access investment opportunities; and the wherewithal to commit a large amount of capital into a single investment. Until now.

Why Read this Book?

• This e-book is the culmination of nearly 20 years of experience in office, industrial, retail, multi-family and development transactions. The ebook is designed as a follow-up to Commercial Real Estate Investing 101 and will cover the following topics:
  • What factors affect real estate values?
  • How do I value commercial real estate?
  • How do I run a simple cash flow analysis? (Computing the Net Operating Income)
  • What is a capitalization rate and how is that determined?
  • How do I determine if the asset is located in a quality location?
  • What should I be looking for in a quality real estate operator?

RealCrowd
www.realcrowd.com   invest@realcrowd.com

Start With Risk
CRE 201: The Valuation Series
How do you compare multiple commercial real estate opportunities to decide where to allocate your investment capital? *The Valuation Series*, a multiple ebook series, is going to teach you the art of analyzing commercial real estate opportunities in order to make the decisions that are right for you.

**After Completion Of The Valuation Series You Will Know:**

- The Start with Risk Approach
- The Different Investment Styles
- Cash Flow Analysis
- Market Analysis
- Reading Financial Models
- How to do a Quick Snapshot Analysis
- How to use the RealCrowd Platform
Introduction

RealCrowd is growing and soon our online platform is going to be filled with commercial real estate opportunities from all around the globe. It’s exciting to be bringing investors this level of access to build not just a portfolio, but your own empire.

We understand that because this industry hasn’t before opened itself up to the benefits of technology, you’ve been locked out. It’s not your fault, but because you haven’t had access, investing in commercial real estate may be a bit foreign to you. This first ebook in The Valuation Series can be scary topic, risk, but it’s important to know and understand the risks of investing and how to protect your account before we get into how to effectively value commercial real estate opportunities.
What is your investment style? The advantage of picking an investment style is focus. Once an investor finds a style that is right, the investor can focus on developing skill at identifying opportunities for that style. At RealCrowd our mission is to give investors the tools they need to build successful commercial real estate portfolios by first helping the investor discover their style and then developing skill. Start With Risk is going teach you how find the right investment style that meets your needs.

To help you discover your investment style, we must tackle a fundamental flaw in the world of investing; too often investors focus on profit potential in lieu of risk.

**It Starts With Risk**

Have you ever read an investment letter and noticed the fine print at the bottom that reads something like this, “Investment opportunities are risky, you may lose all of your investment?” Maybe it’s just us at RealCrowd, but we think this kind of information should be at the top and read like this "**INVESTMENTS ARE RISKY.**"

We are all naturally competitive. We all like to win and we all hate losing. Not only do we like to win but we are optimistic in the face of defeat. We carry the belief that we will eventually come out on top. The problem is that this competitive psyche permeates our investing strategy as well. It's natural to hope for a positive outcome in the midst of turmoil. To this end, we believe all our investments are going to eventually win and over-extend our capital based on hope and not realities of risk.

Any investment that doesn’t start with understanding risk is a bad investment whether it turns a profit or not. The goal of every investment is to make money, but the initialization of an investment decision should never be based solely on profit potential. **An investment decision must be based on understanding the risk.**

An investment decision must Start With Risk.
The Professional Approach

Commercial real estate investing like a professional requires a long term approach. The investor should make investment decisions under the assumption that investment capital is limited and above all else must be protected. This is the start with risk approach. This approach separates the professional from the novice.

If all your investment capital is spread between two investments, then the failure of one of those investments will be a 50% hit. Ouch! Say instead, you had your investment capital spread between 10 investments, the failure of one of those investments is only a 10% loss. Between those two scenarios, which risk appears more tolerable?

This spreading of capital amongst multiple investments is called DIVERSIFICATION. Diversification is the investor’s safe guard and it’s the reason why the investor will be able sustain a low probability, high impact event, as well as catch profitable moves.

Until now, diversifying in institutional quality commercial real estate has been nearly impossible for the individual investor. Unless you are of an ultra high net worth, there is no feasible way you could invest $250k+ in one investment. It is for this reason you’ve been cut out from commercial real estate opportunities.

RealCrowd, backed by the power of our large investor base and industry connections, has removed this barrier of entry for you. RealCrowd gives the individual investor access to commercial real estate by creating investable units as low as $10k per unit. This low cost of entry allows the investor to build wealth around commercial real estate like never before. Instead of putting $250k in one building, you now have the ability to put $10k in 25 institutional quality commercial real estate investments where you see fit.

The next step after implementing sound investment fundamentals is to choose your investment style. A style lean is how you will build your portfolio. Will it be an aggressive lean with more risk intensive investments? Or will it have a conservative lean with one or two higher risk investments? To discover your style lean, once again we start with risk.
Core Investments

Core Investments are lower risk and lower reward opportunities. Core Investments are buildings that don’t require any value add and have stable tenants. Core Investments are all about earning income from the cash flow derived from tenants paying rent. A benefit of a core investment is the degree of predictability and the lack of correlation with the overall stock market. Core Investments can both be a foundational strategy and a method for balancing out a portfolio that has a high risk lean.

Example: A building that houses a stable tenant like Starbucks. From all appearances the tenant runs a solid business and will lease the space for the foreseeable future with virtually no need for building improvements.

Core Identifier:

- Located in major markets
- Low Vacancy Rates
- High Employment
- Stable Tenants
- Staggered Lease Expirations
- Low use of leverage
- Potential Annual Cash Returns: 3-7%
Core Plus Investments

Core Plus has a moderate risk profile attached to it. The difference between a core and core plus strategy is that there is some element of a value add in core plus. Adding value increases risk because it taxes capital to enhance a building. There will always be a risk that the added value doesn’t correlate to an increase in rent or a higher sale price.

Example: Very similar to core but let’s say that this time Starbucks want’s new carpeting and counters or else they will let the lease expire in 4 years. The value add slightly increases risk but also increases reward potential.

**Core Plus Identifier:**

- Located in Major Markets
- Low Vacancy Rates
- High Employment
- Stable Tenants
- Spread out leases
- **Income Derived From Ability To Raise Rent Through Value Add**
- Low to Moderate Annual Cash Return: 6-10%
**Value Add Investments**

Value Add are higher risk and higher reward investments. Value Add are commercial real estate properties where the strategy for turning a profit is improving the building and then selling it when the time is right. This is an appreciation play.

Example: Converting a vacant rundown restaurant into a modern open floor space that attracts a higher paying tenants and increases the sale value of the property.

**Value Add Identifier:**

- A rundown building in a major market with rising market rents
- Undervalued market or undervalued within the market
- Lease Up
- Required Physical Enhancements
- Higher Use of Leverage
- Low Vacancy Rates
- Profit dependent upon response to enhancements
- Potential Reward Typically: 10-16% annually
Opportunistic Investments

Opportunistic Investments are the highest risk and reward investment style. These are opportunities that either require major enhancements, development or land prospecting. Finding these “diamond in the rough” opportunities takes skill and an understanding of the surrounding market. Correctly projecting the costs of the major enhancements and the markets response to the enhancements is vital.

Example: Converting a vacant school into a movie theater. The extreme cost could reap major rewards but also has a higher probability of a loss.

**Opportunistic Identifier:**

- Major Enhancements needed
- Higher Use of Leverage
- Low/Falling Vacancy Rates
- Often Relies on appreciation for returns
- Potential Reward Typically: 16% - 25%+
**Risk Factors**

Understanding the risks you will be exposed to as a commercial real estate investor is vital to the investment selection process. Once you know the risks you can compare opportunities and determine if one property is more or less exposed to those risks. Through the analysis you will learn as we continue with *The Valuation Series* we will teach you how to limit your exposure to the following risks.

**TENANTS**

For the investor, income usually comes from the tenants’ rental payments.

Commercial Real Estate is an industry that relies on revenue from tenants. At the end of the year, the income sheet is going to show either a profit or loss. The difference will be determined by how much tenants are paying in relation to operating expenses. If tenants are paying more than the operating costs, the property is profitable. If tenants are paying less than the operating expenses, the property is losing money.

The less stable a tenants business, the more risk there is associated with that income. A tenant in an office building could have a failing business and file for bankruptcy, thereby not being required to pay the rest of the lease. If the property is an area with a high vacancy rate, the space may have trouble leasing up.

**MARKET ILLIQUIDITY**

Commercial Real Estate is a buy and hold proposition where the liquidity is tied to the sale of an asset. If an investment is losing money and the market dries up, it may prove tough to exit and the sale price may be significantly lower than the purchase price.

**TAXES**

Federal and state income taxes vary according to each individual investor, leaving some investor’s with greater tax liability. Income taxes can change, increasing or decreasing tax liability. Additionally, different deal structures also have different tax consequences. It is always in the best interest of an investor to consult a tax advisor prior to investing in commercial real estate.

**COMPETITION**

The property you own isn’t the only property trying to earn a profit. The competition of the market can drive rent prices down and even take away potential tenants.

**OPERATING COSTS**

Operating costs can increase due to repairs, renovation, insurance and other costs associated with operations. It is not always possible to raise rent to cover extra costs.

**MARKET RENT**

The value of market rent can vary in the area of your property. If your property is reaching for above market rents expect to lose tenants or lower rent which will lower revenue.
LEVERAGE

Leverage adds risk for the same reason it increases reward. The capital the investor puts down is amplified by the loan from the bank by as much as 10 to 1. This means that if property value increases the total investment is amplified by 10 times and if property value decreases its amplified by 10 times, potentially leading to a total loss.

BAD BUSINESS PARTNERS

If you haven’t been burned by a bad business partner, you likely know someone who has. Commercial Real Estate is just as likely to have business partners who aren’t looking out for your interests as any other industry. This is a real risk.

Choosing Your Style

Each style has a different risk profile attached to it, but its important to note that risk can be managed to a degree in all investment styles. Choosing the right investment style lean for you isn’t a matter of the ability to utilize risk management, but to identify your own personal risk tolerance. That is, how much risk can you personally take on before it affects your quality of life?

Assume the worst, assume you lose your entire investment. How much are you ok with losing? If your risk tolerance is low then your primary investment strategy should reflect a low risk strategy. If you have a higher risk tolerance level you may find that your style lean is more in line with a higher risk strategy.

There is no blanket right answer for risk tolerance, every investor handles risk a bit differently.

In commercial real estate, low risk strategies are typically attached to a lower reward, and high risk strategies, a higher reward. If the investor were to pick a strategy based on reward, investors would naturally gravitate towards high reward strategies with no respect for the inherent risk. The Start With Risk approach is key to finding the right strategy for you. **Start with risk and the reward will take care of itself.**
Analyzing Multiple Opportunities

Once you pick your style lean how do you further filter the investments that are right for you? For instance if you had 10 core plus investments to pick from which one do you select? This selection process starts with risk and ends with the skill of analyzing property value. Analyzing value requires a process that includes: market analysis, cash flow analysis and projection analysis. Analyzing property valuation is a heavy topic, but don’t worry, we are going to break it down for you in our next ebook in The Valuation Series.

At RealCrowd, we believe that real access doesn't come without real education.