

**The Advanced Teachings of Mrs. Langerhorn: 20**  
**by Klarise Yahya, Commercial Loan Broker**

*Note to the Reader ... These are not the notes of our conversations that were published earlier under the title "Mitochondria Learns to Invest". These are the papers Mrs. Langerhorn left me after she passed away. They are her advanced teachings, and as such they overlap and reinforce her earlier principles. I hope you gain from them as much as I did. The earlier lessons are incorporated in the book "Stairway to Wealth" available at LuLu.com*

**The Negotiation**

Dear Mitochondria,

I'm sure you've been through enough negotiations by now to know that they are all about money. This can't be a surprise. You want to buy or sell and the counterparty wants to sell or buy. All that is left to settle is the price. And it is important to keep the discussion price centered. If it becomes focused on something else the negotiations dwindle.

The most fundamental rule of negotiation is: don't criticize. Do not justify your number by bad-mouthing the property. That only results in an argument over whether or not the property has the deficient feature you mentioned and how serious it is. Instead, simply incorporate all the good and bad things into the number you put on the table. When the other party says, "Yes, but ..." you just smile and say, "My offer includes that". Normally, the other guy will give you several "Yes, buts" and you will have to respond each time with "My offer includes that." If your offer is reasonable, agreement will sooner or later be reached.

It's important that your offer is reasonable. It's probably natural to dream of taking advantage of someone who wants to sell. You know, finding a property that we can buy with favorable terms and at pennies on the dollar. "Yes, I understand that you bought these 24 beachfront units for \$40,000 back in 1937, but they were freshly built back then. The paint was still tacky. Now, they're much older and can't possibly be worth as much. Haven't you written them all off? So even the government agrees they are worthless. Why don't I just give you \$6,500 right now and you can be rid of these old things?"

The dreadful thing is that urban legend suggests something like this really does occasionally happen. Every once in a while you will hear of a friend of a friend who "stole" a property. I've been investing in real estate for over 50 years now, and it's never happened to me, even though I've been consciously aware of the market every day of those five decades. Furthermore, it's never happened to anybody I know. But some people continue to cherish the hope ...

Sellers aren't stupid. Their property is the biggest investment they have, and you have to accept that they know almost to the penny what it's worth. Naturally, in a declining market a lot of sellers will price their buildings at what they might have brought a year or

two ago, hoping that a naïve buyer might somehow appear. But this is an overpricing, not the exaggerated underpricing in the stories.

And even if an underpricing occurred, the normal digestive actions of the marketplace would attract overbidders. Auctions are based on that concept. A property is auctioned and a low bid is finally generated. What happens next? Someone bids higher. Eventually equilibrium is reached and the next fellow who bids \$500 more than equilibrium gets the property. You may have confidence that if a building is widely advertised over a reasonable length of time, price equilibrium will be reached.

Nonetheless, it's possible that a seller may secretly harbor a low number in his mind. Perhaps he first thought of selling the property thirty years ago and, back then, the price he put on it was so high that no capable bidder offered to match it. Three decades have now passed and he's still fixated on that same, secret number. Well, under some conditions – perhaps a quart of Jack Daniels – it might be possible that you could somehow become the only other person in this world that knows his secret number, his thirty year old price point. You could find yourself with a significant bargain. But the key to this possibility is that the seller has not widely tested his number in the marketplace. If he did, such a bargain would quickly be bid up to full value. You know that's the case. If it wasn't, why wouldn't you take out a full page ad in the local paper announcing the fact that you intend, sometime next month, to buy the property at (blank) address for eight cents on the dollar?

And it's really not important whether or not you pay full market price. If you buy an investment (i.e., a stream of income), you will still do well even buying at full price. This doesn't mean paying trophy prices for some dilapidated sty in a run down section of the city. It means paying fairly for the property, and that depends on the income the property generates.

Most of the time, properties are optimistically priced. It's important to realize that doesn't mean “not market” priced. The market is what it is, and most people just pay too much for a building. Even so, they still find apartment ownership eventually becomes the best investment they ever made due to (a) a typically rising stream of net income and (b) leverage.

Remember how when you make an “investment” all you are really doing is buying a “stream of income”? Sometimes the market values this stream of income expensively, and sometimes cheaply. For example, can you reflect for a moment on how much (or how little) ultra-safe 30 year U.S. Treasury bonds have returned? I remember very clearly - the early 1980's saw thirty year bonds paying over 14%. In 2005 they were down to under 4%. Now, a dollar of interest from a U.S. Treasury bond is just as safe whether it was paid in 1982 or 2005. Why would the market place a different value on it? Why would a dollar of ultra-safe interest on one date be worth \$7.14 ( $\$1.00$  divided by 0.14) and on another date cost \$25.00 ( $\$1$  divided by 0.04)?

All streams of income are subject to fluctuation in value just as Treasury bonds are. Apartment buildings, for example, are sometimes so expensive that they sell at essentially break-even prices even with as much as sixty percent (60%) down. This could be a reasonable price, based on what similar buildings are selling for. For example, if a building's net operating income would cover the loan payments and generate enough cash flow that it reflects a C.D. equivalent yield on your down payment with 60% down, well, there have been times that has been "market".

Other times, apartments languish unsold when a 25% down payment would generate a 7% or more positive cash flow. Well, it doesn't do to buy when prices are high, but when prices are cheap you must buy with both hands.

Historically, the market never values a stream of income cheaply for very long. If you drew a line from one side of this paper to the other – make the line a little higher on the right side than on the left to indicate a rising rental stream over a multi-year period – and then graphed the market values of apartments around that line, you would find that the values mostly stayed above the line. Once in a while, however, the values will briefly dip below the line. That's when you buy.

How do you know when they are beneath the line? My husband and I used to use a simple metric: if we could buy well located apartment buildings with 25% down and a 5% or better cash flow, we thought the market was cheap. "Well located" simply meant (a) it was located in an area of rising population and (b) development restrictions were in place. The restrictions could be as simple as little or no land available to build competing units. And if we could get that kind of cash flow with a 15 year fixed rate loan, well, my husband was known to hyperventilate.

But you have to have the down payment or nothing happens. To do this we arranged to have have two "portfolios" of apartment buildings. One portfolio contains franchise buildings. These are buildings that rent for reasons other than price. It may be close to the beach, or in a splendid school district, or it may be in the hilly area and have magnificent city views. Franchise buildings may or may not be "well located". (The best of all possible worlds, of course, is to have a portfolio of well located franchise buildings.) We try very hard to pay off our franchise buildings as quickly as we can. As they're paid off they generate a pleasingly secure stream of ever-increasing net income. Life is good. The second portfolio contains our trading stock. These are commodity buildings that rent only on price. For example, one of them is a ten unit building at the end of a block of identical ten unit buildings. I counted them one time. There are 18 identical ten-unit apartment buildings on that block, seven on our side of the street and 11 on the other side. Don't ask me why we bought that puppy. Wait. I remember. It was all we could afford, the only way to get on the train. But as property values appreciate, even that building went up. We refinanced that building (and all our other commodity buildings) several times over the years just to generate big piles of cash so we could be selective buyers when the inevitable reversion to the mean occurred. We don't refi the franchise buildings, but we keep the commodity buildings fully leveraged.

That's how you accumulate the funds to become really wealthy.

Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or purchasing five units or more anywhere in the U.S.A., **Klarise Yahya** can help. **Find out how much you can borrow!** For a complimentary mortgage analysis, please call her at **(818) 500-9966.**