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Demand Grows for Properties Requiring Little Management

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Property investors are increasingly eager to get their hands on real estate they can pretty much ignore.

Demand is strong for single-tenant net-lease properties, which are office buildings, warehouses or retail properties occupied by one tenant that is responsible for expenses, including taxes, insurance and maintenance, and almost everything else.

Investors find net-lease properties desirable because they don't require hands-on, day-to-day management. What's more, the tenant usually holds a long-term lease -- sometimes 30 years -- which gives investors the impression that income can be counted on for years.

But there's "leasing risk in the fact that the tenant can go belly up," says Whitney Peyton, a senior managing director in the Minneapolis office of CB Richard Ellis, a Los Angeles-based real-estate services firm. "That's the downside. When you go vacant, you go 100% vacant."

Individuals can invest in net-lease properties by either buying a property on one's own or forming a partnership with one or more investors and purchasing it jointly. A third option is buying a fractional interest in the property through what is known as a tenant-in-common program. That option allows investors to get in on more costly properties. A tenant-in-common program is a form of 1031 exchanges, transactions in which an investor sells a property and replaces it with a like-kind property to defer capital-gains taxes.

There are two basic types of single-tenant net-lease properties. Triple net-lease properties are ones in which the tenant -- the lessee -- pays rent to the owner, as well as all taxes, insurance and maintenance expenses. Double net-lease properties are those in which the tenant pays rent to the landlord, as well as all taxes and insurance expenses that arise from the use of the property. But the owner pays maintenance expenses.

Among the most common net-lease properties: auto-parts stores, video stores, drugstores and restaurants. Auto-parts and video stores generally cost between $600,000 and $1.5 million, while restaurants can range from $750,000 to $2.25 million, according to Bernard Haddigan, national director of Marcus & Millichap Real Estate Investment Brokerage Co.'s national retail group. Drugstores can cost between $3 million and $7 million, says Mr. Haddigan, who is based in the Atlanta office of the Encino, Calif., firm. Properties with tenants that have good credit ratings have prices toward the higher ends of those ranges, he says.

Though management of net-lease properties is hands-off, investing in such real estate requires some homework. Investors should analyze the tenant's financials. That's easy if a company is public, but it's a lot harder with a private company. "You can make a request, and maybe 50% of the time a private company will share that information," says

Tom Powers, a senior vice president in the Cincinnati office of Colliers Turley Martin Tucker, a real-estate services firm based in St. Louis. "That's why investors would rather buy a net-lease property with a tenant whose financials are public." He recommends talking with companies' financial officers and operations heads as well.

It's also important for investors to learn about the tenant's business plan. "If I were a small investor, I'd want to learn more about [the tenant's] business," he says. "Are they expanding or contracting? Do they have 50 clients or just two they are relying on?"

Brokers say investors should physically inspect the building, looking at everything from whether the roof is in good shape to whether the parking lot needs repaving to the condition of the building's heating and cooling system.

In addition, investors should lean toward general-purpose buildings, as opposed to special-purpose buildings, brokers say. General-purpose buildings can accommodate all manner of tenants so that, in the event a tenant leaves, a new tenant can move right in without having to reconfigure the entire building.

"Keep in mind: What if the tenant failed?" says Rick Putprush, vice president of the financial services group in the Boston office of Grubb & Ellis Co., a Northbrook, Ill., real-estate services firm. "Is [the property] easily leasable or is it readaptable to a better use?"

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