bank gets a non-performing loan off its books. I make money. The student/investor makes money. And a family realizes the American Dream of home ownership. It's a win/win/win/win situation.

3. My private fund

In 2009, I set up a private fund and filed it with the SEC. It is called MIGSIF (Medawar International Group Secured Income Fund). My *accredited* student-investors—those with a net worth of more than $1 million, not including their home—can invest their money with me, as little as $25,000 . This opportunity presents very little if any risk since their capital is secured against all the properties in the fund.

I persuaded a team of successful investors and competitors to join me instead of competing against me. Thus, I have a strategic alliance and powerful relationship with a great team of professionals in California. I made their lives easier by giving them more capital to invest and a structure of business that created a critical mass of power and profit for everyone with less time and effort. This setup uses the leverage of everyone's experience and expertise by focusing on distressed properties in Northern California.

This also allowed the fund to gain momentum over any old and new competitors.

Together, we buy properties for cash at California foreclosure auctions for huge discounts. We focus on San Francisco and San Mateo counties in the northern part of the state because that area has the most affluent buyers in the country, with the highest education, and the largest down payments. We rehab these properties, stage them attractively, and sell them for cash within six months.

We handle approximately 10 properties at a time with an average price of $600,000 each. I pay annual returns of 10 percent to 12 percent, and investors' positions are secured by real estate. The entire program is hassle-free, and investor can withdraw their money with a 90-day notice.

I positioned it uniquely when I set up the fund: It is the highest-cash-flow-paying fund in the United States. It pays on a regular basis, offers the highest liquidity ever in a private fund, and costs no fees to join, manage or withdraw. It is an all-cash fund set up specifically for my accredited student-investors. It is all about results, and we are getting them. Consequently, we have consistently raised more than a million dollars per quarter since MIGSIF's inception in 2009, and currently have 45 high-net-worth investors and counting.

The success has been phenomenal. Talk about a blue ocean opportunity.

I use this private fund business model as a structure to demonstrate to each of my students these three possibilities:

1. Invest with me to benefit from my experience, resources, and relationships. The entire process is fully disclosed, and anyone can see where and how the money is invested safely and profitably.
2. Invest by yourself using the same methods as the fund to acquire, rehab, and resell distressed properties at a huge profit.
3. Duplicate my methods to create your own fund/syndication. You can invest your raised capital into my fund, make a spread of 2 percent to 5 percent, and get into the game of syndications. Once you accumulate enough capital and experience, you can branch out on your own and acquire your own commercial properties through syndication.

4. The syndication business

Speaking of syndications, I teach people how to start their own syndicates by grouping investors together and getting them into a commercial real estate opportunity. It is the same concept as raising money for any business venture. Doing partnerships, joint ventures, or larger-scale syndicates is one of the best ways to get into big profitable deals with less risk and more rewards.

I do special events once a quarter to train my student-investors how to apply this unique and powerful method. Hundreds of licensed brokers in real estate consider syndication the best way to combat the current down market with hard-to-obtain bank loans. In addition, it is the best way to capitalize on the low prices and huge potential that exists today and in the foreseeable future.

In short, syndication is the "nothing down" commercial real estate technique for today.

5. Securities trading

I trade the stock and option markets actively, making more than 30 percent a year. The style of trading I teach is simpler and more powerful than any other in the market. Unlike any other program or teachers out there, I show my own trading account with several millions in it. I demonstrate the actual results and often trade live-in-the-market when I teach. This proves to them that this is real and I have done it for years.

These trainings usually take place during private wealth retreats in a resort in Cancun, Mexico, where I spend part of the year with my family.

6. Business leadership and profit growth

I teach business development strategies that apply to executives in corporations, professionals with private licenses, and entrepreneurs/business owners in any field. When I worked for Mr. Baysari, I was the executive in charge of his real estate holdings and worldwide business empire. It was called Olympic Resources.

After that, I worked as an executive for several hotel chains, primarily Hilton, to transform their hotels, resorts and casinos into more profitable operations. I was a professional broker in the insurance and real estate businesses. I was also a professional national speaker.

Currently, I am involved in several businesses. These enterprises range from angel investing—where I am on the advisory board of a unique high-tech company in Silicon Valley—to a specialty retail clothing company to an international jewelry design and wholesale business. I also keep growing my training, education, and investment companies to serve student-investors who aspire to be more, do more, and have more of what they deserve.

I get yearly returns on my money of 30 percent or more a year. In some business models, it is not unusual for me to even double my returns in relatively short periods of time, depending on the business model and the market. I dispense this expertise and knowledge to others by holding special training events to help executives, professionals and entrepreneurs reach their potential, both personally and professionally.

Many student-investors find it beneficial to not only learn directly from me—a successful practitioner who likes to teach in person—but to invest alongside me in any of my business models. This allows them to grow with less risk, with less hassle, and at higher and faster rates of compounding returns. And they can do it with almost zero taxes legally by understanding and following the proper tax code and investment set-ups.

Despite all these endeavors, my biggest success continues to be in commercial real estate. In some of my deals, I have achieved *infinite rates of return* with *endless streams of income*. There is never a dull moment. And in everything I do, each deal is more exciting than the last.

Keeping my promise

When Mr. Baysari asked me to share my knowledge with 10 people one day, I promised him I would. What he was really asking me to do was to “pay it forward.”

Paying it forward is a concept that involves doing something good for someone in response to a good deed done for you. However, when you pay it forward, you don't repay the person who did something nice for you. Instead, you give a gift to someone else.

For example, if someone changes your tire while you are stranded on the highway, you might pay it forward by shoveling your elderly neighbor's walkway after a snowfall.

The modern-day concept of paying it forward comes from the novel *Pay It Forward* by Catherine Ryan Hyde, which was then followed by the movie starring Kevin Spacey and Helen Hunt. In the story, a young boy is given a school assignment that requires him to find some way to change the world. He develops the “pay it forward” concept, setting forth a chain reaction of good deeds.

The 1951 book *Between Planets* by Robert A. Heinlein also contained the concept and is actually considered the first work to popularize the idea.

The “pay-it-forward” concept even has a firm foundation in history. Ben Franklin described it in a letter he wrote to Benjamin Webb in 1784. In this letter, he wrote about his intention to help Mr. Webb by lending him some money. However, he did not want to be repaid directly. Instead, Ben Franklin hoped Mr. Webb would at some point meet an honest man in need of financial help and passes the money along to him.

Mr. Baysari paid it forward to me. I am passing along my knowledge, experience, and good results to you. My simple request is that you eventually do the same.

Today, I have properties all over the world—yet I work less than ever. No more long hours. My wealth works for me. I will be richer tomorrow than today, even if I take today off and relax.

This can be your future, too. This book has revealed the secrets for you, just as Mr. Baysari did for me many years ago. Now it’s time for you to continue your education and get started buying property.

Having taken the journey from paycheck to paycheck to multimillionaire, I can assure you that you can step out of your ordinary life and become rich beyond your expectations. You can rewrite your destiny. You are in full control once you get the knowledge, take the responsibility, and focus your actions. And you can achieve your financial freedom much faster than I did ... because I've mapped out the steps.

I no longer consider myself indebted to Mr. Baysari. I have long ago fulfilled his request. But my work is far from done. We have hundreds of success stories, and these are what inspire me to continue.

Perhaps you will become one of them. To hasten your success, I encourage you to become a member of CMREI.com. By joining CMREI, you will immediately be in the presence of an amazing group of individuals who can help you take your knowledge and investment strategies to higher levels.

Plus, CMREI delivers top-quality education, turnkey business models, and proven investments for all levels of students and investors. Through CMREI, hard-to-get information covering residential and commercial real estate strategies, business development, and personal growth and development is at your fingertips.

No one is born a genius. But all of us have genius within us. My goal is to make you see your genius, tap into it, and apply it.

Today can be the beginning of your breakthrough … if you want it to be. I hope one day soon my team and I will get to meet you in person. Check our event schedule on CMREI.com if you are interested in coming to a live event. It will change your life.

If you want to do more with your life than simply scrape by … if you want true success … then learn from those who have achieved it for themselves. Break through to the top level. Start today.

The vehicle that will create unimaginable wealth for you is commercial real estate. The only thing I ask of you is this: When you experience success in commercial real estate, share what you have learned with at least 10 others. Pay it forward. Then one day, as a group, we can say we have made a positive and meaningful impact on the world.

Until we meet, take care.

At the end of each investment endeavor, and at the end of your life, the result is not determined by how much you know and understand; it is determined by the decisions you make and the actions you take.

— Cherif Medawar

Conclusion:
We Are the Next Generation of Investors

When Cherif hired me as his full-time business manager in 2008, I eagerly accepted. I'd known Cherif for three years already. I'd seen him speak, done business with him, and attended his trainings.

When someone is the real deal, you can generally tell—especially when you see the trades, the real estate transactions, the business models, and the way the person conduct business. Cherif is the real deal. And everyone who knows him gets to see how he "walks the talk."

Cherif Medawar Real Estate Investing (CMREI) was founded to serve the need that exists in the marketplace: Training and business models that produce results, taught by the guru himself. I began managing the business and executing his vision and plan. I have a team of top-notch professionals under me. Together, we are able to deliver Cherif's specialized trainings, the Inner Circle Retreats, and CMREI.com, an active website full of videos and information from his live events and programs. Recently, we added mentorship by phone and in-the-field training.

If you've been to one of Cherif's events, you and I have met. You probably also met Nyle Mameesh, who is instrumental in the creation and daily execution of MIGSIF, and Agustin Garcia, the business manager for the discount mortgage notes investment program. There's nothing we enjoy more than hearing from successful students who graduated from the trainings and got involved in investments by following Cherif's formulas and strategies

During any given week, Cherif, myself and several key executive team members and support staff can be found in hotel ballrooms around the country teaching and supporting students. You might also find us out in the field executing deals based on the business models being taught at CMREI.

We do lots of work behind the scenes to support Cherif's untiring efforts to educate you. We are constantly evolving the service and support provided at CMREI—including the recent addition of our mentorship and coaching programs. These coaching sessions are being delivered by a team of hand-picked professionals. Many of them are graduates of CMREI with proven results and a passion for teaching and guiding others.

We have unique wealth retreats in places such as Cancun, Mexico; Old San Juan, Puerto Rico; and Napa Valley, California—and we intend to keep growing these special events. They are held for smaller groups of no more than 20 students at a time. They are taught by Cherif for the full four days, and our students produce the highest results after them. On occasion, Cherif does one-on-one coaching engagements and retreats for a few high-net-worth students.

Cherif is paying his knowledge and experience forward to me and to many of the executive team members—just as he is paying it forward to you. Soak it in. Take advantage of it. You and I are the next generation of business owners and commercial real estate investors. And in today's market, it is hard to find the right guru who has proven strategies that help you survive and prosper in any market. Cherif has been that person and continues to lead the way for many loyal students and members of CMREI. When it comes time, you and I will pay it forward to others.

I continue to spend a lot of time focusing on the marketing and operations expansion of CMREI. Hopefully, we'll see you at a live CMREI event soon. I hope to hear your success story about how Cherif has positively impacted your life and the lives of your loved ones … just as he has done for many others through the years.

Ashlee Jones
Vice President
CMREI