

How To Get The Highest Possible Rents With No Vacancies

By Willard Michlin-CPA

Having a vacancy, producing no income, is very much like an hour of your life. Once it is gone you can never recover it.

These are wise words that were told to me by Michael Davidson, in 1981, over lunch, in a Persian restaurant on Westwood Boulevard. Let me tell you about Michael. In Iran, while the Shah was still alive, he was one of the biggest and richest landlords in Terain. He owned office building with thousands of tenants. He estimated in 1981 year that he had real estate worth over \$1 Billion still sitting back home that he could not touch. To try and claim his wealth would gain him a free vacation in an Iranian prison for committing two unforgivable crimes. First he was Jewish and the second was that he had wealth the government did not want him transferring out of the county.

I tell you this so that you will appreciate the value of what he taught me that day, and to acknowledge the wisdom of this man. Michael owned a piece of vacant land in Camarillo that he wanted to build a commercial building on. He was asking my assistance in getting this property developed and income producing. Because of the economic climate, he was going to be able to develop the property very economically. The economy was going into the dumps, very much like it is doing today. I was worried that he would not be able to rent the property for the \$1.00 per foot that was being asked, all over town. He was not at all concerned. His attitude was that if he had to rent the space at 50 cents a foot, then so be it. If a quarter was all he could get then a quarter it would be. He of course would not sign a long-term lease at 50 cents but only short 1-year leases or just month-to-month agreements. When the economic times improved he would then get his \$1.00 per foot. Until that day came he would not settle for having a vacant space.

I listened to what Michael had to say and responded with. "Of course! Doesn't everyone understand that?" He responded with "No." I was shocked. I thought that any landlord would rather have 50 cents a foot rent rather than zip-zero a foot. Boy, was I young and stupid. Michael explained that all of the leasing agents in Camarillo were still asking the \$1.00 per square foot rent and their buildings were sitting empty. They did not want to lower the rent to make a deal. I couldn't make sense as to why people would take that approach and I still find it fascinating.

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Lets move forward 27 years to 2008. I have now been a real estate also doing business brokering for 20 years, watching commercial rents go up to astronomical rents that the business tenants cannot afford to pay. The economic crash drives down the gross income of most small retail businesses 30%. The business owners find their rents becoming 15-25% of their gross sales. A business cannot survive paying that amount of rent. Some business owners started closing down. Others try to hold out for better times. I was asked by many business owners to talk to their landlords about rent relief so that they could stay in business. I of course thought, that would be the correct action for everyone concerned. Boy, was I wrong, and Michael right. I met with over ten property management companies and some were owners of vast commercial spaces. All but one would not lower the rent even five cents. "If the tenant does not pay the rent, I will evict them," they bellowed at me. I argued that the vacancy rate was going up and who in his or her right mind was going to start a new business while everyone was going broke. I further argued that if they lost a paying tenant, then probably they would have an empty space for a long time. The property management firms did not give a hoot. The property owners were worried that if they gave one tenant a break that all of them would come asking for a rent reduction. They also were worried that the building lenders would demand a principal loan reduced since the rental value of the building had gone down. The building owners explained to me that they could afford up to a 7% vacancy but could not have the rental rates go down, because the lenders would become a problem for them. This is what we all know as sitting between a rock and a hard spot.

We will not discuss how the property owners handled this problem in this article. That is another story for another time. The interesting piece of information for me was that they were more afraid of the market rents going down then having a large amount of vacant space. Michael Davidson was correct. These landlords would not lower their rents to their existing tenants and until 2010 they didn't offer lower rents to new tenants.

Currently some types of commercial space are beginning to rent slowly. The landlords can now take vacant non-producing space and get some income from it. My position is that if they would of lowered the rent to the tenants and saved them from closing down, that they would of kept the tenant in business paying half the rent, but at least it would not of been zero rent.

My father ownz a commercial storefront building in the East Los Angeles- Whittier corridor. It is not the best location but it is on a major street. We currently have it rented to a real estate company that started falling on hard time in 2007. The tenant couldn't pay the rent every month, but he could pay the rent when a real estate deal closed, which is what he has been doing for three years. If we were to throw him out, would we have people standing in line to

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rent the space? No, we would have a vacant building, waiting and hoping for the perfect tenant willing to pay the old market rents.

As my son would say, "Dad, you're dreaming." We have had that space rented at high rents and low rents but we always work hard to keep it rented. The fact that we have no loan on the property, of course, allows us the flexibility to do that and not have a bank threatening to foreclose on us.

I manage a beautiful building in West Los Angeles-around Veteran and Santa Monica Boulevard that I built 20 years ago. Because I am always willing to settle for the maximum rent the market will pay me, and not a penny less, my building stays fully rented. I had two vacancies in the 4th quarter of 2009 and had both rented on the day the old tenants moved out. The penthouse rent had to be lowered from \$2,850 to \$2,400 but the other unit I rented for the same \$2,400, which was identical to the amount, the leaving tenant was paying- top market rent. Those two units were the only turnover I have had in the last 3 years. In 2009, the tenants were tell me that the number of "For Rent" signs on my street had increased many folds and they were at one point threatening to move out on me. None did, because a few small concessions, and I mean small, kept them in my building happily paying rent.

I lowered the rent for two by 4% and a few others I cleaned the carpets and/or did some painting. Life is not simple but there are solutions to all problems, if you look for them.

A bird in the hand may or may not be better than a bird in the bush, but a bird in the hand is always better then not having a bush to have a bird in.

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