

The Advanced Teachings of Mrs. Langerhorn: 35

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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

BULLET POINTS: AN EXAMPLE

Dear Mitochondria,

The *Wall Street Journal* recently published a splendid article by Maura Webber Sadovi where she reported the acquisition by 84 year old Harold Brown of one of the largest apartment purchases of 2009.

Mr. Brown, according to the article, paid \$129,500,000 for the 409 unit Dexter Park apartment building, 175 Freeman St, Brookline, MA 02446. He paid \$40,000,000 (31%) down and financed nearly \$90,000,000. ***Bullet Point:*** *The down payment was sufficient to bring the LTV ratio beneath 70%.*

Mr. Brown began his investment career with 6 units in 1954. By 1990 he had 2,000 apartment units and 10 million square feet of commercial space. A year later everything collapsed. He filed for Chapter 11 bankruptcy in 1991, listing corporate and personal debt of \$660,000,000. Then Mr. Brown started all over again using the skill set acquired over the prior 37 years. This time around, his rebuilt portfolio contains a greater percentage of apartments and less commercial space.

The most recent data available shows the Dexter Park zip code (02446) having \$78,884 individual adjusted gross income. Rents for two bedroom apartments in the zip code typically range between \$1,000 and \$2,000. Dexter Park, however, gets average rents of \$2,700 while maintaining a 94% occupancy. The apartments are within walking distance to Boston University. The high rents suggest to even the casual reader that most units are probably shared by roommates, which increases the total rent per unit while reducing the cost to each tenant. The downside is (a) wear on the building and (b) management difficulties. ***Bullet Point:*** *The project is a franchise building (high rents / high occupancy ratio) located in an archipeligo (high income zip).*

Compare these numbers with Glendale, California, 91203, which during the same period reported individual AGI of \$41,225. Glendale market rents had a mode of \$800 to \$1,250. Relating the Brookline, MA individual AGI and rent levels to an area we know helps us to gain a sense of the foreign market.

The Dexter Park purchase forecasts a NOI of \$8,200,000. Deducting expected debt service, reported at \$5,000,000, leaves a leveraged return on down payment of about 8%

(\$3,200,000 divided by \$41,000,000).

The WSJ article continues, “Mr. Brown expects a rebound in demand for Boston-area rentals within about three years thanks to rising population and little construction”. We know that rising population places upward pressure on rents until the tipping point where the elevated rents eventually support new construction. But, of course, the new construction comes on line at much higher cost-per-unit than Mr. Brown is currently paying for Dexter Park (\$316,626).

Now, it’s nice if tenants are grateful but that doesn’t always happen. Some random tenant comments (google: Dexter Park) include:

Posted 2006: “Dexter Park offers a lot of amenities but the drawbacks are significant as well. I would recommend it for students but ABSOLUTELY (emphasis in original) not for couples or young families.

“... the layout of the units are (sic) weird, and the walls and floors are paper-thin which is a serious problem when you have BU students partying all hours of the night. Management is very smug and treats every encounter, however gracious and polite you are, like a request to move mountains.”

Posted 2007: “This place is a rip off (sic). It is filthy and disgusting ... The building pretends to be an extension of Boston University. You would think that the kids that go to the most expensive University in the country would be clean, they are not. They vomit in the halls and elevators ... they yell and scream off balconies (sic) at all times of the night on any day. The building embraces this behavior. They sent around threatening letters to every resident, without taking time to investigate which apartments were making noise ... The building is also used as a group home for mentally challenged people (and) they really bring down the living experience when they have fits in the laundry room or try to touch you in the elevator.

Posted 2008: “I just moved in and am enjoying it so far. The problems that I had moving in were solved quickly by staff, in fact, it was the front staff person that called maintenance for us and scheduled all the work we requested. It seems that there must have been a staff change over and some nicer, more helpful people were hired since the last post on this site.

From a buyer's prospective, then, Dexter Park is a franchise building located in an archipelago being purchased at full (current) market value with a significant down payment. The history of poor management does not appear to be an issue because management can be changed.

Obviously, this sophisticated buyer / investor is not a bottom feeder. He has learned from building two successive multimillion dollar portfolios over 55 years that it's best to acquire quality apartments when they (rarely) come on the market, even if one must pay full market price. Harold Brown's purchase followed the applicable Bullet Points we've been discussing the past couple of Letters, and can be condensed into the following: *Buy a franchise building in an archipelago, Be willing to pay full market price. Do not count on the building significantly appreciating. Be content to gain from increasing cash flows and equity build-up.* These expectations are appropriate for an investment environment of increasing interest rates.

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