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Adding Value Means Increased Cash Flow

Since the value of a rental property is based directly on the cash return, adding value means increasing cash flow.

When small investors set out to increase real estate values, the steps are in upgrading houses, duplexes, triplexes, etc., enhancing the cash flow and therefore increasing equity when the property is sold.

When working with larger commercial and apartment properties, there are two major actions:

- Be aware of the things that have the potential of adding value, taking advantage of this knowledge and moving quickly before another buyer can purchase or option the property.
- Do the required homework on the property. A feasibility analysis can measure the ability to add value. There may be many other measures that must be taken, such as market analyses, applications for new zoning, design and construction planning and a plan for marketing.

Making Money

Investors purchase commercial income producing real estate to make money. There are two obvious ways of making money from a property.

First, the owner takes a share of the annual operating profit generated by the

investment, and

Second, profits from increasing the market value of the investment beyond what it would be because of inflation alone.

Apartment properties lend themselves to the second way of making profits better than many other types of investments. Increasing the market value of rental units does require know-how, absolute understanding of the market values of this type of property and excellent management.

The Operating Income

Good management has always been the most important point in increasing or maintaining annual operating profits. Being a skillful manager requires intelligent handling of the functions of buying and selling properties, rent collections, maintenance, leasing, controlling expenses, refurbishing, management accounting and more. All of this requires long "hands-on" experience in the field with plenty of assistance from the latest in operational and administrative hardware and software. Professional property managers will do a much better job than most owners and will more than cover their fees. □

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This publication is not a solicitation but is an information service from this office.

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

Checklist For An Apartment Investment

When any particular apartment building is under consideration for purchase, there are a number of factors that should be considered. Here are some of the more important points:

- **Location** is always at the top of every list of considerations in real estate. Always check not only the building itself but also the entire neighborhood. How does this building compare with others in the area? How do rents compare? How close is a business area and is there adequate transportation? How close are schools, recreation areas, shopping and churches?
- **Rentals and floor plans.** What is the layout of the apartments and the average rent per room? How competitive is the rent level and is there any chance for increases? The rent level may not always be equal to the rental value. An apartment that is rented at a bargain price in a good community may have more rental value than high-rent premises in a declining area.
- **Condition of the property** can be the difference between profit and loss after purchase. Check the building and the grounds. What is the age and type of any equipment used? Is there any deferred maintenance? If you have checked the other nearby buildings, your building and grounds must compare favorably with the others to get the same rents.
- **Vacancies.** How many currently vacant units? Based on comparisons with neighboring buildings and past history of this building, when do you feel that the vacancies will be filled?
- **Amenities offered** to your tenants must be in line with the type of tenant. Singles might be interested in recreational equipment and a pool. Tenants with children might want play areas. Perhaps the amenities you offer will be compared more to other apartments by potential tenants than the apartment itself. Does your unit have air conditioning, fireplaces, built-in kitchen appliances and modern bathrooms?
- **The Income.** As stated, the value of the property is based on the income. While everything should be checked thoroughly, anything to do with the cash flow and expenses should be double-checked. Income can come from many sources, apartments, garages, utilities, parking spaces, coin-operated washers & dryers, or other vendors. You must see if there are any pre-paid rentals, rents in arrears, and contractual rent increases. Find out if there are any free rent concessions and be aware that these concessions may not appear in the rental agreements or leases, but in some side agreement.

The following may be a way to protect yourself from any problems with the income and possible concessions or side agreements:

- A. Have the seller state in writing the rent for each unit, the terms and amounts, any concessions or pre-paid rents, any written or unwritten arrangements between the tenants and the owner or his agent. A provision can be included that these representations will survive the transfer of title and any misrepresentation found before that time will be grounds for rescinding the contract, with the buyer to be entitled to costs and disbursement incurred.
- B. Verify the information on the seller's statement against the leases and against seller's receipt books. Interview

several tenants to check terms of their leases against seller's statement.

C. Have the seller sign an affidavit that the statement reflects the correct rental amounts and terms, that there are no other lease agreements in existence, and that he is making the statements to induce the buyer to purchase, knowing that the buyer is relying on the affidavit.

D. Also look into the possibility of options to cancel leases and commitments for future improvements to apartments.

E. Finally, check whether the amounts that the seller has reported as tenant's security deposits are correct. Check contracts with any outside company, such as coin-operated washers and dryers to check for the terms and income.

- **The Expenses.** Examine the expense statements for past years, not just for a few months or one year. See if there could be any under maintenance, which might not be apparent in an inspection. Maintenance could have been deferred recently to improve the current net income to facilitate the sale of the property. Check the number of employees, their jobs and the total payroll, and any requirements of union contracts. Are there any rent concession agreements with employees? Can you reduce costs by better staff management?

The following items of expense should be carefully examined:

1. **The loans on the property.** Check all of the terms of any existing mortgage that will be assumed. Determine if refinancing is desirable and feasible.
2. **Real estate taxes.** Are assessments and tax rates correct? What will the recording of the sale do to change the assessment? Will the property tax change after the purchase? Determine the percentage of assessed valuation between land and improvements to see if a satisfactory corresponding allocation of the purchase price can be made to establish a depreciation base.
3. **Insurance.** Is property properly covered? Can premiums be reduced in any way? Will more insurance be required if you increase the mortgage?
4. **Utilities.** Check the bills for the costs of heating, gas, water, and electricity. Check bills on an annual basis, rather than a few months. Are there separate sewer charges? If so, how are they computed?
5. **Check all outside contracts.** There may be contracts for maintenance, separate contracts for elevator maintenance, cable TV, and exterminating.

All of these checks and investigations are part of the routine of the real estate professional. Some of the duties of the broker or brokers representing the buyer and seller in a real estate transaction are to satisfy the buyer that all of the information about the property is correct and complete. Normally, when employing the most professional real estate firms, this research will be completed by the brokers before the information is presented to the purchaser.

After the purchase, continue with the most professional actions by employing a professional real estate management company. □

Condos – Developments And Conversions

Most anything that can be subdivided to be sold or rented can be developed or converted to condominiums. When we say “condo” maybe the apartment might come to mind first. Then, you may think of the commercial office building that was converted to condominium offices. Less common are the other, unusual types of condo developments such as condo parking garages, boat marinas, and other properties that are usually rented. Here are examples:

Motel Vacation Units

When Americans go on vacation to resort areas, they often stay in motels that may be located close to the action - the beach, the lake, or the ski slopes. Usually there are condo units also available. For some vacationers, the motel may be too small for an entire vacation, but the full size condo apartment would be too large.

Now, in some parts of the country, motel units are being converted to condo vacation units. The south shore of Long Island, New York, is an area of scarce and extremely expensive rental homes. Rents for one season often exceed \$100,000.

Even Condo Rooftops

We said anything that can be rented can be a condo. The New York State Attorney General’s office accepted a plan which was the first in the state, where owners in a 65 unit co-op would be eligible to buy space on the roof of the building. Only owners in the building could purchase the space. A patch of the roof 15 feet 4 inches square would sell for about \$13,000, plus a monthly maintenance fee of \$43.00. A larger piece of roof 25 feet square would sell for \$36,000 with a monthly maintenance charge of \$128.00.

Vacation Houses

Currently, the practice is to lease a house to a group of young, single professionals from New York City, who split the total cost into shares that can cost \$10,000 to \$15,000 each. Then the group of 25 to 30 individuals decide who can use the house on which weekends and weekday vacation periods. In this way, the house is occupied about every day of the season, but never has to accommodate the whole group who have purchased shares at the same time. This has worked well for the renters.

The lessor of the property receives the full rental price at the beginning of the summer season and does not have to rent the house to different lessees for short periods of a week or two during the season.

Family Accommodations

These shared rentals of a house do not work well for a family. They also do not work for individuals who want a place available various times during the summer, such as a week or two at one time, plus every weekend.

A motel converted to condo motel units appeal to families who otherwise cannot afford to vacation in this very expensive area. These units also attract people who want privacy, which is not available in a shared home arrangement.

One large motel was converted to 64 condominium units several years ago. There were 7 one-bedroom units, 25 studio apartments, and 32 bedroom-bath (but no kitchen) units. The one-bedrooms have a kitchen and were priced at \$76,000 with monthly maintenance charges of \$575. The 25 studio units were priced from \$51,000 to \$66,000 with monthly maintenance charges of \$399 to \$525. The 32 bedroom-bath units were priced from \$49,000 to \$51,000 with maintenance of \$378 per month.

A second motel was converted to 40 identical units, each with a bedroom, a bath, a kitchen and dining room. The price was \$87,000 to \$96,000, depending on the view from the unit. Monthly maintenance charges were set at \$520 to \$577.

Each of these motels had both tennis courts and swimming pools. The condo owners have access to these when they are using the units. Prices in both units would be higher today.

Aircraft Hangar

In a community in the mid west, a residential airport community was built. There are approximately 135 homes custom-built on one-acre or larger lots. Each house has an attached hangar in which the homeowner parks his or her own airplane. The homeowners are able to taxi the aircraft to the 3,400-foot runway owned by the community. The runway is owned and maintained by the homeowner’s association (\$100 per month charge to each homeowner). The association also sells fuel to the homeowners at cost.

The developer planned an additional second-phase development of 225 town houses and 50 single-family houses built on less than one-acre lots. There also will be 270 condominium hangars to accommodate those residents. The hangars, priced at about \$50,000, are located across the runway, with the homeowner’s association offering full maintenance and repair services. □

Investment Planning – What is Right For You?

A prospective investor may have a problem getting started with a real estate investment because of the great variety of properties that are out there. They may be fearful that someone will “sell” them something – something that is wrong for them.

An answer to these problems can be an interview with an interested professional real estate broker who can act as a real estate investment counselor. Each prospective investor can be interviewed in depth to find out specific needs in an income property. At the same time their needs are being evaluated, the broker will also communicate what benefits are available in various properties and how to identify them.

Some considerations should be given to the risk of loss for each age bracket of investor. Should an older investor purchase a property with the smallest down payment and highest leverage position? This will limit cash flow and may cause the property to have a “negative” cash flow. Is this what they want – or do they want cash flow from the property?

How about the younger couple? Are their objectives for

long-range estate building or for current cash flow? Would they be more willing to take chances with a marginal investment that might bring big returns later?

These answers must be decided by each investor for himself or herself. But, only after enough information has been furnished so that an intelligent decision can be made.

When a new investor has a better idea of the type of property that will do the right job for him/her, or them, then and only then should they be exposed to the market place and shown specific properties. Now the investor or investors can evaluate the various benefits and risks for the information shown on each property and apply the information to their own situation.

What is right for you? A new rental unit? A strip center? A one-hundred unit apartment property? An Outlet Center? Perhaps you should have five or six apartments or commercial properties in scattered locations. Real estate counseling can show you that you can choose which is right for you and know the reasons why it is right! □

Real Estate Investment Consultants

When you need professional advice and help in commercial real estate you must come to our office. We are experts in values and knowledge of the entire market in this area. If you have been looking for a certain type of property we probably have the full information on several like it already.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated. As your professional commercial real estate advisors, we are in the position to represent you in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of

real estate

More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of information, planning is better and there is less chance for error.

Real estate investing is not just the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

We can be your consultants. □



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A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.