court procedures, contracts, and dozens of related laws, rules, and regulations *will not* mirror those with which you are familiar. Consult local competent counsel. Question thoroughly.

Compare prices locally: Even though that $600,000 Chicago apartment building looks cheap compared to Boston, it may look expensive compared to other similar properties in Chicago. Bargains exist relative to local comparables, not relative to the comps that you know of from back home.

Easy financing can cost you: Some sellers and builders will tempt you with easy terms. Buy the property, not the financing. Easy financing dulls the critical faculties. (Of course, this error occurs locally, too—but somehow easy financing seems even more irresistible when the charms and excitement of a new area intervene.

What price turnkey deals? Fearful of long-distance management, and worried about possible vacancies? "No problem," says the promotion, "we offer a turnkey operation. We even guarantee returns for three years." Sounds pretty good. But read the fine print. What costs will you pay? How do they calculate returns. How much price premium are you paying over similar properties that do not offer such enticements? Does the financial strength of the builder stand to support those golden promises.

To make their sales, many sellers, builders, and agents who cater to out-of-area buyers depend on the ill informed and uninformed. And when scouting on your own, beware of the error of overconfidence. Unless you have researched local laws, properties, neighborhoods, and markets, you almost certainly know much less than you think you do.

COMMERCIAL PROPERTIES

When most people think of investing in real estate, they think residential. Everyone's familiar with houses, condos, and apartments. In contrast, most people lack knowledge of commercial properties. Or they think such properties cost too much.

But a growing number of investors now realize that commercial properties can offer lower prices and higher yields (that is, higher cap rates, higher cash on cash returns) than houses, condominiums, and small apartment buildings. You can purchase single-unit retail or office condominiums for as little as $100,000. Similar to the boom euphoria that drove residential prices beyond the level that rents would support, so, too, the experience in small commercial properties.

As a result, many distressed and bank-owned properties are available. On a recent loopnet.com search for office buildings priced at less than $500,000, REOs were plentiful. A nearly new North Carolina dentist office that had sold several years ago for $250,000 was listed at $125,000. A search of California office buildings turned up hundreds of choices priced less than $300,000; cap rates of 6 to 11 percent set the norm; price per square foot as low as $35 with a typical range of $135 to $200.

You can find similar prices and yields among retail properties. How about a bank-owned retail center in Flagler Beach, Florida—13,000 square feet for $495,000. Or maybe you see possibilities with this 28,000-square-foot former supermarket located on a 10-acre site in Winchester, Indiana. How much? $299,000. Yes, you read that right, $299,000. A leased retail store or restaurant will yield 7 to 12 percent. If you want a value-add opportunity, buy a vacant building at a much-reduced price. Then research your market (actually better to perform the research before you buy) and sign up a tenant. Your building will immediately jump in value.

Low Effort Management

Depending on the type of property and the terms of your leases (see the discussion further on) you may not need a property management company for your commercial rentals. Likewise, you may or may not need a leasing agent.

For example, say you own a medical office condominium that is leased to a doctor for a remaining term of five years. This doctor has three five-year renewal options. If she chooses not to relocate, you enjoy a long-term, virtually carefree investment. The condo association maintains the building common areas. The doctor accepts maintenance responsibility for the interior of her offices.

You can find similar opportunities with offices for professionals such as lawyers, accountants, and insurance agents. Open your Yellow Pages. Scroll through the listings. Nearly every one of these businesses needs a place to operate. Potential tenants for your commercial properties number in the thousands. Just make them a winning value proposition (WVP.)

The Upside and Downside

One strong upside of commercial properties is that (in most but not all situations) your tenants operate businesses or professional practices. They establish themselves in a set location. This desired stability means that commercial properties experience lower tenant turnover than houses and apartments.

When a vacancy does occur, though, that vacancy could last for months. Or if you own a specialized property (or a property in an inferior location)—a vacancy could last for years—if you do nothing but place a sign in the window and list the property with a mediocre agent. On the other hand, if you think about the Yellow Pages and all of those potential tenants, if you design a WVP, you will re-lease your building promptly.

In fact, some commercial property investors seek out buildings with leases set to expire within a year or two. Expiring leases increase risk for the unskilled owner. But for the entrepreneurial minded, vacating tenants spell profit potential. The expiring leases discount the sales price. The retenanted property is valued substantially higher—especially if the new tenants pay a higher lease rate than the departing tenants.

Opportunity for High Reward

Vacant (or high vacancy rate) commercial properties sell at steep discounts. When you value a zero (or depressed) NOI by using a high (risk-adjusted upward) cap rate, you obviously compute a relatively low price. (Of course, you would also use the comparable sales and replacement cost appraisal techniques to value such a property.) Nevertheless, after balancing the three appraisal methods, you can still negotiate a low purchase price. Next, turn this lemon into lemonade. Through research of the market, develop a profitable profile of a tenant (or use) for the property. Bring that idea to life and you've created value two ways:

1. You've raised rent collections and NOI.
2. You've reduced the riskiness of the property (which justifies a lower cap rate).

Envision realistic leasing possibilities that others miss and you will be richly compensated for your insights.

Commercial Leases Create (or Destroy) Value

Generally, tenants who rent *residential* units sign leases of one year or less. If you don't like the lease (or the tenants) of the previous property owner, no problem. You can get your own lease and rental policies up and running within a short time.

With commercial properties you may confront a more tenuous situation. Many commercial leases run for 3, 5, or 10 years or longer. Plus, commercial tenants often obtain the right to renew for multiple periods (for example, an original five-year lease with three five-year renewal options).

Just as important, commercial leases differ greatly in their terms. Even tenants who rent units within the same office building or shopping center might operate under disparate terms and lease rates. That's because the terms of commercial leases depend on the market conditions when the lease is signed and the negotiating powers of the tenant vis-à-vis the property owner. You can bet that tenants who sign office leases in Dublin or Dubai today negotiate sweeter deals than those tenants who signed near the peak of the boom in 2006.

How Leases Differ. Lease terms determine your NOI. Great leases keep your NOI high. Leases with adverse terms drive your NOI down. Here are several examples:

- *Who pays what?* In commercial leases, property owners often shift some (or all) of the property's operating expenses to the tenant. In some leases—especially long-term, single-tenant properties—the tenant pays for operating expenses, building repairs, and major replacements (for example, roof, parking lot, HVAC).
- *On what space does the tenant pay rents?* Commercial tenants frequently pay rent per square foot (psf). But the rentable square footage may exceed the tenant's private usable space. Some leases require tenants to pay rent for hallways, common areas, HVAC rooms, storage areas, public restrooms, and so on. The lease may even specify the precise way the space is to be measured. The method of measurement can add or subtract 5 percent (or more) to the quantity of rentable space.
- *Are the rents inflation protected?* If the property is leased to a tenant for 5, 10, or 15 years (or longer) will your rent collections increase with inflation? When, and by how much?
- *Are the property owners entitled to percentage rents?* In retail, leases may require tenants to pay a base amount of rent plus a percentage of the tenant's business revenues (which also should be precisely defined—for example, must the tenant pay a percentage of their off-premises sales?)

Read Each Lease Clause. I don't want to make leases sound too complex. Some owners of small commercial properties write relatively simple, three- or four-page leases that involve month-to-month tenancies. However, unless you read each tenant's lease, you won't know what pitfalls lurk within the fine print.

Beware of buying a property only to learn later that an undesirable tenant can stay in place for another eight years at a rent level $6 psf under market. Beware of buying a small retail strip center with the idea of bringing in a Dollar General store only to learn that an existing tenant had previously negotiated an "exclusive right to sell general merchandise" clause in its lease.