



# Investing in Small Apt Buildings

Presented by William Bronchick, Esq

# **My Goal for You...**

**Learn the Concepts of  
Profitable Apartment  
Investing this Weekend  
and be Able to Take  
Action on it ASAP!**

# What Are Your Goals?

- **Quick Cash – Flip or wholesale**
- **Cash Flow – Buy and Keep**
- **Turnaround – 3 to 5 yrs**
- **Retirement**

# Why Apartments?

- **Economy of scale**
  - Cheaper cost per unit
  - Better returns on capital
  - Less vacancy factor
  - Easier to manage
  - Bulk material discounts
  - Bigger depreciation



# Why Apartments?

- **Easier to finance**

- Focus on the deal vs. borrower
- More likely to get seller financing
- Private capital easier to raise
- Non-recourse loans
- No # of loan limits



# Why Apartments?

- **Less Cash Invested**
  - Easier to do no “money down”
- **Diversify Risk**
- **Tax write-off**
- **Reach goals Faster!**



# Are Apts for You?

- **Bigger deals – more risk**
- **Bigger deals – take longer**
- **Heavy on math**
- **Heavy on management**
- **Capital, credit, experience**

# 5 Biggest “Myths”

- ✓ You need a lot of experience
- ✓ You need a lot of money
- ✓ The risks are bigger
- ✓ Deals are more complicated
- ✓ You need to be a “player”





THINK  
BIG



***"You become the average sum of the five people with whom you associate with."***

**-- Jim Rohn**

# Don't Rely on Talent...Instead Develop SKILLS

- Talent is Rare
- Talent is What You're Born With
- Skills are What ANYONE Can Develop

# Create a Mastermind

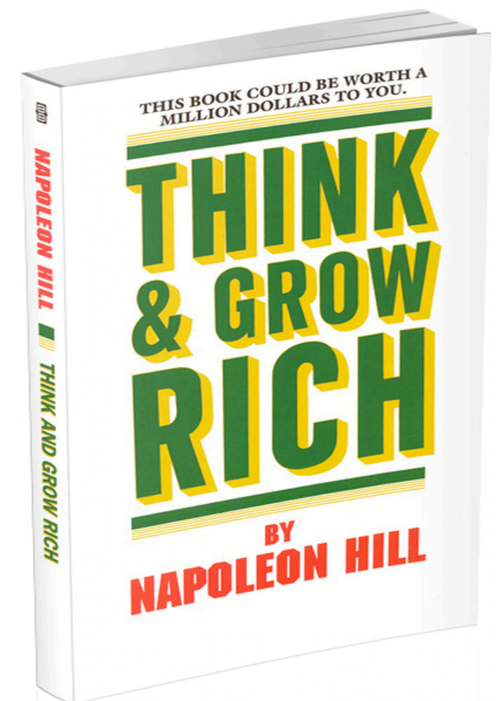


- **Call on 3-5 People in Business**
- **Common Goals**
- **Common Purpose**
- **Common Beliefs**
- **BRING SOMETHING TO THE TABLE!!**

# Be DECISIVE!!!

*“Analysis of several hundred people who had accumulated fortunes well beyond the million dollar mark, disclosed the fact that every one of them had the habit of REACHING DECISIONS PROMPTLY... People who fail to accumulate money, without exception, have the habit of reaching decisions, IF AT ALL, very slowly”*

**- Napoleon Hill,  
“Think & Grow Rich”, 1938**



# Be a Life-Long Student

- **Be Teachable**
- **Be Open to Ideas that Challenge**
- **Always be Asking, “Where’s the Cheese”?**



# Play BIG, Live Big

- **We'll Always Have Problems**
- **Bigger Problems Dwarf Little Ones**
- **Accept bigger problems as Part of Playing Big**



**ONE GOOD DEAL CAN  
SET YOU UP FOR LIFE!**





# Formula For Success

- Right time
- Right Properties
- Right market
- Right fundamentals
- Right financing
- Right management
- Have an ACTION PLAN

# Timing is (almost) Everything...



## **Grand Junction 4plex**

**Paid \$127,000**  
**Sold for \$185,000**

**\$58,000 PROFIT!!**



# South Florida

8 UNITS

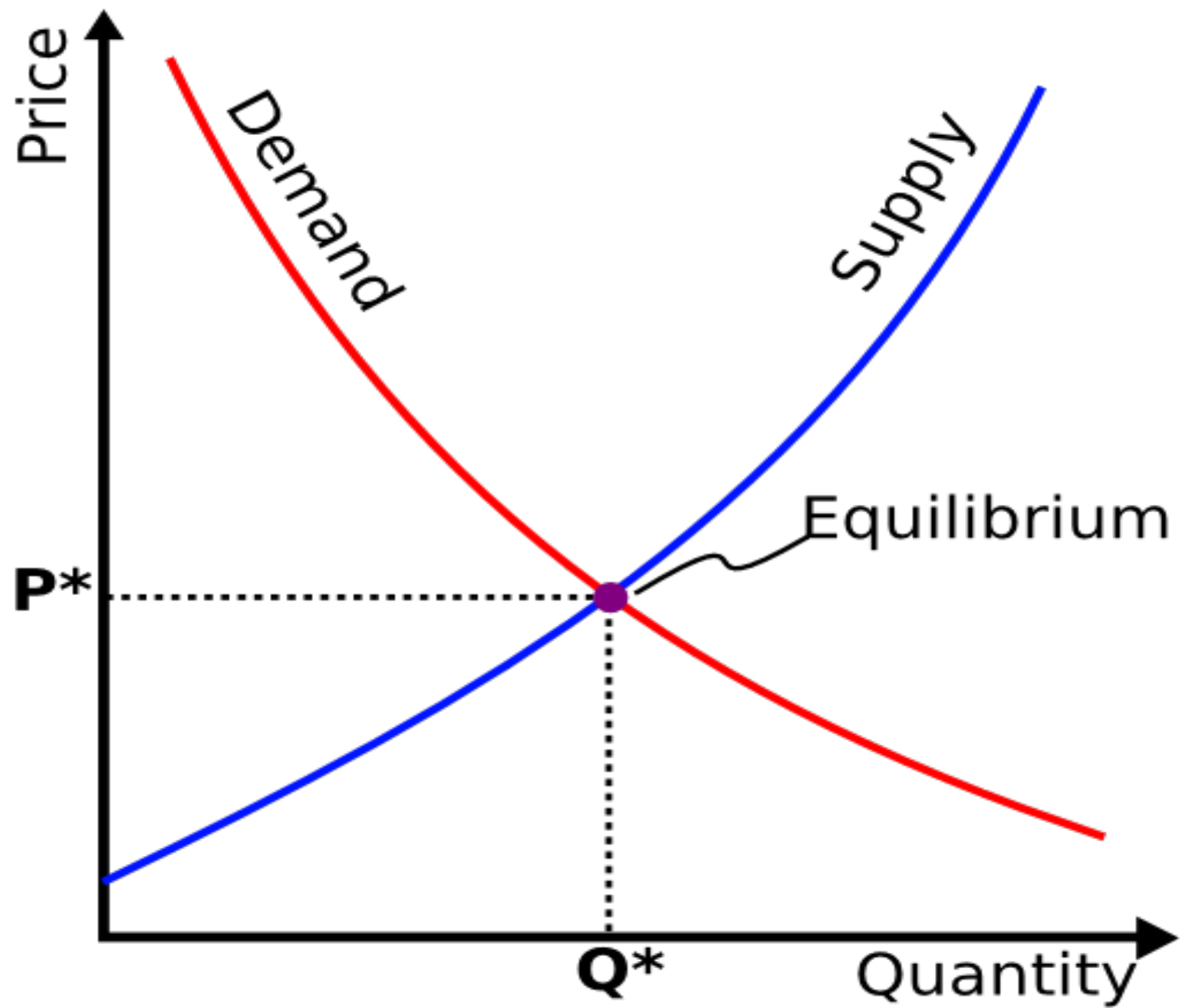
**Paid \$125,000**

(2001)

**Sold for \$280,000**

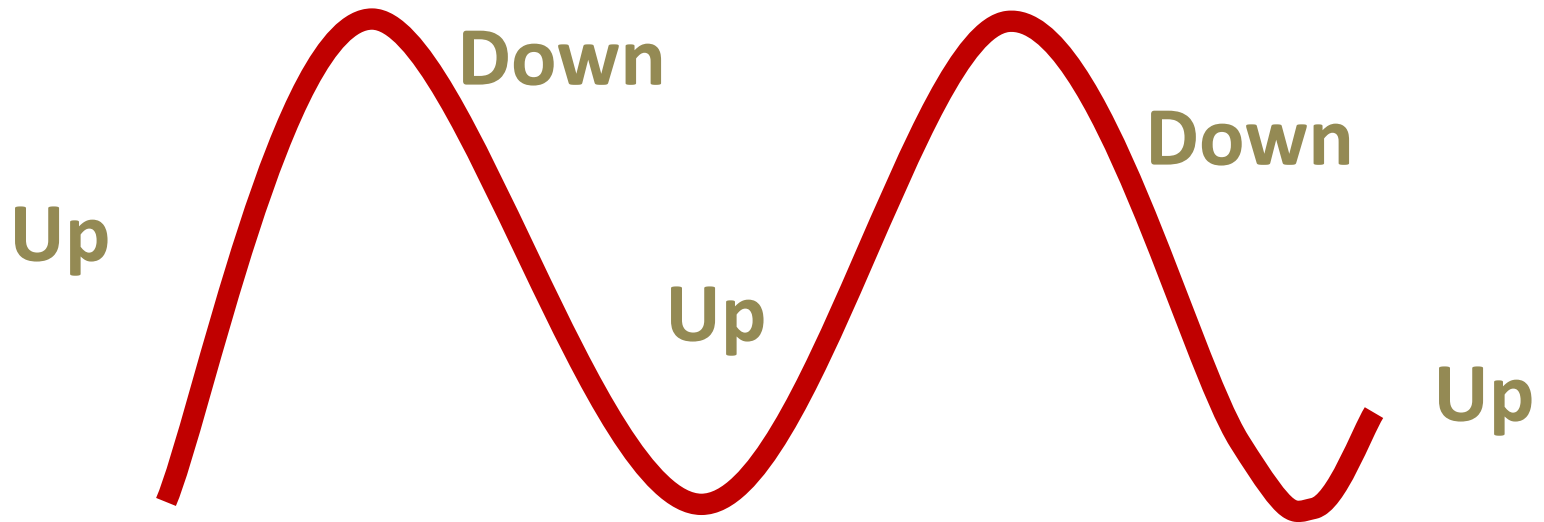
(2005)

**\$155,000 Profit !**



# Market Cycles

- Seller Market I
- Seller's Market II
- Buyer's Market I
- Buyer's Market II



# Buyers Market Phase One

- **Market Still Oversupplied**
- **Prices, Rents Falling**
- **Time on Market Increasing**
- **New Construction Stagnant**
- **Unemployment Reaches Height**
- **Foreclosures Rise Sharply**

# Buyers Market Phase Two

- **Market Absorbs Oversupply**
- **Time on Market Decreases**
- **Job Growth Increases**
- **Existing Properties Rehabbed**
- **Rents begin to Slowly Increase**
- **Prices begin to Slowly Increase**

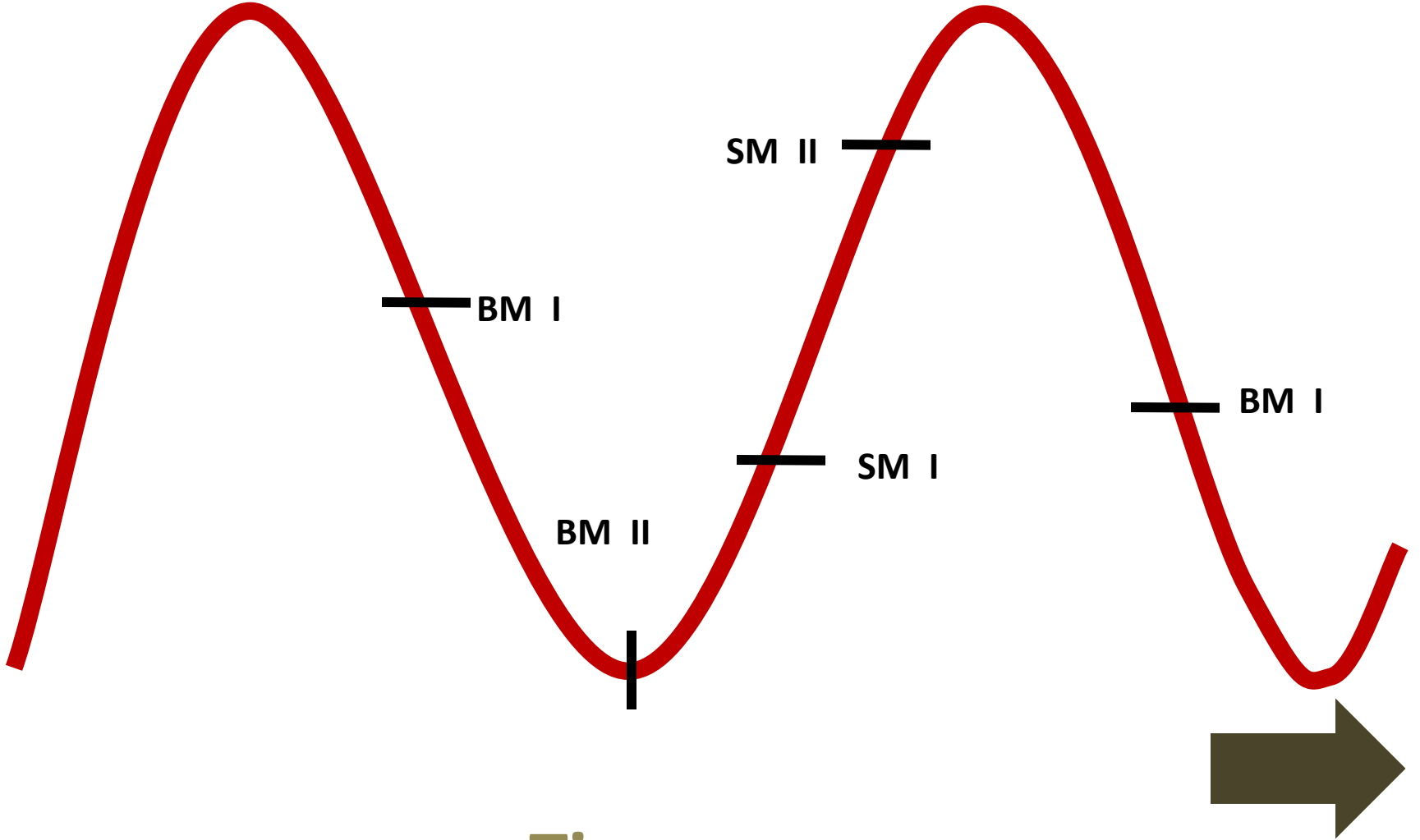
# **Seller Market Phase One**

- **Supply Dwindles**
- **Property Selling Fast**
- **Time on Market at Lowest Point**
- **Unemployment Low**
- **Property Prices and Rent Rising**
- **Demand at It's Highest Point**



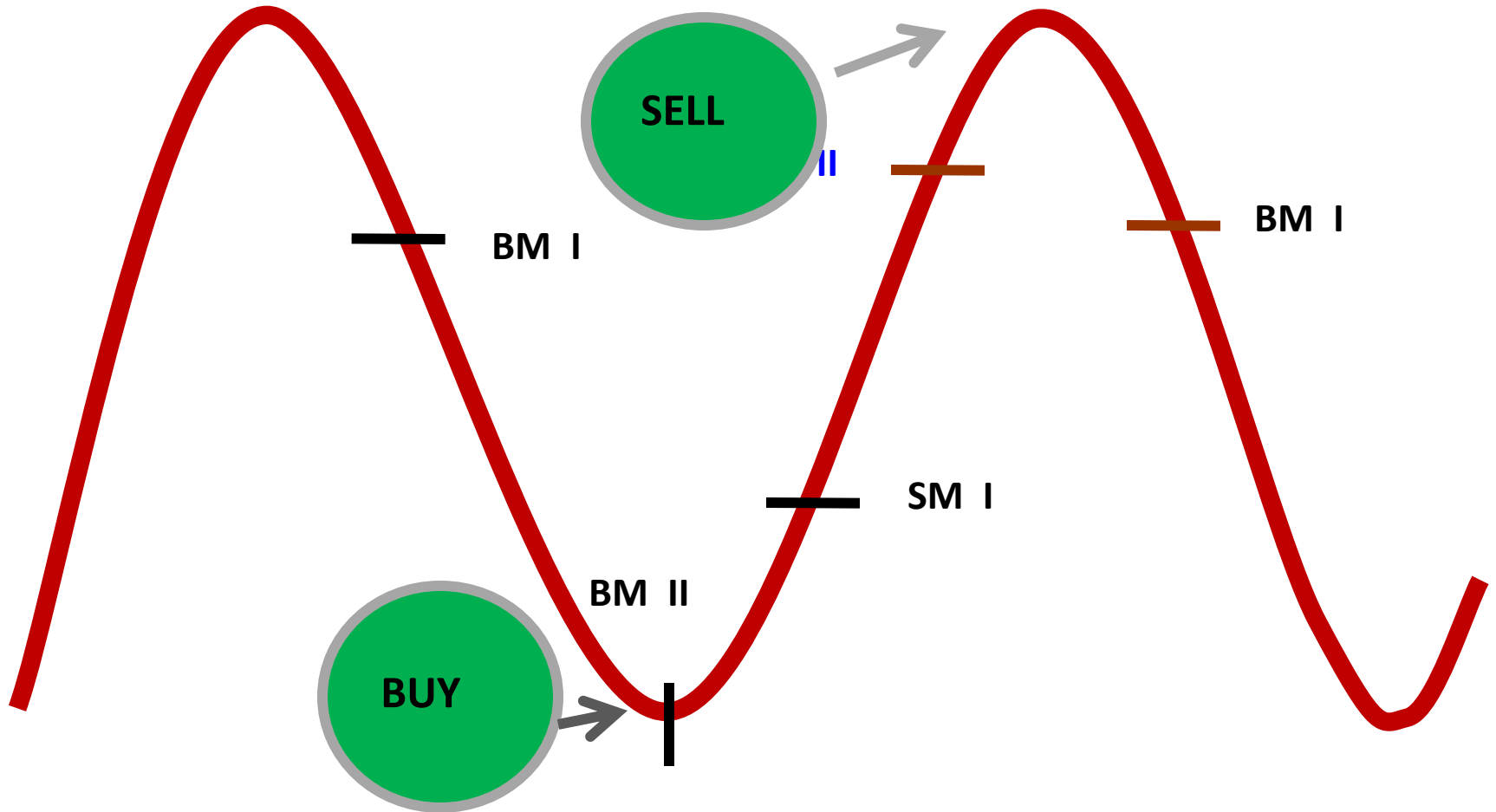
# **Seller Market Phase Two**

- **Time on Market Increases**
- **Supply Increases**
- **Seller Waiting but Still Get Inflated Prices**
- **Construction Pipeline Excessive**
- **Business and Job Growth Slow**



Time

# Market Cycles



# Right Properties...

## Class A Apartments

- Newer properties (< than 10 years old)
- Excellent condition
- Upper income area
- Lots of amenities
- Not much upside potential

## Class B Apartments

- 10 to 30 years old
- Relatively in good condition.
- Solid middle income
- Most stable

# Right Properties...

## **Class C Apartments**

- 30 to 40 year range
- Fairly stable
- Need some work
- Offer a lot of value play

## **Class D Apartments**

- Older buildings
- Declining neighborhoods
- High vacancy
- Blighted area

# Right Market...

**LOCATION!**

**LOCATION!**

**LOCATION!**

Macro

vs.

Micro

# Location: Macro View

- **Jobs**
- **Low supply of housing**
- **Growing demand**
- **Limited building**
- **Improving economy**
- **Long-term growth**



# Location: Micro view

- **Nearby amenities**
- **Property taxes**
- **Schools**
- **Crime**
- **Future growth**
- **Rents vs. values**

# Right Fundamentals

- **Capitalization rate**
- **Expense ratio**
- **Debt coverage ratio**
- **Rates of return**

**Gross Scheduled Income**

**MINUS**

**Vacancy**

**Equals Gross Effective Income**

**MINUS**

**Operating Expenses**

**Equals NET OPERATING INCOME**

# Gross Scheduled Income

- **Includes:**
  - Rent
  - Late fees
  - Parking
  - Vending
  - Etc.

# Vacancy...

- **Physical vs. Economic Vacancy**
- **Bad Debt**
- **Concessions**

# Operating Expenses

- **Includes:**
  - Maintenance & Repairs
  - Management
  - Legal/acct'ng
  - Utilities
  - Services
  - Property Taxes
  - Insurance
- **Do NOT Include:**
  - Principle & Interest
  - Capital Expenditures
  - Depreciation
  - Income Taxes
  - Amortization
  - Loan Points

# Expense Ratio

**Ratio of Operating  
Expenses to  
Gross Income**

# Typical Expense Ratios

- **Single Family – 25%**
- **2 to 4 Family – 30 to 35%**
- **5 to 50 – 40 to 50%**
- >>> 50 can decrease**



# CAP RATE

$$\text{CAP RATE} = \frac{\text{NOI}}{\text{Purchase Price}}$$

$$\text{Value} = \frac{\text{NOI}}{\text{CAP RATE}}$$

# Cash on Cash

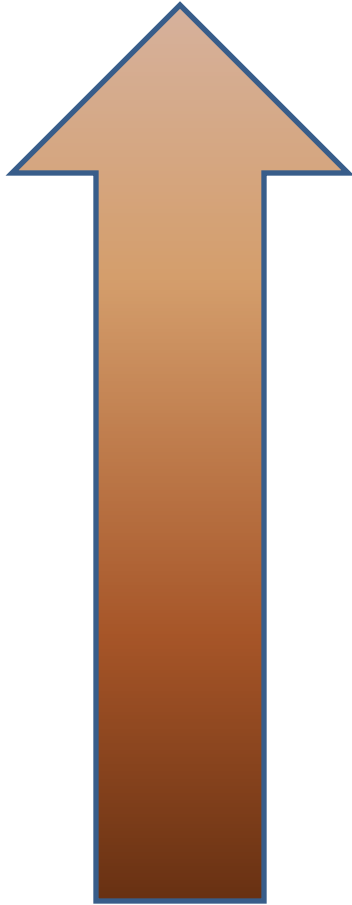
$$\text{Cash on Cash} = \frac{\text{Net Cash Flow}^*}{\text{"ALL IN"}^{**}}$$

\* Net Cash Flow = NOI – Mortgage Payment

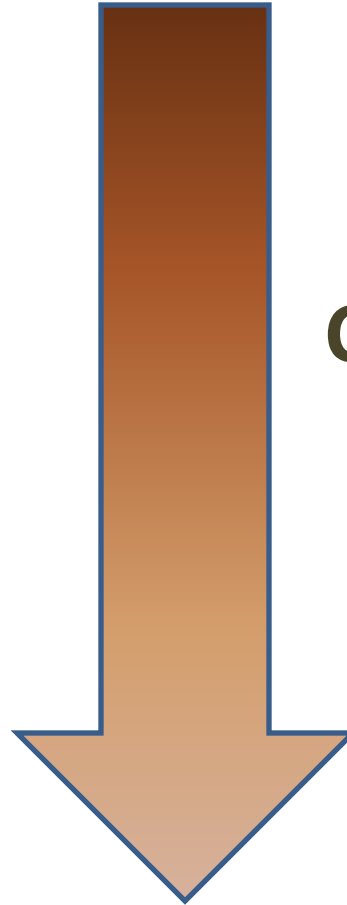
\*\* Down payment + closings costs, etc.

# Cash on Cash

**Cash  
Down  
Payment**



**Cash on  
Cash Return**



# Average Rate of Return

**Total Cash Flow  
PLUS  
Backend  
DIVIDED BY  
Number of Years**

# Present Value

**Discounting future dollars  
or cash flow into  
present value dollars**

# Present Value

**Joe wins the lotto...  
\$50,000/yr for 20 years**

**or**

**\$10,000,000 now?**

# Internal Rate of Return

## Internal Rate of Return

$n$  = number of cash flows

$CF_i$  = cash flow at period  $i$ .

$IRR$  = Internal Rate of Return

$$0 = \sum_{i=1}^k CF_i \cdot \left[ \frac{1 - (1 + IRR)^{-n_i}}{IRR} \right] \cdot \left[ (1 + IRR)^{-\sum_{q < i} n_q} \right] + CF_0$$

**“Annualized effective compounded return rate”**

# Debt Service Coverage

**DSCR = NOI/Debt Pmts**

**Should be at LEAST 1.2  
(1.5 IMHO)**



# Example – 10 Units

- **10 units x \$1,000/unit = \$10k/month = \$120k/yr**
- **Vacancy = approx \$10k/yr**
- **Operating expenses = 40k/yr**
- **NET OPERATING INCOME = \$70k/yr**
- **Asking price = \$1,000,000**
- **CAP = 70k/\$1M = .07 or “7 cap”**

# Example – 10 Units

- Asking price = \$1M
- NOI = \$70k/year
- Seller carry - \$200k down, 5% interest-only
- Interest payment on \$800k = \$40k/yr
- Net cash flow = \$70k (NOI) – \$40k = \$30k/yr
- Cash on Cash = \$30k/\$200k = 15%

# Example – 10 Units

- 5-year hold -  $\$30k \times 5 \text{ yrs} = \$150k$  cash flow
- Sell for net  $\$1,2M$  – backend profit  $\$200k$
- $\$150k$  cash flow +  $\$200k$  backend =  $\$350k$
- $\$350k/5 \text{ years} = \$70k$  profit per year
- $\$70k$  annual avg profit/ $\$200k$  investment =  
35% Average rate of return per year
- IRR - approximately 22%

# Financing Options

- **Local Commercial Bank**
- **FNMA & Freddie Mac**
- **FHA**
- **Seller finance**
- **Partners**
- **Master Lease/Option**



# Loan Variables

- **Property Type**
- **Loan Term/Amortization**
- **Rate – fixed vs. ARM**
- **Min loan size**
- **PPP & Balloon**
- **Guarantees/recourse**

# Loan Variables

- **Debt Service Coverage Ratio**
- **Occupancy/loss Requirements**
- **Reports – appraisal, survey, etc**
- **Borrower assets/credit/income**
- **Repair reserves**
- **Assumeability**

# Seller Financing

- **Regular carry**
- **Partial owner carry**
- **Subordination**
- **Wrap**
- **Short term vs. long term**

# Using Partners

- **ALL partners vs. financing**
- **Easier to do**
- **Cash discount**
- **Lower returns!!**
- **Securities regulations**



# Master Lease/Option

- **Secure a master lease w/opt**
- **Sublet to tenants**
- **Do your magic**
- **Refi, flip, or keep**
- **Sell your option**

# Self-Directed IRA

- **Convert your IRA to SD IRA**
- **Get others to do so**
- **Pool money together**
- **Can't borrow money w/recourse**
- **Can't take management fee**
- **UBIT or UDFI tax**

# Offer Through The Closing



# Preliminary Discussions

- **Review seller/broker pro-forma**
- **Run figures through spreadsheets**
- **Research the area**
- **Due diligence on seller/broker**
- **Find out why seller is selling**
- **How long he's owned it.**
- **Verbal offer on price/terms**
- **Initial walk through**

# Letter of Intent

- **Summary of price and terms**
- **Conditions and contingencies**
- **Required docs for seller to provide**
- **Approximate Closing Date**
- **Subject to attorney-prepared contract  
within a few weeks**

# First Round of D.D.

- **Review P&Ls**
- **Inspect property preliminarily**
- **Run your numbers in detail  
based on seller's figures**
- **Start talking with investors/lenders**

# Going into Contract

- **Have attorney prepare or review**
- **Earnest money schedule**
- **Form LLC or allowed assignment**
- **Right to extend closing date**
- **Contingencies**

# Due Diligence: Inspection

- **Walk through all units**
- **Hire inspector for roof, plumbing, HVAC, electrical, foundation, sewer, etc.**
- **Talk with tenants, handymen, property manager, neighbors, former owner (if you can track down)**
- **Go to city hall – talk with code enforcement, building dep't, zoning and planning, civil clerk**



# More Due Diligence

- **Talk with insurance agent**
- **Talk with lenders**
- **Talk with property managers**
- **Meet w/Atty to prepare PPM, Prospectus, Biz Plan**
- **Have CPA review financials**
- **Feel out investors that you have existing biz or personal relationship with**
- **Review title**

# Management



# Management Options

- **Do it yourself**
- **Hire a management company**
- **Hire an employee**
- **Have and onsite manager**
- **Combination**



# Considerations

- **Time**
- **Quality of management**
- **Aggravation**
- **Skills**
- **Anonymity to tenants**
- **Liability**



# Picking a Manager

- **Experience**
- **Number of units**
- **Reputation**
- **Forms/contracts**
- **Management agreement**
- **Policies with regard to tenants**
- **Fees**
  - **Percentage of rents – what does it include?**
  - **Leasing fee/renewal fee**
  - **Markup of work/supervision of work**
  - **Inspection fees**
  - **Reports**
- **Maintenance of Records**



# Minimize Your Taxes



# Tax Issues

**Capital gains**

**Depreciation & recapture**

**Passive Loss Limitations**

# Passive Loss Limitations

**“Material participation” rule**

**\$25k limit rule**



# 1031 Exchange

**“Like Kind”**

**Must be held for Productive Use**

**45-180 rule**

**Replacement Property**



*90 Days to Your  
First Small  
Apartment Deal!*

# Week One:

- ✓ **Assess your resources**
- ✓ **Potential partners**
- ✓ **Write out your goals**
- ✓ **Map out your weeks**
- ✓ **Develop a marketing plan**

# Week Two:

- ✓ **Put together a financial statement**
- ✓ **Learn a software program**
- ✓ **Review Small Apartments Course**
- ✓ **Start reviewing potential areas**
- ✓ **Put together team members**

# Building Your Team

✓ **Brokers**

✓ **Bird dogs**

✓ **Lenders**

✓ **Appraiser**

✓ **Inspector**

✓ **Insurance**

✓ **Attorney**

✓ **CPA**

✓ **Credit partner**

✓ **Cash partners**

✓ **Contractors**

✓ **Mentor?**

# Week Three:

- ✓ **Nail down farm areas to market**
- ✓ **Interview real estate brokers**
- ✓ **Get your first mailer out**
- ✓ **Develop your phone skills/script**
- ✓ **Create system for follow up on leads**

# Week Four:

- ✓ **Subscribe to Loopnet – contact brokers and see what else they have**
- ✓ **Comb Craigslist commercial section – [searchtempest.com](http://searchtempest.com)**
- ✓ **MLS leads**
- ✓ **Develop a Bird-dog system**

# Week Five:

- ✓ **Start calling Craigslist FRBOs**
- ✓ **Contact other investors and ask for leads and referrals**
- ✓ **Contact eviction attorneys, property managers, etc for leads**
- ✓ **Comb court records for evictions**



# Week Six:

- ✓ **Start lowball LOIs on Loopnet/MLS**
- ✓ **Second mailing to small apts**
- ✓ **Follow up on 1<sup>st</sup> round leads**
- ✓ **Call brokers to remind them you are still interested in apts.**

# The Second 45 Days

- ✓ **Marketing, marketing, marketing!**
- ✓ **Network, network, network!**
- ✓ **Make offers, offers, & more offers!**
- ✓ **Line up all the players**
- ✓ **SD IRA or 401k rollover?**
- ✓ **eBay some unused stuff for cash**