CREATING and GROWING

REAL ESTATE WEALTH

The 4 Stages to a Lifetime of Success

William J. Poorvu

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William J. Poorvu
with Jeffrey L. Cruikshank

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Publishing as FT Press
Upper Saddle River, New Jersey 07458

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Printed in the United States of America
This product is printed digitally on demand.
First Printing February 2008
ISBN-10: 0-13-243453-9
ISBN-13: 978-0-13-243453-9

Pearson Education Ltd., London
Pearson Education Australia PTY, Limited.
Pearson Education Singapore, Pte. Ltd.
Pearson Education North Asia, Ltd.
Pearson Education Canada, Ltd.
Pearson Educatión de Mexico, S.A. de C.V.
Pearson Education—Japan
Pearson Education Malaysia, Pte. Ltd.

Library of Congress Cataloging-in-Publication Data

Poorvu, William J., 1935–

Creating and growing real estate wealth : an insider's guide to the many paths to success / William Poorvu.

p. cm.

ISBN 0-13-243453-9 (pbk. : alk. paper) 1. Real estate business. 2. Real estate investment. 3. Entrepreneurship—Psychological aspects. 4. Success in business. 5. Work and family. I. Title.
HD1375.P6637 2008
333.33068—dc22

2007039362

To many generations of students, who have taught me so much

Contents

Acknowledgements

Creating and Growing Real Estate Wealth is about how to craft a successful long-term career in real estate. But because there is no single path to follow into real estate, this book seeks to present multiple paths, which in turn reflect the wisdom of many skilled people with a variety of backgrounds.

I have conducted more than one hundred in-depth interviews with real estate entrepreneurs in the U.S. and abroad, and I greatly appreciate their candor and insights. Similarly, I need to thank the people at all those real estate companies—of all sizes and configurations—about which I've written cases, over the years.

Besides my experience as a practitioner over many decades, I also have benefited from the students I have taught, and learned from, during 35 years of teaching at Harvard Business School. Many have continued to come to me for career counseling, and again, their stories, comments, and questions have taught me even more about my field.

Over the decades, I have served on three REIT Boards: Connecticut General Mortgage and Realty Investors, Trammell Crow Realty Investors, and CBL Associate Properties. In recent years, Charles and Steven Lebovitz and John Foy, the chief executives at CBL, have given me innumerable insights into the effective management of a public company. As an advisory board member to the Shorenstein Company, I learned from Walter and Doug Shorenstein what it is like to adapt your strategy to attract institutional investors. In writing cases about the Hines Company over the years, I discovered that a properly structured entrepreneurial company can continue to thrive over a number of economic cycles.

This book started with an inquiry from Jim Boyd, Executive Editor of Pearson Education. He and his associates have continued to support and advise me. Jim even convinced me that I could say more in 80,000 than 115,000 words. Former teaching colleagues, Don Brown, Arthur Segel, and John Vogel added their input at various stages of the manuscript. Seth Klarman, Marilyn Yalom, and Stuart

Lucas effectively challenged numerous points they thought were unclear. Bob Glauber gave me a reality check on the financial markets.

My real estate partner, son Jonathan, politely made me aware of sections that did not tie together. My daughter, Alison Jaffe, did the same, even if she had to remind me that she had made similar comments earlier, and I should have listened to her the first time. My mother who passed away a few months ago just short of her 97th birthday encouraged me for 72 years to *do better*; she also served as my grammarian of last resort. My wife Lia has supported me not only through the writing of this, my fourth book, but through 50 years of marriage—truly a mind-boggling example of perseverance.

Tyler Kim typed more drafts than either of us would like to count with patience, good will, and endless cheerfulness. This is the second book I have collaborated on with Jeff Cruikshank. By now, I can't tell which of us has written or rewritten what. The key is we are still speaking, and, I believe, continue to be energized by our dialogue.

About the Author

William J. Poorvu managed the real estate program and taught real estate courses at Harvard Business School for 35 years. He has personally trained many of today's most successful leaders in the real estate industry. He is a successful real estate entrepreneur himself and also a professional investor, both on his own behalf and for various endowment boards on which he serves. He also authored *The Real Estate Game: The Intelligent Guide to Decision-Making and Investment.*

Introduction: The Many Paths to Success

Real estate is a wonderful business.

It is as pure and enjoyable a form of entrepreneurship as you can find on the planet. You will come in contact with amazing people from all walks of life—people from whom you will learn more than the nuts and bolts of real estate. You have the chance to be creative, to find a niche where the competition doesn't already have an advantage of greater knowledge, better contacts, or a deeper skill set. More than most endeavors, it lets you define what's important to *you,* and then go after it.

And, of course, it can reward you very well financially. However, this book is not a "get rich quick in real estate" book—the kind that have spilled off the bookstore shelves in recent years. As I see it, those books are written by people who don't really understand the field, or who are simply trying to cash in on whatever is the current fad in real estate. The truth is, there are many real estate success stories, more than in most other businesses. But, few of them came easily or quickly. Most involved years of hard work: acquiring experience and building relationships with the many people you will need to help you achieve your goals.

Many of these books focus on a particular path to success—one that presumably has worked well for the author—and then prescribe that *everybody* go down that same path. Several things are wrong with that approach. First, there's no single aspect of the real estate business in which everybody can be a winner. To cite just one example of an option that I've seen proposed in some books, there aren't enough foreclosure auctions to go around if everybody tries to specialize in buying properties at them.

Second, there are many different ways to be successful. Although real estate is often considered a single industry, it is for most participants a local business—one that is, in fact, incredibly fragmented. This fragmentation can be good news. You just have to be opportunistic enough to find the approach that suits you best, and then work hard. If you get a little lucky along the way, that won't hurt either.

You also have to find out what you *don't* want to do. Foreclosure auctions aren't for everybody. They certainly weren't, and aren't, for me. If someone had told me five decades ago that success in real estate could only come from snapping up homes that families in distress were forced to abandon, I would have found something else to do, *quickly.* I wouldn't be writing this book today.

A "Typical" Life in Real Estate

What does a "typical" life in real estate look like? What are the milestones, pitfalls, and rewards? How can you create, grow, and use wealth successfully? How do your challenges and opportunities change over time? How can you make a difference? When is your product a commodity, with price being the key criterion? Alternatively, when can you add value through your skills at assembling the parts and providing services to your customers?

This book sets out to answer those questions. In the process, it describes exactly how the real estate industry works, what has changed, and what has stayed the same. It tells you how to get into the real estate business, and—if you choose—how to *stay* and *grow* in that business. It tells you how to spot opportunities, and how to respond to them. It explains the wide range of roles you might play—either as an active or passive participant—and helps you figure out which role might be most appropriate for you. Again, one of the main themes of this book is that there's no one way to succeed in real estate. You can't point to a single path and say, "This is the right way to do it."

In my previous book, *The Real Estate Game,* I explained how projects get built and how deals are put together. My central theme was that to succeed in the real estate game, you have to take into account several key factors: the people, the property, and the deal. You have to be immersed in the process. You have to get the details right and adapt them to the environment in which you operate.

A major objective of this book is to help you be more strategic: to define for yourself what makes a successful real estate career, and how to go about making it a reality. For many people, a job in this field is primarily a means to make a good salary (and perhaps earn a sizeable bonus) that will enable them to support their family. Others see their career as an opportunity to achieve responsibilities in an organization—a way to acquire not just money, but power and influence. Then, of course, there is the wealth-building aspect, whereby you can build an equity base by acquiring, improving, holding, and selling properties.

For still others, a career in real estate becomes a *way of life.* The deal-making, and the excitement of developing new projects, turns them on. For most of these people, retirement is not something they look forward to. Fortunately, retirement is something you can easily postpone when the business is yours and you call the shots.

Others have loftier aspirations. In their mind's eye, they have a compelling picture of a better world. They hope to make the physical environment a more satisfying place to live in.

Most real estate people, myself included, fit into more than one of these categories. The questions for you to answer are, *where do you fit, or want to fit? What are your goals?*

Even if you are not looking at a career in real estate for yourself—for example, if you are a passive investor, a service provider to the industry, or a student of business—you can use this book to derive a better understanding of how the real estate world works.

There are a number of questions asked for which there is no one right answer. Your challenge is to decide the answer that works best for you.

A Career in Four Stages

Think about a career in real estate as having four stages:

- **Starting out.** This is about building your foundation—your first job, your first deal. How and where can you add value? Are you coming into the field cold, or are you a lawyer, a contractor, or someone who's already providing services to players in the industry? How, exactly, do you do your first deal? (Did you inherit a property?) Where can you get the money that you may not have, and how do you deploy it? How much of your time will this new enterprise take? Most likely at this stage, you will be working for someone else. Getting the right job or training should be high on your priority list. You may begin doing your own deals on the side, but often as a sidebar to your day job.

- **Scaling up.** This focuses on finding your way through the forest—the deals after your first deal. First of all, *do* you get bigger, or do you stay small? Do you expand geographically, by product type, or by project size? If you get bigger, how do you build an organization that will help you succeed, and not swallow you up in all the complexities of finding, motivating, and managing people? How do you find the capital to do multiple projects? When do you give up your day job? When do you leave a position in someone else's real estate company and start your own firm, either alone or with others?
- **Hedging your bets.** This is my way of reinforcing the notion that real estate is *risky.* It gives a reality to the stock disclaimer, so prevalent in the mutual fund industry, that "past performance is not necessarily indicative of future results." There are a number of "X" factors that you cannot control and that will affect your outcome. As a highly cyclical business, it is vulnerable to externalities that can do you in if you're not careful (and sometimes even if you *are* careful). Some of these cycles may be related to your local or regional market, others can be macroeconomic, political, technological, or product-driven.

  To survive is like surfing: No matter how much you practice, you still have to be willing to take risks. You have to alter your plans to take advantage of new realities. At the end of the day, you may have gotten a great ride, falling and getting up again . . . or you can get wiped out. In real estate, there are winners and losers. Whether or not you are good at market timing, there are ways to minimize potential damage and to take advantage of the potential turnarounds in each cycle. You have to practice a form of "preventive maintenance" to prepare yourself for such times.
- **Taking stock.** This fourth and final career stage has to do with understanding your later career options in today's world and deciding what to do about them. It's not just about harvesting

or not harvesting profits (although that's a piece of it). Depending on your circumstances, it may be about jumping back into the game in a new way. It may be about involving your family in the business, possibly over multiple generations. Conversely, it may be about encouraging your children to go out and do their own thing.

You may want to increase your charitable giving, perhaps to give your family a platform in the community to grow from. You may want your projects to be not only successful financially, but to have broader significance. You may worry more about how the environment is changed. Although it might seem counterintuitive, as you grow older—and as you start thinking about your legacy—your perspective may start becoming longer term.

This book is divided into four parts, with each part corresponding to one of these four stages. I open each part with some introductory comments and questions, and list a number of generalizations or takeaways that emphasize the major points in that section. I then introduce a series of characters who are going through that particular stage of their career. All of these characters are real people. I have known almost all of them personally. Some I have met through my academic work, I have done business with several, and served on boards for others. Their stories should be fascinating to anyone interested in real estate, no matter what his or her level of experience.

I don't claim that these people are "typical" or that they collectively represent all the different types you can find out there. In a field this diversified and fragmented, that would be impossible. I've chosen them because I believe their careers—individually and as a group—illustrate a variety of problems, opportunities, and situations you might encounter at some point in your career. Some stay small, buying properties opportunistically, whereas others establish large companies. Without exception, however, they gain experience, work hard, remain flexible, and attempt to manage risk—traits I have found in virtually all the successful real estate entrepreneurs I know.

Although many of these characters started in real estate decades ago—which means we can trace their careers over the four stages in this book—their earlier experiences are still relevant today. For example, real estate is a cyclical business, and being able to anticipate and then manage in the downturns is essential for survival. This involves managing both the asset and liability sides of the balance sheet: the property on one side, and the financial structure on the other. Whether the cycle occurred 10 or 20 years ago is not important. The key is to expect and prepare yourself for such changes and be ready to capitalize on them.

Many decades ago, I realized that I was unlikely to win the U.S. Open tennis tournament. With some help and practice, however, I could learn to play a better game, and maybe even make fewer mistakes. When you are young, you tend to hit the ball harder and try for more outright winners. As you get older, you try to become a more strategic player, perhaps lobbing the ball over your opponent's head a little more often. You adapt to your own physical condition and to your external environment. In both tennis and real estate, *playing smarter increases your chances for success.* It is not so much about winning each point as it is ending up on top, at the end of the match. Helping you to play smarter at every stage is the goal of this book.

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The Starting Line

Is real estate a good personal fit for you? If so, how do you find your first job? After that, how do you find your first deal?

Most likely, you have no experience, very little knowledge, not much money, no relationships, and no credibility out there in the world—in other words, none of the things that you'll eventually need to succeed in a real estate venture. So, why should you consider a career in real estate?

There are many advantages to being in this field, financial and otherwise. The industry has almost unlimited points of entry. You can practice your craft in any community in the country. The product comes in all sizes, shapes, and price points. Each property can be owned in a separate entity, with the ownership apportioned to reward specific contributions. You can be in the business owning one property or hundreds.

Real estate is the poster-child industry for entrepreneurs. You don't need substantial capital of your own to start. Financing is available for individual properties, based *primarily on the income from the property* rather than the net worth of the owner. You can outsource the services required to build, lease, and operate the property, allowing you to keep your own organization small and your overhead minimal.

What do we know about entrepreneurs? The ideal entrepreneur can be described as visionary, driven, energetic, flexible, persistent, detail oriented, good at negotiation, quick with numbers, and able to manage risk. The simple truth, however, is that few of us possess all these traits. (We'd probably be impossible to live with if we did.) In any case, it's really not necessary to be all these things at once. It is more important to be intimately aware of the market, understand the financing options, and maintain a healthy network of contacts and professional resources—achievable goals for most of us.

In many cases, the most successful entrepreneurs are life-long learners. They are people who are willing to listen, and who don't need to prove they are the smartest in the room.

The Job Search

Finding your first job is always daunting. Pick an area of real estate that relates to your strengths—one that will give you a point of entry and an opportunity to gain experience.

You might begin by working for a property owner directly, but such jobs are relatively hard to come by. In terms of sheer numbers, there are many more entry-level jobs in firms that provide services to property owners. These firms usually specialize by function, locale, and product type. *Functions* can include real estate brokerage, law, accounting, financing, building management, design, construction services, and so on. *Product type* can mean residential, office, industrial, warehouse, retail, hotel—or, in some parts of the country, self storage, parking, agriculture, or ranching.

Think about which functional area plays to your strengths—for example, your sales skills, your accounting background, or perhaps even your computer skills (in this day of Internet listings and virtual tours of properties). That will not only help you get your first job, but also put you in a position where you can excel and have more to offer to your next employer. Use your contacts: families, friends, alumni groups, and so on. Talk to as many people as will see you. Word of mouth is vitally important. Firms don't necessarily do their hiring to accommodate your graduation schedule, so be prepared to discover that your job search may take time.

Before you start your job search in earnest, try to learn more about your own strengths and weaknesses. You might want to do some online research, or borrow some books from the library, to get a sense as to what makes you tick. Some online personality tests can expand your thinking, and you can follow up these general tests with more targeted research.

Meanwhile, try to look at the landscape around you with new eyes. Where does opportunity lie? Where are new buildings going up? Can you get a summer job at one of these building sites?

For most of us, *where we live* is where we start looking for a job. In other words, we usually don't pick the location of our first real estate job search based on its inherent real estate potential. Our day job, our desire to be near where we or our spouse grew up, the sheer accident of where we were discharged from the service or where we went to school—these are far more often the determinants of location.

As it turns out, there's usually nothing particularly wrong with being in one location versus another. Each area has its own subsets of communities, neighborhoods, and streets. It has its own social, economic, zoning, and transportation dynamics. Even though, as a rule, it is better to be in a faster-growing market, even slow or no-growth markets have their opportunities. And without a doubt, we tend to have better contacts in the town where we grew up or where we spent our college years. Great contacts can make up for a less-than-hot local real estate market, especially when your goal is to gain experience.

Make your resumé a strong tool. Have a friend—or even better, someone who has experience hiring people—look at it and give you honest feedback as to what this all-important self-introduction is likely to tell a prospective employer.

Don't be afraid to include something offbeat at the bottom of your resumé, such as running a painting crew during the summer, working in another country, or excelling at a sport, second language, or musical instrument. You want to demonstrate to your potential employer that you have some kind of *spark*—and of course, give that person something to talk about at your interview. (Here's where having had that summer construction job will definitely be a plus.)

Do research on the person who's agreed to interview you, and on the company that he or she represents. This will demonstrate your initiative and seriousness, allow you to ask better questions, and perhaps flatter the interviewer. Google is an easy starting point.

Yes, this adds up to a lot of work, which can sometimes be frustrating. You need persistence and patience. Keep in mind, however, that the first success is often the hardest to achieve.

When you finally do get a job, try to perform multiple tasks within that company. The more experiences you get, the better. Talk to your coworkers about your interest in learning as much as possible. They often will be happy to share if they see you are eager to help, and to learn. Again, people may be flattered if you show a genuine interest in what they do and how they do it.

This raises an important and related point: *The person whom you are going to work for is just as important as the work you'll be doing,* and maybe even more so. In an ideal scenario, your boss will spend time with you, share experiences, challenge you, and introduce you to others. If he or she has a great reputation in the industry, that reputation may well rub off on you.

Timing is also important. Sometimes it is better to go into real estate when real estate is out of fashion, when people are flocking to other trendy fields—say, Internet start-ups or private equity firms. There may be fewer openings in real estate at those points in the cycle, but there is also less competition in the tough times, you'll get better training, and you'll be well positioned to take advantage of the eventual upswing in the market.

One Real Estate Career

Gordon Smith, a friend who graduated in 1959 from business school, decided early on to go into real estate. His story illustrates just how personal, and how particular, the starting-up decision can be.

Gordon grew up in a small Midwestern town, with part of his early education taking place in a one-room schoolhouse. He decided while at business school that he wanted to be a homebuilder. Without exception, his professors and friends told him that taking this path would be a waste of his graduate education. The homebuilding field, as they saw it, was a bunch of guys in pickup trucks with hammers, subject to the wild cyclical swings in the housing sector—in other words, low margins and high volatility.

Gordon loved the sound of all this. Something like a million and a half houses a year were being built in the United States back then. (The total is not too different today.) Couldn't he use his skills and smarts to grab a piece of that market? And, the fact that no one else in his MBA class of hundreds of equally smart people wanted to go into homebuilding was a plus: Gordon would be the only one in his class who would be applying what he had learned to the housing market. He picked a good locale—the rapidly growing suburbs around Washington, D.C.—where he made himself into one of the area's premier homebuilders. Half a century later, his firm—now run by his son—is still building something like 500 homes each year.

Gordon's world of 50 years ago is not the same as today's. But that's always the case. The world is always changing. The one reliable constant is that this is a cyclical industry—one in which playing a contrarian game and swimming against the tide can have great advantages over the long term. Even as you start your real estate career, and you're preoccupied by the demands of the moment, try to start thinking long term. Think like a contrarian. What can you do that not everyone else is doing?

Your First Deal

Not too long ago, I took a call from a reporter at the *Los Angeles Times* who was doing a story on a session at which Donald Trump, the ultimate real estate salesman, was speaking. The writer later wrote, in essence, that *Donald Trump said you can make it quickly, whereas Bill Poorvu, the Harvard Business School professor, said, "Not so fast; go more slowly."*

I realize that some people approach the real estate industry the same way they approach the stock market: looking for the quick hit. They hang on the words of a (self-described) billionaire. And of course, Donald Trump wasn't, and isn't, dumb. He was getting free publicity for a session in which he was getting paid a big fee. Meanwhile, I was giving an interview for nothing.

Still, I'll hold my ground. Because real estate is *not* like the stock market, the same answers don't apply. When you dabble in stocks, you can buy an index, such as the S&P 500, and be certain that your performance will mimic the averages, with low transaction costs. Buying individual real estate is much more complicated, and there is much more to learn, in part because it is a less-efficient market with much higher transaction costs.

You hope your first deal will be a financial success. In truth, however, it's more likely to be a good learning experience, in which you discover how the process actually works.

For example, it isn't just about gaining control of a property and sitting on it. Most people who succeed in real estate find a way to *take a property from a less valuable use to a more valuable one.* You can add value in many ways, some of which are listed here:

- Repositioning (that is, changing the use, condition, or pricing).
- Using excess land for new or extended purposes, especially if most of the initial cost can be allocated to the primary use.
- Adding new uses to existing development, such as a shopping center next to a residential subdivision.
- Buying properties at auctions, whether from lenders or distressed sellers, at prices that reflect a lack of liquidity in the financial markets rather than a permanent loss of value.
- Building on one's own tenancy. For example, your retail firm may anchor a shopping center. Your occupancy may fill an office building. In both cases, why not own the building? It is your lease that is creating much of the value of that property.
- Leasing rather than buying land, which is a way of reducing your up-front cash requirements.
- Pre-leasing, which means filling a vacant building with suitable tenants either before or soon after you acquire or construct it.
- Financing/leveraging. As noted, using other people's money is a necessity for most of us. The availability and cost of money will affect your cash flow, *big time.*
- Design/construction. Creative architecture, efficient layouts, cost control, and on-time delivery are keys to good execution.
- Customer service. Understanding and satisfying your existing tenants' needs leads to higher occupancy and lower turnover.

Here's an important point to keep in mind, as you think about deals: Strictly in terms of a percentage return, the *greatest increase in a property's value often comes in the early stages of owning that property,* when your influence or specialized knowledge has its greatest impact.

For example, if you can make a \$100,000 purchase that is worth \$150,000 after a year, that first-year gain is 50 percent. After the property is repositioned, stabilized, and financed, it's unlikely that the annual return will be anything like that in subsequent years. We've already talked about the idea of buying at distressed prices. The corollary is to sell in times when the risk is lower, there is an overabundance of money anxious to come into the market, and the capitalization rate is more favorable.[1]

The example is made even more compelling if you assume that you only had to put up $10,000 of the initial $100,000, and could borrow the rest. If you sold the building for $150,000, your return on sale would be $50,000 on your $10,000: a very satisfying 500 percent return! You have bought wholesale and sold at retail.

But what if you don't sell at that point? Going forward, if you assume you have, after the first year, a theoretical equity of $60,000—that is, your $10,000 initial cash plus the $50,000 potential gain—you won't make anything like that kind of annual return on the higher equity. You will likely only receive an annual cash flow of $5,000 or $6,000 on that $60,000.

So selling, especially early in your career, may make good sense. You might be in a lower-income tax bracket, and taxes might not be a huge issue if you sell the property. In addition, you're likely to need to sell your first property to have the cash to do your second deal. You'll read in subsequent parts of this book that in later stages of your career, *holding the property may be the best long-term strategy.* But, what you do starting out may be very different from what you do later on.

The downside in all this is that *your risk level goes up* as a result of your greater dependency on short-term activities—whether those risks are market related, the result of cost overruns on renovations, or whatever. You may assume that the interest rate is less important because you see yourself selling or refinancing the property in the near future. If you are heavily leveraged, you might need larger reserves to cover higher financing costs.[2] If it takes longer than you projected to generate revenues, you can quickly find yourself in deep trouble.

The Deal Search

Nearly all the deals that I've gone into have come from people who wanted more than just a commission for bringing me a deal. They wanted to be partners, architects, lawyers, or rental brokers in the project. If you treat others fairly, good deals are likely to be offered to you. But, getting the right help through building relationships and networks takes time. *Work at it.*

At some point, you have to pull the trigger and do your first deal. There's no easy answer to the question, "When should I be willing to make a purchase?" Chances are, you won't get it exactly right, or you'll get it right for the wrong reason. If you're lucky, however, a favorable market can make up for a lot of miscalculations.

Speaking personally, if I had known then what I know now, I would likely *never* have done many of my early deals—most of which turned out to be very profitable! As Mark Twain put it in his autobiography, "It is strange the way the ignorant and inexperienced so often and so undeservedly succeed."

Picking a Location

As with your job search, there's no one place to start. Usually, however, you will start in the area where you work or live, picking a property type you understand at a price level you can afford.

You can begin to explore your options simply by looking at maps. (It is amazing how much you can learn by looking at maps—all kinds of maps!) These days, the Internet is making available a wealth of detailed aerial maps that in the past were accessible to only the biggest companies.

You can continue your education by walking or driving around. You can visit apartments, houses, stores, and offices. Try to spot where change is occurring. What areas are in or out? Where are the artists moving? Where are the trendy shops and hot restaurants—the streets with "buzz?" Where are the areas with architecturally interesting structures that might be renovated attractively? What companies, and which brokers, are operating in this area?

Think of yourself as a comparison shopper. You would think nothing of asking the proprietor the price of a particular item in a store. Think the same way about property that goes up for sale. In real estate, it is much more difficult to "find the proprietor," and you might not know how much to believe when you do hear a price, but it is crucial that you begin to understand value. Thinking simultaneously in qualitative *and* quantitative terms about a property is not easy, but it is crucial to successful investment. The size and physical condition, the legal restrictions, the rent structure, the availability and cost of financing—all enter into the equation. There may be a big difference between the asking and the real price.

One of your toughest problems, starting out, is deciding which deals are worth spending time to investigate. Especially if you have a day job, this will be a limiting factor. This is why it's better to focus early on a specific neighborhood or property type where your learning will be cumulative. It is like buying a house. Until you have seen several, preferably in the same neighborhood, you will not have the confidence needed to act quickly when the right deal comes along.

Building Relationships

Real estate is a field with myriad players. They perform a number of services, many of which will be essential to your success. Most operate at the local level. At the same time that you are becoming knowledgeable about your local markets, therefore, you should be cultivating relationships and building your own reputation. At all points in your career, you need help from others, but this is especially crucial when you're starting out.

In particular, brokers are a wonderful source of information. It is not easy to find the right ones—that is, those who will spend time with you, and show you their best listings in a timely way. It often depends on the broker. As in every field, there are good brokers and bad ones. Keep in mind that 1) they are being paid by the seller, and 2) they only get paid if the deal goes through. Obviously, then, you have to assess how much weight you should put on their advice. But the better brokers take a longer-term view, hoping to build long-term relationships. After all, they might someday be selling a building for *you*.

Most brokers specialize in particular property types or markets. You need to find out which brokers fit *your* needs. Not surprisingly, brokers spend more time with their repeat customers. The problem for most of us starting out is that we're not (yet) repeat customers, nor are we flush with cash, nor are we blessed with ready access to credit. The broker has to look past those limitations and see our potential.

One sensible question to ask and answer is this: Do you pick a broker based on the individual's reputation, track record, and willingness to show you around, or on the reputation of the firm with which the broker is affiliated? Personally, I go for the individual—and that's pretty much my rule of thumb in *all* aspects of real estate. If your people judgment is good, picking someone with time to spend who, like you, is just starting out may be a good compromise (at least for most simple transactions).

If you are buying a house, you can turn up a great deal of information online, including specific properties for sale. But because each commercial property is different, and because many property owners desire confidentiality for various reasons, few investment properties are listed this way. Nevertheless, you can often uncover a great deal of general market information online, as well as information about nearby buildings. Comparative real estate tax assessments can be a good starting point. Sale prices are generally public information, although you should keep in mind that a stated price may have been affected by the terms of the transaction. If the seller took back a mortgage at an interest rate favorable to the buyer, for example, that might have led to a higher-than-normal sales price.

Although the transparency of information in the real estate industry is gradually improving, much of that improvement shows up in the single-family home market and—at the other end of the spectrum—properties that are large enough to be attractive to institutional investors. These larger properties are rarely the right fit for those just starting out. Smaller properties will simply require more detective work.

After you've found a promising prospect, be prepared to do a detailed inspection and analysis before you sign a binding purchase and sales (P&S) agreement. If you've purchased a home, you're familiar with the basics here. But most likely, as the stakes are higher and the buildings more complex in a commercial transaction, a higher level of diligence is in order. Make sure you have adequate time between the signing of your P&S agreement and the closing date to arrange for your financing. (Your lender needs processing time.) In some cases, you might make your offer contingent on your obtaining that financing. This may be a negative to the seller, but it is something to consider.

At this stage of your career, if you do not have much cash, you may attempt to limit the amount of your deposit. The seller may take the opposite view, looking at the size of your deposit as evidence of your commitment to the deal. Be careful how you negotiate, especially in a competitive market. The amount of deposit you're willing to put down may determine whether you get the deal.

Lawyers and Other Resources

The P&S and other legal agreements raise the issue of the selection and role of real estate lawyers.

Some real estate professionals believe that signing a P&S confirming the acceptance of your offer to purchase is standard, and therefore doesn't require the services of an attorney. But generally speaking, because *you don't know what you don't know,* that's not true.

What happens if you don't get your financing, or you find major structural problems in the property? Under what circumstances can you cancel the deal and get your deposit back? Is there a time frame within which you can raise certain objections, such as the physical condition of the property? It's important to spell out these and all other conditions in the P&S.

After the P&S is signed, your attorney will help you navigate the next stages of your due diligence process: assessing the condition of the land and the property; examining the terms and conditions of existing leases; confirming compliance with zoning, environmental, and other code restrictions; checking the validity of the owner's title; investigating options for financing; and forming the legal entity that will own the property.[3]

In short, you will need a lot of help from real estate attorneys, who represent a separate, specialized breed within the legal profession. The key here, as with brokers, is to find the one who *fits your needs.* The person within the firm who actually will do much of your work is much more important to you than the partner who brought in your business. Again, don't be afraid to ask for references.

A good lawyer knows the difference between providing *legal* advice and providing *business* advice—although if you're just starting out, you may need some of both. He or she will know which points are important to negotiate, and which ones are unlikely to be an issue in purchase and sales agreements, tenant leases, loan documents, and other contracts. If you are working with a junior attorney in a larger firm—as is often the case when you're starting out—make sure your attorney is not spending your time and money to impress the senior partners by preparing the "perfect" legal brief. (There's no such thing, and you probably don't need it.) Most agreements are variations upon forms that may already be in your attorney's computers, although you can get in a lot of trouble if you and your attorney don't understand the nuances.

Over time, you'll find that from deal to deal, many of the same legal points come up again and again. You will still need your attorney, but you eventually should be able to do much of your negotiating with tenants and contractors yourself.

For really important matters, I often find that it is more cost-efficient to pay the higher hourly fees for an experienced, busy attorney than to work with one who, like you, is just starting out. Remember, however, that these experienced people are in great demand and might not always be willing or able to perform according to your timetable.

Although you occasionally will need to hire attorneys with special skills in areas such as zoning or property tax appeals, your relationship with your prime attorney is well worth cultivating. Besides, like a good family doctor, your prime attorney will know what specialists to send you to. In my own case, in almost 50 years of practice, I have had four prime real estate attorneys. The only reason I ever changed attorneys was because that individual 1) got seriously ill, 2) became a judge, or 3) moved out of town.

As a sidebar, one of the major roles of your attorney is to keep you from needing the court system to resolve disputes. Even when I've been proven right by the legal system, I have generally found the process to be very expensive and unpleasant, both in terms of money and lost time.

I've talked at some length about real estate attorneys, in part because they're inherently valuable to your real estate career, but also because if you understand how to think about them, you'll know how to deal with a host of other professionals who can be similarly helpful. You probably can't afford the overhead of having your own in-house architects, contractors, mortgage brokers, or leasing agents. You will have to go through a similar selection process to find them as you did selecting a lawyer. Don't hesitate to ask for references and, if applicable, to see examples of their work. You'll pay more for experience, and sometimes it's well worth that premium. Keep in mind that the right person for your last project might not be the right person for the next one.

Finding the Money

Money has several aspects.

First, be prepared to *save and reinvest the money you make.* You need to deny yourself in the short term to make good in the long term.

But deferred gratification alone is almost never enough. Much of your wealth accumulation will be illiquid. (In other words, it can't easily be converted into cash.) You need to find other ways to make the money equation work. You want to maximize the value of not only your time and energy, but also of your own limited pocket book.

In most cases, you'll need to get a bank or some other lender to buy into your plan. Real estate is increasingly a numbers game, but some banks still bet on individuals. Similarly, individuals whom you approach to put up equity money are more apt to be betting on *you* personally. Behind the numbers, in other words, it's still a people game. As a Huntsville, Alabama-based developer recently put it, "When you are starting out with little money, trust is your currency." That holds at all stages of your career. Lose trust, and you are in trouble.

Once you get hold of someone else's money, you have to dole it out like hen's teeth. Why? First, it's embarrassing and problematic to run out of money. In addition, every time you go back to the well, you will 1) decrease your own control over the project, and 2) underscore in the minds of your partners that your projections weren't accurate. (No matter how good the excuse, there is no substitute for success.) You also may have to considerably reduce your equity stake to bring in new money, which means that you're going in exactly the wrong direction.

Basically, you have to have *adequate financing at an acceptable cost.* Without it, you can't get started. Most likely, you have only limited cash of your own, and you need other people's money. But this isn't always possible. There are times when capital is readily available, and other times when—no matter how good your idea might be—the financial spigot is turned off.

Despite overall consolidation in the financial services industry, there are still multiple sources of capital out there. Mortgage brokers can help you figure out which lenders are most active in the market at this particular time, and for your particular type of property. Keep in mind that the cheapest money is not always the best. The timing of the repayment, the security you have to put up, or the amount of the loan may be more important to you than the interest rate. Also, if you get in trouble, having a relationship with an experienced lender—who may give you time to work out your problems—may pay off in a big way.[4]

Managing the liability side of your balance sheet is a theme we return to repeatedly as we consider the arc of a career in real estate. After all, this is a capital-intensive industry, in which most of the cost is borrowed. As a result, more than half of your rental income is apt to go to your lender. The amount you borrow, the interest rate, and the terms for repayment (that is, the principal payments) are the major determinants of your cash flow. It's all too easy to focus primarily on the *asset* side: that is, the price we pay for the property. But almost equally important is the *liability* side: that is, how we finance it, and at what cost.

Risk and Reward

I don't want to conclude this chapter without mentioning *risk*.

Risk in real estate is real. However, you can learn to manage many of the risks you will face. As a matter of fact, if you ask entrepreneurs in any industry, most will say they are risk averse. They are able to get others to share the risks and thus minimize their own exposure. We examine how they do so in more detail in later chapters.

So the risks are real, but so are the rewards. Real estate can be a great field—the best of all fields, as almost any real estate entrepreneur will tell you. (Today, you won't hear many doctors or lawyers saying the same thing about *their* fields.) Real estate can be rewarding not just from a creative or financial standpoint, but also from a personal standpoint: You will meet and interact with many fascinating people.

It can also be rewarding from a social, even societal, standpoint: You can reshape the physical fabric of a community. Not all entrepreneurs are motivated primarily by the prospect of financial gain—many like *building,* and later, *seeing what they've built.*

With this picture of risk and reward in mind, you have to decide if this is the field for *you.* Think about what you've read so far. This is a field with a lot of moving parts. To balance and manage all these parts requires a great deal of patience, persistence, and skill. You never know for sure when to pull the trigger and actually commit to go ahead on your first deal. If it works, you'll never really know whether you were smart or just lucky—in the right place at the right time.

If your first deal turns out to be something other than the great success you had hoped for, do you change course and focus on your day job? Or, do you regroup and decide that you have learned from your first real estate experience and have made contacts and relationships that will help you get it right the second time? (Most entrepreneurs don't get it right the first time.) When do you jump out of your day job nest and start your own business? Have you built a reputation where people trust you and are willing to do business with you? Again, there are no easy or right or wrong answers.

Maybe the bottom-line question is this: *Have you caught the bug?* Has real estate gotten under your skin and made any other career choice look dull and unappealing? If so, it's highly unlikely that you'll stop now. Instead, you're likely to start thinking about scaling up: The subject of Part II of this book.

But first, let's meet some people who are just starting out. Let's see how they gain experience, establish good work habits, take the plunge, and do their first deal.

Endnotes

[1] The *capitalization* or *"cap rate"* is the ratio of the projected annual cash return to the estimated project cost or valuation. The cash return is calculated before deductions for financing costs, capital expenditures and income taxes. It may be based on a current, prior, or stabilized year.

[2] As an example of how leverage works, if you buy a property for $1 million that throws off an operating cash flow of $100,000, your return on assets or cap rate is

10 percent. As long as the interest rate is less than 10 percent, you have positive leverage, and the more you borrow, the higher the return on your equity. Conversely, if the interest rate is more than 10 percent, you have negative leverage, and your return is reduced by the differential. The repayment schedule also enters into the equation. If the combination of interest and principal payments exceeds 10 percent, your cash flow will be reduced. It might be more important to you to pay down the principal on your mortgage quickly, or you might prefer the greater cash flow with a longer amortization period.

[3] To limit your personal liability, you may want to set up a corporation to serve as the general partner of the new entity.

[4] You may not have that opportunity, given that so many mortgages today are packaged and resold as part of a larger portfolio. If a problem occurs, the trustee may have limited authority to make a special arrangement for an individual borrower. We have seen that in the recent collapse of the subprime loan market.

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