HOW TO PROSPER IN A CHALLENGING MARKET WITH COMMERCIAL REAL ESTATE

COMMERCIAL & MULTIFAMILY REAL ESTATE INVESTING FOR LESS THAN $100,000

COMMERCIAL REAL ESTATE (CRE) INVESTING CAN CREATE THE OPPORTUNITY TO BECOME FINANCIALLY INDEPENDENT FASTER THAN MANY OTHER INVESTMENT ASSET CLASSES. I'VE ALSO SAID THAT REAL ESTATE INVESTING IN GENERAL IS **THE BEST GET RICH SLOW SCHEME THAT THERE IS.**

I've been an investor since 1970. Five decades. I was told in the beginning that it was very risky and that prices had gone up so much in the prior decades that they couldn't imagine that they could go up much more. My wife's hand was shaking when she signed the closing docs for a $30,200 home in San Jose, CA that rented for $300. 1%/month, the magic ratio that makes a rental house profitable with 20% down. In CRE parlance, this is about an 8.3 gross rent multiplier (GRM).

Over the following decades, I progressed from buying rental homes in my backyard (Silicon Valley), to 1-4 unit rentals in a higher cash flow market (Dallas), to multifamily and condo conversions, to providing several hundred turnkey rental homes to other investors, to commercial properties, to commercial and multifamily syndications for investors as well as for myself (I always invest in everything that I offer to others).

I'll give you a bottom line: If I had known in the beginning what I know today, I would have started off with commercial and multifamily properties and investing in syndications. At the time, I was not aware that I could own properties in multiple asset classes across multiple markets for the cost of the down payment of a single rental house, or about $50,000 for each syndicated commercial property.

Now, I'd like to share that I wasn't always hooked on real estate. In the mix, I have invested in the stock picks, ETFs, retail franchises, dairy LLCs, exploratory oil drilling, and pork bellies (yes, even pork bellies), and much more. And bottom line, commercial real estate over the long haul has performed the best.

I have had some failures in many investment asset classes, including CRE, which emphasizes that in any investing, selecting the right source, partners, products, submarkets, and timing are all critical. These factors can make it or break it with any investment asset class.

TOM'S TOP TAKEAWAYS

1. The market is thousands of submarkets
2. All markets and asset classes have different cycles
3. Do not reinvent the wheel. Ride on the coattails of other successful experts
4. Your source and partners are more important than the product or market
5. Highly vet your sources and partners
6. Diversify
7. What worked best yesterday may not be what works best today. Change your investment model with time and the markets. One of the best things that I did was to change my investing model periodically. The biggest mistake I made was not doing it faster.

Over the last two centuries, about ninety percent of the world's millionaires (in today's dollars) have been largely created by investing in real estate. The virtues of real estate investing are well documented: cash flow, leverage, accumulation of wealth through appreciation, tax sheltering (both cash flow and appreciation), and the fact that they are real tangible assets, not just paper derivatives.

Real estate investing seems to have all of the desired virtues, however, what kind of real estate, where, and when? Most of us start with rental houses where we live, then migrate to rental homes in markets with better returns, then graduate to multifamily, and some discover non-multifamily commercial.

COMMERCIAL ADVANTAGES

- MORE PREDICTABLE AND HIGHER CASH FLOW
- HIGHER QUALITY TENANTS
- LONG TERM LEASES
- RENEWAL OPTIONS
- AUTOMATIC ANNUAL RENT INCREASES
- NNN LEASES: REIMBURSEMENT FOR EXPENSES FROM TENANT
- OPPORTUNITY TO ADD VALUE BY DRIVING UP INCOME (NOI)
- EASIER TO MANAGE PROFESSIONALLY IF ONE HAS THE SKILLS

Commercial properties are the unsung heroes of our economy. While the old adage is true that everyone has to live somewhere, people wouldn't have a reason to live where they do if it were not for the infrastructure around them that includes commercial real estate.

Just think, every place that people work, shop, receive medical services, get education, and get all of the goods that are manufactured, warehoused, and distributed, are all commercial real estate.

There about half a trillion dollars of commercial real estate, which includes multifamily, bought and sold each year in the US. That is almost the same transaction amount as all of the $5.5 million single family home sales last year.

Technically, commercial real estate is any property that is purchased for the main purpose of generating revenue, or commerce. "Commerce" is defined as "the activity of buying and selling for income, especially on a large scale".

This includes multifamily (apartment) properties, because they exist for the purpose of commerce; however, most think of commercial as non-multifamily.

After the crash, people who had not considered real estate as an investment vehicle before now wanted to jump in. Everyone has had exposure to residential properties because they live in one, or rent out one, or both.

WHILE THE OLD ADAGE IS TRUE THAT EVERYONE HAS TO LIVE SOMEWHERE, PEOPLE WOULDN'T HAVE A REASON TO LIVE WHERE THEY DO IF IT WERE NOT FOR THE INFRASTRUCTURE AROUND THEM THAT INCLUDES COMMERCIAL REAL ESTATE.

Even hedge funds and Wall Street identified rental home investing as a hot 'new' asset class. As home ownership dropped from 69% to 63% because of foreclosures, multi-family rental values increased due to investor demand. The new demand relative to the supply has appreciated the prices of homes and multi-family units and historically, property values always appreciate faster than rents. The result is reduced investor returns.

To the new real estate investor, the natural progression has been to invest in multifamily properties because it "feels" familiar (even though they are way more complex than most people realize). Thus, we developed an increase in demand and an incentive to increase the supply.

In response, a lot of Class A multifamily products have been built in most primary and secondary markets to the extent that they are now overbuilt and absorption is decreasing in most of those markets.

REAL ESTATE CYCLES

Remember that the market is thousands of submarkets with variables that include the asset class, sub-asset class, product quality class, and the geographical market and submarket. I never invest in a market or submarket without bringing on an experienced expert. Which side of the street you buy on can be critical, and the casual observer would never know.

Each asset class, property class, and submarket, has their own real estate cycle. The CAP rates and position on the cycle curve of recovery, expansion, oversupply, and contraction is different for every combination of variables. Studying these, or partnering with someone who does, will allow you to move your assets from topped out cycles to ones that still have growth. The charts below will give you some perspective of these variables.

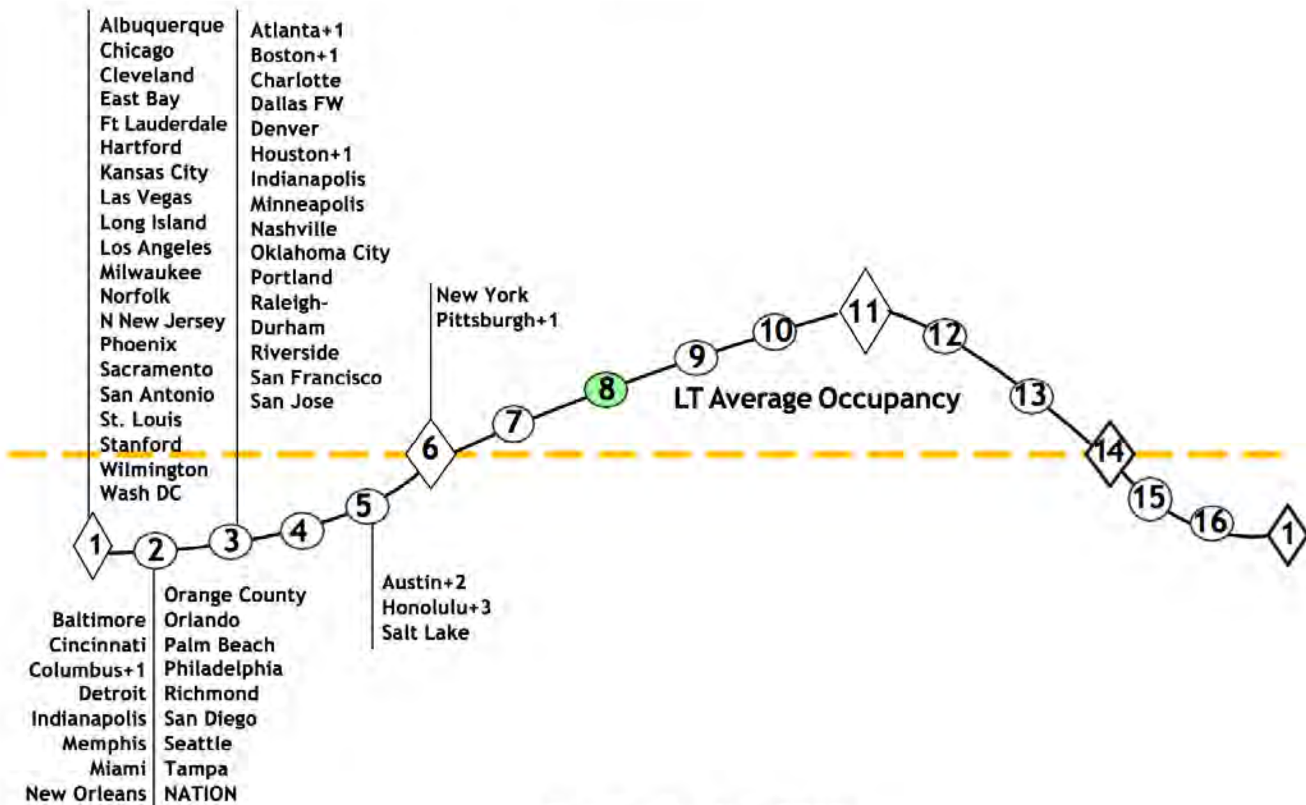
OFFICE MARKET CYCLE ANALYSIS - Q4, 2012

DECLINING VACANCY
NEW CONSTRUCTION

Phase 2 – Expansion

INCREASING VACANCY
NEW CONSTRUCTION

Phase 3 – Hypersupply



Phase 1 – Recovery

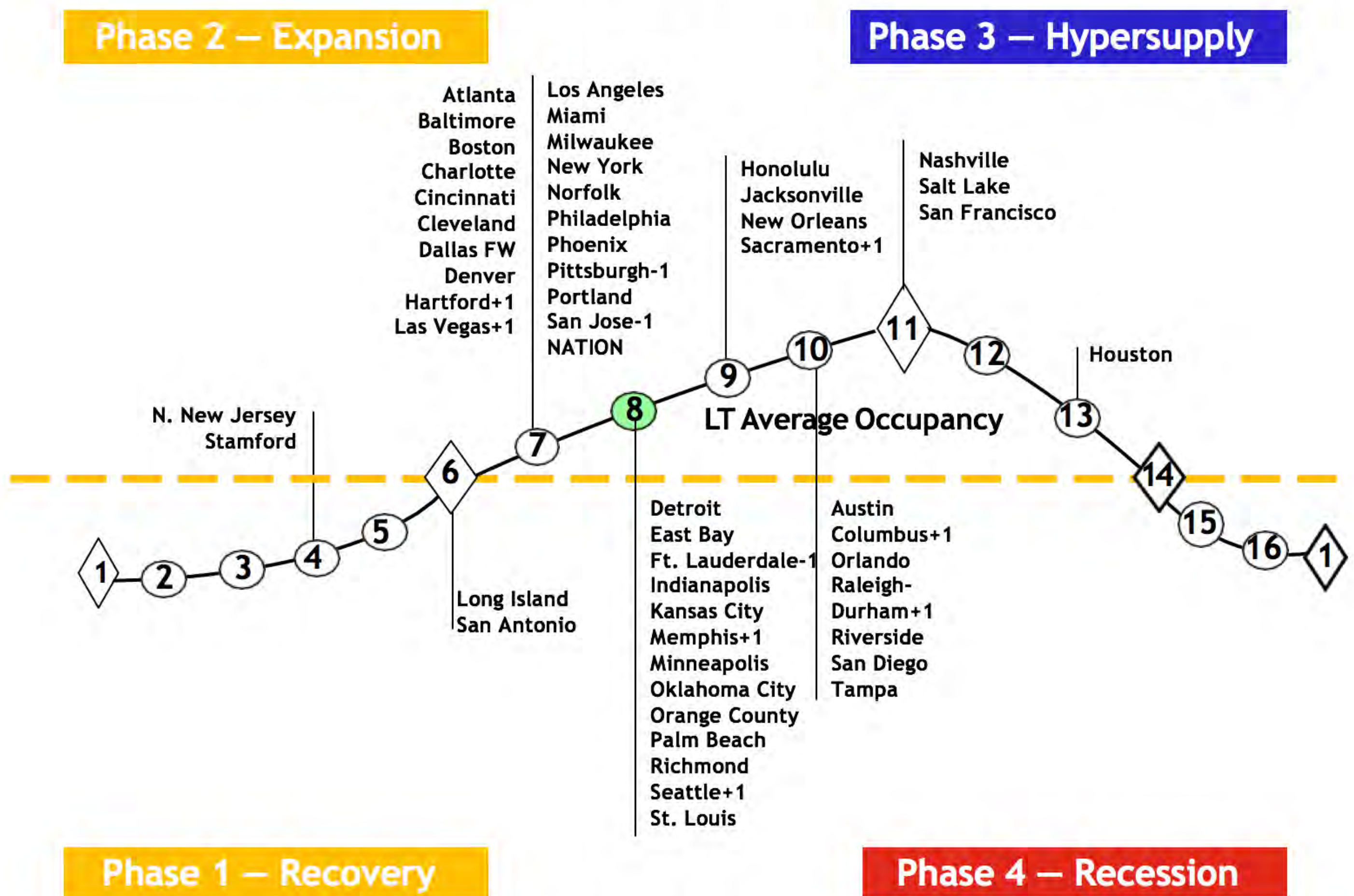
DECLINING VACANCY
NO NEW CONSTRUCTION

Phase 4 – Recession

INCREASING VACANCY
CONSTRUCTION COMPLETIONS

SOURCE: MUELLER, REAL ESTATE FINANCE, 1995

OFFICE MARKET CYCLE ANALYSIS - Q1, 2018



SOURCE: MUELLER

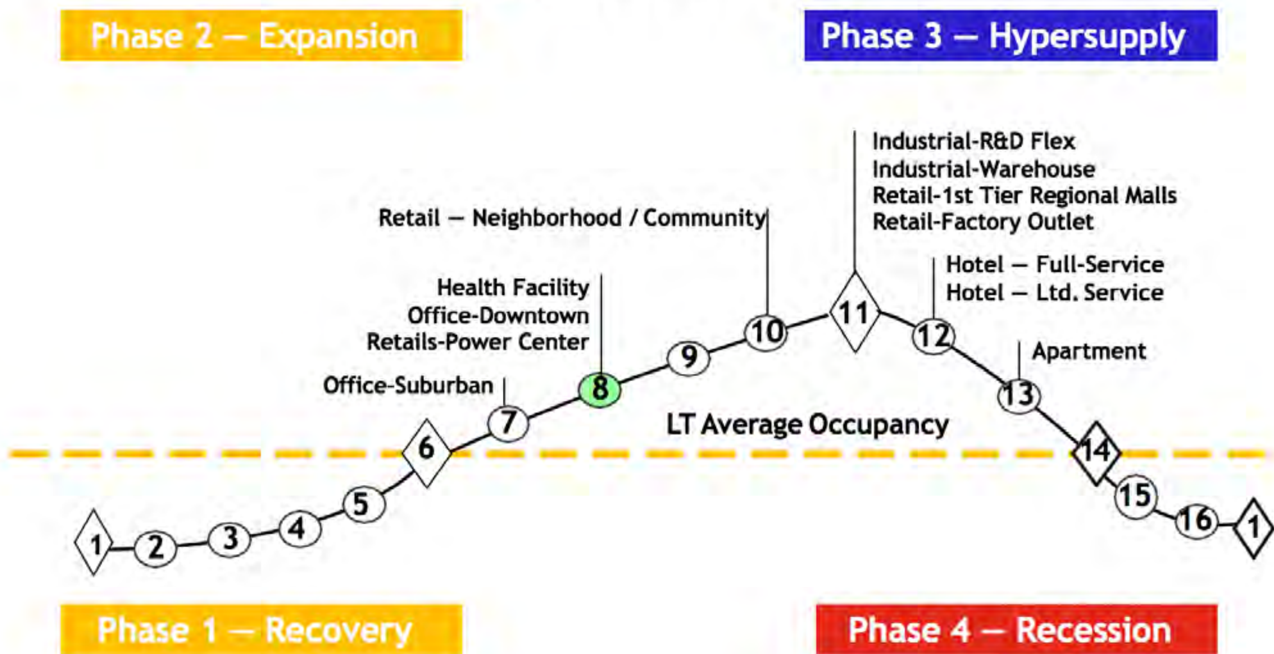
Remember that a market is made up of thousands of submarkets. Using office to illustrate this example, you will see that every market has its own market cycle.

To give you a sense of the progression of market cycles over time, notice that back in Q4, 2012, office was largely still in recovery and expansion across the nation. Now its reaching the end of expansion and even hypersupply in many markets. Do you see where the trend is headed?

When doing due diligence on your own deals, you can even take this a step further and dig deep into each sub-market and office sub-asset type (class A, class B, class C, high rise, mid rise, low rise, single tenant, multi-tenant, and so on...)

This last graph illustrates that each commercial asset class has its own market cycle. Again, bear in mind that these graphs illustrate national trends, so even if apartments nationally are headed toward a recession, you can still find apartment deals in expansion in certain markets. There are just far less of them.

NATIONAL PROPERTY TYPE CYCLE FORECAST - Q1, 2019



SOURCE: MUELLER

WHERE SHOULD I INVEST?

So commercial sounds interesting, but where is best? The short answer is where the returns are the highest as compared to the risks, where the population and jobs are growing, and where the political climate is favorable.

The one exception is for entitlement projects. Ironically, one can get more value added if the entitlement is difficult, such as in California. However, you want to make sure you have the expertise on your team to minimize risk and navigate this course.

Another exception is single tenant industrial, which I will detail below.

For stabilized cash flow, our primary target is the Sunbelt, the Southern half of the US East of and including the Rockies, such as cities in Texas. Why? Most of these markets have high growth, affordable housing for employees, are pro-business, and have rent to market value ratios that produce the highest profits and cash flow. Most of the coastal cities in the West and the Northeast are simply too expensive relative to the rents to cash flow well.

Let's take the simple example of a rental home. In San Jose, a median priced home is $1M and rents for $3300. For a million dollars, you can purchase 7 higher quality homes in Texas that rent for a combined $10,000. However, even in Texas, that results now in only about a 5% annual return, which is about 3 percentage points lower than commercial returns.

Most investors prefer good predictable cash flow with modest appreciation over low cash flow and potentially high appreciation or value add. Some want a little of both.

Now let's take a look at the "what" to invest in and survey the primary asset classes.

THE ASSET CLASSES

MULTIFAMILY

Berkeley Assisted Living, CA, 140 Units, $9M   Forest Cove, Atlanta GA, 646 Units, $63M   Woods of Ridgmar, DFW TX, 235 Units, $17M

Indeed, everyone has to live somewhere. I like multifamily; however, as indicated earlier and as you can see on the earlier graphs in this article, it is hard to find as strong of returns in multifamily as we could right after 2008.

At that time, there was a shortage of housing, and new construction ramped up after the recession. No one built anything other than class A because developers want to maximize the return on the expensive land.

So within a few years, primary and secondary markets got overheated, and the CAP rates (return on investment) dropped significantly. In 2014, I sold a $10M class A multifamily property in DFW for a CAP rate of 6 and exchanged it into two non-multifamily commercial properties with CAP rates of 8 and 9.

Moving assets from topped out markets and asset classes that once were king into other asset classes and markets where there is still expansion maximizes your long term returns.

Multifamily, like all asset classes has many sub-classes, including garden, luxury, government, subsidized housing, student housing, elder care, mobile homes. Each of them in each geographical market has a different economic cycle.

Garden

High Rise

Loft

Student Housing

Elder Care

You need to tap on experts of those markets and asset classes to understand your best investment options. We especially like elder care since there are 10,000 new people turning 65 in the US every day, and most markets have an under supply of product.

NON-MULTIFAMILY COMMERCIAL

Multifamily CAP rates have significantly compressed, and non-multifamily commercial products today are giving typically 2% higher returns than multifamily in most major high return markets in the country because of their relative positions in their market cycles.

Multifamily properties and their returns have peaked out, whereas non-multifamily commercial properties (hereon referred to as just "commercial") are still in the expansion part of the cycle. The apex of returns is now in the marketplace of commercial real estate.

I still like multifamily properties if their returns are similar to non-multifamily; however, they are getting harder and harder to find without submitting to Class C products in Class C neighborhoods, which increases the risks.

Commercial properties are advantageous because of the economies of scale, more predictable income and expenses, higher cash flow, higher quality tenants, longer-term leases, automatic rent increases, NNN leases, and because they are simpler to manage professionally (as long as the manger has the higher level skill set required).

NNN (Triple Net) leases pass the expenses of the taxes, insurance, and repairs to the tenants, giving the investment more certainty of projected returns. And absolute NNN (typically long-term single-tenant leases) even take the landlord mostly out of the loop since all expenses are handled directly by the tenant.

OFFICE

City Plaza, Rock Hill SC, $6M

Plano Parkway Business Center, TX, $10M

Single Tenant

Multi-Tenant

Office buildings are where many of us work if we are not manufacturing or distributing something. They can be large class A glass towers with multiple tenants, low rise small offices, or single tenant buildings. Leases are typically 3-5 years with renewals for small tenants, to 15-20 year leases for larger national credit tenants.

Traffic count and growing economies and populations are important. Office has to be selected carefully because they can have higher vacancies and bigger swings in occupancy during the economic cycles, especially with shorter term leases.

RETAIL

Forney Neighborhood Service Center, DFW TX, $5M

Western Crossing Power Center, Amarillo, TX, $20M

Durham Boutique Retail, NC, $2M

This asset class includes neighborhood shopping centers, community centers, regional centers, power centers, specialty/fashion centers, outlet malls, and lifestyle centers.

Contrary to many sensationalized headlines, many retailers' brick and mortar stores are actually benefiting from their synergy with e-commerce.

Yes, a third of the big malls are in trouble, however, many experts predict that many malls will be repurposed to include entertainment and services and will not only survive, but thrive. And yes, a lot of big box stores are at risk, however, many of those are also expanding as they develop more synergy with their e-commerce partners. The key is to identify the winners from the losers.

Single-Tenant

Multi-Tenant

National Credit Tenant
(lower cap rates)

Regional Credit Tenant
(higher cap rate)

Neighborhood Service Center

Strip Mall

Big Box

The internet is actually driving many shoppers to the stores to see, try on, or pick up the products and buy more while they're there. Neighborhood service centers have little internet competition. You just can't get your hair styled or eat a sandwich online.

And just when everyone thought that all brick and mortar was about to be scraped from the face of the earth, the largest e-commerce company in the world pays $13.7B for 460 Whole Foods stores, and opens up a new line, of all things, of book stores. Yes, Amazon Books. You have to wonder, was this their strategy all along!?

So, we must be careful in drawing broad swept conclusions with sensational news selling headlines. We are bullish on the right retail properties in the right markets that have a predominant or significant service sector and internet synergy.

INDUSTRIAL

NW Houston Industrial Portfolio, $25M

Filtration Industrial, SC & MO, $5M

Cincinnati Industrial Portfolio, $5M

Industrial properties are one the highest demand asset classes at this time. How often have you driven by or flown over industrial buildings and thought nothing about it? They aren't pretty...no windows, usually away from where we live and work, and what in the world are they doing in there anyway? As it turns out, a lot!

The industrial asset class is also very diverse. It includes manufacturing, distribution, warehouse, office/service, freestanding, singe-tenant, multi-tenant, R&D, and mixed use parks.

Single Tenant

Multi-Tenant

Distribution

Warehousing

Manufacturing

This is where everything is manufactured, warehoused, distributed, and data is communicated. And e-commerce is just increasing the demand. Local multi-tenant complexes house businesses that take care of our local services, such as communications installers and servicers, home remodeling services, etc.

Single tenant leases are commonly 15-20 years. Yes, you heard it right. As long as you have vetted that it is unlikely for them to go bankrupt during your hold period, the risk I feel is low. Multi-tenant leases are not as long as single tenants, however, but they can still be typically 3-5 years with renewal options and annual increases. To sweeten the deal, there are virtually no industrial tenant “skips” overnight.

Most asset classes rely on employees or local customers, markets, and locations that have population growth (rooftop expansion, visibility, and high traffic counts). Single tenant industrial is an exception. Manufacturers rely on local affordable employees and access to transportation for their products.

This is one example of where a tertiary or even rural market can be acceptable, or even advantageous, as long as there is a long term lease in place, and the tenant has a strong track record and is in a good product or service market position.

This is contrary to our usual instincts, which once again shows how we must be careful about making broad brush conclusions. Remember, the market is thousands of submarkets.

LAND

Paradise Valley Assisted Living, Fairfield CA, $20M

Rohnert Park Entitlement, 46 Acres in CA, $15M

This has always been the highest potential return asset class. Why? It typically has no income, it is very difficult to get a loan (because it has no income). and it has higher uncertainty and time to perform because of the entitlement (the often long and complex path to getting permits) and development phases.

However, with the right product and well chosen intended use and purpose, it can have a higher return. Generally, the investor needs to be someone who does not need cash flow, can tolerate the uncertainties, and is willing to take on higher risks for a potentially higher return. One of the largest risks of any entitlement and development project is time to completion.

Some strategies are to do just the entitlement (getting the land through the complex process of permitting to being "shovel ready"), development, or both.

This is an asset class that especially needs very experienced experts to navigate the often-political process and has the relationships and resources to execute the plan.

CLASSES: A, B, C, D

There can be huge variations in performance by different classes of product and neighborhood. There is no legal or official definition or specifications for the classes, however industry standards generally agree on the following:

CLASS A

These buildings are the newest and highest quality buildings in their market. They are generally the best looking buildings with the most amenities and the best construction and finishes. Class A buildings also are well located, have good access, and are professionally managed. They therefore attract the highest quality tenants and highest rents.

CLASS B

Class B buildings are usually a little older, but still have good curb appeal and good quality management and tenants. They may have been Class A with they were built. Value-added investors like these buildings as investments since well-located Class B buildings can be upgraded if enough of the neighborhood is Class A, through renovations of interior, exterior and common area improvements. I like class B buildings, especially with multifamily, because in good economies, there is opportunity to capture tenants moving up from Class C and in recessions, you can get tenants moving down from Class A.

CLASS C

Class C are older buildings, located in less desirable areas and are often in need of extensive renovation. Architecturally, these buildings are the least desirable, and the building infrastructure and technology is outdated. As a result, Class C buildings have the lowest rental rates, take the longest time to lease, and are often targeted as re-development opportunities.

CLASS D

These are not for the novice, faint of heart, or those without armed security to collect the rent. They are often urban and inner city, and may be candidates for scraping and redevelopment. I've never owned a Class D property.

NEIGHBORHOODS

Neighborhoods are classified by the general type of properties in them. You can change the class of a building by injecting capital, but remember, you cannot change the neighborhood. A class C building with millions of capital spent to upgrade it to a class B building, will still only get about class C rents if it is in a class C neighborhood. Do not get misled about value adding if the neighborhood will not support it.

STABILIZED OR VALUE-ADD

There are two primary categories of products in every asset class. Stabilized or value add. A stabilized property is typically at or near the area rents and occupancy and has no significant deferred maintenance or underperforming management. The value in purchasing this product is for instant and predictable maximum cash flow at the potential sacrifice of limited appreciation.

An added value purchase is one that is under performing because of below market rents, or lower than area occupancy. The reasons may include inferior product because of deferred maintenance, undercapitalization, or weak management. All of these can present an opportunity to improve the performance of the product with an ultimate higher exit price at the expense of extra capitalization and lower up front cash flow. Remember, the one thing that you can't change is the class of neighborhood.

Many investors like to diversify and invest in both more predictable immediate cash flow and in higher risk products that have the potential of ultimately providing higher overall returns.

"IF ONE DOES NOT ALREADY OWN AND HAVE EXPERIENCE WITH COMMERCIAL PROPERTY, THE CHANCE OF GETTING A LOAN IS ALMOST NIL. THE SOLUTION: GET A PARTNER."

LOANS

Oh yes, the loan, lest we not forget. Historically, a commercial loan, including multifamily, was more dependent on the predictable performance of the property than on the borrower. Before the crash of 2007/8, almost everyone could get a commercial loan if they could fog a mirror. Not as easily as for a single family home, however, money even for commercial was not difficult as long as you had sufficient liquidity and credit score.

The post crash situation is a different story. Money has tightened and the borrower is significantly more scrutinized. And most importantly, if one does not already own and have experience with commercial property, the chance of getting a loan is almost nil.

No need to fret and throw in the towel, however, as long as you have a partner who can qualify. And one of the best partners is a syndicator.

SYNDICATIONS: RIDE ON THE COATTAILS OF EXPERTS

We acknowledge that all of this may feel out of reach for the individual investor, and hopefully you can get a sense, acquiring and managing a large property requires a lot of money, time, expertise, ability to get a loan and experience. A great enabler to overcome this challenge is a syndicator.

Syndicators allow investors to move up to the 'big leagues' that are normally restricted to institutional and wealthy investors.

Syndications are growing in popularity. There were over 50,000 real estate syndications last year in the USA. The small investor can leverage the expertise of the syndicator's skills and experience. With the right syndicator, metro, and product, you can turn $50K into quarterly cash flow and exit with doubling your money in five to seven years.

SYNDICATION ADVANTAGES

- OWNERSHIP IN HIGH QUALITY MULTI-MILLION-DOLLAR PRODUCTS FOR LOW COST OF SHARES ($50K)
- TAKE ADVANTAGE OF SYNDICATOR SKILLS TO NEGOTIATE, PERFORM DUE DILIGENCE, AND MANAGE
- ACCESS TO DEAL VOLUME
- GREATER ASSET CLASS DIVERSIFICATION
- NO LIABILITY BEYOND SHARE OWNERSHIP
- ENABLES INDIVIDUAL INVESTORS TO "MOVE UP TO THE BIG LEAGUES"

A good syndicator has high integrity, a successful track record, filters through hundreds or thousands of opportunities to select the best, narrows the selections, performs extensive due diligence, negotiates the loan, invests along-side the client, and provides professional management of the shareholders' investment.

The syndicator should provide extensive information about each investment and the economy of the region, and be available to answer all of your questions to your satisfaction. The shareholder enjoys the passive benefits without the liability and management headaches.

Typically a commercial syndicator will provide detailed information online or in print, and host events and webinars.

Information you can expect includes summaries of the investment, market analysis, location economics, demographics, property description and condition, comparisons of properties, and independent statistics. Also expect the current and projected financial performance, tax issues, background of the principals, detailed fund disbursement schedule, property performance forecasts, and a exit plan.

SELECTING A SYNDICATOR

1. Track Record
2. Integrity
3. Incentivized in line with investors
4. Access to high deal flow in strong markets
5. Ability to negotiate and close
6. Ability to qualify for good loans
7. Experience and ability to manage the property

GREAT SYNDICATORS ARE EASY TO CONTACT

Great Syndicators are Easy to Contact by Phone, Text or Email.

You should expect answers to your questions within 24 to 48 hours with an attitude of openness and willingness to respond to everything a potential investor asks. While there certainly may be time limitations to invest, you should never commit your hard-earned money prior to establishing the ability of the syndicator to manage the investment with integrity and competence.

THE WILSON INVESTMENT PROPERTIES DIFFERENCE

Today, Wilson Investment Properties offers highly vetted syndicated commercial real estate opportunities with strong economic fundamentals that have proven resilient through all phases of the real estate market. With over 17 years of history and a third of a billion dollars portfolio, Wilson Investment Properties has the track record and expertise that enables high value investments. Investor education can be found on our website www.WilsonInvest.com, or call us with your questions at 408-867-1867.

Wilson Investment Properties' CEO, Tom K. Wilson, managed some of Silicon Valley's pioneering hi-tech companies for 30 years. He has been a real estate investor over five decades, has bought and sold over 5,000 units, 23 syndications, and over $500M of real estate. The company's current portfolio is approaching $300M.

The firm sources the highest quality products in multiple states, provides total transparency, has a long successful track record, and has the experience and skills to find, secure, and manage the products. Wilson Investment Properties is a direct provider, not just a referral service. The company invests in all of the product types and regions in which they sell.

Wilson Investment Properties' corporate headquarters is in Silicon Valley, with teams on the ground in multiple states and is a direct manager of all investment properties under ownership.

Today Tom K. Wilson still lives in Silicon Valley, investing most of his capital into commercial real estate deals with high CAP rates and attractive risk-adjusted returns.

Listen to Tom's weekly radio show, Real Estate Radio Power Investing, at 11am on Saturdays, 2pm on Wednesdays, and 9pm on Sundays on KDOW 1220am, San Francisco's leading business radio station.
Tune in at www.wilsoninvest.com/radio-show

WILSON INVESTMENT PROPERTIES

DURHAM BOUTIQUE INVESTMENT

A Unique Private Offering Retail Expansion & Redevelopment Project

Grow your investment by 1.74x in 4 years!

PROJECT OVERVIEW

Entitlement already **90% complete**

Acquiring existing **12,000 sqft** retail building + adjacent vacant lot

Expansion and redevelopment into a **17,000 sqft** trendy gathering centerand adjacent vacant lot

Partner is Durham **born and raised**, with 26 years experience in local CRE development

RESEARCH TRIANGLE

Raleigh-Durham is located in the Research Triangle and is one of the top 10 US Job Growth Cities in 2018

FINANCIAL OVERVIEW

18.5% PROJECTED AVERAGE ANNUAL RETURN

16.9% PROJECTED IRR

10% PROJECTED CASH ON CASH

8% PREFFERED RETURN WITH **75/25** IF EXCEEDED

$2,181,500 aquisition price

$4,410,000 total project cost

$1,300,000 equity raise

4YR PROJECTED HOLD

1.74x INVESTMENT MULTIPLE

$50,000 MINIMUM INVESTMENT