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Strategizing A Real Estate Purchase

by Clifford A. Hockley

Dr. Joanna Flores is a successful medical practitioner. After 10 years in the business she is tired of paying commercial rent and wants to purchase a building for her practice and share it with a group of other doctors.

She is nervous. She knows nothing about real estate and does not want to make any money-losing mistakes. One of her clients, a real estate broker, mentioned to her that he offered a basic "introduction to owning real estate" class. She decided to attend the class; this is what she learned.

She discovered how to obtain comparable sales information as well as income and expense information. This information helped her get over her concern that a property could keep demanding cash from her. She found out that parking and handicapped access are important features for a medical building. In addition she learned about property inspections to ensure that the building was in good condition. She also learned about the virtues of location. Good location may cost more, but it will be easier to lease to potential tenants.

She had questions about property management and was told that in a smaller building (maybe under 7000 sq. ft.) her staff could probably handle the management themselves, but with a large building she might want some help from a professional management company. Outside management would guarantee that someone is available to take care of her tenants 24 hours a day 7 days a week, and would also provide assistance in finding new tenants in the event of tenant turnover. As most landlords don't like asking their tenants for rent, the management company additionally makes sure rent is collected, mortgages and other bills are paid, and monthly financial reports are prepared.

As part of the real estate class, the broker also outlined different partnership styles: Limited Liability Companies, Limited Liability Partnerships, Partnerships, Subchapter S Corporations, and Tenancies In Common. These were options she might want to consider as she approached friends and other doctors to share in the investment of a building. He suggested that she meet with her attorney and CPA to get a handle on any potential taxation or tax shelter issues.

Joanna was getting excited about the idea. She wanted to know if they could start looking for a building immediately. The broker cautioned her that she needed to consider an exit strategy before she purchased a building. He told her nothing lasts forever, and that she should have a long-range vision. He added that she ought to know why she was buying the building and what she wanted to do with the cash residual once she sold it. He also mentioned that she should look at a



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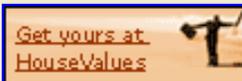
Video Showcase Of Homes

Mortgage Rates

30 Year Fixed: 5.38%
 15 Year Fixed: 4.69%
 1 Year Adj: 3.39%

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5-10 year window of time and make some realistic assumptions. He asked her to consider whether she would want a bigger building, or if she wanted to pay it off and lease it to another doctor for retirement income. He also offered that perhaps she will want to sell it so she can trade the equity into a duplex at the coast when she retires, or maybe she could trade the equity into another building, see it grow in value, and potentially provide some cash flow income.

They also discussed the nitty gritty: where the financing was going to come from to help her buy the building. They reviewed interest rates, term of loan, loan fees, and closing costs. He encouraged her to talk to her banker, but to also look into SBA (Small Business Administration) loans. He also suggested meeting with at least two or three other mortgage bankers to see if they could offer a better deal such as a lower (or no) prepayment penalties, higher or lower down payments, no required environmental inspections, or maybe no fees at all.

Finally they discussed the tax implications of her purchase, including the 39.5 years of depreciation and capital gains taxes (state and federal) she would be subject to when she sold the property if she did not use a (tax deferred) 1031 exchange to trade up to another property. They also talked about insurance to pay the mortgage should something happen to her, and estate planning should she want to leave the building to her children, or her favorite nieces and nephews.

By the end of the presentation, her head was spinning. "This is too complicated," she complained, "maybe I should just continue leasing." The real estate agent said, "You need to be educated in order to make the right decisions, and buying real estate where you are the tenant is the best way to not only pay off a building, but to also invest in your retirement at the same time."

Epilogue

Joanna bought a building. Because she used more than half of the building for her practice, she qualified for a SBA loan which she obtained through her personal banker. Ten years later she sold her practice, but not the building, and used the revenues from both to fund most of her retirement.

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