

# **Commercial Product Specialties – Apartment Buildings**

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## PRODUCT OVERVIEW

Apartments are a basic necessity! Economics or affordability of housing forces many to rent. And with present challenges in the real estate market, this creates the broadest and most competitive marketplace in the commercial real estate sector.

There are more apartment buildings than all office, retail and industrial properties combined. Their market value exceeds the Gross National Product of many countries. The continued volume of building permits indicates that strong multi-family construction will continue. Present economics of housing indicate that demand for apartments will not only continue to be strong but will probably increase and that the value of existing properties should increase markedly.

### TYPES OF APARTMENT BUILDINGS

**Garden Apartments** – One- and two- story buildings, often a courtyard or single family-type setting, wide range of units.

**Walk-Up Apartments** – Three- to five-story buildings, but no elevator; area may be mixed single and multi-family; usually only two or three different types of units.

**Mid-Rise Apartments** – Six to ten stories serviced by elevators, usually inner city or dense suburbs, limited range of unit types.

**High-Rise Apartments** – In excess of ten story buildings, underground parking and security, full service, standard plan with limited unit types.

### FACTORS AFFECTING APARTMENT INVESTORS

1. Generally speaking, apartment buildings can be leveraged to a higher degree as compared to other commercial properties.
2. The tax shelter benefits have been favored and though investors usually do not purchase apartments solely for the inherent tax benefits, they do see the tax shelter benefits as a great plus.
3. Real estate has never been considered a liquid asset and prior to the mid-1980's, apartments were usually more liquid than other real estate vehicles. After a period of adjustment in the early 1990's, they regained popularity until 2007 when the commercial real estate market declined. With markets beginning to recover, the resale market is greatly improving.
4. Less sophistication is required to own and operate.
5. Broad rental markets. A utilitarian demand exists because people need places to live.
6. Variety of apartment sizes and prices allows various types of investors to enter the apartment ownership market. From "Ma's and Pa's" to major corporations and pension funds – all own apartment buildings.

7. Responsiveness to entrepreneurial efforts: unlike other real estate vehicles, apartment building value determinants (occupancy, income, expenses, financing, etc.) can be impacted by the owner, and it is easier to do (as opposed to an office building where major tenants have long-term leases which cannot be renegotiated until the end of the lease period, for example).
8. Professional management is usually available, but at a cost.
9. Unit mix must be matched to the demographics of the area (i.e. studio apartments are less likely to succeed in an area where many families need to reside).
10. Anchor tenants may be an advantage due to need to support company employee transfers.
11. Exposure to government regulations (primarily rent control).
12. Institutional and seller financing availability.
13. Elements that contribute to a good apartment location are: visibility and close proximity to major highways, labor, transportation, shopping, residential housing tracts and schools.
14. Pricing apartment buildings involves the use of the gross-rent multiplier, price per square foot, price per unit (CPU), and capitalization rate as “rules of thumb” or value measurers.
15. Property condition. Deferred maintenance can be extremely costly and detrimental to achieving investment objectives.
16. Ratio of land to improvements affects the amount available for depreciation, and this affects the tax benefits associated the property.
17. Master metered. If the owner is required to pay utilities, it will substantially affect the expenses connected with the property. It is best to be unit metered when tenant pays utility bills.
18. Vacancy. In general, this will reflect the physical appeal of the property, in addition to the number of units on the market, and whether or not rents are in line with competition.
19. Parking. The condition and number of spaces available, as well as the type (covered, carports, open).
20. Furnished vs. unfurnished affects the rental schedule and amount of depreciation available.

## **FACTORS AFFECTING APARTMENT BROKERS**

### **Size of the market**

- Various types of property
- Enormous total market
- Wide range of investors

### **Ease of Entry**

- Education readily available – not complex
- They're everywhere – reduced travel time
- Easy for investors to understand
- High demand for competent service

## **Income Stability**

- Basic necessity
- Wide range of investment size
- Only alternative for smaller investors
- Transactions occur in any economic climate

## **Income Size and Frequency**

- Generally 5 to 7 year ownership cycle
- Apartment prices escalate with cost of housing
- Readily available financing from both institutions and sellers
- Income limited only by effort

## **APARTMENT TERMINOLOGY**

**Gross (Gross Scheduled Income)** – The Total income the property will produce if fully occupied at current rentals.

**Effective Gross** – “Gross” less vacancy.

**Operating Expenses** – All expenses necessary to operate and maintain the real estate. Does not include debt service or depreciation.

**Net (NOI)** – Net operating income.

**Debt Service** – Total principal and interest payments on existing loans.

**Cap (Capitalization Rate)** – NOI divided by price.

**GRM (Gross Rent Multiplier)** – Price divided by gross.

**CPU (Cost Per Unit)** – Price divided by total rentable square feet.

**Comps** – Either rents of or sales of comparable properties.

**Unit Mix** – The composition of studio, one-, two-, and three-bedroom units in the property.

**Cash-On-Cash** – Cash flow divided by initial investment.

## **Organizations:**

Apartment Owners and Managers Association