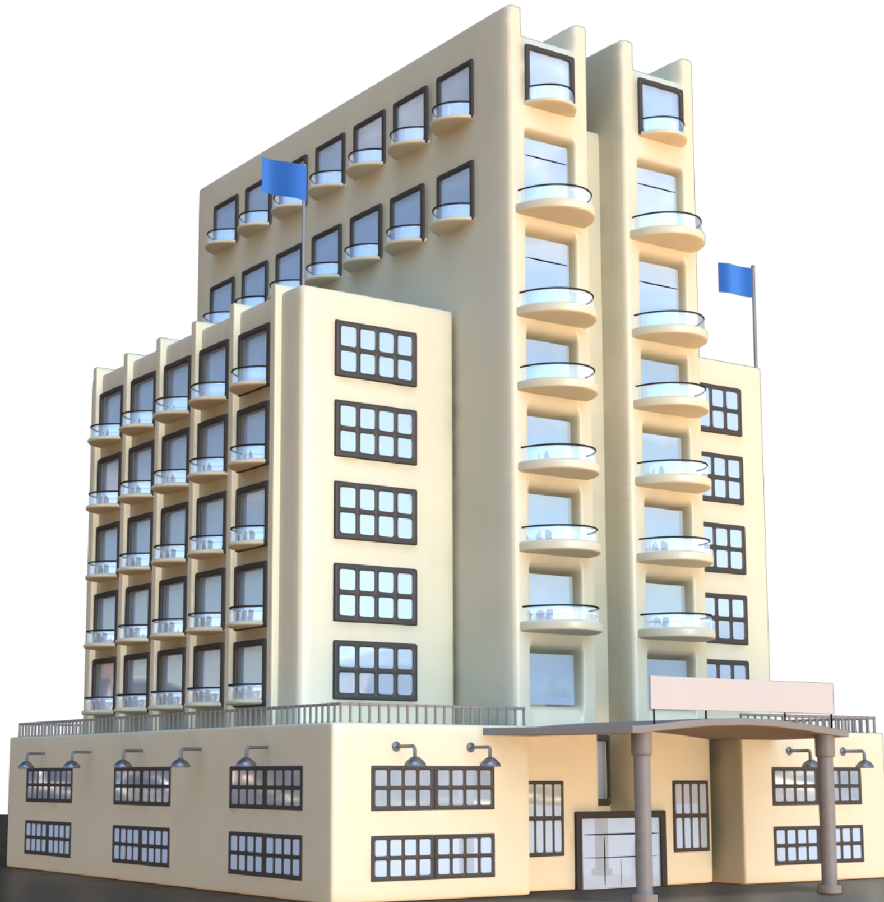

The 7 Steps to Finding & Funding the Lucrative Commercial Deal

THE Lee Arnold SYSTEM OF REAL ESTATE INVESTING

MONEY

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7 Steps to Finding and Funding the Lucrative Commercial Deal

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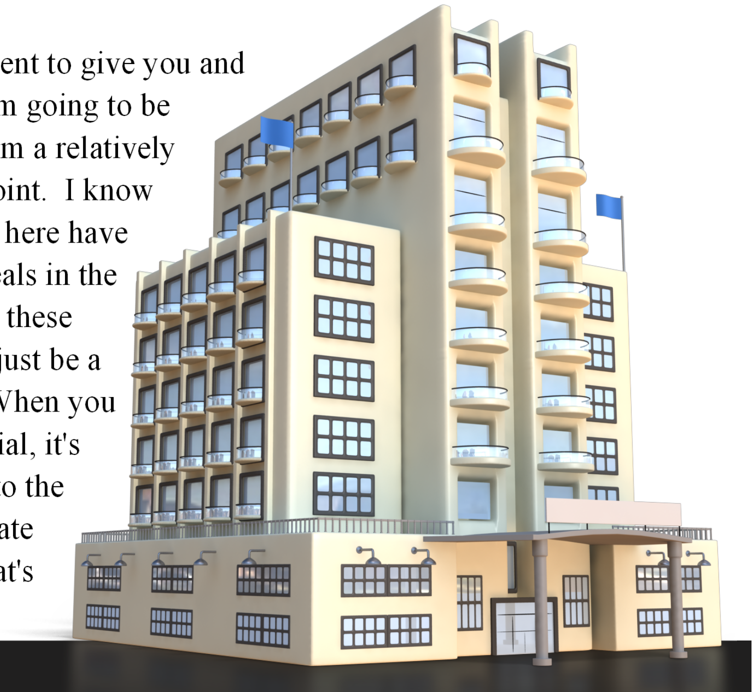
OPPORTUNITY

> Introduction: What is Commercial Real Estate?

I don't endorse commercial investing for new investors. We encounter on occasion, people who have recently gone to a seminar or an event of some kind which is recommending commercial investment. Now, I don't want to steal dreams here, but if you're not working with a team of individuals and you're going it alone, I would highly recommend that, you either begin with a single family home or a duplex. That way you can get comfortable with managing property and tenants. It really is an art as well as a science, and I want to make sure that you have that before you get too deep into what's going on.

I've got a lot of content to give you and just so you know, I'm going to be approaching this from a relatively rudimentary standpoint. I know that some of you on here have done commercial deals in the past, so on some of these points, it's going to just be a reminder for you. When you talk about commercial, it's very easy to take it to the graduate and doctorate degree level, and that's



not where everybody's at. In an effort to make sure that I'm hitting everyone with value, we're going to start at kind of the beginning and take you through commercial investing A through Z at least as much as we can in the next 75 minutes.

Let's begin with the beginning. What is commercial real estate? The term commercial property also called, investment or income property, refers to buildings or land intended to generate a profit, either from capital gain or rental income. Some examples of this would be office buildings, industrial property, retail and or/ restaurant facilities, and multifamily buildings of five or more units. Commercial real estate also includes hotel, hospitality, medical facilities and self-storage developments. That is not an exhaustive list, but those are just of the more common ones.

Why should you invest in commercial real estate?

If you do it right, it can:

1. Produce substantial, and in some cases, a more stable cash flow since the leases can be typically longer.
2. Depending on the type of commercial deal that you're working with, if it's not multifamily or residential use, you're typically dealing with more educated, more affluent

tenants. Because they're running businesses, they understand profit and loss. Now, again, I'm making a blanket statement here because I'm sure that if you have invested in a commercial, like I have, you may have a horror story to tell. However in my experience, the commercial space often yields a better tenant than the residential space.

3. It's has beneficial economies of scale.
4. It's a relatively open playing field, there's less competition,
5. There are affordable property managers and there are bigger payoffs at the sale.

Now, let me qualify some things here. When I say beneficial economies of scale, what I'm referring to is does it make more sense, or is it easier to:

A: Manage 100 single-family properties spread out throughout a market

Or is it easier to

B. Manage one 100-unit building all in one location?

Of course, the answer is B. It's easier to manage a 100-unit building because you've got 100 units all in one location. You've elimi-

> Introduction: What is Commercial Real Estate?

nated drive time and you can actually hire full-time property managers that live onsite, which is very difficult to do when you've got 100 single family homes spread out around the country. Warren Buffet once said, which kind of started the whole hedge fund acquisition of residential real estate boom, "If I had the resources and the infrastructure, I would be buying up single family homes in the thousands." What his statement is really saying is it's a tremendous investment, but he also understood the economics of having to manage properties in multiple locations, in multiple cities, and multiple states—it’s a lot of work. There just aren't enough, in my opinion, competent property managers to do it at that scale. Although hedge funds are doing it and pulling it off, they aren't doing it without some measurable level of severe heartburn and headaches. So, remember, that although residential is great, having one commercial cash-flowing unit can be **REALLY GREAT!**

> **"If I had the resources and the infrastructure, I would be buying up single family homes in the thousands."**
>
> **- Warren Buffett**

OPPORTUNITY

> Step 1: Educate Yourself

There are some terms to know in commercial real estate:

Cap rate is a real estate property's cap - or capitalization - rate. It is used to calculate the value of income producing properties. For example, an apartment complex of five units or more, commercial office buildings, and smaller strip malls are all good candidates for a cap rate determination. Cap rates are used to estimate the net present value of future profits or cash flow; the process is also called capitalization of earnings.

Let me simplify that for you!

Take the amount of rental income coming in from the units, regardless of what type of unit or what type of tenant you're dealing with, then take the total income and divide it by your total purchase price, and that gives you your cap rate. The rate of capitalization does not take into account the cost of financing or debt service. Let me give you a simple example. If you've got a piece of property that's bringing in $12,000a year, in your calculator now, I want you take $12,000 per year and then divide by $100,000 (assuming that's what we're going to pay for the property), you get 12%. You have a 12% cap rate or rate of capitalization. Before all of you seasoned investors start giving me all of these nuances about vacancy ratios and cost of money and everything else, please know that's a very simple calculation that people can understand. Let's do it the opposite way. If you're going to buy a million dollar building, and it has an 8 cap rate, I want you guys to tell me what your anticipated rental income is from that structure. You've got a million dollar purchase price and it's got an 8% cap, so in the form of dollars, what kind of money can you anticipate coming in from that property?

It's $80,000. Right now, I'm just looking for a 30,000 foot view so you guys can all understand it.

Net operating Income or the NOI of a commercial real estate property is calculated by valuating the property's first year's gross operating income and then subtracting the operating expenses for the first year. Hint: you want to have a positive NOI, net operating income. After you pay all the bills, you pay the taxes, you pay the insurance, you pay everything, you're still covering your debt service and getting a return on your investment of capital or your investment of time.

Your Cash-on-Cash Return When commercial real estate investors who rely on financing to purchase their properties often adhere to the cash on cash formula to compare first year performance of

> Step 1: Educate Yourself

competing properties. Cash-on-cash takes into account that the investor in question doesn't require 100% cash to buy the property, but also accounts for the fact that the investor will not keep all of the net operating income because he or she must use some of it to make mortgage payments.

To uncover cash-on-cash, real estate investors must determine the amount required to purchase the property, or their initial investment. Let's say it’s a million dollar purchase, we bought this property for a million dollars and it's bringing in $80,000 a year, which makes it an 8% cap rate. Now, I know that I can get financing of $600,000, and that $600,000 in financing is going to cost me, let's say, $36,000 a year. Now, let’s figure out the interest. Take $36,000 and divide it by $600,000, and just from an interest-only standpoint, my cost of money is 6**%.** Now, I'm going to subtract that from my cap. Out of my $80,000, I'm going to take my $36,000 out, which leaves me with $44,000. I'm going to put in $400,000 of my own money. What I'm looking for here is, “what is my cash-on-cash return assuming that the remaining $44,000 is net-net -net, meaning all of my costs have been subtracted from it?” Take $44,000 divide it by $400,000 and my rate of capitalization or cash-on-cash return is 11%.

> Step 1: Educate Yourself

The question you have to ask yourself is, "Do I want to tie up $400,000 for the duration of time that I own this property for an 11% rate of return?"

Understand that there are some types of investments that you want to avoid simply because you've got to have all cash to be playing there.

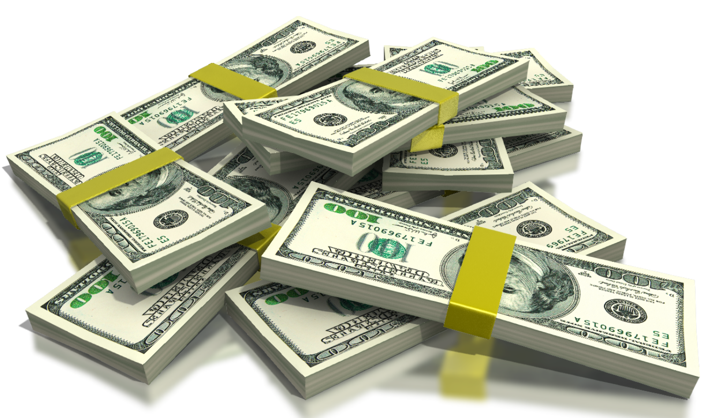
Understand that there are some types of investments that you want to avoid simply because you've got to have all cash to be playing there. You're dealing with rates and with hedge funds that are buying in that space. We're seeing a lot of that in the commercial arena right now on properties that are above $6 million. Anything over $6 million and you're now competing with institutional investors and hedge funds. You're competing with money management firms who are just trying to get a return on their investor's money.

Knowing this, you've got to understand the sweet spot in your market and know who your competitors are. Cash-on-cash return is a very necessary analysis before you move forward. The question is often asked of me, "Lee, what type of real estate are you buying right now?" For me, it's residential, because residential is going up faster than commercial and because there's so much emphasis in

OPPORTUNITY

> Step 1 Educate Yourself

the commercial arena right now. I'm struggling to get a cap rate better than 12 or 15. Some of you might say, "Well Lee, a cap rate of 12 or 15 is pretty good. $100,000 you're going to make $12,000 or $15,000 back." But guys, I've got investments right now in the private money space and in certain funds that we've put together where I'm averaging 20% returns or more. I'm not going to take the same dollar and put it into a 12% cap when right now I'm getting 20%. These are the kinds of analyses that you have to make as it relates to where are you going to invest your hard earned dollars?



MONEY

> Step 2: Determine What You Want & What is Available

In the commercial space, money follows a competent operator more than it follows a good deal.

Where is the building?

What size is the building and lot?

Does it already have tenants?

Is it cash flowing?

What kind of commercial real estate is it?

Is it an apartment or office space?

Is it a customer-oriented space, like a strip mall, a restaurant, or a hotel?

The other thing that I would add here is, does it fit into your particular investment profile? I received a loan application on Friday from an investor that would like to purchase a 65 story, high rise in the heart of Chicago. The asking price on it is $68 million. The projected cap rate is about 8.5%. It's 90% occupied and it has a great cash flow and rental history, but then I look at the borrower's financials, he's making $3,800 a month. Now, I'm not here to steal dreams and I've seen crazier deals happen, but you need to play where you either have the capacity financially, you have the knowledge, or you have the connections and the contacts. I've always said that money follows a good deal. That is 99.9% true in

the residential space. However the saying is tweaked in the commercial arena to, “Money follows competent operators before it follows a good deal.” Write that down, in the commercial space, money follows a competent operator more than it follows a good deal. Again remember, commercial is very rarely about appreciation and depreciation and it's very much about operating income. That's what investors in commercial are looking for. They're not banking so much on the appreciation as much as they're banking on the monthly operating income. To maintain the monthly operating income, you've got to have somebody that can manage it and operate it, who understands profit and loss and contracts. That's who money is going to follow
in relation to commercial.

> Step Three: Narrow Your Search by Looking for Motivated Sellers

Step Three: Narrow Your Search and Look for Motivated Sellers

You need to set the parameters of the deal.

- How much can you afford?
- How much do you want to make?
- ☐ Do you want to rehab to create the highest and best use of the property?
- ☐ Do you have a team of contractors to do it?
- ☐ What are the tax rates, land inventory, and environmental issues?

One of the best ways in my opinion, especially if you haven't done a lot of commercial or you don’t have a lot of operational history, is to go out and find particular pieces of commercial property that have become functionally obsolete for the location that they are in, or have become functionally obsolete for the type of prospective tenant.

I'm going to zero in here on one key strategy that's related to highest and best use. One of the best ways in my opinion, especially if you haven't done a lot of commercial or you don’t have a lot of operational history, is to go out and find particular pieces of commercial property that have become functionally obsolete for the location that they are in, or have become functionally obsolete for the type of prospective tenant.

> Step Three: Narrow Your Search by Looking for Motivated Sellers

Let me give you an example. In an area of North Spokane, which is eastern Washington, there is a big aluminum manufacture by the name of Keiser which has 300 acres of a now shut down aluminum manufacturing facility. A big freeway is being built through there right now and there's a lot of development going on. There's a lot of desire to move into the area, yet they are marketing it to another potential aluminum manufacturer. I'm looking at this piece of property and thinking that is the worst use, even though yes, that's what it was built for, and that's what's currently there, and that's what everybody knows it to be, I think a 1,000 unit apartment complex would be a better fit because of the growth potential. Everything we see, from the demographic mapping to looking where the future growth is happening, it would be a perfect place for a 1,000 unit apartment building. If it were me, I would tie up the land and have an architect draw a schematic of what it would look like as an apartment community. I would then take it to the city to see if they would sign off on the zoning, and if the phase one environmental comes through with no toxins within the dirt and soil, then my next step would be to present the plan to a developer for sale. That's what I mean when I say functionally obsolete. I mean, it certainly still could be an aluminum plant, but the odds of selling it to such an operator are low to nil. I believe that the property has a higher and better use. We're seeing this happening a lot in downtown corridors of some larger metro cities where they're taking

> Step Three: Narrow Your Search by Looking for Motivated Sellers

these old warehouses and turning them into residential lots because they can get a higher dollar per square foot, which is smart. That's the kind of thing I'm referring to when I say highest and best use.

One reason I like commercial real estate is that you're often dealing with an investment-minded individual.

Build the Motivated Seller List

We're going to interview for a commercial realtor, and we're going to ask about pocket listings. Pocket listings are apartment building owners that the experienced realtor might know who are serious about selling their building, but they have not listed the property. Or you can post free online classified on Craigslist, "I buy apartment buildings w/ seller financing or quick cash. Need to sell? Moving? Tax benefits run out? Call me for an all-cash offer."
If you want to build your list faster, here's what I want you to do. I want you to go to listsource.com and start querying the database for exactly what it is you are looking for. Once you have the list, I would write a letter saying something as simple and straight-forward as this, "Hi my name is Lee Arnold. I'm interested in purchasing your property located at XYZ street. If you would be interested in selling quickly and getting an all-cash offer, please contact me immediately via my cell phone or email. Let's talk

> Step Three: Narrow Your Search by Looking for Motivated Sellers

through terms which will be favorable for both parties." While I'm licking stamps and sending letters, I'm going to go to do a Zabba search and a Google search on the property addresses. One of the things that I love about the commercial space is that it's a lot easier to track down the owner or the manager than it is in residential. When a person owns 12 and 36 units or 100 units, they are consistently marketing for new tenants, which means when you Google the address of a property, you’re going to find every ad that's been posted on Craigslist, Backpage, Loopnet, and Zillow. This is one way you can find the owner's name and phone number. So, now I'm going to take the list that I printed off from ListSource, and I'm going to find all the phone numbers of those owners. Now I have to marketing channels that I’m able to approach the potential seller from.

One reason I like commercial real estate is that you’re often dealing with an investment-minded individual. They purchased the property as an investment, not as their personal residence. They bought it to make money, which means you're dealing with a professional in most cases so you can take a more professional tone and talk about return on investment (which is usually not the case with a homeowner).

> Step Three: Narrow Your Search by Looking for Motivated Sellers

Here's an example conversation and strategy I employ with commercial owners:

Always remember that motivation changes very quickly in the commercial landscape, especially when you're dealing with apartment owners who have three 12 unit apartment buildings and it's their full time job. Their motivations change rapidly with the state of their rent role.

Lee: "Hi, have you ever thought about selling that property?"

Property Owner: "Well, you know what, no I haven't. I actually bought it about 4 years ago, it's been a pretty good piece of property for me and I'm going to hold it as a portfolio piece."

Lee: "Oh, that's fantastic. Do you anticipate wanting to sell in the next 1-3 years, because I'm just going to put you in my file and reach out to you in the next 12 months?"
Property Owner: "Yeah, why don't you call me in 12 months."

"Ok, great."

And I'm going to put in a note to call them next month. Why? Because if you've ever owned a lot of property, when your property is fully occupied and all of your tenants are paying on time, the last thing you want to do is sell that property. But you're motivation

> Step Three: Narrow Your Search by Looking for Motivated Sellers

for keeping the property changes the first of every month when you identify which tenants are not going to pay, which tenants are not going to stay, how many units you have vacant that particular month, and just how much of your operational cash you're going to have to take out to cover your negative debt service, because you don't have enough tenants to cover your mortgage. Always remember that motivation changes very quickly in the commercial landscape, especially when you're dealing with apartment owners who have three 12 unit apartment buildings and it's their full time job. Their motivations change rapidly with the state of their rent role.

After we've pulled the list and we've identified as many phone numbers as we can, the next thing we're going to do is drive and look at all 31 properties. I'm going to look for vacant, boarded up, or properties in disrepair, and I'm going to research the addresses online in the county records. Another advantage of driving for dollars is that often certain sections or areas of town are zoned commercial multifamily which means, if you identify one 12 unit owner in that area, there's a good chance that just by driving over there, you're going to identify 4 or 5 additional multifamily units in that area. You just added to your prospective database.

> Step Three: Narrow Your Search by Looking for Motivated Sellers

Here are some questions to determine equity and level of motivation. Keep in mind, we know pretty well whether or not they have equity because we pulled the list that way.

Seller financing is a big piece of the pie, and it makes the deal much more exciting and profitable for you.

What is your situation? The situation always trumps price, location, and operating history. The situation always trumps everything. If the situation is not one that would suggest a level of motivation, then we are not interested. If they are not motivated based on the situation, they're going to want top dollar and rarely (if ever) do we want to be paying top dollar.

Are you willing to seller finance the deal? Why is this so important? Let me answer that question with a story.

There is this guy at my church in his 40s or 50s, who volunteers each and every day. Finally I asked him, "Don't you have a job? How is it you can be here every single day helping in the children's ministry or working odd jobs to help the church out?"
He said, "Well, you know Lee, when I was pretty young, I went out and I bought apartment buildings. I was fortunate enough to find an older seller who was looking to retire, and he just wanted some cash flow, so he sold them to me for 100% seller-carried fi-

> Step Three: Narrow Your Search by Looking for Motivated Sellers

nancing. He just wanted to turn over the operation and collect his 7% interest. So I spent the next 25 years paying him off.
I never refinanced them and I never went crazy. I just serviced and managed them for cash flow. That was my job, but on the 25th year, when I paid off the mortgages on all three of these properties, I turned around and sold them to new investors and I carried the financing. I'm now making the same amount of money as I was managing these properties full time, even after all the debt service and operation costs are paid. I actually make more money now as a passive investor just carrying the note against these properties."
That was his whole strategy. If you are here and you are younger in years, take advantage of that strategy and look for people willing to structure 30-year, seller-financing with you. If you are a little more mature in life, than a 30 year old, here's the plan for you. Go to ListSource and look for loans taken out in 1995 that are about 18 years old. Most of these have only 12 years left of payments on them. Now if you're 50, and you go out and you take over a bunch of properties subject-to with mortgages written in 1995, you've only got 12 years left of payments. You take over the payments and in 12 years, you own the properties free and clear. You're now 62, and you sell them on contract, carry the paper, and there's your retirement plan.

> Step Three: Narrow Your Search by Looking for Motivated Sellers

Once you know what it is you want to accomplish, and the amount of time that you have to accomplish it in, then you just pursue the properties that fit into that plan. Unfortunately, I see too many would-be investors just kind of going out there shooting from the hip or chasing anything that moves, just because they might be able to make some money with it. There is far too much real estate and opportunity to pursue it from a "if it makes me money, I'll buy it" standpoint. You need to be more strategic in where you invest, how you invest, and when you invest. Do it strategically based on your plan. So my question for you is, "Do you have a plan? What does your plan look like? How many assets do you need to acquire? What does your net worth need to be so that you can retire and retire well?" Once you have those answers, then you can go and buy.

Seller financing is a big piece of the pie, and it makes the deal much more exciting and profitable for you.

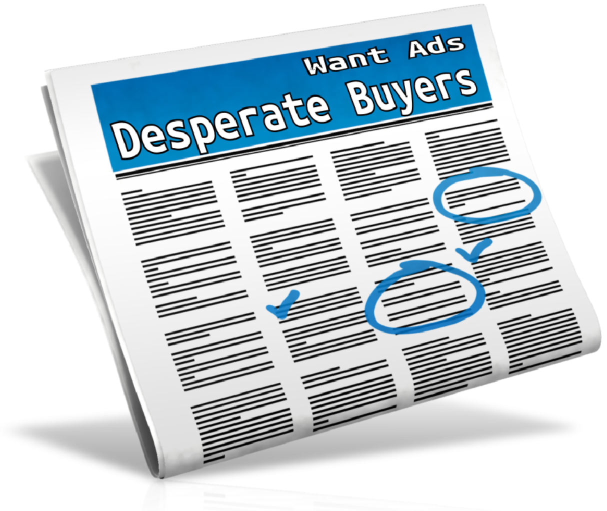
How fast do you need to sell the property?

Is that the best you can do? Get the lowest price possible but get them to name the price first. Now, when you're going after already listed property, the seller has already made the number one mistake in negotiation, where you name the price first. Unfortunately,

> Step Three: Narrow Your Search by Looking for Motivated Sellers

when you're selling real estate, you are breaking the cardinal rule because you've got to name the price. If you can find somebody that loves the property and they're willing to pay more, and they name the price, then you might be able to get a better deal. When I'm selling property, I'm always going to list it high, and I'm going to see what kind of interest I garner from there, and then I'm going to negotiate down. When I'm buying property, I'm always going to lowball price and then I'm going to negotiate up. In these situations, I'm always going to ask the seller first, "What kind of money do you want for this place?"

Keep in mind that I'm pursuing almost 95% of the time unlisted property. I think that's a fatal flaw that many of you are making is that you are pursuing listed property, and the reason that you're doing it is because it's easier to do it that way. I think we can all agree that easy doesn't always equal most profitable. In fact, my experience has been



> Step 4: Crunch the Numbers and Make the Offer

Remember, no offer, no deal.

Here's how you need to begin ending the phone call with a prospective seller, "Hey, Mr./Mrs., Seller, I want to thank you for your time. The next step now in our potential, future relationship is I'm just going to put down the thoughts and main points of our conversation here on paper and I'm going to shoot them over to you and you tell me if I got them right or if I need to adjust or amend some things, but you can anticipate that from me by tomorrow at five o'clock. Do you prefer that I email that to you or fax it?" Always give them two options, do you want me to email it, or do you want me to fax it to you, or even if you prefer, I can have a courier bring it over. My "thoughts on paper" is a purchase and sale agreement. That's the next step. If I have a phone conversation with you and there's a possibility that you might be interested in selling to me, the next step is an offer. That is the next step.

Now this does not mean to jot your thoughts on a yellow pad and just fax or scan the notes them in an email with your talking points of the terms.

It needs to be a legally binding agreement. I want that seller, if it's a good deal, to be legally obligated to sell the property to me if I decide I still want to buy it. Don't be scared of the term

> Step 4: Crunch the Numbers and Make the Offer

“contract.” If you know what you’re doing, you can write hundreds, if not thousands, of contracts on millions of properties throughout the country and not be obligated to buy any of them. How? Because we have clauses, amendments, and addendums written into the contract that give us certain provisions and certain rights to access to the property for due diligence in a specified period of time. If I don't like it, I simply write the owner an addendum, which is a one page form that says, "My inspections reveal that there are more challenges with the property than I'm currently willing to take on and as a result, I am cancelling the purchase and sale agreement." That's it.

So let's review, we've prospected, we've written the offer, we get the offer accepted by the seller with conditions, then we put earnest money in escrow to complete the contract. Again, remember a Purchase and Sale agreement is not legally binding until consideration has been tendered. Now, that doesn't mean that you've got to put up 10%. You're buying a million dollar building, and they want 10% in escrow, that's $100,000. You don't need to do that. Simply tell them, "The legal amount of consideration for a binding agreement in this state is $20, so here's $20, sign here that I gave you 20 bucks." It binds the contract with the same intensity as if you put up $100,000.

MONEY

> Step 5: Find Funding: Get Your Financing in Order

Understand that the directions we use to obtain the leads in the first place are going to make funding so much simpler. We only targeted properties where the seller had sufficient enough equity that I know I can go anywhere and get 50 cents on the dollar financing.

Any lender on the planet is going to give you 50 cents on the dollar financing. If you are pursuing owners that only owe 40%, you've still got 10% of leeway or room there where some cash could still go to the seller, they carry a second mortgage for 50 or 55% of the purchase price and you bring in no cash. The reason many of you struggle to get financing on commercial property is you pursue listed property without checking the title to determine what the underlying liens are to verify whether or not there's enough equitable spread for them to do creative financing with you in the first place. You have to recognize that it all begins with where you source the lead and how much advance due diligence is done prior to engaging the lead.

Now, fortunately, you have come to the right seminar because I did not go to the right seminar. When I was starting in real estate, they told me to go to the newspaper and look at all the people that want to sell and call them and find out why they're selling and how much they want. Nobody even told me to pull the right leads, forget about listed property, and forget about advertisements of people selling. That simply means that they've got more people than just you pursuing them.

Let me put this into perspective with a story.

When I was working with a seminar company and traveling all over the country, I worked with a group of guys and we all kind of traveled in a pack. Now we were putting on this seminar in Salt Lake City and this really, really beautiful girl walks into the room. All the guys look at each other and we all say, "Dibs" simultaneously. However, it was up to me to break the ice. They referred to me as the “King of the Cold Call.” I was the one who always made the opening statement, which in this case went something like this: "Hi my name is Lee. What's your name?" (Smooth, right?)

"My name is Jaclyn."

"Oh, hi Jaclyn, it's nice to meet you. What do you do here in Salt Lake?"

"Well, I'm an accountant."

"OK, well great. Well, what are you doing later?"

She says, "Oh I don't know, I was going to go out with some friends."

So I said, "Why don't we go all together."

"That would be great."

So the date has been established, we're all going to go out to dinner after the event. Unfortunately for the guys, but fortunately for me, they had forgotten their IDs. So they said, "Lee, we have to go back to the hotel and get our ID's. When we get there, we'll call you for the address."

'm not going to go after properties that are for sale by owner because they are basically advertising for suitors to come and pursue them, which makes it incredibly hard for me to be the best offer on the table because I'm not the only offer on the table.

I said, "Absolutely, no problem. I'll make sure to answer my phone."

They all leave, and I turn off my phone, because here's what I learned early in life: If you want to be the best offer, the best looking, the best athlete, the best anything then be the only competitor in the room.

I’m happy to report that my strategy worked and Jaclyn is now my wife, we've been happily married for 11 years and we have 3 beautiful children together. The moral of the story? There is an advantage of being the only suitor. That is true in relationships, and that is true in the acquisition of real property as well.

That’s why I’m not going to go after listed property. I'm not going to go after properties that are for sale by owner because they are basically advertising for suitors to come and pursue them, which makes it incredibly hard for me to be the best offer on the table because I'm not the only offer on the table.

Understand the way that you pursue the lead, and the direction of how you pursue it, will very much affect whether or not you're able to get financing. I don't pursue any deal that I know I'm going to have to bring any of my own money into. I can't tell you the last time I brought money to a closing table that was mine. I always use other people's money. I know that the deal will qualify for seller-financing and I know that I've got private funds ready and waiting in the wings on every deal that I find because of the way that

> Step 5: Find Funding: Get Your Financing in Order

I'm pursuing these deals. If you will go out and pursue the way that I teach you to do it, you will never need to come out of pocket another dollar to buy real estate again.
Now I'll tell you this, here at Cogo Capital and Secured Investment Corp, we want to fund your deal. If you'll find the types of deals that I'm showing you, you will not need to go find funding, because we will fund it every time. Here are some of the common types of funding that you can pursue:

Seller financing
Bank financing
Private lenders

The objective is to use other people's money to purchase your investment property, but be sure you understand the criteria that must be met for your particular lender.

Cogo Capital Financing

If you guys are not familiar with Cogo Capital, let me explain what it is. When I went out to New York a couple of years ago, I met with some hedge funds there and I showed them what we were doing, they said, "Lee, we love it. Everything that you're doing, we

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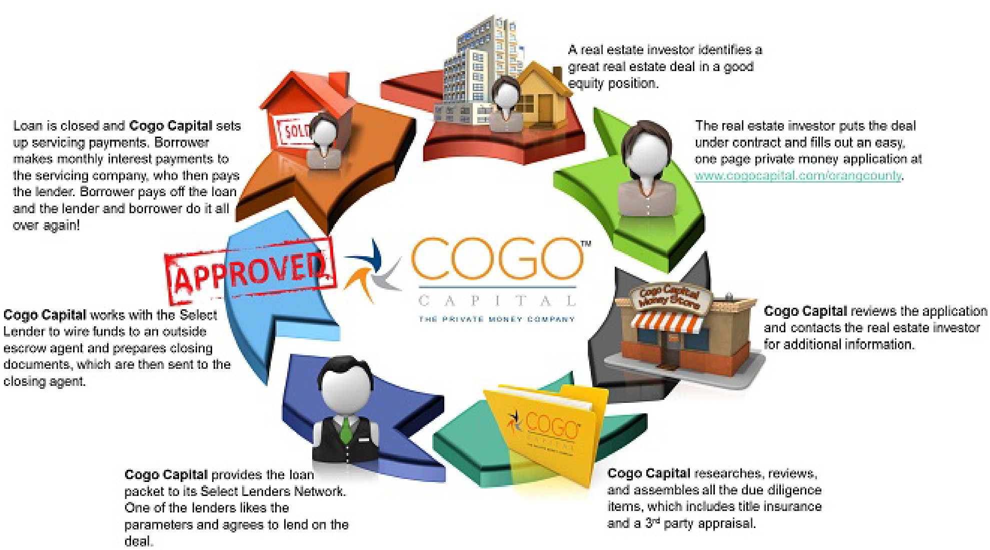
> Step 5: Find Funding: Get Your Financing in Order

love it. Call us when you're moving $40 million in mortgage paper each and every month."

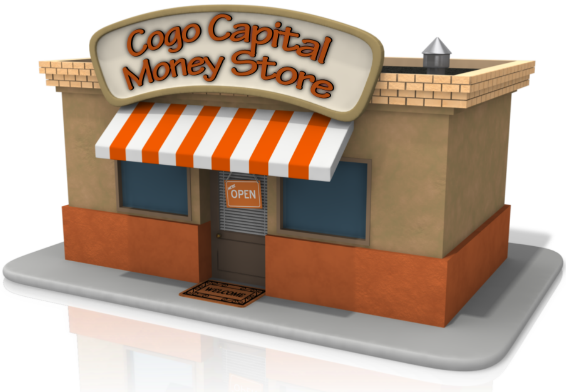
So, I came back to the office and I sat down with my executive team and I said, "Guys, here's the objective. We need to get this company to a place where we're moving $40 million a month in mortgage paper. How are we going to accomplish that?"

What we came up with was to branch out and set up brick and mortar locations throughout the country. We've already opened



three of these brick and mortar companies and they're called Cogo Capital, the Private Money Store. We're now expanding the plan, and the goal is to have 100 of these facilities spread out throughout the United States in the next 60 months. Each one will be tasked with deploying $15 to $25 million per year out of that facility. If any of you are interested in being involved with us in that capacity, send me an email, I'd be happy to put your name on the list. Because of that, we're moving everything that we do from the financing arena under the Cogo Capital branding. You can go to www.CogoCapital.com and check it out.

So, you'll go to Cogo Capital, you'll fill out a completed application, you'll give us your current financials, including your profit and loss statements and balance sheet, both on you and the property and that you are acquiring or that you are looking to get financing on. We're also going to need interior and exterior photos of the property, but not until you've negotiated and put it under contract with the seller. Also, copies of all current lease agreements, executive sum-



mary of the deal including your exit strategy. How are you going to get in and how are you going to get out of the deal? We also need personal financial statement for the guarantor.

On commercial properties, the loan to value of what we will lend, our participation, cannot exceed 55% of any refinance or purchase. The loan amount cannot exceed 70% of the purchase price. So it's 55% of the refinance amount, or the appraisal, but it cannot exceed 70% of your purchase price. If you're buying it for a million, and it appraises for 2 million, the most that we would lend is $700,000, not 70% of $2 million. You’re not going to get cash back by over financing. Kudos that you found a great deal, but you're going to be hard pressed to find any company that's going to over finance a commercial transaction without seller-financing being a huge part of the participation of the money that's going back to you.

The LTV not to exceed 50% for any commercial loan, which includes cash out. Uses of the cash must be detailed as part of the underwriting documents.

Here's an example of a 16 unit apartment building we did in Detroit. They were buying it for $154,000 and it appraised for $280,000, so the LTV was 55% based on the appraised value of $280,000. Their exit strategy was to acquire long term financing.

> Step 5: Find Funding: Get Your Financing in Order

We did a 24 month term on this at a 10% interest rate which is good in the private money space. Each unit is averaging about $500 a month, which means they've got $8,000 coming in on this deal with a loan amount of $154,000. Their monthly payment is going to be less than $1,500 a month and they've got $8,000 coming in. That is a fantastic deal.

Here's another deal we funded in Glenwood, AR. This is a commercial building and a 2-story apartment. It appraised for $210,000, they were buying it for $110,500. Our loan to value on this was 55%. We charged 2 points and 11%. It's a 24 month term. The cash flow is $1,500 a month plus a Laundromat for income. Their plans are to pay off the loan with income, business income, and employment income. All tenants in the subject property are long term, which we liked. Don't let the loan amounts fool you guys. We have done multimillion dollar deals where we've funded car washes, we've funded 185 unit apartment building over in the mid-west.

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> Step 6: Do Your Due Diligence

Do you notice that our due diligence didn't happen until right now? There's a reason. Every document concerning the building and its operation must be examined. A lot of that is going to happen in the underwriting process. When you get your financing through Cogo, through our underwriting, we will identify around 99% of the issues that you need to be concerned with. In our underwriting, we will send you a list of all of the additional information we need you to gather, and that way you don't have to do it more than one time.

We study the leases. We look at the notes and the mortgages and whether or not you assuming them. We'll need to look at the terms, title policy, the certificate of occupancy, and the insurance policies. Is the property ADA compliant? Is there an elevator or other maintenance contracts? If it's three stories or more, you're going to need an elevator. If it's 2 stories, you're going to need ADA approved ground floor units, especially if you're going to get any kind of subsidies. Also, we look at tax tickets and history of the licenses. In some jurisdictions, commercial properties do require that you carry a business license for the operations as well as parking lot contracts if the parking lots are not going to be utilized for the tenants. Also, if the building has a Laundromat, oftentimes the washer and dryer have financing against them, and it's usually in the form of an equipment lease. When you buy the property, you'll either have to pay off those equipment leases, so that that those services can stay, or you'll have to assume the business loan that was utilized to purchase the washer and dryer units. Be aware of that.

- Is it rent-rolling?
- Are there any units that need to be rehabbed and rented?
- What is the physical condition of the property?
- What is the highest and best use?
- What is the allowable use?
- What are the limited conditions on the inside and outside of the building?
- What will the after-developed or future value be?
- Are there any issues with the soil or the environment? This would be found in a phase 1 environmental study, if they find some things that are concerning, certain toxins, you'll have to go to a phase 2 which increases costs. You'll have to dig perk holes, so they can do a deeper sampling of the soil, and if that doesn't look good, then you'll have to do a phase 3 environmental which in some cases can run up to $50,000 to $100,000. So just be aware of these things as you're getting into certain properties.

OPPORTUNITY

> Step 6: Do Your Due Diligence

- Are there any potential governmental concerns? Right now, in Spokane for example, they're building a big massive North/South Freeway. There are a lot of tenants that are in its path, which means eminent domain is going to take over, and they are only going to get the fair market value of the property. Be careful as it relates to any governmental or zoning issues prior to going into a deal. You will find that on title. Oftentimes when they're doing big governmental developments like that, they will put a lien on everyone's title related to the future condition or possession of the property. If the government is going to take it over through eminent domain, that will show up on the title, which is why it's so important to get title insurance. Or if you know how to read title to at least close through an attorney so you have some insurance coverage related to the title and the future of the property.

MONEY

> Step 7: Implement Your Exit Strategy

Your pay days are a lot bigger when you finally sell your property. This is because an apartment complex costs more than single homes in some cases. Because of this, they obtain a greater dollar amount of appreciation. Now, there should be an asterisk there that says, "Subject to certain trends and market conditions."

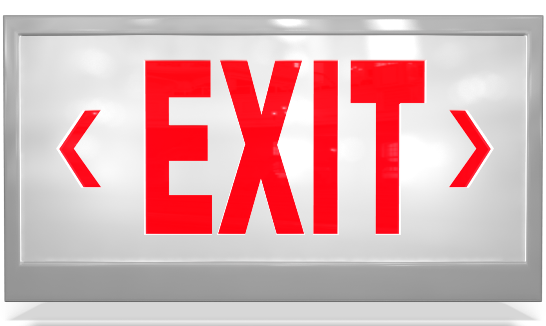
For example, if a $100,000 single family house appreciates 10%, it be worth $110,000, while a three-plex worth $300,000 in the same market, at 10% appreciation, will increase to $330,000. That's $20,000 more money in your pocket.

If you are reading the Wall Street Journal, the USA Today, or even Baron's, you know that interest rates are going up. It's kind of creating an unintended consequence that nobody was really anticipating. We're actually seeing a spike in home sales, because as interest rates continue to creep up, all of these people who were sitting on the fence are racing into the marketplace. Here’s what happens when interest go up. There are more people out there buying single family homes, but as soon as we run out of inventory and interest rates peak, you're going to see a much larger appetite for people who are renting. They can see rates on commercial residential property are going to go down, and prices are then are going to go up. When you see interest rates go up, your vacancy

> Step 7: Implement Your Exit Strategy

rates are going to go down, which means the value of your property goes up because your rental income is higher, you can sell it at a greater cap, or a lower cap with a higher purchase price, and you make more money. Not only is it necessary to know when to buy, it's also important to know when to sell. You've got be looking at interest rates housing inventory, and saturation rates for certain markets depending on where you're buying. There are a lot of factors that you need to be looking at and you need to understand how to read those factors.

So step seven, complete the transaction, 2 possibilities. You can turn a property quickly after increasing its value by selling it at retail or offer seller-financing to another investor. You can refinance it and rent it to tenants. It's always a good idea to have more than one exit strategy so that if one doesn't work out, you can fall back on one of the others.



MONEY

> Costly Mistakes to Avoid

Mistake Number One: Botching the Math.

Value is dependent on net operating income, gross revenue minus operating expenses. That's your NOI. Get the real operating numbers, not a projection of potential gross income and estimated expenses. If you've overestimated revenue and underestimated expenses, your profit not only can suffer, it will suffer. If you're not good at math, or you've never run through a commercial NOI scenario, make sure that you do have somebody review it before you go all in.

Mistake Number Two: Overleveraging.

The proper use of leverage is by knowing the break-even ratio = operating expenses plus the debt service, divided by the gross potential income. Operating expenses plus debt service divided by gross potential income equals your break even. When break even exceeds 80% of your gross revenues and the structure depends on perfection, you're in dangerous territory. You need to be running your numbers, and I would be very conservative in the way that you run your numbers. Also, pay close attention to vacancy rates or occupancy rates. Oftentimes these are overstated by the owner. They'll try to tell you that occupancy has been higher, but it's pretty simple math. Look at the gross income that they've generated divided by the number of units, divided by the number of months, and that's going to tell you exactly what their vacancy has looked like. Don't let them overstate it.

Mistake Number Three: Inadequate Due Diligence.

You must know the property condition, including physical items such as building systems, environmental matters, and structural components. Just as important are title, survey, zoning, and land-use regulations.

Again, it is not my intention here to scare you out of investing in commercial real estate, but I certainly want you to make sure that you're doing it knowing what you're getting yourself into. You see a lot of commercial real estate spread out throughout the country, so clearly people are making money at it and there's no reason that you can't or won't, but you do need to make sure that you are doing your due diligence properly.

Questions and Answers:

"Why are you not using a letter of intent rather than a contract on commercial?"

> Questions

I think that letters of intent are as worthless as the paper they're written on. They make you, in my opinion, look like a less serious investor. I want a purchase and sale agreement. When you're dealing in the commercial space, it's even more important that you come across as a professional, competent investor, and that's with a purchase and sale agreement and not a letter of intent.

"Is the 70% of the purchase or 55% of the appraised value including seller-financing, in other words, the CLTV (or the cumulative loan to value)?"

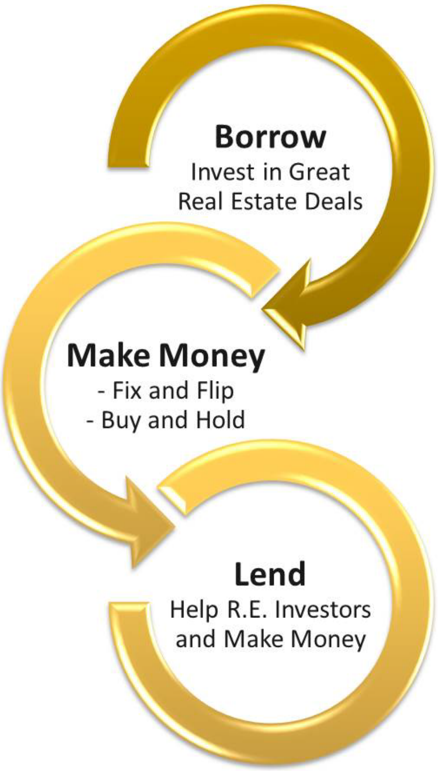
No that does not relate to the CLTV. I don't care if your CLTV is 150% or 120%, if you can get the seller to carry that much paper above and beyond my first loan of 55%, that is great. Our decision is simply based on the appraised value, the purchase price, as it sits, and you can very easily if you prefer have a CLTV upwards of 100%, 110%, 120% if the seller is willing to carry that much risk on your behalf.

OPPORTUNITY

> Get Involved in the Circle of Wealth

After years of teaching and mentoring around the nation, I found that education doesn't mean a lick, if the person being taught doesn't have the capital to put their knowledge into genuine action.

So, I took the challenge and created a place, Private Money Exchange, where real estate investors could go for unlimited funds for their non-owner occupied investments.



While the progression seemed natural, we were missing one, very large and essential piece of the pie. The marketplace was teeming with people who had the funds, who aspired to make higher returns on their invested dollar, but lacked the desire to get involved in real estate at the ground level.

In light of this opportunity, we created Secured Investment Corp, which gave people a medium to lend on first trust deeds (real estate), and

> Get Involved in the Circle of Wealth

make higher returns than they were currently seeing in their stock market, bank CDs, or bond investments.

As we combined all these facets—training, funding, and the means to lend on real property—we began to notice a progressing trend of growth and success with the clients involved.

Through this model, what we call *"The Circle of Wealth,"* we also noticed that people who entered in at the training level and borrowed funds for their real estate investments, eventually became lenders in their own right. They then helped others obtain the capital needed to grow their real estate portfolios.

This allowed everyone, on every side, to win!

It is our goal that **everyone** can enjoy some level of success in ***The Circle of Wealth***, and inevitably lap it several times over! We hope you're one of them!

Circle of Wealth Member

"I chose to invest with Private Money Exchange because I have watched Lee over the past few years. I have been impressed by his attitude, ethics, and humility. My experience has shown that the company performs excellent due diligence before agreeing to an investment.

Becoming a lender was an easy business decision for me. But a thank you gift was icing on the cake. Where do I send my thank you note.

I have to believe this is a terrific place to work! Thanks for all your help."

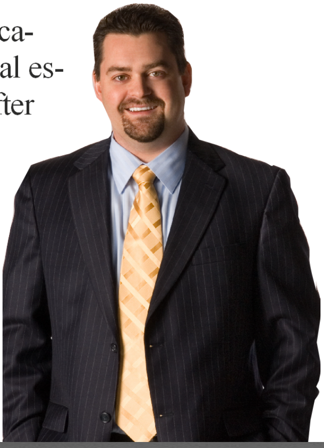
- Susan C.

> Who is Lee Arnold?

Like most self-made millionaires, I began at the bottom of the financial food-chain. My humble beginnings started as a bag boy at a local grocery chain in Spokane, Washington working for $3.90 per hour. My first “aha moment” happened while I was aspiring to a management role at the store and was reading the life-changing book, “Rich Dad, Poor Dad” by Robert Kiyosaki. Suddenly my management aspirations looked very small, but my future possibilities became extremely big.

My second “aha moment” happened while I was sitting in a philosophy 101 course in college. My attention span was divided between the slow ticking of the clock and my professor’s long winded discussion on the economy. While the minutes ticked by, he let it slip that he was making only $45k a year. That information and the knowledge I gained from Kiyosaki’s book, made me realize I was on the wrong path to success and needed to make some very important changes fast. So, from those experiences and an influential nudge from an incredibly persuasive late-night infomercial, I went into real estate.

I began the way many people do—in the educational and training space. Like many, I went to real estate seminar after seminar and bought course after course. Through long years of trial and error, I built up a very profitable, million-dollar real estate business from the ground up. I’m proof-positive that the training system can and does work! Because of this, I decided to help others by teaching them how to translate workbook education and real estate theory into the real world of real estate investment.



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