HARTMANN RENTALS

2505 Vandalia • Collinsville, IL 62234
618.344.7900
DougSr@HartRent.com www.HartRent.com

Doug Hartmann Sr
CPM CCIM

Serving REAL ESTATE INVESTORS for over 30 years

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Improve Income On Apartment Properties

Property managers must do everything they think of to improve income in properties managed.

For apartment owners, the way to increase rental income and gain a bigger return on investment is to improve the property. One way to reduce vacancies and increase rentability of apartment units is to make them cleaner, brighter, fresher, more comfortable and homey than other apartments in town.

Sometimes these two objectives can be in conflict. For instance, an improvement designed to attract tenants may cost so much that the amount of necessary rent increase makes the units harder to rent.

Factors In The Decision

Here are some ideas about the factors that come into the decision to make alterations, or remodel the apartment property:

• Take a hard look at the rent schedule to see what the vacancy situation is now, if there are any concessions or giveaways currently in effect in the building, and the prospects for renewals. The answers can provide some answers about the timing of renovations.

• Painting both exterior and interiors is a good and inexpensive way to make a property look instantly better. This usually yields an immediate and satisfactory return on the cash cost.

• If you replace carpets, window coverings and appliances, the appearance of the unit is dramatically improved and the chance for rentability increases. These costs, however, cannot usually be recouped quickly by means of a higher rent charge.

• Adding some recreational facilities can be a way to attract tenants. An indoor exercise room with a few pieces of exercise equipment, and a yoga and aerobic exercise area can be expensive, and may not be justified by either an increase in rentability or return on investment.

Take care if any kinds of exercise facilities are added, check with your liability insurance agent to determine the protection needed against litigation from injuries.

• Remodeling a kitchen or bathroom is always expensive. If your kitchens and bathrooms are now very outdated, they may be costing you lost rentals. Instead of a remodel, think about painting or refinishing the cabinets and add new hardware.

• Sometimes a washer and dryer rental company will totally refurbish the laundry room as part of the opportunity to install their coin-operated equipment. The owner of the property can make the property more attractive and rentable without any cash outlay at all.

• In some apartment properties, recreation rooms have been converted into a day-care center staffed by a licensed day-care operator. It becomes a source for additional income. Again, check your liability insurance!

Always keep tabs on the condition of the property. Make repair and improvement decisions promptly. If conditions deteriorate, it can lead to costly projects later.

Keep very alert to what the competition is doing and always try to stay competitive with them. ✦

Leased Property - An Interesting Investment

There are real estate investors who specialize in making profits, sometimes big profits from properties that they lease and do not own.

This cash flow from a lease can be extremely interesting. Often the lessee making a huge profit has a relatively small cash investment in the property.

The Usual Lessee

Take the position of the person acquiring property for use in a retail business or profession. For this person, the fundamental advantage of leasing over purchasing is the fact that the entire amount expended for leasing is currently deductible. On the other hand, if the property were owned, the owner would not be able to deduct any part of the purchase price. His entire cost would have to be capitalized, and could only be recovered through depreciation of the cost of the improvements over their life. The remainder would only be recovered on the disposition of the property.

An Estate for Years

A lease is defined as a contract between the owner of the land or building (landlord or lessor) and a tenant (lessee) in which the lessee agrees to pay a stipulated sum (rent) for the use and enjoyment of the property for a specified period of time. This is, for the lessee, very much like an ownership, and is also called an Estate for years.

A lease is a complicated legal contract and it should not be entered into by either the lessor or lessee without professional assistance. All leases are different and so we cannot cover all of the possible combinations of items in a lease in this publication.

We can cover just the elements that can result from negotiating leases and subleases for profit.

The Original Lease

The original lessee may lease a property for a certain specified monthly rental amount. This lease is with the owner of the property.

As an example, what if a commercial building is leased for $10,000.00 a month? If the lessee could sub-lease the same property to another renter-user for a rent of $11,300.00 per month, then the original lessee would have a cash flow of $1,300.00 from this situation that is often called a "sandwich" lease. The original lessee is "sandwiched" between the owner and the user of the property.

This original lessee still pays the original specified monthly rental of $10,000.00 to the owner, but since he is collecting $11,300.00 from the sub-lessee under a separate contract, the difference of $1,300.00 is a monthly profit for him.

The Right to Sublease

As we pointed out, you need professional assistance to prepare the lease. If a "sandwich" situation is contemplated, a provision giving the tenant the right to sublease space is an absolute necessity in the lease agreement.

It is customary, in landlord prepared "form" leases, to preclude assignment and subletting. The ideal position for an active landlord who intends to provide competent continuing management to his real estate is to maintain this clause intact throughout the lease negotiation and thereby provide himself complete control of all assignments and sublettings, since none can be accomplished without his prior approval.

The usual original reason for the lessee to place the provision to sublet into the contract is the question about the future amount of space that the original tenant will need. If a tenant believes that he will need less space in the future, a sublease clause can be provided to solve the problem. The owner will usually agree in this situation, since the alternate provision might be for a cancellation of the lease.

A good counter-offer from the owner in this situation might be a "right of approval" of a subtenant. There might be other things that the owner wants into the lease regarding the use, etc., of a sub-lease tenant. All must be negotiated.

The Profits

- Our example of the commercial space leased for $10,000.00 and sublet for $11,300 showed a $1,300 a month cash flow.
- One speculator, when looking through an area for a commercial property, noticed a well-located house with an owner's "for rent" sign. He inquired and leased the house for his own use. A few months later, he moved from the property, but was able to sublease the house for a $500 a month profit.

(Note: This is getting into a dangerous area. The original lessee would probably be liable for any damages to the home. Take care!)

- A retail store operator leased a 30,000 square foot retail location, knowing that it was too large for him. By negotiating for the entire space, he was able to get an excellent price per square foot - a wholesale price based on his financial strength and ability to lease the large space.

The retailer used 15,000 square feet, as originally planned. The balance of 15,000 square feet was remodeled (by the retailer at

(continued)

his expense) and sub-leased to a number of smaller retail operators, who paid a premium price for their store area.

The original lessee ended up with enough income from the sub-leased space to pay all of the rent on the building. He had negotiated a situation where he had free rent for himself in an excellent downtown location.

- One lessee leased a commercial building that had been used entirely by the offices of an insurance company as a regional location. By taking the entire building, he was able to work out the same rental rate that the insurance company had paid – also on the entire property

With very little in changes, the lessee then leased each room or suite of the building separately to various professionals - attorneys, insurance agents, real estate agents, etc. His cash flow from the “sandwich” lease situation amounted to a profit of $13,000.00 per month - for leasing and managing a property that was not owned, and in which he had little cash investment.

Making these profits may take a little ingenuity on the part of the lessee. He may have the imagination to see the uses of a property that the owner does not, or would not have the time to do himself. ✦

Commercial Lease Negotiations

Today’s office market remains highly competitive. Tenants who used to sign “standard” lease forms without a second thought are giving the same care and attention to their space needs and lease obligations as they would to the operating aspects of their businesses. The major goal of the corporate tenant is to obtain a variety of options that give them the maximum flexibility to expand, consolidate, terminate, alter, and change use as needs arise.

On the other side of the negotiations, landlords and managers (on their own behalf and on behalf of the lenders that finance their buildings) emphasize the tried and true long-term lease with a fixed base rental (plus escalations to protect against inevitable inflation). Tenants may want flexibility, but landlords need stability of occupancy and rents to ensure that debt service payments will be made, that property taxes will be paid, and that the capital asset that is the office building will be properly maintained.

Reconciling These Goals

One answer is to view the commercial real estate lease as a complicated financial instrument like a kind of bond. Instead of borrowing cash, the tenant borrows space. At the end of the term, the tenant returns the space to the landlord just as a borrower returns loan principal.

A lease viewed in this way can be seen as a transaction in which the total rent can be broken down into a series of payments for different kinds of returns. The basic rent would reimburse the landlord for (1) the essential costs of maintaining the space (operating expenses, debt service on the mortgage, and reimbursement for the loss of value due to depreciation of the physical assets) and (2) the landlord’s return on his equity. Additional rent (in the form of add-on rent during the lease term through the application of operating cost escalation) reimburses the landlord for additional dollar costs by inflation or new laws and regulations (e.g., asbestos removal).

If the tenant wishes to have various options (to renew, cancel, expand or contract space), additional rental that is in effect a monthly fee for such privileges would be paid. As is already done in many lease negotiations today, special arrangements would cover tenant improvements, and the tenant might be given (or be asked to give) additional concessions depending on whether the market was in favor of the landlord or the tenant.

By looking at a lease as a combination of several economic transactions, each of which must be priced individually, both landlord and tenant can walk away from the bargaining table with a feeling that they either have received the benefits they desired or have been compensated for not receiving them. In short, the tenant that wishes flexibility should compensate the landlord for the resulting risks to the rental stream from the building; the landlord that seeks the stability of long-term rentals must be prepared to compensate the tenant. That this can increase the complexity of the lease cannot be doubted. The concept of net present value will have to be applied to the returns and costs of each economic transaction in order for each party to determine its true cost (in the case of the tenant) or the true return (in the case of the landlord). ✦

Property Management can be a tough business where small mistakes can have big consequences. At Hartmann Rentals our goal is to increase your ROI (Return On Investment). Our team of specialists are dedicated to taking care of your investment for maximum cash flow & growth. We manage your investment just as we do our own.
MAKE YOUR LIFE EASIER, LET HARTMANN RENTALS MANAGE YOUR INVESTMENT.

Over 35 years of experience makes Hartmann Rentals one of the most respected property management firms in the area.

We manage apx 700 units in Madison & St Clair counties & represent over 100 owners (from single family, & 4-plex, to larger complexes).

Management fees- residential 10% of rents collected. Finders fee of $100 to move a new resident in. No advertising fees. We only employ properly licensed Leasing Professionals by State & Local government entities.

Decreased Vacancy- by attracting the right tenants with our vast internet presence, local advertising, professional signage, & a name area residents have trusted for over 35 years. RECENT TURNOVER TIME WAS 31 DAYS, (from keys turned in to new movein.)

Strict Tenant Screening Methods-to place quality tenants, checking credit/criminal backgrounds, verifying incomes & rental history. But still conforming to all local, state, & federal laws/mandates.

Lease drafting & Move in Procedures-Our lease is constantly being reviewed to comply with the ever changing local, state & national laws & statues.

Streamlined Rent Collections & Evictions-We are knowledgeable in state & local property management laws, to swiftly (as the courts allow) regain the home.

Cost Effective, reliable maintenance-minimizes expenses using in house staff & preferred vendors we have long term relationships with. Copies of “Maintenance Orders” are included in your monthly statement, with any charges. (Home Depot, etc)

24/7 Emergency Requests- limiting expenses & liability. Plus keeping residents happy, reducing turnover & by controlling repair costs with quick response.

SEE HOW WE CAN MARKET YOUR HOME—www.HartRent.com

The abilities of a Professional Property Manager will usually more than make up for the cost of his services. The yield from the property will be maximized and the value will be preserved or enhanced.

When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.