Multi-res investing part 3 – choosing the right property wisely

Any investment in real estate is about location. This is no less true for multi-res properties where the economy, future growth and building types all play an important role. *Joel Kranc* explains

The leap into a new real estate asset class is never an easy one. But for those who have already made the mental and emotional switch out of single-family investments and into multi-res properties, multi-res often means multi-decision.

In the first two parts of *Canadian Real Estate Wealth's* look into multi-res investments, the challenges, tricks of the trade, pros and cons, and financing issues were analyzed and explained for would-be investors. In this, the third instalment in the series, investors will learn how to locate properties that best suit their needs, both in terms of location/geography and the right type of property. Of course the old adage of location, location, location is certainly an important one when choosing the right investment property, however, there is more to it than that.

And in many cases location alone only tells a portion of the story. Economic analysis, demographics, growth and decline of certain areas, and a building's condition will also help guide investors into the right fit for them.

Finding a location

Patrick Gergen of Seattle, Washington along with Madeleine Ficaccio of Calgary, Alberta co-own AmeriCan Multifamily Alliance Group, LLC which owns and operates multi-family properties in Canada and the U.S. Gergen says that Texas has become a focus for the company because it has strong growth and a diversity of jobs, and the state is business-friendly. Also, both add, the influx of migration is an important part of their due diligence.

"The population of Dallas/Ft. Worth is 6.5 million," notes Ficaccio, "but the expected growth by 2030 is nine million so that shows a lot of in-migration."

Interestingly, in places like Ontario, where supply of multi-res properties is very small, the luxury of choosing locations becomes a little less available. "You're going to have to make a decision about how far

you are willing to travel if you're managing the property yourself or you want to be in a position to easily respond to any situation that might arise," says Christopher Seepe, broker and president of the Durham Landlords Association. For most investors, he adds, that distance is only about an hour's drive from where they live – "and that's how they pick the market."

He explains that people often look at up and coming areas with condos and single-family homes more frequently than they do with multi-res buildings, because very few of them are being built.

Beyond that, when looking at particular areas, Seepe says investors should be concerned with occupancy and vacancy rates. Similar to Gergen and Ficaccio, Seepe adds that it is important to look at the economic business development plan of particular locations and the types of businesses they are trying to attract. "As a consequence, the types of employees they are trying to attract – middle management, blue collar, students – will help define your business plan of who you will attract and how you are going to attract them to your building."

But location has other considerations attached to it. Gergen says that the ability to find buildings at a deep discount is also very important. Even though there was a slight upswing from the bottom of the

WHAT TO LOOK FOR

Multi-res investment is not like buying a house (although location remains vitally important). There are many aspects to consider. The following is a short list of the types of criteria to look for before making the leap.

- **Employment statistics**
- **Job growth**
- **Is the job market diverse?**
- **Is it a landlord-friendly area?**
- **Is there road construction or infrastructure near by?**
- **What is the occupancy rate?**
- **Is there access to schools, retail, etc?**
- **Is the neighbourhood or city trending upward or downward?**

"How far are you willing to travel if you're managing your property?"

CENTURION'S DUE DILIGENCE

Centurion Apartment REIT's Greg Romundt says his company has three aspects of due diligence:

Financial due diligence

– Looking at rent rolls, taxes today and where they might go, utility costs, and are there operational savings and historical data in terms of tenants and turnover?

Physical due diligence

– Using their own team and bringing outside engineers to inspect all aspects of the building, mechanical systems, roof, etc.

Environmental due diligence

– The costs of environmental clean-up can be high and so significant due diligence must be obtained.

"Before we do a deal, we will undertake significant financial due diligence and do a first cut – are we interested or are we not interested?" says Romundt.

From the time financials are delivered to Centurion, an offer can be made within a day, if conditions are met.

market a few years ago, he and Ficaccio say they look at cities where they can still find those discounts. Also, part of their strategy involves areas where banks prefer to finance properties based on their own confidence in certain robust markets.

For example, The Federal National Mortgage Association in the U.S. (affectionately known as Fannie Mae) – which is one of the largest lenders for multi-family properties – favours cities and areas that are economically viable. "And so we look at areas from a financing point of view," adds Gergen.

Greg Romundt is the Chief Executive Officer of Toronto-based Centurion Apartment REIT, which owns properties in Ontario and Quebec. He says that he looks for areas that have population and demographic growth and consequently stays away from areas with stagnant population growth rates.

"We look for number of jobs moving to those areas, number of people moving to those areas and population growth, income levels and income level changes on a relative scale to provincial averages," he explains.

Because apartment buildings are a long-term asset with high costs to acquire, renovate and add value to, Romundt says ensuring the proper location ahead of time is key. "You have to make sure you buy in a place that you want to hold for a very long period of time."

On the economic front, Ficaccio and Gergen say they visit cities and look for things like road and infrastructure building and "cranes in the skyline" to denote further growth and job creation.

Seepe agrees and says infrastructure – whether its highways and roads being built, proximity to an airport, or a solid transportation system – "always has a positive impact on development."

The right fit

Once location has been established and even sub-areas within a city have been targeted, the next step is finding the right building that suits your needs and portfolio.

According to Ficaccio, investors have to look at the kinds of buildings they want to buy. She categorizes them into 'A,' 'B,' 'C' and 'D' buildings, with 'A' buildings having the greatest amenities and quality of tenants. "[My partner] and I are very specific," Ficaccio says. "We buy 'B' buildings in 'C' neighbourhoods." She adds that the cash flow potential in 'C' neighbourhoods is much greater than in 'A' neighbourhoods because with 'A' buildings, you end up paying much more for the buildings but don't necessarily collect that much more in rent.

"The bones of the structure and the design should be good and we want to make sure it has a nice unit mix (one and two bedrooms)"

The goal for Ficaccio and Gergen is to take a building that is not performing well and stabilize it to 90% occupancy rate or higher and increase the value. Then they plan to refinance at a higher level and pay investors out (although investors maintain ownership).

Some investors take a slightly different approach. In Ficaccio and Gergen's case, there are investors to consider. In Seepe's case, it is his own financing he takes into consideration. As a result, he looks at three things:

1. **The building should pay for all expenses**
2. **The building should pay for the mortgage costs**
3. **The building should pay for the interest on the money borrowed for a deposit on the property**

He explains that if an investor is looking for appreciation, than perhaps location is a more important factor. But for Seepe, and he thinks other investors as well, he is after income-generation and cash flow – an annuity stream. "If you want an annuity stream, the top things to look for is how much income and profit does it generate and is there hidden opportunity in the building to turn it around and make more money?"

What to look out for

From a physical standpoint, Gergen says they look for buildings that were built in 1985 or newer. The buildings should have pitched roofs, individual air conditioner units and significant amounts of bricks. "The bones of the structure and the design should be good and we want to make sure it has a nice unit mix (one and two bedrooms)."

If you are buying in areas you are not familiar with, explains Ficaccio, you have to adjust to the needs of that building or location. She points to things like air conditioner units in Dallas, where she invests. Buildings with individual units tend to have lower costs compared to those with a central unit. In Canada, she adds, owners must take into account high cost heating expenses in the winter in contrast with high cost cooling expenses in the summer in warmer climates like Dallas.

A general rule to follow, according to Seepe, is the 'cost per door.' He says from six-plex to 20-plex, $85,000 per door might be considered the average cost. For 200-unit buildings, this amount might be $60,000 per door.

Separately, he adds that if you invest in lower-end properties, there is a likelihood that you could keep your tenants longer because tenants in higher-end buildings are more than likely saving up to buy a house. "You have to be aware that you will experience more turnover in a middle-class building than in a blue-collar building."

Gergen and Ficaccio drive by buildings, particularly the lower-end ones, during the day and at night to see if they feel safe around them and if the building feels the same at all times.

Also, in higher-end or middle-class buildings, investors have to be much more service-minded, says Seepe. People paying high rents expect quicker service than someone paying low rent.

Learning the ropes

Of course, investors new to the game should look to those that have past experience in the multi-family market. "It is far worse to do a bad deal than no deal at all," says Gergen. He explains that investors should get their feet wet through joint ventures or partnering with experienced professionals before they branch off.

Overall, investors have a great deal of information they must comb through before they even consider purchasing that multi-res investment. Understanding the location, the local economy, the future of the local economy and even demographics must be forefront in the minds of investors. They must become instant experts in all of these subject matters to ensure that once the decision has been made, they won't regret any aspect of the investment.

However, notes Romundt, there is one attribute, above all, that investors must possess. "For people who want to get into this space, patience is probably their greatest asset." ■