



# How to Buy, Manage, and Sell Apartment Buildings

A Layman's Guide  
to Getting Started

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# Agenda

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- Acquisition
- Asset Management
- Disposition



# Michael Shields, CCIM

- Certified Commercial Investment Member (CCIM)
- Certified California Residential Manager (CCRM)
- Silicon Valley Multi-Family Specialist
- Broker/Owner: Silicon Valley Multifamily Group
- 20 years professional marketing experience
- 10 Years Commercial Real Estate Experience
- Real Estate Investor
- Association Affiliations
  - Bay Area Apartment Brokers Forum
  - Association of Silicon Valley Brokers
  - Tri-County Apartment Association
  - Silicon Valley Association of Realtors
  - Past-President, Park Villas Ridgecrest HOA



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# How to Buy



# RE Investment Factors

- **Risk** — Unique due to amount of money needed, time required to maximize return and regulatory environment
- **Liquidity** — Low liquidity. Allow adequate time to get best price.
- **Leverage** — Shrewd use of debt can increase returns and provide tax benefits, but increase risk.
- **Management** — Management intensive. Costs can be time, money, or both
- **Tax Impact** — Can be highly advantageous, especially with a IRC 1031 exchange
- **Change in Value** — Can be from location, interest rates, rental rates, economy, job market, and financial markets
- **Holding Period** — Must be regularly reassessed



# Action Plan

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1. Inventory your resources
2. Learn the market
3. Analyze properties

*“A good plan, violently executed now,  
is better than a perfect plan next week.”*

-- General George S. Patton, Jr.



# Your Resources

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- Financial
- Experience
- Personnel
- Time
- Energy & motivation



# Financing

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1. Source and amount of down payment?
2. What are your financial limitations?
3. Judiciously use leverage
4. Are funds available for future emergencies?
5. Work with a qualified loan broker or lender





# Profile Your Ideal Property

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- Size
- Location
- Financials
- Condition
- Management involvement

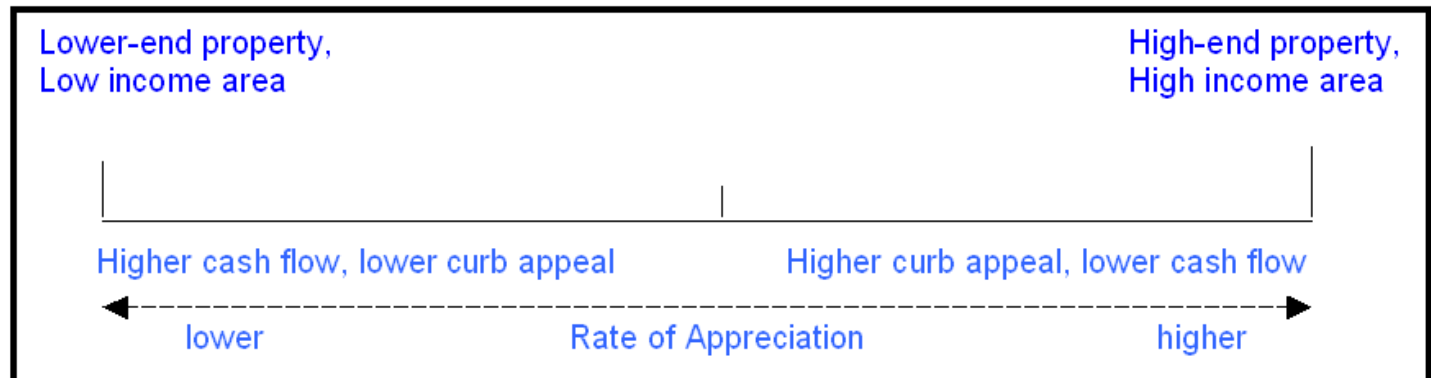
# Which would you prefer?



- Both are 8-unit buildings
- One has a GRM of 19.6, the other 14.4
- One has a Cap rate of 2.9%, the other 5.6%
- One lists for \$965,000, the other \$1,795,000

# Slums & POO

## Condition vs. cash flow



**Are funds available should the building's income drop below the point at which it pays for itself?**



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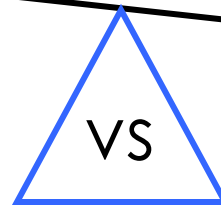
# Property Analysis



# Residential vs. Commercial

- 1-4 units
- Residential Property
- Buyer protection laws
- Easier to find
- Easier, favorable financing
- Lower down payment
- Lower rate of return

- 5+ units
- Commercial Property
- Buyer beware
- Harder to find
- Harder to finance
- Higher down payment
- Higher rate of return





# Buyer Beware

- 1-4 units protected by buyer protection laws of full disclosure
- 5+ units: commercial transaction = Buyer beware
- Seller must disclose “material” items, but may not disclose all issues
- Contract terms & clauses



# Disclosure Differences

<b><u>Disclosure</u></b>	<b><u>1-4 units</u></b>	<b><u>5+ units</u></b>
Agency	X	
TDS	X	
Broker Inspection	X	
Natural Hazard	X	
Drug Lab	X	
Megan's Law	X	
Industrial Use Zone	X	
Mello-Roos/Bond Assess.	X	
Military Ordnance	X	
Smoke Detector Statement of Compliance	X	
FHA/FHD Inspection	X	

# Cash Flow Model Diagram

## Cash Flow After Tax

	<b>Potential Rental Income (PRI)</b>
<b>+</b>	<b>Other income (affected by vacancy)</b>
<b>-</b>	<b>Vacancy &amp; credit losses</b>
<hr/>	
	<b>Effective rental income</b>
<b>+</b>	<b>Other income (not affected by vacancy)</b>
<hr/>	
	<b>Gross Operating Income</b>
<b>-</b>	<b>Operating Expenses</b>
<hr/>	
	<b>Net Operating Income (NOI)</b>
<b>-</b>	<b>Annual Debt Service (ADS)</b>
<hr/>	
	<b>Cash Flow Before Tax (CFBT)</b>
<b>-</b>	<b>Tax Liability</b>
<hr/>	
	<b>Cash Flow After Tax (CFAT)</b>



# Calculating Tax Liability

**Tax Liability**

**NOI**

- Interest
- Depreciation

**RE Taxable Income**

**x Marginal Tax Rate**

**Tax Liability (savings)**

# Gross Rent Multiplier

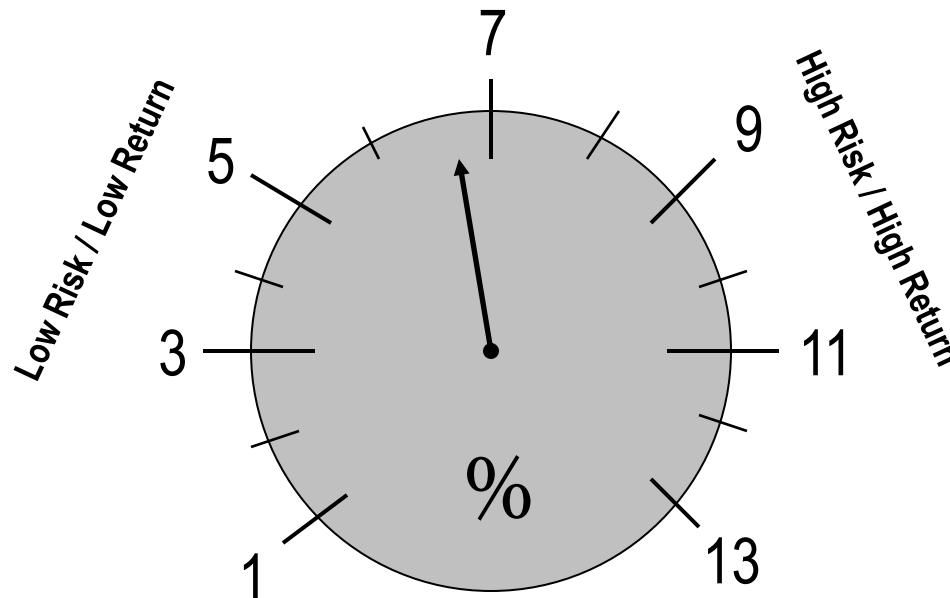
$$\frac{\text{Price}}{\text{Gross Rents}} = \text{GRM}$$

$$\frac{\$1,500,000}{\$150,000} = 10.0$$

**The lower the number, the better.  
A relative number useful for comparing similar  
properties at a glance. Omits expenses and risk.**

# Capitalization Rate

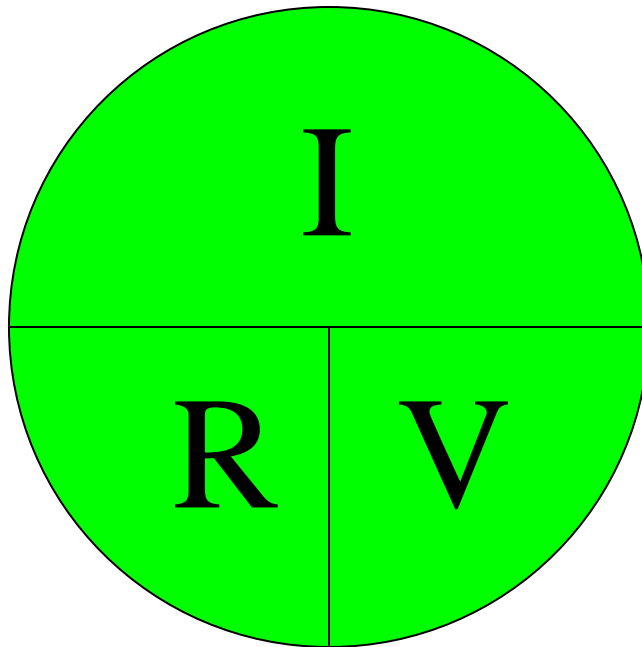
$$\frac{\text{NOI}}{\text{Price}} = \text{Cap Rate} \quad \frac{\$100,000}{\$1,500,000} = 6.7\%$$



The Cap rate incorporates risk.

**Cap Rate  
Riskometer**

# My Buddy "IRV"



V = Investment Value

I = First year NOI

R = Overall Cap Rate

Direct Capitalization is a process of converting a stream of future income into a present value by dividing a future income amount by a cap rate.

# Price Per Unit/Door

$$\frac{\text{Price}}{\text{\# of units}} = \text{Price/unit}$$

$$\frac{\$1,500,000}{10 \text{ units}} = \$150,000 \text{ per unit/door}$$

A relative number useful for comparing similar properties at a glance.



# Cash-on-Cash Return

$$\frac{\text{1<sup>st</sup> year cash flow before taxes}}{\text{Initial investment (down payment)}} = \text{Cash-on-Cash (yield)}$$

A useful method to determine investment value or measure investment performance. The C-o-C requirement is derived from comparable properties in the market and/or the investor's own objectives.

# Internal Rate of Return

N	\$
0	<Initial Investment>
1	Annual CFAT
2	Annual CFAT
3	Annual CFAT
4	Annual CFAT + SPAT

$$i = \text{IRR}$$

**IRR or Yield = The rate earned by each dollar for each year that the dollar remains invested.**

# Calculating Sales Proceeds

## Sale Proceeds After Tax

**Sale Price**

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- **Cost of Sale**

- **Mortgage Balance**

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**Proceeds Before Tax**

x **Tax Liability on Sale**

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**Sale Proceeds After Tax**





# Financial Analysis Software

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- Argus Edge / Argus  
[www.argussoftware.com](http://www.argussoftware.com)
- Planease  
[www.planease.com](http://www.planease.com)
- Star Investment Analyzer  
[www.wanderingstar.com](http://www.wanderingstar.com)

## Property Investment Analysis

Property Information			Investment Summary				
Property Name	Alden Way Apartments		Price:			\$2,950,000	
Address	3517 Alden Way		GRM:			10.9	
City, State	San Jose, CA		Cap Rate:			6.2%	
# of units	20		Price per foot			\$182	
Building Size (approx)	16,200		Price per unit			\$147,500	
Lot Size (approx)	22,900		Est YR1 Cash-on-Cash Return			4.98%	
Age	43		Debt Coverage Ratio			1.26	
Remarks: Income as of Dec 2003.			DCR Qualifying Rate			6.50%	
Initial Investment			Proposed Primary Financing				
Price		\$2,950,000	Primary Loan Amount			\$1,917,500	
Down Payment	35.0%	\$1,032,500	Interest Rate	5.500%		5.500%	
Borrowed Funds		\$1,917,500	Amortization Period	30		30	
Est Acquisition Costs	0.20%	\$25,075	Loan Term	5/30		5/30	
Initial Investment		\$1,057,575	Payments/Yr	12		12	
			Number of Payments	360		360	
			Monthly Debt Service			\$10,887	
			Annual Debt Service			\$130,648	
			Loan Points	1.0%		\$19,175	
Annualized Operating Data			Pro Forma Scheduled Income				
Scheduled Gross Income		\$271,520	<u>Unit Qty</u>	<u>Beds</u>	<u>Baths</u>	<u>Rent/Unit</u>	<u>Current Income</u>
Actual Vacancy Factor	4.5%	\$12,047	1	2	1	\$1,475	\$1,475
Effective Operating Income		\$259,473	2	2	1	\$1,295	\$2,590
Less: Expenses	28%	\$76,168	1	2	1	\$1,250	\$1,250
Net Operating Income		\$183,304	1	2	1	\$1,175	\$1,175
Less: Annual Debt Service		\$130,648	2	2	1	\$1,150	\$2,300
Cash Flow Before Taxes		\$52,656	1	2	1	\$1,095	\$1,095
<b>Est. Annualized Expenses</b>			1	2	1	\$1,055	\$1,055
Property Taxes (est)	1.20%	\$35,400	6	2	1	\$1,050	\$6,300
Insurance (est)		\$8,500	1	1	1	\$975	\$975
Maintenance		\$1,325	1	1	1	\$895	\$895
landscaping		\$1,800	1	2	1	\$850	\$850
Garbage		\$1,463	1	2	1	\$1,025	\$1,025
Gas & electric		\$3,496	1	2	1	\$1,325	\$1,325
Water & sewer		\$4,529		(last unit is pro forma)			
Reserves		\$0	20	Monthly Scheduled Rents			\$22,310
Management (est)	6%	\$16,291	Total Units	Annualized Rents			\$267,720
Misc. cleaning, paint, supplies		\$3,364		Other Income (laundry)			\$3,800
<b>Total Expenses</b>	<b>28%</b>	<b>\$76,168</b>		<b>Annual Gross Scheduled Income</b>			<b>\$271,520</b>



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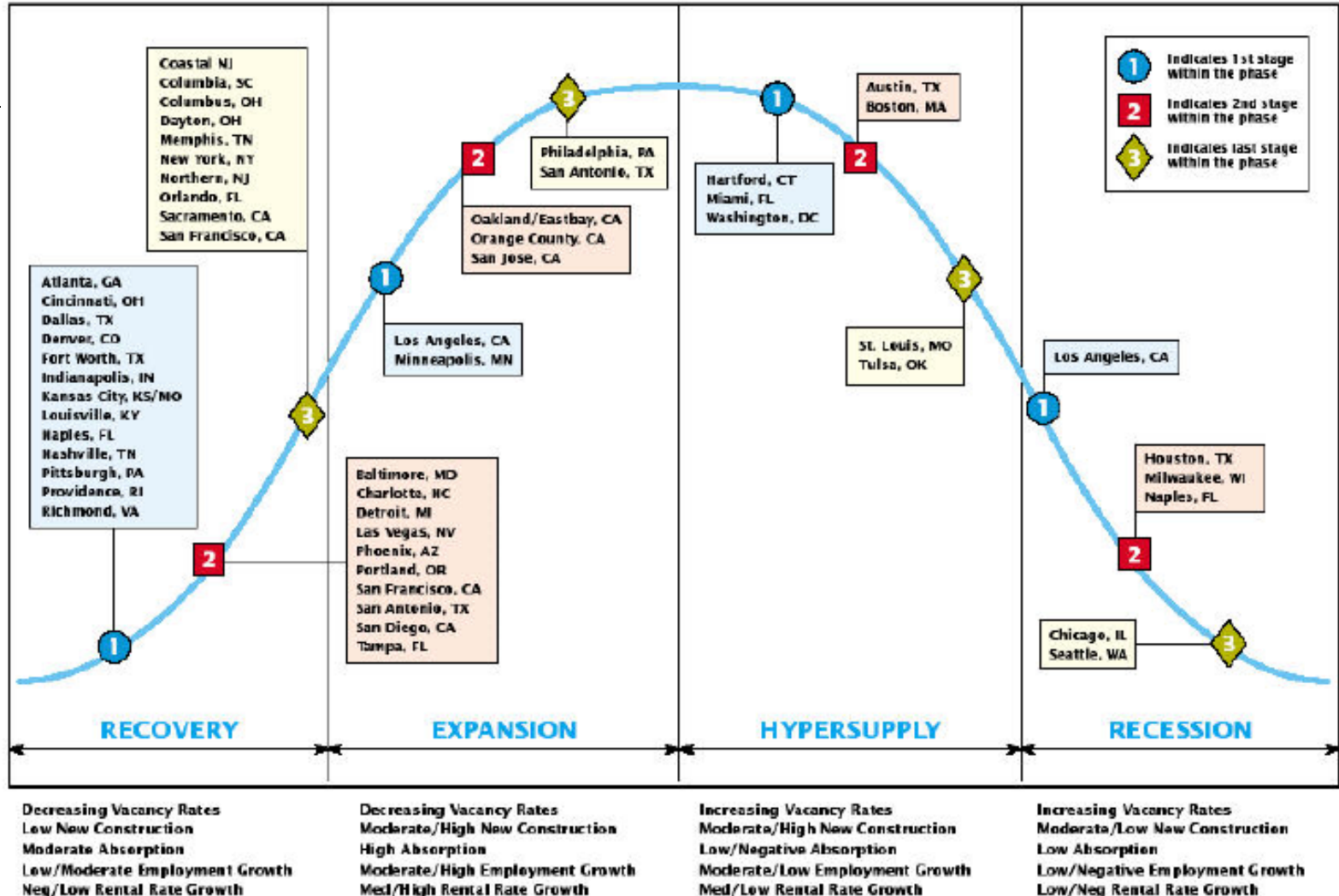
# Market Analysis



# What to Look For

- Growing / recovering markets
- # of available properties
- # of properties in-contract
- Recent comps
- Read brokerage reports
- Properties w/upside potential

# Market Life-Cycle





# What to Avoid

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- Saturated or declining markets
- Properties at the height
- Overpriced properties
- Inappropriate Properties

# Current Market

Address	City	Units	List Price	GRM	Cap Rate	DOM	GSI	NOI	Sq. Ft.
262 HIGDON	MV	10	\$1,350,000	14.6	4.5	35	\$97,430	\$60,333	6,000
2002 W MIDDLEFIELD RD	MV	10	\$1,939,999	14.3	5.1	2	\$136,080	\$98,016	9,934
4734 HAMILTON AV	SJ	10	\$1,850,000	13.8	5.8	160	\$134,340	\$107,580	8,252
39 ATLAS AV	SJ	10	\$1,450,000	16.5	4.3	47	\$92,400	\$62,015	5,202
1185 BIRD AV	SJ	10	\$1,468,000	14.2	5.7	70	\$103,452	\$83,718	5,831
2131 MARLBORO CT	SJ	11	\$1,665,000	15.4	4.4	154	\$111,650	\$72,614	5,757
150 BLOSSOM HILL RD	LG	12	\$2,199,900	16.6	4.3	138	\$132,564	\$93,914	6,968
528 S 10TH ST	SJ	12	\$1,560,000	12.1	6.3	40	\$135,720	\$97,559	9,496
260 N 3RD ST	SJ	12	\$1,550,000	13.9	0.0	40	\$117,480	\$10,991	5,680
804 S ALMADEN	SJ	12	\$1,450,000	14.7	5.1	19	\$103,800	\$73,900	5,680
649 BLYTHE CT	SU	12	\$2,050,000	14.5	4.8	25	\$148,800	\$97,500	8,792
358 N 7TH ST	SJ	13	\$1,560,000	12.4	0.0	40	\$132,150	(\$1,192)	6,536
357 S 4TH ST	SJ	13	\$2,155,000	13.4	6.0	181	\$160,450	\$129,877	9,545
655 RESEDA DR	SU	14	\$2,150,000	15.1	4.7	19	\$150,128	\$100,320	7,494
560 S 10TH ST	SJ	15	\$2,125,000	12.2	5.3	6	\$177,540	\$112,604	9,808
270 E OKEEFE ST	EP	16	\$2,850,000	14.6	5.8	8	\$195,840	\$165,565	20,774
2080 MARLBORO CT	SJ	16	\$2,100,000	12.9	5.6	7	\$167,760	\$117,158	9,316
102 S 14TH ST	SJ	16	\$1,500,000	12.4		4	\$127,428	\$86,295	4,042
255 N 3RD ST	SJ	16	\$1,895,000	12.5	5.0	210	\$158,950	\$95,602	6,525

Note: This information is believed to be accurate but is not guaranteed.

# Sample Property # 1



2080 Marlboro Court


- List Price: \$2,100,000
- Unit Mix: (12)1x1, (4)2x1

<u>Income:</u>	
Gross Rent Income:	\$158,420
Laundry:	\$4,800
TOTAL INCOME:	\$163,220
<u>Expenses</u>	
Real Estate Taxes:	\$24,212
Insurance	\$5,268
P.G. & E.	\$5,036
Water	\$4,051
Garbage	\$2,202
Pool	\$1,200
License+permit	\$1,280
Maintenance	\$4,800
TOTAL EXPENSES:	\$48,049
EXPENSES/UNIT:	\$3,004
% of EGI:	29.40%
Cash Flow Before Debt: \$115,171.00	



# “Does it pencil?”



		<h2 style="text-align: center;">Property Investment Analysis</h2>				Michael Shields Investment Broker 408-354-7470		
Property Information			Investment Summary			Low	Mid-Range	High
Property Type	Apartment		Price:	\$1,900,000	\$2,000,000	\$2,100,000		
Address	2080 Marlboro Ct.		GRM:	12.9	13.6	14.3		
City, State	San Jose		Cap Rate:	4.8%	4.6%	4.4%		
# of units	16		Price per foot	\$204	\$215	\$226		
Approx Building Size	9,300		Price per unit	\$118,750	\$125,000	\$131,250		
Approx Lot Size	18,600		Est YR1 Cash-on-Cash Return	0.32%	0.31%	0.29%		
Age	49		Debt Coverage Ratio		0.93			
Remarks			DCR Qualifying Rate		6.50%			
Initial Investment			Proposed Primary Financing					
Price (mid-range)	\$2,000,000		Primary Loan Amount	\$1,235,000	\$1,300,000	\$1,365,000		
Down Payment	35%	\$700,000	Interest Rate	5.620%	5.620%	5.620%		
Borrowed Funds	\$1,300,000		Amortization Period	30	30	30		
Est Acquisition Costs	0.1%	\$2,000	Loan Term	5/30	5/30	5/30		
Initial Investment	\$702,000		Payments/Yr	12	12	12		
			Number of Payments	360	360	360		
			Monthly Debt Service	\$7,105	\$7,479	\$7,853		
			Annual Debt Service	\$85,266	\$89,753	\$94,241		
			Loan Points	1.0%	\$12,350	\$13,000	\$13,650	
Annualized Operating Data			Current Monthly Income					
Effective Rental Income	\$147,331		Unit Mix	Beds	Baths	Rent/Unit	Current Income	
Other Income (Laundry, etc)	\$4,800		0	2	1	\$0	\$0	
Gross Income	\$152,131		0	2	1	\$0	\$0	
Expenses	41%	\$60,218	0	2	1	\$0	\$0	
Net Operating Income	\$91,912		0	2	1	\$0	\$0	
Annual Debt Service	\$89,753						\$0	
Cash Flow Before Taxes	\$2,159		Monthly Scheduled Rent				\$0	
Estimated Annualized Expenses			Pro Forma Monthly Scheduled Income					
Property Taxes	1.20%	\$24,000	Unit Mix	Beds	Baths	Rent/Unit	Pro Forma Income	
Insurance	0.35%	\$7,000	0	2	1	\$0	\$0	
Maintenance		\$4,800	0	2	1	\$0	\$0	
landscp/advert./reserves	???	\$0	0	2	1	\$0	\$0	
Garbage		\$2,202	0	2	1	\$0	\$0	
Gas & electric		\$5,036					\$0	
Water & sewer		\$4,051					\$0	
License/permits		\$1,280	0	Monthly Scheduled Rent			\$0	
Pool		\$1,200	Total Units	Projected Annualized Rents			\$158,420	
Management	7%	\$10,649		Vacancy Rate	7%		\$11,089	
<b>Total Expenses</b>	<b>41%</b>	<b>\$60,218</b>		<b>Effective Rental Income</b>			<b>\$147,331</b>	

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# Sample Property #2



2107 Marlboro Court

- \$1,500,000
- 10 units:
  - (9) 1/1 @ \$800 / unit
  - (1) 2/1 @ \$950 / unit
- Well maintained
- Good condition
- Recent Roof
- Workshop/storage
- Fully occupied
- Owner financing

# Does it pencil?

		<h2 style="text-align: center;">Property Investment Analysis</h2>				Michael Shields Investment Advisor 408-354-7470	
Property Information		Investment Summary		Low	Mid-Range	High	
Property Type	Apartment	Price:		\$1,400,000	\$1,450,000	\$1,500,000	
Address	2107 Malboro Ct.	GRM:		14.0	14.5	15.0	
City, State	San Jose, CA	Cap Rate:		4.1%	3.9%	3.8%	
# of units	10	Price per foot		\$233	\$242	\$250	
Approx Building Size	6,000	Price per unit		\$140,000	\$145,000	\$150,000	
Approx Lot Size	13,000	Est BT YR1 Cash-on-Cash Yield		0.71%	0.68%	0.66%	
Age	50	Debt Coverage Ratio			1.09		
Remarks: Well maintained, fully occupied		DCR Qualifying Rate			5.75%		
Initial Investment		Proposed Primary Financing					
Price (mid-range)	\$1,450,000	Primary Loan Amount		\$700,000	\$725,000	\$750,000	
Down Payment	50%	Interest Rate		6.000%	6.000%	6.000%	
Borrowed Funds	\$725,000	Amortization Period		30	30	30	
Est Acquisition Costs	0.08%	Loan Term		30	30	30	
Initial Investment	\$726,088	Payments/Yr		12	12	12	
		Number of Payments		360	360	360	
		Monthly Debt Service		\$4,197	\$4,347	\$4,497	
		Annual Debt Service		\$50,362	\$52,161	\$53,960	
		Loan Points	0.0%	\$0	\$0	\$0	
Annualized Operating Data		Actual Monthly Scheduled Income					
Scheduled Gross Income	\$100,300	<u>Unit Mix</u>	<u>Beds</u>	<u>Baths</u>	<u>Rent/Unit</u>	<u>Current Income</u>	
Vacancy Factor (est)	5%	9	1	1	\$800	\$7,200	
Effective Gross Income	\$95,410	1	2	1	\$950	\$950	
Expenses	38%						
Net Operating Income	\$57,110						
Annual Debt Service	\$52,161						
Cash Flow Before Taxes	\$4,949						
Estimated Annualized Expenses							
Property Taxes	1.25%						
Insurance	0.35%						
Maintenance (\$500/unit)							
landscaping							
advertising/credit reports							
Gas/Electric/garbage							
Water/Sewer							
License/permit	\$500	12		Monthly Scheduled Rent		\$8,150	
cleaning	\$1,000	Total Units		Projected Annualized Rents		\$97,800	
Management	0%			Other Income (laundry)		\$2,500	
<b>Total Expenses</b>	<b>38%</b>	<b>\$38,300</b>		<b>Annual Gross Scheduled Income</b>		<b>\$100,300</b>	

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# The Buying Process



# Finding an Apartment Building

1. Work with a qualified agent/broker
2. Local MLS
3. Commercial Websites
  - Loopnet.com
  - Propertyline.com
  - CCIM.net
4. Commercial Brokerage sites
5. Commercial Brokers



# Commercial Sales Protocol

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1. “Subject to inspection”
2. LOI → Contract
3. Contract Type
4. Legal review
  - Clauses & addendums
5. Due Diligence
6. Renegotiations



# Commercial Sales Protocol (cont)

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7. Remove physical contingencies
8. Increase of deposit
9. Remove financing & appraisal contingencies
10. May or may not **“Go Hard”**  
(As in “Hard Money” = Loss of deposit)
11. Longer time to COE



# Inspecting Books & Records

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- Accounting records or tax returns
- Rent roll & deposits
- Copies of rental & other Leases
- Tenant Estoppel Certificates
- Receipts for expenses & capital improvements
- Guarantees & warranties

***“Talk is cheap.”***





# Building Inspections

- Walk-through
- Roof
- Commercial Property inspection
- Wood destroying pests
- Water damage
- Other inspections as needed



# Commercial Financing

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- Lenders minimize risk
- Property must be self-sufficient
- Scrutinize financials
- Lending Criteria
  - The lesser of the two:
    - Loan-to-value (LTV)
    - Debt Coverage Ratio (DCR)  
$$\text{NOI/ADS} \geq \text{DCR}$$



# Taking Title

- Protection through legal entities
  - LLC, LLP, Subchapter S Corporation
  - Pass-through taxation
- Greater protection
  - C Corp.
  - Taxable entity
- Follow 1031 Exchange Rules
- Consult an attorney



# Summary: Buying a Building

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- Have funds / financing available
- Use a qualified broker
- Know the market
- Run the numbers
- Do your Due Diligence



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# Property Management



# The Apartment Business

- People business
- Asset management
- Legal considerations
- Assess your experience & knowledge



# Risk Management

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- Follow the law
- Be consistent
- Use correct procedures
- Use correct forms
- Document everything
- Prepare for the “Anna Ayalas”



# Which works?

- Outside Property Management
- Self-management
- Pros / Cons
- Match to your needs/experience





# Using a Property Manager

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- **Typical Fees: 6% - 9% of Gross Revenue,**  
(not including maintenance and repairs)
- **Lease units**
- **Manage tenants**
- **Collect rents**
- **Issue notices & terminate tenancies**
- **Turn / prepare units**
- **Monitor / repair buildings**
- **Recommend / manage capital improvements**
- **Manage finances**
- **Adhere to the law**



# Hiring a Property Manager

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- Interview more than one
- Check references
- Look at their buildings
- Talk to tenants
- Manage your property manager
- Monitor discretionary spending
- Regularly review their reports and YOUR building



# Questions to Ask

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- How many & what type of buildings do you manage?
- CPMs or CCRMs on staff?
- How long have you been in business? What is your experience?
- How do you keep abreast of the laws?
- Who will be my manager? What is his/her experience? (meet them)
- How often are you on-site?
- How do you keep your books and records?
- What type of reports (financial & status) will I receive? How often?
- How are repairs handled?



# Self-Management

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- You need experience or assistance
- Time consuming
- Must deal with tenants
- Must deal with building problems
- Must deal with vendors
- Must adhere to all regulations
- Different size buildings have different challenges
  - 1-4 units
  - 16+ units



# Management Issues

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1. Preparing the property for market
2. Leasing skills & taking applications
3. Move-in process, rent collection & notices
4. Resident Issues
5. Tenancy termination



# Management Issues (cont)

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6. Supervisory skills
7. Maintenance management
8. Liability & risk management
9. Fair Housing Laws
10. Ethics



# What Troubles Owners?

- Finding tenants
- Finding the right tenants
- Excessive vacancies
- Regulatory environment
- The economy
- Repairs & maintenance



# Resources

- TCAA & the CCRM Program
  - Resources, training, seminars, pubs
  - [www.tcaa.org](http://www.tcaa.org)
- Books & management software
  - Search the web
- Join an Owners' group
- Robust Rolodex
  - “Ask Fran”
  - Legal, maintenance, marketing





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# When to Sell



# Selling Your Building

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- When do you sell your building?
- How do you sell your building?
- Tax Considerations
- Cash-out



# Timing is Critical

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- Monitor the market
- Follow your plan
- Assess alternative opportunities
- Calculate IRR

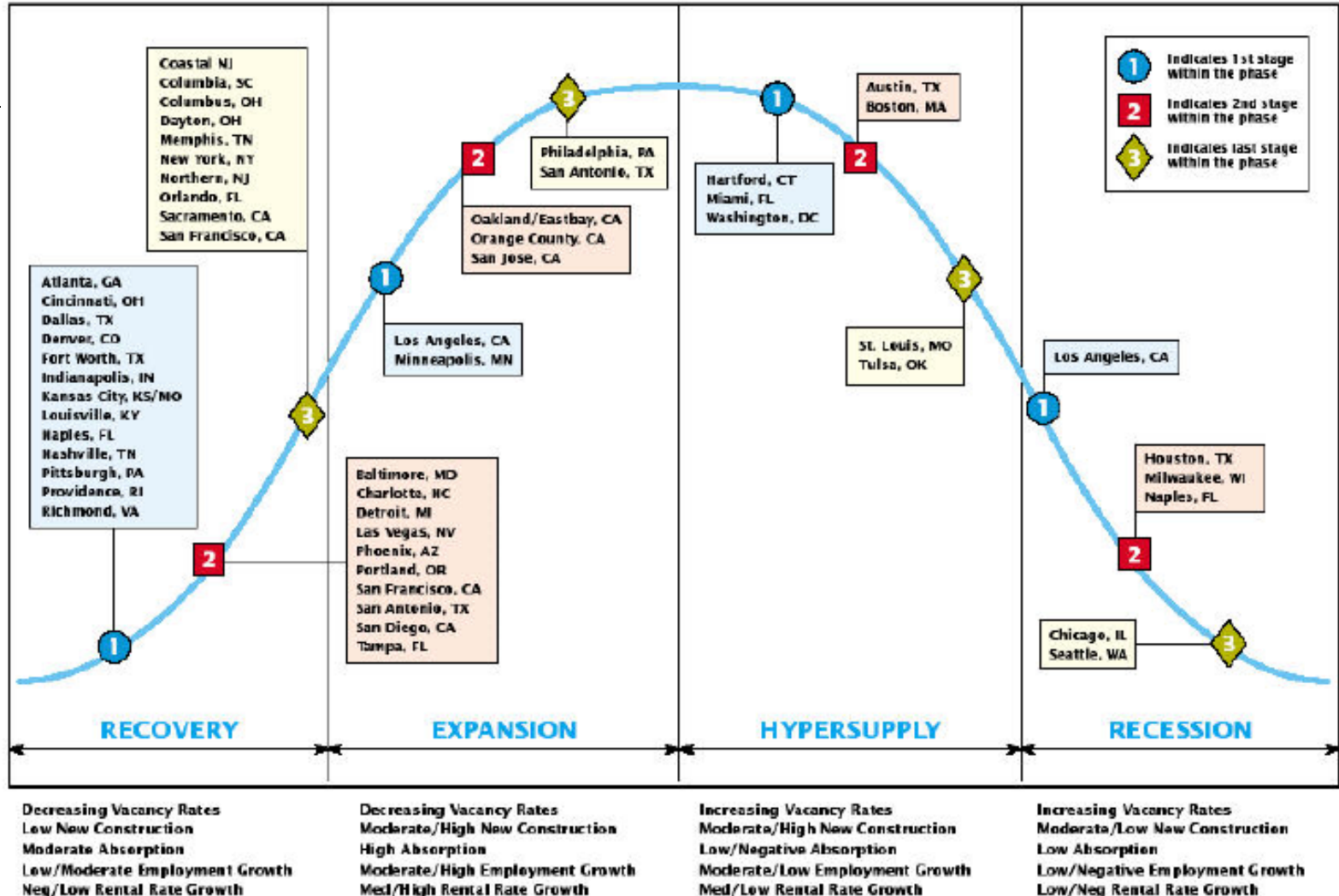


# Market Indicators

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- Sell at the near the height of the expansion
- Watch earnings from major area employers
- As more lose money, layoffs – and vacancies, are inevitable
- Follow economic projections in local newspaper articles
- Don't wait for rents to start falling, so will value

# Market Life-Cycle





# Assessing Alternatives

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- Look for opportunistic exchange candidates
- Can you refinance and carry both?
- Can you exchange at a profit and do the numbers justify the exchange?
- Don't hold past 27.5 years, exchange to take advantage of cost recovery.
- Can you sleep at night?



# Selling Your Building

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- Reduce expenses two years prior to sale
- Maximize rents if possible or,
- Keep rents at or just below market to maintain full occupancy and project stable tenancy
- Project Curb appeal
  - Paint building
  - Fresh landscaping and flower boxes
  - Repair eyesores
  - General clean up
- Books & records in order



# Selling (cont)

- Use a qualified commercial broker
- Price it realistically. Scrutinize comps.
- Market to as broad an audience as possible
- Use as many venues as possible
- Don't fall for the old "private investor list"
- Prepare professional materials
- Don't de-motivate your sales force
- Get monthly status reports from broker
- Adjust price and expectations accordingly





# Disposition Alternatives

- Cash-out
- Installment Sale
- Refinance, buy more
- 1031 Exchange

Each has a different tax impact  
and will affect overall IRR.



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