Revisiting 7 Key Factors Before Purchasing Apartment Investments
by Craig A. Lane, CCIM

Rental units continue to be a preferred investment. Demographic trends point to increased future demand for apartments as the baby boomers (aged 45 to 65) become empty nesters and begin thinking about retirement. For them, apartments in central cities or in retirement areas will be preferred.

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 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. Professional property managers will do a much better job than most owners and will more than cover their fees.

Increasing Market Value

Since the value of a rental property is based directly on the cast return, adding value means increasing cash flow. When working with apartment properties, there are two major actions:

1. 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.
2. 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.

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:

1. **LOCATION** is always at the top of every list of considerations in real estate. Always check not only the building itself, but 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?
2. **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.
3. **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 favorable with the others to get the same rents.
4. **VACANCIES**. How many units are vacant now? Based on comparisons with neighboring buildings and past history of this building, when do you feel that the vacancies will be filled?

5. **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?
6. **THE INCOME**. As stated, the value of 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 vending machines. 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 terms and income.

7. **THE EXPENSES**. Examine the expense statements for the 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:

A. **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.
B. **REAL ESTATE TAXES**. Are assessments and tax rates correct? What will the recording of the sale do to change the assessment? Will 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.
C. **INSURANCE**: Is property properly covered? Can premiums be reduced in any way? Will more insurance be required if you increase the mortgage?
D. **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?

E. **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 real estate transactions are to satisfy the buyer that all of the information about the property is correct and complete. Normally, 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 profession actions by employing a professional real estate management company.

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