# Twitter Thread by Nick Huber

Nick Huber
@sweatystartup

**The wealthiest person I know prints millions out of thin air in the real estate business.**

**This is what he does...**

**A thread.**

He finds a distressed retail plaza. Let's say 50% of the space isn't leased.

On a 300,000 sf plaza that might mean 150k square feet is vacant.

If asking rent is $8 per square foot per year, that means the building has a "potential revenue" figure of of $2.4MM.

So in this retail center 50% is leased and 50% is vacant. So the actual revenue, right now, is $1.2MM.

Most retail leases are whats called "Triple Net" or "NNN". This means the tenant pays the taxes, insurance, maintenance and CAM (common area maintenance).

They basically pay all of the landlord's expenses (except debt service on any loans he/she has, of course).

Commercial properties are valued based on something called a "cap rate".

The equation is:

net operating income / (cap rate) = value

The cap rate is a %.

Think about it as the return on your money, annually, as a percentage, you spent to buy a property.

If you want a 7% return on your overall spend (not taking into account debt on the property) you'd buy at a 7 cap.

An 8% return would mean an 8 cap.

Cap rates (as a measure of value) change based on risk, upside, trends and investor appetite for a certain type of asset.

But the bottom line is this:

Commercial real estate is valued based on how much money it makes (Net Operating Income)

Increase NOI --> increase value

Decrease NOI --> decrease value

Back to my friend.

He's looking at a distressed asset. Half vacant. So there is some upside potential. That potential is baked into the cap rate he can buy it at.

So he makes an offer to buy at an in-place 6 cap.

The NOI = 1.2MM

Cap rate is 6

A quiz -> what is the value?

You guessed it. $20MM.

So my friend gets the property under contract for $20MM.

And while its under contract, before he buys it, he pulls an ace out of his sleeve.

You see my friend owns several Planet Fitness franchises and also several trampoline park franchises.

So he prepares his plans to sign long term leases with both of these businesses the day he closes on the property.

And the day he closes he does so and they both move in.

And now the retail center is 100% full.

Bringing in $2.4MM a year in NOI.

So now what cap rate would we use to value this full retail center with long term leases in place across the board?

The upside is gone, so the cap rate will go up slightly, and my friend generally achieves an 8 cap valuation here.

So with $2.4MM in NOI, what is the new value at an 8 cap?

You guessed it. $30MM.

So my friend just bought a building for $20MM, signed two leases, and now its worth $30MM.

So he created $10MM of value out of thin air.

And he does this to two or three retail plazas a year.

If you enjoy stories like this and want to learn more about the dynamics of real estate, sign up for my newsletter:

https://t.co/FEt1sBoSWS