



Neal
Bawa



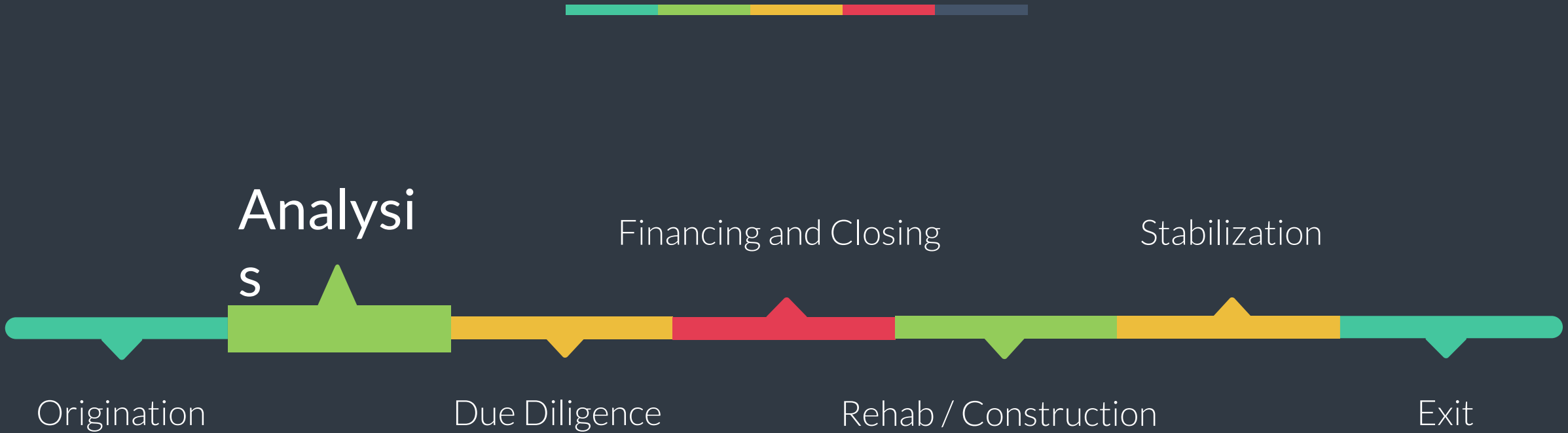
Anna
Myers

BUYING RIGHT- DEAL ANALYSIS



Multifamily University

ACQUISITIONS TIMELINE



Underwriting as an iterative process of analyzing a multifamily property. At each step you learn more, and assumptions can change...

WHERE WILL OUR ADVENTURES IN UNDERWRITING TAKE US TODAY?



- 1 Key Underwriting Terms – NOI, Cap Rate, DCR, CoC
- 2 The OM, Rent Roll & T12
- 3 Demo of the Deal Analyzer v1
- 4 Underwriting Logistics & What you will Need
- 5 Calculating Returns : CoC to IRR
- 6 Your Turn - Underwriting
- 7 Risks & Opportunities
- 8 Rent Comps
- 9 Commercial Lending for Multifamily
- 10 Syndication Structures

NET OPERATING INCOME (NOI)



A multi-family investment is a business

- Operating Income
 - Rental Income
 - Laundry, parking and other sources of income
- Operating Expenses
 - Property tax, insurance
 - Repair and maintenance
 - Management, marketing, administration
- Debt Service

$\text{NOI} = \text{Annual Operating Income} - \text{Annual Operating Expenses}$

*NOI DOES NOT INCLUDE DEBT SERVICE

CAPITALIZATION RATE (CAPRATE)

This is a measure of the relative return the Net Operating Income (NOI) yields on the purchase price on an annual basis

$$\text{CapRate} = \frac{\text{Net Operating Income (NOI)}}{\text{Purchase Price}}$$

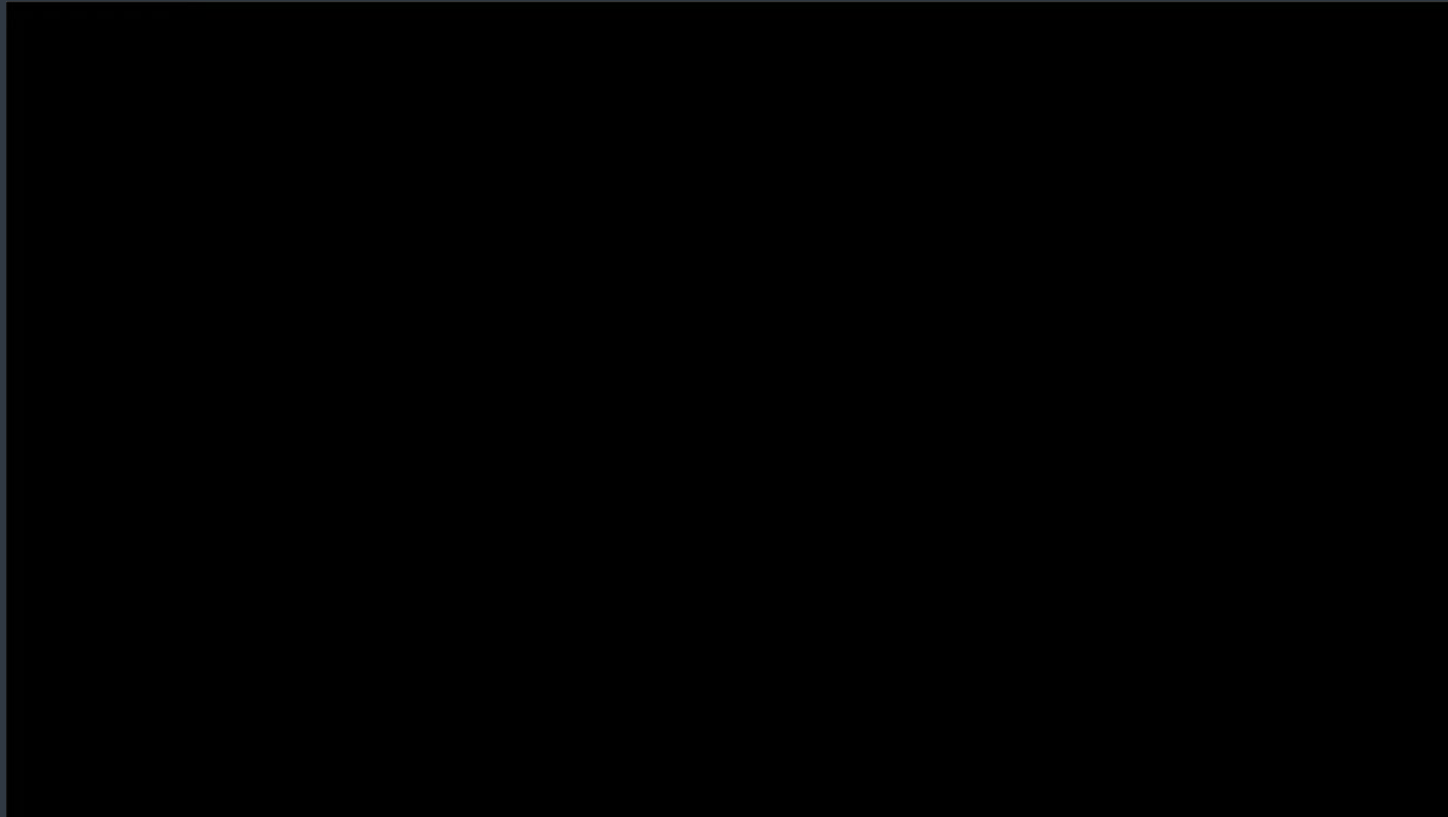


CAPITILIZATION RATE (VIDEO)



Here is a video that summarizes cap rate nicely

Go to Link 20 in Bootcamp Portal sheet



EXAMPLE

What is the Cap Rate of the following property?

- *Purchase Price = \$10M
- *Annual Income = \$1.3M
- *Annual Expense = \$500,000
- *Debt Service = \$480,000

$$\text{NOI} = \$1,300,000 - \$500,000 = \$800,000$$

- $\text{Cap Rate @10M} = \frac{800,000}{10,000,000} = 0.08 = 8\%$

How will it change if the price is reduced to \$8M?

- $\text{Cap Rate @8M} = \frac{800,000}{8,000,000} = 0.10 = 10\%$

Higher Cap Rate → Cheaper Property



MAIN FACTORS AFFECTING CAP RATE



- 1 RISK** - *Higher Risk Higher Cap Rate
- 2 LENDING ENVIRONMENT** - *Easier to get money Lower Cap Rate
- 3 LIQUIDITY IN THE FINANCIAL MARKETS** - *Rising Market Lower Cap Rate
- 4 TAX CODES** - *Favorable code create tax shelters Higher Demand Lower Cap Rate
- 5 APPRECIATION** - *When real estate prices are expected to rise, investors are willing to pay based on a lower Cap Rate



DEBT COVERAGE RATIO (DCR)



The ratio between cash flow and mortgage payment

$$DCR = \frac{NOI}{Debt\ Service}$$

Also known sometimes as “Debt Service Coverage Ratio” (DSCR)

EXAMPLE



= 1.67



CASH-ON-CASH (COC)



All in cash =

Down Payment +
Closing Costs +
Acquisition Fee

$$CoC = \frac{NOI - Debt Service}{All\ In\ cash}$$

EXAMPLE



10.3
%

THE HOLY TRINITY

- The first “make or break” filters for a deal
- Represents the interest of the various stakeholders of the deal



BEFORE YOU START ANALYZING PROPERTIES...

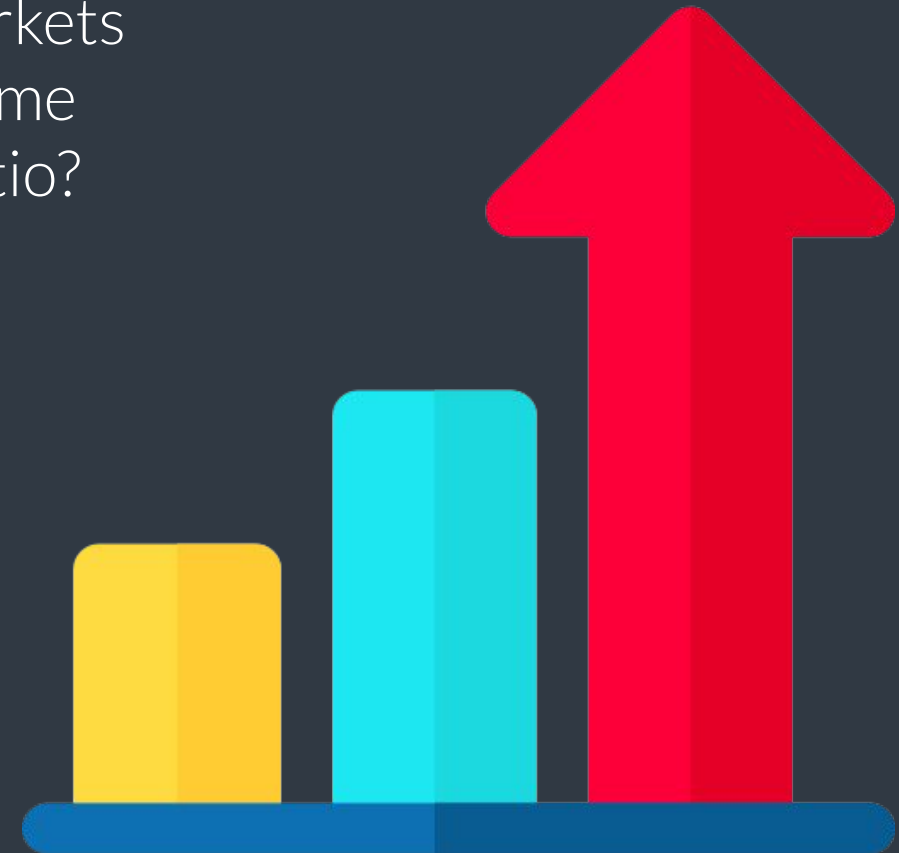


What are your market demographics?

- Location : primary, secondary, tertiary markets
- Jobs, Population, Median Household Income
- Landlord Friendly State? Price to Rent Ratio?
- Distance from Home

What are your property characteristics?

- Class A, B or C
- Year Built
- Roof & Construction Type
- General Size (# units)



GETTING A LISTING

Looks like this.

Sign the Confidentiality Agreement to get access to the property's docs.



EXCLUSIVE OFFERING

Maryland LIHTC Portfolio

Germentown, Olney, Silver Spring, Edgewater, North East | Maryland

Rare opportunity for investors to make a large scale investment in affordable housing. The Portfolio contains five senior communities with excellent amenities and access to public transportation.

- 438-unit portfolio in D.C. and Baltimore suburbs
- Developed under the tax credit program between 2004-2006
- In-place rents 12% below maximum

Offering Summary



[SCHEDULE A TOUR](#)

[SIGN THE CA](#)

Sign the Electronic CA to view the Due Diligence

WHATS IN THE PACKAGE (THINGS YOU'LL NEED)



- Operating Memorandum (aka. OM)
 - Tells you quite a bit about the property
 - This is a *marketing brochure*!!
- Rent Roll
- T12 (aka. Trailing 12 months' Income & Expenses)
 - There's also T3, T6

OFFERING MEMORANDUM or “OM”

□ Property Address

Use to Research Crime, Flood Zones...

□ Asking Price (not always listed)

□ Utilities - who pays what?

□ Year Built, Year Renovated

Is it older than 1970? Additional Risk

Was it recently renovated - how many units not renovated?

□ Type of Construction & Roofs

□ Number of units

Confirm with rent roll - Types and sizes of units

□ Key Words to Look out for



OM samples

LOOK FOR THE THINGS THAT MATTER TO YOU



Location:

- What are you near
- What's happening around the area (new employers, new metro rails, etc)
- What are the demographics in the immediate vicinity
- What is the current tenant profile of this property



Sources:

- Google Maps & Street View, Google Earth
- Crime Mapping – check several sources
- Better Business Bureau
- Zillow, RedFin, Trulia
- Local Tax Assessor's Office
- Broker – Brokerage reports
- Property Management Companies
- News – use alerts, local papers, follow major employers' news
- CoStar, AxioMetrics
- Local REIA clubs

RENT ROLL



Sometimes, they're in PDF form. You'll want to convert into Excel.

- Actual average rents / unit type
- Loss to Lease
- How long have tenants been at property
- What are the "proven" rents that are on record?
- And more

Go to Link 21 in Bootcamp Portal sheet

TRAILING EXPENSE-T12



What IS that?

- Profit & Loss info about the Revenue & Expenses
- There's also T3, T6

Pay attention:

- Trends – are there unexpected expenses out of norm?
- Missing expenses
- Anything in particular looking high / out of place




□ T12 tells a lot in a story of the property

[Go to Link 22 in Bootcamp Portal sheet](#)

INCOME	
Gross Potential Rents (GPR)	Assuming 100% of all units rented out at current market prices
Economic Vacancy	Rent \$ lost compared to ideal financial performance. GPR – Net rental Income
Loss to Lease	Amount "lost" due to rent increases and earlier signed leases at lower rents
Physical Vacancy	Actual unoccupied units
Bad Debt	Tenants not paying rent
Concessions	Model Units, Discounted Employee units, Move-in Specials...
Utility Reimbursement or RUBS	Recapture of utility expenses charged back to tenants
Other Income	Pet fees, admin fees, parking, vending, laundry, etc.
Effective Gross Income (EGI)	Effective Gross Income is the Gross Potential Rents (GPR) plus other income minus physical & economic vacancy of a rental property

PUTTING IT TOGETHER: INCOME



INCOME		Seller T12
Gross Potential Rents		\$1,765,800
- Economic Vacancy	22.5% 	\$396,800
Loss to Lease	15%	\$267,800
Vacancy	3%	\$57,000
Bad Debt	3%	\$60,000
Concessions	1%	\$12,000
Net Rental Income	78%	\$1,369,000
Utility Reimbursement	4%	\$72,000
Other Income	5%	\$82,000
Effective Gross Income (EGI)		\$1,523,000 

PUTTING IT TOGETHER : EXPENSES

OPERATING EXPENSES			
Item	Total/Year	Per Unit/Year	% of EGR
Property Management	\$38,485	\$428	3.00%
Payroll	\$108,000	\$1,200	
General & Administrative	\$18,000	\$200	
Advertising & Marketing	\$13,500	\$150	
Unit Turnover	\$18,000	\$200	
Repairs & Maintenance	\$45,000	\$500	
Contract Services	\$15,750	\$175	
Utilities	\$69,750	\$775	
Utility Reimbursements (RUBS)	\$31,500	\$350	
Property Taxes	\$126,000	\$1,400	
Insurance	\$31,500	\$350	
Capital Expense Reserves	\$31,500	\$350	
Total	\$546,985	\$6,078	

Expenses	
Property Management	Property Management Fees - % of EGR
Payroll	On-site staff who support your property
General /Admin	Administrative costs, office supplies, etc.
Advertising/Marketing	Website, flyers, renter referrals, etc.
Make-Ready	Costs related to turning over the units
Repairs & Maintenance	Normal wear and tear on units
Contract Services	Landscaping, carpet cleaning, pool, etc.
Utilities	Electric, Gas, Sewer, Trash, etc.
Property Taxes	
Insurance	
Reserves	Money put aside regularly to cover expenses

RULES OF THUMB

FOR OUR BUSINESS PLAN - Where do we get these numbers from?

Expenses	Rules of Thumb
Taxes	80% of Purchase Price x Mill Rate = Taxes
Insurance	\$250 / Door
Repairs and Maintenance	\$300-600 / Door (must confirm with PM)
General / Admin	\$100-25- / Door
Management	% of Total Collected Income. Typically 4% for larger properties.
Marketing	\$100-250 / Door
Utility	Use Last Year's & Annualize this year's. Take highest value.
Contract Services	\$200-400 / Door
Payroll	\$700 -\$1,000 / Door**
Capital Expenditures	\$250-300 / Door

These numbers are general rules of thumb – each market may vary *significantly* from these ROT.