CAPS Training:
Property Evaluation and Due Diligence Course

INSTRUCTOR GUIDE

NATIONAL APARTMENT ASSOCIATION
EDUCATION INSTITUTE

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Table of Contents: Property Evaluation Module

Just for Instructors

The National Apartment Association thanks you for your time, talent, and expertise in training and developing the next generation of Certified Apartment Portfolio Supervisors.

Whether you're a subject matter expert or lay person…a seasoned instructor or a new teacher…this guide will help you become an even more engaging and effective trainer.

In this course on property evaluation and due diligence, you'll help property supervisors:

- Understand the various processes employed when owners want to sell, buy, refinance, or renovate properties.
- Prepare for the CAPS designation examination.
- Increase their property management knowledge and skills.
- Although this course is targeted at people with at least one year of supervisory experience, it can also be used to teach those who would like to learn more about property evaluation and due diligence.

Fast Facts: The CAPS Property Evaluation and Due Diligence Course

This overview will help familiarize you with the educational approach for this course and ways you can enrich the training for participants.

Course Type

- Instructor-led classroom training
- Uses presentations and individual learning activities to teach the course material

Course Materials

- This instructor guide
- The *Property Evaluation and Due Diligence Participant Guide*
- The *Property Evaluation and Due Diligence PowerPoint Slides* (these are optional; use them if you wish)

Course Length

Approximately seven and one-half hours

Where this Course Fits in the CAPS Training Curriculum

"Property Evaluation and Due Diligence" is the fourth course in the CAPS training series. Here's how the entire series lays out:

- Legal Responsibilities and Risk Management
- Financial Management
- Property Performance Management
- Property Evaluation and Due Diligence
- Effective Leadership

Course Schedule-at-a-Glance

Here's a quick look at the topics included in the Property Evaluation and Due Diligence course, the approximate time it will take to teach them, and a suggested schedule.

Training Topic	**Length**	**Suggested Time**
1. Introduction to Property Evaluation and Due Diligence	30 min.	8:30am–9:00am
2. Why Owners/Companies Buy, Sell, and Renovate Properties	30 min	9:00am-9:30am
3. Market Analysis	60 min	9:30am–10:30am
Break	15 min	10:30am-10:45am
4. Property Inspections	75 min	10:45am–12:00pm
Lunch	60 min	12:00pm-1:00pm
5. Operational and Financial Analysis	45 min	1:00am–1:45pm
6. Analyzing and Reporting Property Evaluation Results	30 min	1:45pm-2:15pm
7. Property Acquisition	45 min	2:15pm–3:00pm
Break	15 min	3:00pm-3:15pm
8. Property Renovation	30 min	3:15pm–3:45pm
9. Property Disposition and Refinancing	30 min	3:45pm–4:15pm
10. New Development Feasibility	30 min	4:15pm–4:45pm
11. Key Takeaways and Closing	15 min	4:45pm-5:00pm

Preparing to Teach the Course

To give course participants a first-rate learning experience, plan to spend several hours preparing to teach this class.

When to Prepare

Depending on your experience with this course, begin preparing one to two weeks before the scheduled course date. That's enough time to absorb the material without feeling rushed.

How to Prepare

- **Read the leader's guide carefully**. Get familiar with the organization and flow of the course, as well as the content itself.
- **Look for ways to personalize the instruction.** Add your own stories, examples, and insights. Make the material come alive for the participants.
- **Mark up this guide.** Write notes throughout. Highlight passages you want to emphasize. Add prompts for your examples and explanations.
- **Practice.** Do a dry run of the material (or at least some of it) in front of willing colleagues or family members. Get their feedback. Find out: What are you doing well? What's one thing you could improve?

When It's Time to Teach the Course

- **Use this guide.** Refer to it often to keep the class on track. Using notes will make you look natural, relaxed, and yes, even confident.
- **Approach the course as a conversation, not as a presentation.** Keep things open and easygoing. Pick yourself up if you make a "mistake." Answer the questions you can. Most important, avoid the temptation to be the expert—simply share what you've learned.
- **Keep participants actively involved.** Allow participants to ask questions, share ideas with one another, and get as much hands-on experience as possible. Remember: telling isn't training.
- **Be yourself.** Participants appreciate (and learn more from) instructors who are not only knowledgeable, but also approachable, personable, and dedicated.

Preparing the Classroom

To complete your final preparations, arrive at the training site at least one hour before class begins.

Find the Location of these Public Facilities or Services

- Rest rooms
- Kitchen facilities or vending machines
- Emergency exits

Prepare Materials

- *Property Evaluation and Due Diligence Participant Guide* (one for each participant)
- *Property Evaluation and Due Diligence Instructor Guide* (with all your preparation notes in it)
- *Property Evaluation and Due Diligence PowerPoint Slides* (their use is optional)
- Sign-in form (to be turned in to the affiliate office after class)

Prepare and Test Equipment

- Flipchart with stand or whiteboard
- Markers
- Microphone or sound system (if needed)
- Laptop computer with LCD projector (if using PowerPoint slides)

Prepare a Learning-Friendly Classroom

- Arrange the tables and chairs in the room so that participants will be able to talk with one another, work in small groups, and take notes.
- Make sure the room isn't too hot or cold.
- Ensure that there's adequate lighting.
- Write the course agenda on the flipchart or whiteboard.

1. Introduction to Property Evaluation and Due Diligence (30 minutes)

In this section of the training, the CAPS student will receive an overview of property evaluation and due diligence.

Learning Objectives

- Relate risk assessment to property evaluation and due diligence.
- Understand all processes in evaluating a property as a business opportunity that mitigates risk and provides the return sought by the investor.

Topics

- Property Evaluation and Due Diligence
- Overview of Property Evaluation and Due Diligence

Property Evaluation and Due Diligence

Due diligence means **assessing possible risk** to the business when a buyer or investor is considering acquiring, refinancing, or renovating an existing property—or developing a new one.

Why the Due Diligence Process Is Important

The due diligence process discovers critical information that might affect the buyer's investment. It can save a buyer from making a bad investment, improve the investor's ability to negotiate a purchase price, or help formulate and clarify an owner's goals. Due diligence can help the owner determine when to buy, sell, refinance, or renovate. This process can find a property to buy or evaluate a pre-selected property acquisition.

Who Performs Due Diligence Activities

Although buyers and sellers may both be involved in the due diligence process, **the primary responsibility falls to the buyer to discover risks and use the due diligence process to ensure an outcome that meets owner objectives.**

As a multi-property supervisor, you may be involved in the due diligence process in these ways:

- In smaller companies, you may lead the evaluation and due diligence process for the owner.
- In larger companies, you'll be an important member of a larger due diligence and discovery team and be assigned certain responsibilities in the process

Assessing Risk

Because risk is not easy to measure and evaluate you'll find that some properties are more impacted than others by:

- Inflation trends
- Interest rate changes
- Management efficiencies
- Market condition changes
- Physical improvement needs
- Obsolescence issues
- Staff performance
- Neighborhood or community changes

Overview of Due Diligence Processes

The due diligence process is carried out within the set of investment goals a prospective buyer identifies. Some of the most common processes follow.

Analyzing the Rent Roll

Purpose: To determine whether rent information, lease term duration, recurring charges, rent delinquencies, and write-offs are accurate.

Methodology:

- Compare **r**esident leases and lease file contents to rent roll data. Always evaluate rent roll data with an on-site file audit, rather than relying on seller or broker pro forma information.
- Compare specifics such as resident names, lease terms, rental amounts, recurring charges, deposit amounts, and amenity features to those represented on the rent roll.

Reviewing Service and Maintenance Agreements

Purpose: To identify all service and maintenance agreements (or contracts) at the property and carefully examine all obligations relating to price, length of agreement, and cancellation and renewal clauses.

Methodology:

- Check the terms and pricing for all service and maintenance agreements, including those relating to landscaping, trash removal, elevators, apartment or common area cleaning, carpet cleaning, painting, security, fire protection, and so on. Can these agreements be cancelled? With how much notice and under what terms?
- Check for recurring performance issues with service and maintenance providers.
- Do chronic problems indicate future major costs?
- Review equipment warranties.

Ensuring Governmental Compliance

Purpose: To ensure that the property is operating in compliance with local zoning, building, occupancy, and environmental regulations and requirements.

Methodology:

- Review statutory and regulatory requirements applicable to the property at local government offices.
- Confirm compliance by answering these type of questions:
  - Do local zoning and building codes allow the current or intended uses?
  - Do boundary problems exist? Are utilities, roads, streets, and access to and from the property in compliance?
  - What environmental issues should be considered? (Third party firms will often do an environmental review and provide an opinion report.)
  - If not in current compliance, are variances "grandfathered" so they won't require correction?
- If it is a new construction project, ensure that items such as building heights, floor area ratios, parking space requirements, and setback lines are checked for compliance by federal, state, and municipal authorities.

Reviewing Recorded Documents and Litigation

Purpose: To assess the nature and extent of easements granted, to identify potential problems with the title, and to determine the potential benefit or liability they will present for the property. Pending litigation will let the buyer know about any current legal issues, which may affect the purchase price or prevent the acquisition.

Methodology:

- Check for any financing, mechanics, tax, or judgment liens on property.
- Look for any pending condemnation proceedings.
- Investigate potential governmental or private litigation.
- Conduct a full title search – usually accomplished through a third party provider

Performing Physical Inspections

Purpose: To assess the overall condition of the buildings and its mechanical components, including structural defects or limitations that may pose obstacles in repositioning or renovating the property.

Methodology:

- Review the historical records on repairs, maintenance, and warranties.
- Inspect, in great detail, building exteriors and common areas, mechanical components, and all apartment home interiors in the community.
- Review the “as-built” plans and specifications for the property. (Third-party architects or engineers will often perform this review for you.)

Checking for Tax Issues

Purpose: To assess what the expected future tax liability will be for the property.

Methodology:

- Verify the current assessed value.
- Compare the assessed value to similar properties to expose potential tax protests.
- Check for special assessments and fees in previous years' taxes.
- Look for any expiring tax abatement.

Reviewing Insurance Policies and Risk Management Claims

Purpose: To assess a property's liability risk.

Methodology:

- Review the property's current insurance coverage.
- Review claim information if the current owner is willing to share them it with you.
- Complete a thorough risk analysis. Note the likelihood of incidents and impact to the property. Consult with your insurance provider to estimate coverage options and limitations.

List of Personal Property

Purpose: To confirm the personal property that will remain at the apartment community and be included in the purchase price. These items are generally listed, and their combined value stated, on a UCC-1 form.

Methodology:

- Obtain the seller's inventory of all personal property, which often includes apartment appliances.
- Verify that the inventory remains by performing a physical inspection just before the closing date.

Market Study

Purpose: To confirm the property's market value relative to comparable properties.

Methodology:

- Assess the strength of the local economy, rental rates, operating policies, absorption rates, and growth trends.
- Relate each of these items to the potential impact on the property.
- Analyze the findings to forecast future values and upside values for renovation and new construction.
- Do not rely on a market study provided by the current owner or the broker. Use qualified management company team members to complete the study or hire someone to do it.

Debrief Questions

Have participants discuss their experiences with due diligence.

1. What situation do you remember most when analyzing a rent roll most caught your attention? And how that specific situation affected the due diligence process?

2. Among physical inspections, documentation assessment, governmental compliance, which of these analysis represent most recurrent obstacles to an owner's investments in your routine?

3. When facing some tax irregularities in a property's analysis, how did you use to proceed before participating in this instruction?

4. Describe a situation where you had doubts on personal properties being listed in the inventory.

5. Have you ever faced a situation where performing a property's market study what a little if not a lot more challenging to you?

2. Why Owners/Companies Buy, Sell and Renovate Properties (30 minutes)

There are many reasons why owners choose to acquire, sell, or renovate a property. The chief reason, however, is that **owners want to further their investment goals**.

Investment goals and the advantages and disadvantages of apartment ownership were discussed in prior material (see Financial Management). Investors/owners seek a variety of goals; for example, a specific rate of return, regular cash flow, tax benefits, investment diversification, quick profit that can come from repositioning the property, an increased property value over time, and the pride of ownership. Some or all investment goals are considered when evaluating selling or buying apartments. The disadvantages of lack of liquidity, the active management required, business risk, financial risk, interest rate risk, and property damage risk must also be weighed.

Acquiring and selling properties can take place in a variety of ownership structures. Sometimes these ownership structures have a limited life which means that the property is often acquired with the intent of disposition at a predetermined time. Often refinancing and/or renovations take place during the ownership holding period. This process of evaluation is just as important as an evaluation intended to determine buy and sell activities. As for renovations, owners will undertake these often to reduce operating costs, increase revenue, and thus enhance the profitability and marketability of an asset that has increased value.

Each reason behind acquiring, selling, or renovating a property has certain advantages and disadvantages. Therefore, it is essential to understand how to improve these business transactions, as well as to understand the types of issues that can occur during these processes. Sometimes buy or sell decisions are as simple as the need to put excess cash to use, take advantage of current tax benefits, or even to generate funds for other purposes. Sometimes owners liquidate their holdings because they need money elsewhere for other purposes or other real estate or a line of ownership succession is not present. Sometimes there is a decision to enter or exit a particular market that is evaluated as declining or not growing quickly enough. Some companies will attempt to sell entire portfolios in a particular city or buy several properties in a city.

Learning Objectives

- Differentiate the motives why an owner/company buys, sells, or renovates a property. This determination may not be easy since motivations like cash flow, timing, and tax benefits are likely to be the same to varying degrees. Even renovation designed to protect or improve an asset that is done to maintain or improve value has similar motivations.
- Improve rental market management by knowing the rental population characteristics. It is important for multi property supervisors to know the rental housing industry and the environment of rental housing in which they operate. Who rents and why, what part of the housing market do renters represent, what is the size of that group, what are their demographic characteristics such as income level, gender, ethnicity, and marital status. All are important to know in a general way so that the multi property supervisors are more equipped with knowledge to respond to market conditions and meet rental housing needs.

Topics

- Ownership Types
- Reasons for Renovating Properties
- Current Outlook for Apartments

Ownership Types

You'll see listed below the principal types of ownership structure that you will likely encounter in the management of rental apartments. Different ownership types may impact the timing of buy and sell decisions. Further such structures impact tax benefits, ability to raise capital, liability and risk with different ownership types, and the need for active or less involved management of the ownership types.

Individual Owner or Sole Proprietorship

One person owns the property.

- **Advantages—**Easy and inexpensive to start and dissolve a business; one person retains the profits.
- **Disadvantages—**Unlimited liability (high risk), limited ability to borrow money; one person takes the losses. Partnership: Two or more people jointly own a property.

Limited Liability Companies (LLC)

These combine aspects of corporations (protection from personal liability for business debts) and partnerships or individual owners (a pass-through tax structure). Most LLCs consist of two or more members, but many states allow a single-member LLC.

- **Advantages**—A separate legal entity from its members; usually, only the LLC is responsible for the company's debts, which means limited liability for all owners (low risk).
- **Disadvantages**—Taxable in some states; lack of uniformity in state laws.

S-Corporation

A corporation that's taxed like a partnership—that is, the corporation's income is taxed only as the personal income of the shareholders; it's not double-taxed like a C-Corporation.

- **Advantages—**Shareholders can personally claim their share of losses incurred by the corporation to offset personal income; limited liability to all owners (low risk).
- **Disadvantages**—Limited number of shareholders, which provides less flexibility in income allocation—that is, income and losses are allocated in proportion to stock ownership.

Limited Liability Partnerships (LLPs)

Limited partners contribute capital but don’t actively manage the business.

- **Advantages**—Liability limited to amount invested by each partner (moderate risk).
- **Disadvantages**—Lack of uniformity in state laws; some states have insurance requirements; LLPs have "joint and several liability," which means all the owners are liable for 100% of the financial and legal responsibilities of the business.

Joint Venture

A partnership formed to achieve a specific goal or to operate for a specific period of time; once the goal is reached, the partnership is dissolved.

- **Advantages**—Availability of more capital and the combined expertise of the partners (low risk).
- **Disadvantages**—Partners may have different business strategies and exit goals.

Real Estate Investment Trusts (REITs)

REITs allow small investors to pool investments in real estate while diversifying their risks, maintaining their liquidity, and getting professional management services for the property. REITs are governed by IRS regulations, the most significant of which is the requirement to distribute at least 90% of their taxable income in the form of dividends to shareholders. The shareholders pay taxes on those dividends; the REIT does not pay taxes on its income. Investors have no control over when the REIT sells its holdings or how it manages its properties.

Equity REITs generally specialize in the ownership of certain types of income-producing property, such as multi-family residential properties, office buildings, shopping centers, student housing communities, health care facilities, or manufactured housing. REITs seldom own several types of income-producing property; most specialize in a specific type.

REITs typically manage these properties using in-house professional management organizations experienced in managing the type of income-producing property they own. In other instances, they may hire outside third party fee management companies.

Mortgage REITS, on the other hand, own mortgages of income-producing property.

Tenants in Common (TIC)

This ownership entity occurs when two or more people own an apartment community, office building, or shopping center in equal or unequal shares. Owners receive a proportional share of all revenues generated by the property, and ownership can be inherited.

- **Advantages**—Can defer the capital gains tax that would be owed on a property that's sold, as long as the proceeds are reinvested in a similar type of property (1031 tax-deferred exchange); provides a way for the average person to own part of a large property with a small investment; investors don't have to worry about the day-to-day operation of the property (low risk).
- **Disadvantages**—May be difficult to sell interest in the property, except to one or more of the co-tenants; the TIC sponsor, who locates appropriate properties and provides turnkey real estate investment services, controls the management of the investment rather than the investors.

Reasons for Renovating Properties

Depending on local economic conditions and a property's location, an investor or owner may want to improve the current property by increasing its size or by making major capital improvements. These improvements might include:

- Re-siding or re-roofing
- Repainting
- Replacing appliances, cabinetry, or countertops
- Remodeling kitchens or bathrooms
- Adding energy efficiency measures such as new windows or new heating and air conditioning.

All these improvements are intended to produce **higher rents and/or lower operating costs for the property**. Sometimes it is necessary to renovate to upgrade and modernize simply to maintain the asset and protect current rent levels. Renovation could also include conversion to a different use such as rental apartments to condominiums.

Current Outlook for Apartments

Once you understand the demographics and characteristics of the rental market, you'll be able to better manage the rental housing inventory that serves **one third of all households in this country**.

As of 2010, renter-occupied households now represent 33% and owner occupied housing 67% of the number of households in the United States according to National Multi-housing Council (NMHC) data. Renters as a share of the number of households has increased as owner occupied households have dropped from an all time slightly in excess of 69%. This shift is expected to continue for the coming decade.

There are now approximately 17.5 million apartment units in buildings of five or more units. Permits for new units as of September 2010 are currently at a seasonally-adjusted basis of 111,000 units. Apartment starts will likely be at 100,000 at year end.

In May 2010, a Harris survey confirmed the trend to acceptance of rental housing as 76% of U.S. adults deemed renting to be more favorable than owning a home. Only 12% of renters now have plans to buy a home. According to the U.S. Census Bureau:

- Median age for first-time marriages is increasing.
- Growth of non-family households is increasing.
- Age of women giving birth for the first time is increasing

The 2010 Harvard University Joint Center for Housing Studies (JCHS) analysis showed the number of renter households grew by 3.4 million – almost 10% - between 2004 and 2009.

- The Midwest surged 13.4%
- The South posted the largest number of renter households at 1.2 million, despite a large falloff in domestic migration to these preferred areas and international immigration

Additional Information

Minorities accounted for most of the growth between 2004 and 2009.

- Hispanics and blacks each accounted for a quarter of the net increase
- Asians contributed 9%
- The minority share of renters reached 45.1% in 2009
- Foreign-born renter households increased from 17.4 percent in 2000 to 19.6 percent in 2009

Minority households contain an average of 2.8 persons, while white households average 2.1 persons.

The share of renter households headed by young adults declined 4.5 percent from 2004 to 2009, while households headed by those 55-64 years of age surged to almost 2/3 of the renter household growth.

Debrief Question

Knowing that renter-occupied households represent 32% and owner-occupied 68% and still dropping, how is this scenario reflecting on your professional routine you have noticed already? Are individuals renting, buying or selling more?

3. Market Analysis (60 minutes)

A market study **delivers the information necessary to allow the buyer to make an informed judgment on the value and price of the acquisition**. By collecting different types of information **a viable investment plan can be developed** that will lead to achievement of ownership's desired financial goals and other owner investment goals. Remember you can't move the property!

The CAPS multi property supervisor is likely to perform the market analysis or lead a team of other property management professionals in that effort. However, sometimes this market study may be performed by an outside third party company that specializes in such work. The CAPS and the management company will be responsible for the market analysis presented to the potential owner or presented to more senior personnel in the management company involved in the property evaluation and potential acquisition, disposition, renovation, rehabilitation or conversion. This evaluation **should describe regional economic trends, describe economic, social, and demographic trends in the neighborhood, and prepare a competitive property analysis report**.

The Three Parts

There are three components to a market analysis:

- Regional analysis
- Neighborhood analysis
- Subject property analysis including competing properties

Regional and neighborhood analysis relates to a specific geographic area and has a particular focus.

Regional analysis considers a larger geographic area such as the metropolitan area where the property is located.

Neighborhood analysis focuses on the localized area such as a small city or neighborhood in a larger city in which properties compete for prospective residents.

Changes in the social, economic, and demographic characteristics of the market area will likely impact the financial performance at the property.

Learning Objectives

- To analyze demographic and economic data of a region, neighborhood and competing properties.
- To investigate the features of the region, neighborhood and competing properties and assemble all collected information into a cohesive actionable assessment.

Topics

- Analyzing a Region
- Analyzing the Neighborhood
- Analyzing the Competition

Analyzing a Region

Extra Information:

Metropolitan Statistical Areas (MSAs) are composed of:

• One or more counties, at least one of which includes an urbanized area (UA)

• A city with a population of 50,000 or more *UAs* consist of a central city (or cities) in a metropolitan area, along with the surrounding closely settled territory constituting its "urban fringe" (a density of at least 1,000 persons per square mile).

MSAs with populations in excess of one million are often further subdivided, and primary MSAs (PMSAs) within them are identified. A *PMSA* may comprise one or more large urbanized counties, all of which have strong internal economic and social links, but it may not have a central city. MSAs in which such PMSAs are identified are re-designated as consolidated MSAs (CMSAs).

Purpose: To investigate the economic conditions in the larger geographic area that serves the apartment community with its:

- Amenities
- Educational facilities
- Entertainment venues
- Job sources
- Shopping areas
- Job growth
- Unemployment rates
- Household formation
- Population growth or decline
- Demographic data
- Population size
- Density
- Age
- Race
- Gender
- Educational attainment
- Income levels
- Family composition

Demographic changes affect the competitive environment for your community by impacting basic demand for rental apartments as well as the potential supply of available housing for sale and for rent.

Sources of Data

There are many resources that can be used to analyze the region, neighborhood, and demographic profile for a specific property. Data is available even down to the census tract level where the property is located although this is often not as current as recently updated data. In particular, a wealth of information can be drawn from local and governmental resources, made easily accessible via internet websites. The following is a list of organizations that may provide data and other information that is useful when performing a market analysis:

U.S. Bureau of the Census (www.census.gov)

- Population size, density, and distribution
- Population forecasts
- Age, education, and family size
- Per capita income
- Consumer spending and savings
- Disposable income

American Housing Survey (http://www.census.gov/hhes/www/ahs.html)

- Vacant housing units
- Household characteristics
- Housing and neighborhood quality
- Housing costs, equipment and fuels
- Size of housing unit
- Recent movers

U.S. Bureau of Economic Analysis (http://www.bea.gov)

- Reports on regional business activity and personal income
- Employment data on available labor force, types of jobs, and major area employers
- Forecasts of expanding job markets

State Agencies and Local Governments (http://www.statelocalgov.net)

- State taxing authority
- Zoning laws and use restrictions
- Construction permits issued for housing

Local Chambers of Commerce

- Local tax regulations
- Variety of companies and industries
- Strength and vitality of businesses

Additional Resources

The National Apartment Association's Annual Income and Expense Survey, which publishes annual data from market rate and government assisted housing. Individually metered and master-metered property data is available as are comparisons of garden and high rise communities. See naa.org

- Income/Expense Analysis®: Conventional Apartments–Published by the Institute of Real Estate Management (irem.org)
- Dollars & Cents of Multifamily Housing®-Published by the Urban Land Institute

There are different member and non member costs for NAA, Urban Land Institute, and IREM income and expense data.

Fieldwork

Property managers can sometimes obtain demographic data from surveys and articles from major newspapers, chambers of commerce, and local economic development and planning organizations that may be more current than government gathered data.

Key Items to Research

There are a few key items that you especially need to research because they have a direct impact on the property.

- **Zoning Restrictions**: Almost every city has a master plan, which outlines patterns of permitted growth. Contact the city or county zoning department/board to acquire a copy of the zoning map and explanation of zoning regulations.
- **Rent Control**: Determine if any state and/or local rent control or tenant/landlord laws exist or are pending. In the interest of the owner, you will need to determine what effect these laws will have on the investment. The local apartment association typically monitors ordinances, codes and laws on local and national levels that impact property operations.
- **Building Codes and Restrictions**: Speak with a staff member of the city's Building Department to learn about building codes, restrictions and guidelines for growth or development. Ask how the city handles violations and, if applicable for an older property, if the city expects a property to be upgraded to new code standards or whether a "safe harbor" exists. Common upgrades for older properties include vehicle parking ratios, density, fire and safety requirements and environmental concerns.
- **Infrastructure**: Proposed changes to the infrastructure, such as the development of bypasses, road construction and street repair, public transportation upgrades, the creation of utility easements that can alter traffic patterns and increase or decrease the desirability of a specific location.

One of the best ways to understand and interpret all the facts you gather is to **personally visit the region**.

Drive around and take note of existing and new developments including office, retail, industrial and residential properties.

- What seems to be the general economic condition of the area?
- Are more businesses opening or closing?
- What is the condition of the roads?
- Does the traffic pattern work?
- What makes a neighborhood unique or more desirable?

Be sure to visit or at least view the competing multifamily communities and learn as much as you can about them.

An excellent way to obtain information is to join the local affiliate of the National Apartment Association and other professional community organizations, such as the Chamber of Commerce. Attend meetings and participate in activities. Not only will you gain knowledge about your local area, but you may have the opportunity to network with professionals in other areas of the city, state, or nation, thus extending your skills and resources.

Analyzing a Neighborhood

To diligently analyze a neighborhood, you should do both of the following: first, investigate data available in public records; and second, visit the neighborhood.

Visiting the neighborhood of the subject property that is being sold or purchased is key to perform its analysis. It's a good idea to drive at least several blocks in each direction of the property, so that you can assess the neighborhood. There is a direct correlation between a neighborhood's appearance and rent levels at the properties in the neighborhood.

Rents are affected significantly by the prestige and economic conditions of the neighborhood. Defining the neighborhood correctly is the most important beginning task.

Sources of Data

Similarly to regional analysis neighborhood information can be determined from public sources noted above for the regional analysis.

Key Items to Research

- **Changing demographics may impact the popularity of unit types**. For example, if a study of the demographics suggests a growth in the amount of young, single professionals, then one-bedroom apartments may become more desirable than two-bedroom, two-bathroom units.
- **Fluctuating real estate sales prices** may impact the demand for rental apartments.
- **Economic forces (local and national),** which are evaluated in a regional analysis, will affect the neighborhood's vacancy rates, property development and land value. For example, if unemployment levels are high in an area, then vacancy rates for larger, more expensive apartments may likely be high as well.

Neighborhood Conditions

- **Neighborhood Amenities**: Shopping, entertainment, churches, recreational and cultural facilities, and note the proximity to the property.
- **Property Comparisons/Condition**: Does the subject property match the general appearance of the area? Is the age and construction relatively similar? Is the property well located for its purpose? Have recent improvements been made in the neighborhood? Is the neighborhood kept in good condition by local government and residents? Are there specific issues or problems in the area such as crime rate, flooding, adverse traffic patterns, and industrial waste or environmental issues?
- **Planned Infrastructure Improvements**: Determine if there are plans for new or upgrades to existing utilities such as power, water or sewer services. Contact the local public works department to find out if there are plans to upgrade local roads or construct new roads and highways. Will new roads or improvements affect access to the property?
- **Transportation**: Is public transportation available and convenient?
- **Schools**: Local school districts can provide information about the schools and student transportation. Additionally, determine the quality of the school district relative to others in the area.
- **Employment**: What are the local employment opportunities? What's the general unemployment rate of the area? Obtain employment trend reports for the past 18-24 months. Are specific businesses planning to enter or leave the area? What kinds of employment opportunities are available – worker income can determine rental structure.
- **Neighborhood Government – Associations**: Deed restrictions, conditions, covenants and restrictions (CC&Rs), municipal utility districts (MUDs), and planned unit developments (PUDs). Determine if any deed restrictions and CC&Rs apply to the subject property and whether it is located in a MUD or PUD. Are there financial obligations related to prior financing mechanisms such as tax credit or bond financing provided by state or local government. Obtain a list and explanation of restrictions, rules and associated fees from the local governing organization.

Neighborhood Boundaries

The property's neighborhood may encompass a **small geographical area**, such as a few nearby properties, or a larger area, such as multiple blocks. These **boundaries** can be natural, such as rivers and lakes, or manmade barriers, such as streets and highways.

The **boundaries of a particular neighborhood**, i.e., the physical perimeter within which prospects are looking at properties, are best defined by competition. You are competing with these properties on the basis of such factors as:

- Location
- Rent
- Age
- Quality and type of construction
- Amenities
- Appearance

You must be able to identify how your property compares on multiple levels against your competitors in order to develop your marketing strategy and set rent levels.

An effective way to **map the neighborhood** of a residential property is to determine where the competition is located. It may also be helpful to plot out existing residents' places of employment. Plot these points, along with the location of the property, on a map. The entire encompassed area will determine where residents live and work and help determine the neighborhood as it exists "today". Renovation, rehabilitation, and modernization may be a strategy to target other geographic areas or a new resident profile.

Since a neighborhood is not a static environment, one of the central tasks of market analysis is to understand why neighborhood conditions may have changed and how they will affect your property.

Analyzing the Competition

Sources of Data

When performing an analysis of a property's competition, you may rely on different sources of data such as:

- Property records
- Publications
- Public Records
- Multifamily broker information

Review Property Records

The first and most obvious sources of information are the property's files. These records will show what competing properties are considered competition and why. Data is usually updated and adjusted regularly by the subject property in order to keep current on rent levels, concessions, and leasing policies among the competitors.

Publications

Much information for market analysis is in published form. Useful sources of information include:

- Census of Housing, Bureau of the Census, U.S. Dept. of Commerce
- Survey of Current Business (monthly), U.S. Dept. of Commerce
- Urban Housing Market Analysis, Federal Housing Administration, U.S. Dept. of Housing and Urban Development(HUD)
- Economic Development (monthly), Economic Development Administration, U.S. Dept. of Commerce
- Construction Review (monthly), Office of Business Economics, U.S. Dept. of Commerce
- Census of Manufacturing, Bureau of Census, U.S. Dept. of Commerce
- Census of Business: Retail Trade, Selected Services: Wholesale Trade (Area Statistics, Bureau of the Census, U.S. Dept. of Commerce
- City and County Data Book, Bureau of the Census, U.S. Dept. of Commerce
- Census Data for Local Communities: population, housing, manufacturing, and business. Bureau of the Census, U.S. Dept. of Commerce

Publications (continued)

- Regional and Local Surveys of Vacancies, U.S. Post Office Dept.
- Regional and Local Housing Market Analyses, Federal Housing Administration, HUD
- United States Bureau of Labor Statistics, www.USBLS.gov
- Local apartment rental publications and online sources that provide competitor data
- Public Records

Information from public records or public agencies include the following:

- Deed recordings
- Mortgage recordings or Deeds of Trust
- Foreclosures
- Building permits
- Local regulations: planning, zoning, subdivision, housing codes, fire codes, building codes,
- Taxes, assessments, tax rates
- Public housing units, rentals and vacancies
- Zoning exceptions and variances
- Certificates of Occupancy (if applicable)
- City Planner data

Local Industry Professionals

These local operation and asset experts can assist you with objective analysis of market factors impacting the health and future of multifamily investments. Develop a strong network of industry professionals who can provide you this critical insight.

Multifamily Broker Information

These local sources often have valuable information relative to rental histories, income and expense data, and other multifamily apartment sales information quite useful for the market analysis.

Shop The Competition

An extensive face-to-face analysis of all active competition is always required. The competitive area is an essential element in developing an acquisition or renovation case.

Rent Analysis

In addition to demographics, it is important to examine the economic characteristics of the area and their effect on the rental market. Supply and demand, vacancy rates, and absorption rates provide insight into the economic environment of the area. In a soft market, supply will go up, which increases vacancy rates, and demand will decrease.

Supply and Demand

Supply refers to the number of apartments available in the market at a given time.

Demand is the need or request for those available apartments.

Supply is less than demand = it is a market that favors the owner; there is less competition for residents, therefore the **value and rent of the apartments increase**.

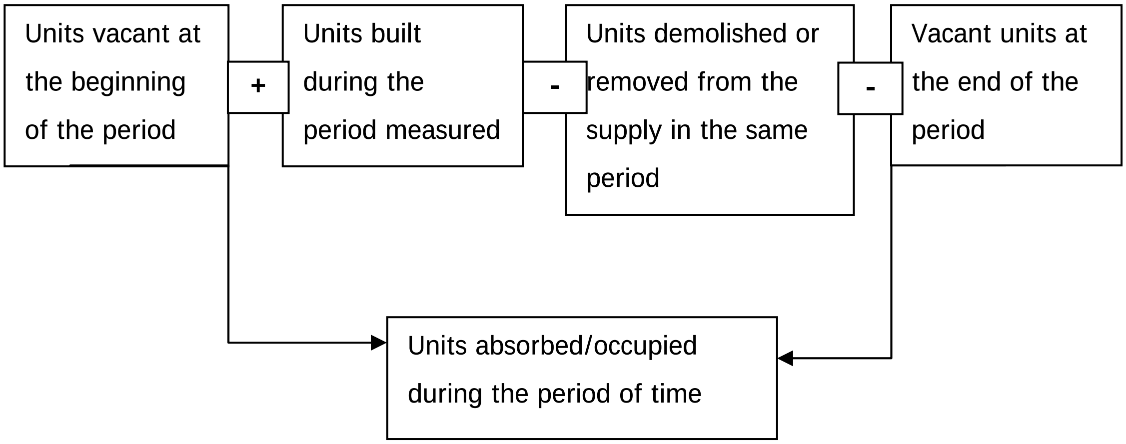
Supply is greater than demand = it is a market that favors the resident; increased competition for occupants leads to a **decline in rents and difficulty leasing**.

Supply and demand for residential property can be affected by demographic characteristics such as household income, age, and family composition. In turn, these very same characteristics can, themselves, be affected by supply and demand. An in depth market study will determine unit mix, floor plan features, amenities, targeted profile and rent recommendations based on what is currently in the market. This study should also include projected job growth and city plans for infrastructure, including building permits, construction already permitted, not yet built and raw land sales.

Absorption Rate

Absorption is the net **change in apartments occupied within a market or submarket over a specific time period** usually the prior year. Absorption formulas consider both construction of new apartments and demolition or removal from the supply of existing apartments.

Absorption can be computed as follows:



Supply is less than demand = vacancy decreases and absorption is positive.

Supply greater than demand = vacancy increases and there is negative absorption.

Understanding the circumstances that caused this is important.

Rental Comparison

Obtain or create a market rental schedule for each competitor and compile a rental comparison chart. It is important to compare base rents and market rents. Establish specific comparisons for:

- Unit type
- Square footage
- Market rent including additional recurring charges for amenities
- Market rent per square foot
- Amenities
- Incentives – these will reduce market rents to effective rents.

1. **Begin with a definition of all unit types**. Categorize each unit into the number of bedrooms, and further separate each group by the number of baths and dens available.

2. **Compare rental rates**. Begin with the base rent for each unit type or category and add premiums or charges for each amenity. Use your chart of amenity pricing for both the subject property and comparable properties.

3. **Create a chart or list similar to the chart below**. There are no common standards used by the multi-housing industry for these charges, so you will have to rely on experience and commonly used amenity charges in the area.

   Below are some **examples** of amenity pricing. The charges you determine may not be the same as the example.

Fireplace	$15	Ceiling fan	$10
Vaulted ceiling	$10	Microwave oven	$10
9-foot ceiling	$5	Self-cleaning oven	$5
Pool view	$15	Ice-maker	$5
Woods/creek view	$20	Wet bar	$10
No balcony/patio	($10)	Bay window	$15
Washer/dryer connection	$15	Book shelves	$5
Washer/dryer included	$30	Electronic alarm system	$15

Rental Comparison (continued)

4. Once you complete the above chart, you can **summarize the rental comparison** where you will indicate the monthly dollar rate and rate in dollars/cents per square foot for each type of unit.

Completing all the exhibits will produce a complete and objective analysis of the community and its competition. This data can be used to write a comparative market analysis that will explain the property's overall market position whether it be advantageous or disadvantageous.

After you have analyzed area rates and compared them to the subject property, consider:

- Can rents and amenity charges be increased and if so how soon?
- Can rents be increased after capital improvements have been made?
- How much of an increase is appropriate based on the current condition of the property or renovation plans?
- Can rents be increased for selective units?
- What is the competitive leasing edge for the subject property or what needs to be done to improve it?
- What improvements must be made to meet or beat the competition?

The current reputation of the subject property will have a bearing on future marketing plans. Ask others for their opinion about the property as you compile your surveys – particularly the competitors. Find out competitor improvement plans. If there are plans at the subject property to improve, upgrade, or rehabilitate the property, you may consider changing the property's name and advertising campaign.

An analysis should be detailed and objective. Note the strengths and weaknesses of the neighborhood and those of the subject property and its competitors. This will help you to advise or offer recommendations to an owner.

Debrief Questions

1. From what you've experienced, what economic trend you've seen to most increase and another that most decreased a property's value?
2. Now, describe a demographic trend that increased and another that decreased a property's value?

4. Property Inspections (75 minutes)

A thorough physical inspection of both the interior and exterior of the subject property is necessary to identify problems, flaws, or concerns that will impact the investor decision on property acquisition, rehab or renovation.

Identifying any problems prior to purchasing or acquiring an asset will influence the investor's offering price and expected rate of return on the investment, as well as any cost-benefit analysis associated with renovation. In some instances it will cause an investor to not go forward with the planned action.

The property inspection is intended to identify environmental concerns and document the inspection of:

- Exterior structures
- Interior apartment units
- Mechanical facilities
- Maintenance
- Leasing/business offices
- Common areas and amenities

It is important to determine when professional or technically qualified personnel such as architects or engineers should conduct inspections and assist with cost estimates.

The CAPS Role

Inspecting a property is a time and effort-demanding task. It must be performed in a thorough and professional manner. Much is at stake for the owner/investor as well as the management organization's reputation and professionalism.

Aside from management company personnel and professionals noted above that are a potential part of a strong inspection effort, the multi property supervisor will likely be leading the management team's inspection effort on behalf of the acquiring entity.

Community personnel from other portfolio properties are likely sources of inspection help. Further, company personnel in other disciplines such as accounting, asset management, construction, information technology, training, marketing, or human resources are additional resources for inspection purposes.

Before beginning the inspection, consider the following:

1. Make sure you understand the owner's objectives and the purpose and intended result of the inspection;
2. Use detailed, standardized inspection checklists for interior, exterior, and mechanical inspections;
3. Take checklists, notebooks, tape measures, cameras, video equipment, and tape recorders;
4. Work closely with current onsite management to encourage their cooperation and provide suitable and legal notice as needed for onsite interior inspections.
5. Allow enough time for a thorough inspection that is the least disruptive to current management and residents.

NOTE: Make sure you are aware of what information the current on site team knows. Sellers, sometimes, do not tell existing site personnel about considering selling a property.

Evaluation Steps

Each step for inspecting a property must be carefully and diligently undertaken. Begin with an overview focusing on deferred maintenance and functional and economic obsolescence.

Deferred maintenance is that property upkeep that has been “deferred” or not completed that should have been done to maintain the asset. Peeling exterior paint and leaking roofs are two examples. Maintenance may be deferred if the property owner has attempted to save operating costs and thereby reflect a stronger net income than may be realistic. Evaluate conditions carefully.

Deferred maintenance **can cause costly damage and result in repair costs considerably larger** than if the problem had been taken care of when discovered. The inspection should note all related or extended repairs and/or replacements associated with the needed maintenance.

Functional obsolescence refers to those items that may not be worn out or needing replacement but **which are outdated or obsolete**. Examples include light fixtures, colors used in the décor, wallpaper, floor coverings, or equipment in the apartment home, and cabinetry, counters, and appliances. Once again, the inspection should note what should be replaced and the estimated cost.

Economic obsolescence is the result of those problems that can not be remedied such as a **property located in a rapidly declining area without potential for improvement or turnaround**. These issues are likely caused by problems in the neighborhood rather than by the property. Try to determine how much current management may be contributing to problems at the property.

Economic obsolescence is typically external to the property and makes it even more important to learn about the area surrounding the property as well as the property itself. Businesses across the street, around the block or down the road will give relevant clues as to the strength of the area and therefore the pay back of any significant investment.

In general, also evaluate property curb appeal and location. Well located properties even with negative features, aging or less than new amenities, can outperform better maintained newer assets in poor locations.

- Assess the condition of the buildings, grounds, signage, landscaping, lighting, parking areas, common areas, and amenities
- Identify the first impressions that the property conveys to residents and visitors
- Evaluate why a prospective renter would want to lease at this property instead of elsewhere

Consider the Following

When inspecting for environmental hazards you should look for:

- Asbestos
- Lead
- Mold
- Radon
- Mercury, etc.

When inspecting the exterior of the property you should look for:

- Potential trip hazards; sidewalks and building access
- Drainage
- Landscaping
- Parking lots, curbs and curb cuts
- Garages
- Fences
- Pools, spas and water features
- Exterior amenities such as gardens, sports courts, BBQ and picnic areas

When inspecting the exterior of the buildings you should look for problems with:

- Roofs and gutters
- Facades
- Stairs and railings
- Patios, balconies, landings
- Paint condition
- Foundations, etc.

When inspecting mechanical operations you should look at:

- Metering and billing equipment
- Gas
- Electricity
- Water and waste systems
- HVAC
- Irrigation systems
- Key retention and access systems
- Pool and spa equipment

When inspecting the interior of the building you should look at the conditions in:

- Individual units
- Common areas – hallways, unit entries
- recreational facilities
- business centers
- office areas
- clubrooms and common gathering areas

You will eventually, as part of the inspection process, be required to identify the problems as well as the cost necessary to fix, repair, upgrade, or replace in these areas:

- Deferred maintenance
- Major repairs
- Capital improvements

Environmental Inspections

Most lenders and prudent buyers will require a Phase I Environmental Survey before funding a loan or acquiring a property. Based on the extent of any renovation or rehab, environmental inspections may also be required. This is especially true with regard to asbestos, lead, mold and other indoor air quality assessments.

The **information provided in this report is critical** because property owners are responsible for a site's environmental clean up, even if that owner did not cause the problem that contaminated the property. It **ensures** that during the life of the property, no one will be mandating the current owner to clean up a property long after acquisition.

Such surveys are conducted according to standards established by the American Society for Testing and Materials (ASTM).

Requirements include a site visual survey including **surrounding areas** and re**cord searches of federal**, **state**, and **local databases**.

A **visual inspection may not detect underground problems** unless part of an earlier environmental database. It may also not identify the presence of asbestos, lead or other indoor air quality contaminants

These surveys are intended to reveal such problems as:

- Asbestos containing material
- Lead based paint
- Radon gas, mercury, or carbon monoxide
- Waste disposal facilities
- Proximity to sensitive environmental and chemical areas
- PCB containing materials
- Fuel or solvent contamination
- Buried fuel storage tanks
- And contamination from prior use

Even if the property is being purchased without a loan, it is wise have an environmental inspection. Future clean up requirements discovered with an inspection will be the responsibility of the new owner if not corrected prior to acquisition.

Use a professional to confirm or eliminate the concern or hazard. Use professionals to test, treat, remove, or correct the hazard(s).

Before acquisition, it is the seller's responsibility to correct or remove the hazard unless this is negotiated as part of the purchase. If this is not done, the offering price should be adjusted enough to allow the buyer to fix the problem.

These **costs** would include:

- Inspection fees
- Permit fees
- Contractor costs
- Disposal fees
- Long-term liability costs for the materials removed
- Replacement costs
- Possible resident relocation costs

Landfill or Dump Sites

Typically, landfill and dump sites are carefully regulated and present few problems to residential communities. However, if the potential site is located in an industrial district, check local records to avoid potential liability. Also check with the local EPA office for any records of violations.

Look at previous title records for abandoned underground chemical containers, petroleum storage tanks, or piping. According to the law, it is the owner's responsibility, no matter who abandoned the containers, tanks or piping, to remove these items and clean up any soil and/or water contamination these items caused. Under EPA provisions, these pollutants must be removed and a clean-up plan submitted to the state within 30 days of a leak or discovery of a leak.

Because on-going legislation can result in changes in the current law or enactment of new laws, it is important to remain current about environmental issues.

Mold

Mold, also referred to as mildew and fungi, can grow anywhere moisture is present. Mold can exacerbate health problems including skin irritations, respiratory difficulties, allergies, asthma, cancer, and nervous and immune disorders.

Inspect all water damage problems because mold growth can occur as a result of:

- Leaking roofs
- Pipe leaks or "sweating"
- Sewage backups
- Floods
- High humidity
- Heating, air conditioning and ventilation systems
- Construction design defects in the building envelope
- Water-damaged building materials.

Mold can also grow on hidden surfaces, such as:

- The backside of dry wall, wallpaper and paneling
- The top of ceiling tiles
- Under carpets and pads.

As you inspect a property, note water-damaged areas, wet or moist spots, musty or moldy odors. Ask the current management if residents have reported health problems they think are mold related.

Mold issues are not confined to "older" projects. If a new community is built during a particularly rainy or wet season and is not allowed to "dry" completely before walls and ceilings are installed, moisture trapped in wood framing can result in the growth of mold behind walls, in ceilings and around windows.

According to the EPA, the best way to control mold is to control moisture. The presence of mold or mold-conducive conditions may be determined by a moisture indexing of multiple areas of the interiors as well as physical inspection.

Property Exterior Inspections

Hazards and Liabilities

An important part of your total inspection begins with knowing applicable local and state building codes and regulations. You need to know this information to determine if the property is meeting these standards or needs updating. If upgrades are required, calculate the potential cost of correcting any hazards.

A photo record made during your inspection is especially helpful. As you walk the property, look for the following potential hazards (this list is not intended to be all-inclusive):

- Uneven sidewalks caused by tree roots, or ground settlement
- Potholes in the parking lot
- Untrimmed tree limbs that may cause damage to roofs or cause injury to someone walking past
- Streets, sidewalks, parking areas and/or landscaped areas that do not drain properly
- Overgrown shrubbery that might hide an assailant or threaten a residents' safety
- Ineffective lighting in pedestrian, parking or service areas (best viewed at night)
- Unsecured electrical junction boxes or loose wires
- Faulty or incorrectly grounded wiring
- Ineffective or nonexistent pool fencing, life saving equipment and GFI switches
- Deteriorating stairwells, balconies and walkways
- Presence of a sufficient number and appropriate type of fire extinguishers. Note inspection dates
- Loose or missing banisters, hand rails and posts
- Door, windows, steps or stairways in disrepair
- Fences. Actually push on a fence to determine how sturdy it is
- Unattended equipment left lying about the property
- Unsafe playground equipment
- Garages or covered parking areas that need clean up or repair
- Trash collection areas that need clean up, repair or that are not within local code (i.e., trash chutes)

Resident Safety

Safety is always of prime importance. A safe community retains and attracts residents— and protects the owner's investment.

Once again, the following list of items to be inspected is not intended to be all-inclusive, but should provide a good starting point for your inspection.

- **Locks**: What types of locks are used for entry to the residence and on patio or balcony doors? Deadbolts, night latches, pin latches, or others? Also, is the property in compliance with state or local codes and ordinances?
- **Type of door**: Are hollow-core, metal, or solid-core doors used? Do unit external doors have "peep holes"? Do handicap accessible units have "peep holes" set at the appropriate sight level for wheelchair users?
- General **condition of doorframe** molding, sidelights, weather and rodent/pest-proof, loose or damaged materials.
- **Windows**: Locks/latches, condition of windowpanes, bars, screens.
- **Electronic or manual perimeter** and privacy fences and gates.
- **Intercom** or intrusion alarm systems and devices.
- The use of any patrol services.
- **Exterior lighting**: working, type, location, on timer or photocell?
- **Landscaping**: fences, overgrown shrubbery, uneven areas or trip hazards.

In addition to the physical surroundings, you will need to know the state and local ordinances regarding resident safety. Check with the local police and/or the local NAA affiliate office if you need information or clarification of existing laws. Determine if the property is in compliance with these laws. If the property is not in compliance, determine what must be done and estimate the cost for compliance.

Drainage and Irrigation Systems

Water damage from improperly functioning drainage and irrigation systems can cause structural damage and be very costly to repair. Therefore:

- **Examine the topography of the site for adequate drainage.** Note the site's location in terms of surrounding development, including streets and alleys for draining run-off water.
- **Inspect the grounds and note the areas water may collect, particularly around the foundations of buildings.** Are the grounds properly graded? Are the interior walls of foundations completely dry? Are sewers, drain connections, and sump pumps (if applicable) working properly?
- **Check ponds, fountains, and swimming pools.** Are they properly maintained and inspected regularly as part of the preventive maintenance program?
- **Inspect the irrigation and sprinkler system.** Are there city or local water restrictions that apply to the property? Is there a preventive maintenance program in place, including a winterization program, if applicable?
- Do french drains, flumes, or retention areas exist? If so, determine location and condition.
- Check for weep holes. See if they are plugged.

Landscaping

- Are the grounds well maintained? If not, note the work that is needed, such as re-seeding or re-sodding, replacement of shrubs, pruning, etc. and estimate the cost of this work.
- Does the current maintenance program include treatments for fertilization and insect control? Is this type of work done by the staff or a contractor? Does insect control require a special license or permit to perform?
- Is the landscaping appropriately designed aesthetically and environmentally for the area?
- Can some changes be made to the landscaping that would reduce water usage and maintenance costs?

Garages and Covered Parking

- Leaking and damage to roof, support posts and siding or doors.
- Oil stains or deterioration of parking surfaces.
- Proper signage and lighting.
- Abandoned cars.
- Proper grading and drainage.

Trash Containers and Compacters

- Dumpsters and compacters should be in good condition.
- Both interior and exterior dumpster and compacter areas should be clean and controlled for odor and pests or infestation.
- Determine if dumpsters are owned by the property or provided by the trash removal service.

Drives/Parking Areas

- Check for severe cracking, potholes, recent repairs, drainage problems, etc.
- If repairs are needed, obtain professional estimates and determine budgetary needs.
- Parking areas should be striped, and special areas, such as fire lanes or spaces for persons with disabilities, should be easily visible.
- Check the local code for the required number of parking spaces per building for persons with disabilities.

Perimeter Fencing or Enclosures

- Note type of fences used on the property.
- Fences should be structurally sound, free of loose, bent, broken, deteriorated or missing material.
- Area around fences should be well maintained and free of any accumulation of rubbish, garbage and graffiti.
- Note needed repairs and estimate the cost.
- Consider adding new fences to create a new image or hide unsightly areas.
- Evaluate the feasibility of installing electronic gates.

Access Gates

- Inspect general condition of gates. If they need to be painted or repaired, estimate the cost.
- Are all gates operational? If not, what is estimated cost to restore operation?

Sidewalks

- Sidewalks should be structurally sound and level.
- Check for cracks, holes, and spalling (chipping of surface).
- Ground surface around the sidewalk should be properly graded to drain well.

Energy Evaluation

Conservation of energy and natural resources is important for every part of the country. Recent technological advances have produced many energy efficient measures.

During your inspection, note:

- Weather-stripping on doors and windows.
- Exterior caulking.
- Roof and foundation vents.

Consider what changes might be made to conserve energy and water, and the estimated costs for these changes. Items to consider include energy efficient lighting, low flow toilets, high pressure faucet heads. Also check to see if there are city or energy company incentive programs that encourage these purchases and possibly provide rebates.

Building Inspections

Building inspections should be comprehensive and detailed. You may want to consider hiring experienced professionals to assist with inspections.

Roofs

A comprehensive and responsible roof inspection involves actually standing on the roof to inspect it. Check for the following:

- **Age** of the roof and **repairs or replacements** that were made.
- Identify the type of the roof.
    - Flat roof with mineral sheet cap – characterized by its light-colored granular surface with many seams because it is applied in narrow coils.
    - Flat roof with built-up surface – usually has a gravel surface to deflect the sun's rays from the underlying emulsion.
    - Mansard – roof with two slopes or pitches on each of the four sides, with the lower slopes steeper than the upper slope. May be part of a flat or pitched roof system.
    - Pitched or hip – sloped or inclined sides and end slopes that are connected by a ridge.
    - Gable – a ridged roof, the ends of which form a gable (generally a triangular shape).
- Identify the structure of the roof.
    - Trusses: Large, usually wooden, triangular forms used to form the ceiling joists and rafters.
    - Joists or horizontal beams: Parallel horizontal beams, usually wooden, and set 16 to 24 inches apart. Joists are placed from wall to wall to support the boards of a roof of a building.
    - Joists and rafters: Rafters are the structural member extending from the down slope perimeter of a roof to the ridge or hip and is designed to support the roof deck and roof system components.
    - Post and beams: A post supports the beam. It's a vertical piece of lumber or metal pipe with a flat plate on top and bottom. A beam runs horizontally and is used to support the weight of the joists or a roof.
    - Panels

- What roofing materials are used? Common materials include:
    - Asphalt, rubberized and fiberglass shingles
    - Wood shingles and shakes
    - Clay or cement tiles
    - Slate
    - Metal
- Check the chimney, stack, and vents. They should be structurally safe, durable and smoke tight – able to bear the action of flue gases. Chimney and stacks with cracked bricks, loose mortar joints or other leaks are a serious fire and health hazard. Check for proper flashing.
- On flat roofs, particularly, check repairs around vent pipes, air conditioning units, gravel stops, flashing or parapet walls.
- Make sure roof drains are not clogged. Check gutters and downspouts. Splash pans or diverters if necessary should be in place.
- Inspect antennas and solar panels, if applicable.

Façade and Carpentry

When inspecting the façade and carpentry, note:

- Types of materials used: cedar, pine, brick, stucco, Hardiplank (fiber concrete siding that looks like wood clapboard), Masonite, T-111 (plywood siding), etc.
- The condition of siding and trim for evidence of rot, buckling or warping. Test areas with suspicious appearance – i.e. cracking, bubbling, warping – for problems below the paint surface. Pay close attention, as many problems may be covered with a coat of paint. Note any new wood.
- Check balcony joists, soffits, columns and decks. They should be structurally sound and free from cracked, rotted, rusted or bowed materials.
- Schedule a termite inspection. Most termite damage is unseen and cannot be easily detected by an inexperienced person. In coastal areas, dry wood termite and subterranean termite inspection are advisable.
- Inspect outdoor stairways, stringers and handrails for condition and secure attachment to the building.
- Inspect painted surfaces for peeling, cracking, chipping or unusual discoloration. Estimate when repainting will be necessary.

Façade and Carpentry (continued)

- If the property has a vinyl siding façade, it will be necessary to determine what components are beneath the shell and the nature of their condition
- If cracks are evident in brick or stucco exteriors, it may be an indication of settling and foundation problems. A foundation expert should be consulted.

Foundations

Foundation types vary and may include:

- Poured concrete walls, concrete or cinder block walls that rest on concrete footings.
- Older buildings may have foundations of cut stone, stone or brick.
- Mat and raft foundations, also known as floating foundations or monolith slabs are used over soils that have low load-bearing capacity. They are made of concrete slabs that are reinforced with steel.
- Pile foundations are made of columnar units of concrete, metal, or wood that transmit loads through soils with poor load bearing capacity to lower levels where the soil's load bearing capacity is adequate.
- The foundation should show no sign of seepage, entrance of rodents into the building or settlement.
- It should be structurally sound and free of large cracks, holes or loose material. If foundation cracks are detectable, consult an engineer. Foundation repairs can be costly and should be estimated by an expert.

Accessibility Inspections

As you conduct your building inspection, you need to be aware of certain conditions required under federal and state Fair Housing laws, Section 504 of the Rehabilitation Act of 1973 (Section 504), and the Americans with Disabilities Act (ADA) for persons with disabilities.

Fair Housing: New Construction Accessibility Requirements

Housing that consists of four or more units that was built for first occupancy after March 13, 1991 must comply with the seven technical requirements for new construction. The standards apply to ground level units of a building with four or more units with no elevator, or to all units in a building that has an elevator.

Note that there may be more than one floor that qualifies as a ground floor. State construction requirements may be more stringent. There are eight "safe harbors" for compliance including the ANSI and International Building Code.

Fair Housing: Seven Design and Construction Requirements for Buildings

1. All covered units must be on an accessible route.
2. Public and common use areas must be easily accessible and usable by people with disabilities.
3. All doorways must be wide enough to allow entry by wheelchairs.
4. Accessible routes must be provided into and through the residence.
5. Light switches, thermostats and electrical outlets should be installed in accessible locations.
6. Bathroom walls must be reinforced to allow installation of grab bars if necessary.
7. Kitchens and bathrooms must be designed so that wheelchairs are easily maneuverable.

Fair Housing: Accessibility Requirements for Renovations

The Fair Housing Act has not established accessibility requirements regarding renovations. Therefore, an existing building going through renovations may not be required to make the building accessible, but state building codes may require it.

An applicant or resident is always allowed to make reasonable modifications at their own expense whenever necessary because of a disability.

Fair Housing: Accessibility Requirements for Existing Rental Housing

The housing provider must allow applicants and residents with disabilities to make reasonable modifications to the residence and common areas in existing housing at their own expense, unless the property is subject to Section 504 or if the property was not built in compliance with the Design Requirements (depending on the modification needed.)

An excellent source of information on fair housing accessibility is provided at `www.fairhousingfirst.org`.

ADA: Accessibility Requirements for the Public Areas of Rental Housing

The ADA requires that places of business, such as the rental office, and other areas to which the general public is invited must be accessible to disabled individuals. It **does not apply** to those areas of the property used only by residents and their guests.

Therefore, the **ADA does not apply to the individual apartment units** except in those cases where the property is owned or financed by a state or municipality or in transient housing where the rentals are short term.

ADA: Public or Assisted Housing

The ADA requires programs of a state or local government, such as public or assisted housing, to make their programs, services, or activities accessible to disabled individuals.

ADA: When Meeting the Requirements May Be Unreasonable

Whether in conventional or assisted housing, removing barriers to accessibility would not be considered reasonable if it is not readily achievable. “Readily achievable” is based on size and resources of the business, and barrier removal is expected as resources become available. “Unreasonable” is not specifically defined in the legislation or implementing regulations although examples are provided in the ADA Guide for Small Businesses.

Tax credits (Section 44 of IRS Code) and tax deductions (Section 190 of the IRS Code) are available to offset the costs of barrier removal for small businesses.

ADA: Resource Information

Extensive information is found at the ADA Home Page at (http://www.ada.gov).

Technical questions can be answered at 800-USA-ABLE, where trained ADA consultants can provide answers and information.

Section 504 Accessibility Requirements:

Section 504 of the Rehabilitation Act of 1973 requires that federally-funded or assisted housing be readily accessible to and usable by individuals with disabilities. The Act requires properties to conduct a “self-evaluation” of the property and prepare a plan that removes any barriers. It also requires the housing provider to pay for these changes. Further, 5% of the total number of units must be wheelchair accessible and 2% must be hearing or vision impaired accessible. The provider must also pay for reasonable modifications requested by disabled residents.

Properties subject to Section 504 should refer to the UFAS standards (Unified Federal Accessibility Standards) to assure technical compliance.

The process includes:

- Identifying accessibility barriers resulting from the policies.
- Conducting an accessibility review.
- Undertaking reasonable modifications to common areas and residences.

Section 504 requirements are extensive. The regulations are found at 24 CFR 8.3. Additionally, HUD provides an excellent and thorough discussion of the many requirements at http://www.hud.gov/offices/fheo/disabilities/sect504faq.cfm in a useful question and answer format.

General Accessibility Compliance Checklist

Some of the items to consider as you conduct your inspection for Fair Housing accessibility compliance include:

- **Parking** – number, size, location, striping, and signage.
- **Entryways** – ramps, entryways wide enough, and accessible door handles.
- **Corridors** – non-slip floors and wide space needed.
- **Stairs** – width, traction, secure handrails.
- **Elevators** – doors that remain open long enough, accessible controls, audible floor signals, etc.
- **Drinking fountains** – must meet height and knee space requirements.
- **Bathrooms** – accessible urinals and mirrors, special door handles and grab bars and wheelchair accessible.
- **Alarms** – must be accessible.
- **Signs** – raised letter and Braille signs where needed.
- **Phones** – accessible height and volume control.
- **Common areas** – flashing warning lights in areas like the community center are advisable.
- **Building to Building Access via sidewalks and ramps**
- **Access to office/units from parking lots, public transit**

The most comprehensive accessibility checklist for ADA compliance is the “ADA Checklist for Readily Achievable Barrier Removal,” which is found on the ADA website at www.ada.gov.

Mechanical Inspections

Mechanical inspections include the major systems that serve the property, such as:

- Electricity
- Gas
- Water
- Sewer
- CATV
- SATV
- Broadband/high speed Internet
- Telephone service
- Trash disposal

The focus of the inspection should be on how services are metered and billed, as well as, the current physical condition of the systems.

Metering and Billing

Determine how each utility is metered and subsequently billed to residents.

- In most instances, individual metering of each residence is the most desirable option since residents can be billed directly, and management has less administrative work.
- RUBS – Residential Utility Billing System. The property receives the bill for services and must assess a part of the total bill to each residence. There are companies that specialize in administering RUBS programs. They generally charge a fee per unit
- Sub-metering: A separate company reads the meters each month and manages the billing. The metering company may also monitor some central systems such as gas heating and bill each residence (a modified RUBS).

Gas

Since most gas lines are underground, it may be difficult to determine the actual condition of the gas system. However, you should check:

- The age of the system and type of pipe used. Some materials deteriorate naturally with time and natural causes such as ground shifts. You should be able to determine the age of the system from maintenance or building records.
- Major repair work completed and type of work done.
- Warning signs for gas leaks, such as odor, hissing sounds, and dead or dying vegetation located near gas line connections. Problems should be reported to and repaired by the gas company.
- Check for compliance with the Gas Pipeline Safety Act.
- In most cases, a licensed plumber can pressure test gas lines to determine if any leaks exist.

Electricity and Lighting

Your inspection should include:

- The age of the overall electrical system.
- Type of wiring – aluminum or copper.
    - If apartment homes are wired with aluminum, make sure that all receptacles, switches and connection points were made for aluminum wiring. Remember to consider conversion alternatives such as pig tailing, Ko/Lar receptacles, etc.
- Type of exterior lighting. Are energy-saving lights used? Are they on a timer or photocell?
- Visible contacts and junctions for corrosion. Corrosion causes increased resistance to electricity and can cause increased consumption.

Water and Waste Water Systems

Inspect the property for wet areas. Again, since water lines are below ground, deterioration and problems caused by ground shifts may cause damage. Clogged drainage and sewer pipes may cause water to collect. Check:

- Sidewalks for excessive repair work. Look for evidence that additional concrete or paving has been laid over existing surfaces or that sidewalks may have been reduced by grinding or a similar method to make them level.
- Maintenance records for a history of past problems.
- Individual hot water heaters:
    - Note any water damage and obvious discoloration that may have been caused by leaking water tanks.
    - Check or ask about sufficient water pressure in all residences. Low pressure in many units may indicate repairs needed in the main water lines.
- Boilers or central water heaters: Unless you have extensive expertise, you may want to hire a more experienced or licensed technician to inspect the system. However, you can review maintenance records, inspect pipe insulations and the general condition of the system.
    - Note the rate at which the boiler can supply hot water. The output of a boiler is expressed in gallons per hour (gph) and should be indicated on the boiler. The supply to each unit can be calculated by dividing gph by the number of units served. For example, a boiler rating of 1,500 gph serving 100 units would provide 15 gallons per hour to a unit. Under normal conditions, 10 to 15 gallons per hour is sufficient.
- Find out who supplies water to the property. Note the quality of water and if water softeners, filters, purifiers or chemical treatments are used. These devices can be costly to operate and maintain. Balance the continued use of these items with probable plumbing repair costs caused by calcium buildup in the lines or other materials that may cause clogged lines or leaks.
- Waste water systems/sewers:
    - Sewers and pipes function well and are free of debris and clogs.
    - Property drains properly – no water accumulation, wet spots.
    - Are retention ponds used on the property?

Heating and Air Conditioning

A thorough assessment of heating and air conditioning systems requires an experienced technician. However, your visual inspection should include:

- Type of heating and air conditioning systems installed.
- Central systems: Most equipment should be located in one area. Check the condition of the pumps, chillers, compressors, boilers, cooling towers, etc.
    - Chilled water systems can be two-pipe or four-pipe systems. Four-pipe systems provide heating and cooling simultaneously, while two-pipe systems either heat or cool.
- Individual heating and air conditioning units: Each unit will have its own condenser outside and near the residence. Note the number of units per apartment and the number of new condensers – this will give you a hint about future replacements. Also inspect air filters and coils to get an idea about how the units have been maintained. Dirty ceilings near air ducts are an indication that units are not working efficiently. Complete your inspection by checking cracking around the air ducts coming out of the units, and by looking at condensation pans and lines to determine if the system is functioning or requires service.

Irrigation

Turn the sprinkler system on, if weather permits. There should be sufficient water pressure and coverage for the intended area. Dry locations may indicate damaged or missing water heads or clogged pipes.

- Ask about the preventive maintenance program for the system.
- Note if the system must be manually turned on or is operated by timers or sensors.
- Check for proper positioning of sprinkler heads.

Intrusion and Smoke Alarms

- Note the type of intrusion alarm system used – individual alarms or alarm monitoring service.
- Who pays for the alarm system, permits and monitoring – management or residents?
- Are there mandatory pull downs on fire alarms on exterior locations or building interiors and are there fire extinguishers in apartment units, if applicable?
- Are smoke alarms located in the areas required by safety codes? Are they battery or photo cell? Who changes and how often?
  - Most codes require one smoke alarm for each bedroom.
  - Some codes specify the location of alarms in terms of distance from the ceiling.

Cable Television

- Is there an exclusivity contract currently in place and how long does it last?
- Is the community wired for cable or satellite antenna?
- Note conditions of antenna(s) and proper installation during your inspection of roofs.
- Satellite antennas must be maintained by the community's management and may require specialized knowledge and skills.
- What are the state/local regulations regarding individual satellite dishes?
- Who pays for the cable service – management or residents?
- Are resident satellite systems installed properly and legally

Elevators

- Qualified personnel should inspect elevators.
- Check for service contracts for preventive maintenance. Full service contracts that include parts and labor are preferable.
- Are all elevators up to code and do they have permits?

Controlled Access Systems

- Determine the type of access system installed, and general operating condition. Some examples are card access control systems, electric locks, automatic or electric gate controls,
- Check for compliance with local ordinances or codes.
- Is the system programmable?
- Is there a back-up system such as an emergency power system?
- Is special training required to maintain the system?

Required Permits

Be sure to contact local government authorities regarding required permits prior to commencement of work. Permit requirements vary within each local jurisdiction. If you are inspecting a property in an unfamiliar region, all municipal codes are listed by county at www.municode.com.

Note expiration dates of all permits and replace or renew those that have expired. Expired permits can incur substantial fines. Also check that permits are properly displayed.

Following is a list of commonly required permits:

- Business license
- Certificates of occupancy in some cities
- Combustible waste (dumpster or compactor)
- Elevator operation
- Boiler
- Access gate
- Signage (Generally, main identification signs only)
- Pool/Spa operation
- Alarm systems
- Communication – if property controls resident telephone access line or similar systems

Interior Inspections

Inspecting the interior of every occupied and vacant unit is a critical exercise in establishing current value and estimating future values of the asset. This section contains useful information and checklists that help organize inspections and record information.

Key Points to Inspect

As you conduct your inspection:

- Stay alert and look for existing and potential problems. For example:
    - Leaks under the sinks, poorly made repairs, window leaks, odors and unleveled floors.
    - Cracks around doors and foundations and/or doors and windows that do not close properly may indicate settling or foundation problems.
- Note the general design of the units. Note the unit sizes, room sizes and wall spaces. The layout should be functional and attractive. Ask yourself if you would be able to rent each unit or if there would be certain marketing problems.
    - A tape measure is handy for measuring rooms that appear to be smaller than the seller claims.
    - Is there space to add washer and dryer connections? Can the plumbing and electrical systems accommodate it? Can dryers be properly vented?
    - Is there adequate closet space and resident storage areas?
- Note the general condition of appliances, plumbing fixtures, floor coverings, window treatments and lighting fixtures.
- Consider the view from each unit. Attractive views of landscaped courtyards, pool, and wooded areas can command higher rents.

A good rule of thumb: Inspect every unit the owner plans to buy. In other words, inspect them all.

Inspections

The Appendix contains an Interior Checklist and Replacement Chart that will help you record information and make a complete inspection. There are automated inspection devices such as PDA's that make the inspection easier. Use any owner-provided inventory to check that fixtures, furnishings and supplies are intact.

Following are some points about specific areas you will inspect.

Individual Units

- Appliances:
    - Operable and color matched.
    - Age. Management may be able to furnish information about frequency of replacements.
- Light fixtures:
    - Operable, dated, obsolete.
- Flooring and floor coverings:
    - Type: hardwood, carpeting, tile, linoleum, vinyl.
    - General condition.
    - Type and condition of sub floors.
- Decorator items:
    - Wallpaper, paint, ceiling fans, fireplaces, bookcases, cabinets, woodwork, mirrors.
- Ceilings:
    - Bowed or sagging.
    - Signs of leaks, damage, discoloration.
    - Color and condition of paint.

- Windows:
    - Missing or cracked glass.
    - Caulking, moisture and rot.
    - Coverings – drapes, blinds.
    - Window air conditioners – operable, condition, maintenance schedule.
- Kitchens and baths:
    - Condition of fixtures – operable, cracks, leaks, damage.
    - Under sinks and cabinets – leaks, unusual types of piping.
    - Note type and approximate age of fixtures, as replacement parts may be difficult to find.
    - Condition of cabinets and countertops
- Smoke and carbon monoxide detectors:
    - Check city code requirements. Can they be battery operated or must they be hard wired? If detectors are required and not installed, the owner should be told as he/she may want to secure these funds from the seller at closing.
- Elevators:
    - Ride each elevator.
    - Operating and maintenance inspections are current.
    - Clean, well lit, odor free and well ventilated.
    - Walls: Kind of surface texture, condition, previous poor repairs, location of repairs that might indicate other problems such as leaks.
- Doors:
    - Doors that seem to close themselves or not close properly are often evidence of settlement.
    - Condition: Well-maintained, proper fit with door jam, weather stripping.
    - Types of knobs or locking devices.

Common Areas

- Interior hallways and exterior walkways free of clutter, odor free, clean and well lit and well maintained.
- Mail areas – accessible, well-maintained, well-lighted, clean, individual mailboxes with working locks.
- Laundries:
    - Centrally located or in each building, clean, well lighted, secure and adequate to serve the community.
    - Machines rented or owned. If rentals, review the contract to determine if it is transferable or renewable. If under contract, who has the responsibility for redecoration and equipment repair/upgrades during the contract period?
    - Inspect the condition of the floor for leakage problems – the result of inadequate or poor plumbing and drainage problems.
- Model Apartment:
    - Convenient location near the leasing office yet away from eyesores such as dumpsters, noisy play areas or storage facilities.
    - The floor plan and fixtures of the model should be representative of the most common units
    - Decorating – current, pleasant, offers imaginative decorative ideas to prospects, never over improved. Will it need redecorating?

Recreational Facilities and Areas

- Pool:
    - Condition of pool surface and deck area – cracks, holes, paint, slip-resistant.
    - Pool equipment – functioning, repairs needed.
    - Deck furniture – needs to be replaced or updated.
    - GFI switches on pool lights and pumps.
    - In compliance with local and state laws – i.e. emergency phone available, drains and drain covers compliant.
- Spa/Sauna:
    - Operable, well-maintained, clean, working timer.
    - GFI switches on lights and pumps.
- Tennis, volleyball, racquet ball courts:
    - Surfaces well maintained, level, free of cracks. If repairs are needed, get estimates from professionals.
    - Lighting, timers, fences, windscreens.
- Club, Exercise or Party Rooms:
    - Type of equipment provided.
    - Condition of furnishings
    - Audio or A/V equipment provided and in working order
    - Clean, well lighted, secure.
- Play areas:
    - Well-maintained equipment.
    - Clean and safe for children.
    - Condition of surfaces and fences.
- BBQ and picnic areas

Employee Work Areas

- Maintenance shops:
  - Location and controlled access.
  - Clean and orderly.
  - Equipment and materials properly stored, labeled, use of MDSD sheets.
  - OSHA and local code compliance.
  - What equipment will transfer with the property – complete inventory with model and serial numbers.
- Storage:
  - Adequate or more is needed.
  - Locked, clean.
  - Vented, if required by law or ordinance.

Marketing

When you have completed the inspection of exterior areas of the property and some common areas and amenities, you will be able to assess changes or improvements that could or should be made to **make the property more attractive and marketable.**

Here are a few questions that will help you reflect on a property's marketing strategy:

- What is overall "**first impression**" of the property? Is it well maintained and inviting?
- **Review signage**. Does it need redesign, repair or repainting? Are there sufficient signs to direct traffic and visitors? Should the property's name be changed and how much will new materials cost?
- Can anything be done to **modernize property appearance** if needed?
- Would additional **landscaping** or change in decorative motif help? Removal of overgrown or dead trees, plants, bushes?
- Add or upgrade a **furnished model**?
- Do **drives and parking areas** need resurfacing?
- Do common areas and/or the rental office need **updating, refurbishing, or redecorating**?

Debrief Activity

In the list of inspections categories below, rate in a scale of 1 to 5 that you've experienced to be the most recurrent issue and indicate which factor inside of each category was the most and less frequent.

[1] very frequent

[2] moderately frequent

[3] somewhat frequent

[4] a little frequent

[5] not frequent at all

[ ] Environmental hazards

What is the most frequent in this category? ____________

What is the less frequent in this category? ____________

[ ] Exterior of the property

What is the most frequent in this category? ____________

What is the less frequent in this category? ____________

[ ] Exterior of the building

What is the most frequent in this category? ____________

What is the less frequent in this category? ____________

[ ] Mechanical operations

What is the most frequent in this category? ____________

What is the less frequent in this category? ____________

5. Operational and Financial Analysis (45 minutes)

The operational and financial analysis is a critical part of the property evaluation process in order **to determine the property's viability** and to identify existing and potential problems.

This evaluation should **pay close attention to potential unforeseen costs that may appear in the future**.

When you perform this analysis, **you are looking for** any problems in:

- Lease documentation
- Sources of and actual income
- Operating and capital expense information
- Resident profile data

During this process, you must carefully analyze and assess the following:

- All sources of income
- Rent roll
- Lease files
- Current resident profile data
- Operating and non-operating expenses

Analyzing Income Sources

Once you begin an operational and financial analysis of a property by looking at its financial statements – in the best-case scenario you'll have actual results from the past 3 to 5 years – there are many details that require attention.

Note: Sometimes you will work with pro-forma statements since a seller may not wish initially to provide financial statements until a sale is more likely to occur. But pro-forma data, rather than actual results, is the least preferred option for providing a sound assessment of property potential.

Often multifamily brokers representing sellers can provide actual income/ expense data and future pro-forma estimates of property performance based on future income and expense assumptions.

When an intent agreement has been reached between buyer and seller, actual financial statements and property operating and financial information are available for more detailed evaluation.

It is usually at this point in time that the buyer's representatives will begin physical inspections in earnest.

From the actual statements, you should be able to review all sources of income for the property, including:

- Fees for **water**, **gas** or **electrical** sub metering (RUBS).
- Fees for **garage** or covered **parking** spaces.
- Fees for **pets**.
- Fees for **cable** access, use of **exercise club** or other services.
- Income from **laundry** and other **vending** facilities.
- Income from **furniture** rental, or other rentals.
- **Administrative** fees for applications, returned checks and late fees.

If you are working with pro-forma financial statements, you will need to rely on your inspection, experience and knowledge, and industry standards to develop a number that you feel best represents these sources of income.

Rent Roll Analysis

The rent roll is a record of occupancy and collection activity at a given time. It allows you **to compare rent potential with lost income due to vacancy, concessions, and collection loss**.

Are rental and collection targets for the current management company being met?

A rent roll is analyzed:

- To ensure the correct amount of rent being paid.
- To determine the actual number of vacancies.
- To analyze delinquency charges.
- To note prepaid sums.
- To verify the mix of unit types.
- To calculate lease expirations.
- To identify month-to-month leases.
- To compare market rent to current rents.
- To match lease terms, lease rent and other fee charges on the rent roll with those on the lease.

A rent roll analysis may occur in these steps:

- Request a current rent roll from management:
    - This request may be routed through an owner to a third party manager or through a broker
    - If current management can provide a rent roll, your analysis will be easier.
    - If a rent roll is not provided, you may develop one from leases or computer printout.
- Develop a draft rent roll using a basic grid or Excel spreadsheet.
- Use the rent roll to conduct a lease file audit and compare to file documents
- Verify data. This will also be an opportunity to determine if leases are executed properly.

Property management software providers can assist when operating platforms are similar and can even provide “bridge” software to convert data from one system to another, saving considerable manual work.

Lease File Audits

Auditing leases is important to **discover irregularities and determine if leases have been executed properly**.

A copy of a blank standard lease and standard riders should be included in your report to the owner. Note any unique features and whether subleasing and assignments are permitted or if alternative security deposit programs are in place (i.e. bond or premium paid in lieu of deposit).

After reviewing all leases:

- Compare the information about rents, deposits and dates with the rent roll.
- Prepare a report or matrix about lease expiration dates and anticipated turnover.
- Compare leases with unit-by-unit inspection to determine if all leased units are actually occupied.

Rental Application

In file:

- Completed and signed by all applicants of legal age.
- Signed by owner's representative.
- Verified information.
- Meets stated or anticipated income and occupancy qualifications (i.e., maximum occupants per unit, minimum income to rent ratios, senior, assisted or other regulated housing qualifications).

Lease Processing Checklist

- In file and completed properly.

Lease Agreement

In file:

- Signed and initialed by resident(s).
- Signed and initialed by owner's representative.
- All changes initialed properly.
- Term of lease is **accurate**
- **Date lease expires**. (Record this date.)
- Amount/accuracy of rental rate and any recurring monthly fees.
- Amount/accuracy of **security deposi**t.

- Amount/accuracy of **subleasing (if permitted)** fees.

Lease Addenda (Community Policies, RUBS, Submetering, Safety, Access Gate, etc)

In file:

- Initialed and signed by residents.
- Initialed and signed by owner's representative.
- Amount and accuracy of additional fees.

Move In Inventory & Condition

In file:

- Completed and signed by owner's representative.
- Signed by resident(s).

Pet Agreement, if applicable

In file:

- Description of pet(s) accurate
- Deposit amount accurate
- Signed by resident(s)
- Signed by owner's representative
- Amount/accuracy of additional fees

List other addenda in the file and determine accuracy of data.

Resident Profile

Resident profile data is usually readily **available** as part of the **reporting capability of the community's property management software system**.

This data is **only as useful as the quality of input** if such information complete or accurate.

For example:

- Was household income reported correctly?
- Was it listed as monthly income when it should have been annual income?

Inaccurate data entry **can distort resident profiles** so it is necessary to analyze this and be aware of that possibility.

Annual incomes at higher rent properties will range from $40,000 to over $100,000. If annual household income data is showing $4,000-$10,000, then the data was entered incorrectly.

Good resident profile information will h**elp you analyze occupancy conditions**, **rent collection practices**, and **resident selection criteria**. It will provide information about work locations and special interests which may be helpful in future marketing and advertising efforts. This information may result in a recommendation that the property's resident profile needs changing to improve the likelihood of better financial performance to meet owner objectives.

If the property is government assisted, certain regulatory compliance functions should be checked.

Analyzing Expenses

When evaluating a potential property acquisition, it is necessary to analyze **current and potential expenses in these areas**:

- Operating expenses
- Capital expenditures
- Renovation costs

Operating Expenses

Information about operating expenses can be gathered from:

- Previous and current financial statements for the property.
- Data you have gathered about the property or the seller.
- Your experience and personal contacts.
- Local, state and National Apartment Association reports.
- Multifamily brokers

Capital Expenditures

The physical inspection should reveal any necessary capital expenditures that will be needed. Note however, infrastructure, software, and other data systems may need to be provided or upgraded. Consider these costs.

Definition: Capital expenses are generally defined in the accounting reports and property budget. Capital expenses are often classified differently by different owners and may vary by property depending on ownership requirements. It is necessary to understand what constitutes a capital expense compared to major repairs at each property. Such expenses may be classified differently by the seller and the buyer.

Example: Major exterior paint jobs will be classified as capital expenses by one owner and major repairs under operating costs by another owner.

Capital expenditures generally include:

- Appliances
- Furniture/Fixtures
- Roofs
- Floor coverings
- Mechanical equipment
- Major plumbing and electrical replacements or repairs
- Major interior and/or exterior repairs.

Renovation

If the purpose of your evaluation is to determine the feasibility of a property renovation, you many need to consult with professionals to obtain cost estimates for thorough cost-benefit analysis.

Items might include:

- Exterior paint, structural repairs, carpentry and lighting.
- Parking lot repaving and striping.
- Repairs to building foundations or roof systems.
- Landscaping.
- Drainage and irrigation system repairs.
- Pool, spa, tennis court and other amenity repairs or upgrades.
- Signage.
- Clubhouse or office renovation.
- Model upgrade.
- Interior upgrades or renovation work (i.e., kitchen counters or cabinets, bathroom vanities, plumbing upgrades, commodes, adding W/D connections, etc.

Critical Operating and Financial Information Review

- Current **property taxes**. You will also want to determine post acquisition tax liability based on the purchase price. The cost could be substantially greater.
- **Insurance costs**. This amount may also increase due to increased value.
- **Management fees**.
- **Utility costs**.
- **Maintenance contracts** (HVAC, elevator, landscape, etc.).
- Service **contracts** (laundry, pest control, trash removal, furniture/equipment rental etc.).
- Employee **wages and benefits**.
- **Advertising costs** (apartment magazine contracts, locator fees, internet costs, collateral material).
- **Delinquency reports** - documentation of who owes rent and other fees, how much they owe, when and how they have been contact about their delinquency, and the results of those contacts. What is the percentage and dollar value of monthly delinquency compared to the total rent and other income potential at the property? Collection summaries will show prior results; compare it to budget and prior actual results. It will further tell you how well the existing staff is performing in the essential task of revenue collection. (It will be very important to know who will be responsible for collecting this money after closing, and to which party the money belongs.)
- **Leasing expenses** (credit checks, commissions, model apartment, resident activities, etc.).
- **Office administration** (supplies, forms/printing, equipment, postage, telephone, answering service, mobile phones and pagers, evictions, bank charges, data processing, professional association dues, etc.).
- **Employee administration** (hiring, testing, training, uniforms, contract labor, etc.)
- Always determine **if contracts automatically transfer to a new owner** or if contracts can be renegotiated or cancelled.
- It would also be helpful to know the **average number of move-outs each month and the costs to paint and clean units** for new residents. Knowing the cost of carpet and vinyl floor covering will also help you estimate make-ready costs.
- **Occupancy reports** of varying types including weekly activity reports reflecting traffic, sales, move ins, move outs, and notices to vacant.

Critical Operating and Financial Information Review (continued)

- What are occupancy/vacancy trends and what is the property turnover year to date and for prior years?
- How well are lease expirations managed?
- Occupancy trends and turnover ratio information is essential to forecasting. Your recommendations that result from the property evaluation will need to take this information into account so that anticipated/forecasted performance is factored into investment decisions.
- Will the property perform generally as it has or is it feasible to expect improved performance and why as result of new ownership or management?

Debrief Questions

Have participants discuss their experiences with operational analysis.

1. When looking at a property's sources of income, what information you pay most attention to after having some difficult experiences? And why?

2. Now, if when you're analyzing the rent roll of a property you noticed the current management was not able to provide all necessary information or if the information wasn't accurate, how did you usually use to proceed?

3. When analyzing the lease files of a property, what information you pay most attention to after having some difficult experiences? And why?

4. During the assessment of a current resident profile data, if you have noticed that the information was not reported correctly how did you used to proceed?

5. What operating and non-operating expenses are most common in a property?

6. Analyzing and Reporting Property Evaluation Results (30 minutes)

The report to the owner about the inspection and analysis of a property should include:

- Your market and competitive surveys
- Regional and neighborhood analyses
- Interior and exterior property inspections
- Income and expense analysis
- The lease file audit
- The recommendations and budgets

The focus of the report is the bottom line. The two main questions that your report will answer are:

- What will it cost?
- Does the investment make sense?

Comments should be brief but informative, bound in a formal package and include photographs and resource/research materials. If the subject property is being considered for acquisition, and there are not going to be any renovations, major repairs, or capital improvements, the focus of your report will be on the marketing information, lease audit, and rent roll, and your recommendations to improve certain areas.

Key Content for Owner/Company Report

A sample template for an owner's report follows.

Section 1: Title Page

- Property name and address
- Name of the person who requested the analysis
- Name of the individual who completed the analysis
- Date of preparation

Section 2: Letter of Transmittal

Type the letter of transmittal on company letterhead and include the date you are preparing the letter. Address the letter to the person who requested the analysis (the same person listed on the title page).

The body of the letter should include an executive summary that outlines the purpose and scope of the report, as well as the final conclusions and recommendations.

Section 3: Description of the Property

- Name, address, and location of the subject property in relation to the region and the neighborhood. (Include an area map with the t property identified.)
- Total number of buildings and units; property acreage and density
- Age of the structure(s) and a description of their construction, including the materials used and the architectural style
- Unit types, mix, and square footage.
- Description of amenities (pools, models, recreational facilities, laundry facilities, parking spaces and/or garages, etc.)
- Type of security measures used on the property.
- Vacancy by unit type and percentage; models and employee units
- Physical condition of the property and evidence of deferred maintenance and capital improvement needs
- Number of property employees and titles
- Current marketing strategies and promotions

Section 4: Market Analysis

- List, description, and photos of competing properties.
- Comparisons of demand and vacancy.
- Geographical summary of the region including property location, climate, topography
- Regional economic conditions
- Demographic data including income, education, gender, family composition, household formation, age groupings
- Population and job growth
- Major employers
- Natural resources, shopping, business, education and recreational/ entertainment venues
- Comparisons of rent, square feet and amenities to comparable properties
- Trends and possible future changes and how it will impact the subject property
- Area map showing location of competing properties to subject property.
- Neighborhood analysis
    - Boundaries
    - Infrastructure and proposed improvements
    - Shopping, employment and recreational venues
    - Community services and transportation
    - Competitive properties including occupancy and rental data
    - Undeveloped land
    - Existence of substandard or abandoned structures
    - Age and condition of neighborhood

Section 5: Physical Condition of the Subject Property

- Interior Inspection Report
- Exterior Inspection Report
- Photographs: Each floor plan, landscaping, signage, typical exterior, office and common area amenities.

Section 6: Operational Analysis

- Lease Audit Findings
- Resident Profile
- Rent Growth History and Future Potential
- 5-year Projected Capital Improvement Plan
- 3-5 year projected pro-forma based on your assumptions

Section 7: Conclusions and Recommendations

- Conclusions
- Recommendations
- Current and historical financial reports
- Budgets

Section 8: Disclaimer

A disclaimer is a paragraph that explains that the report contains data that was accurate at the time it was reported and that you are not responsible for changes that occurred after the report was written.

If the report is going to your owner or management company, the title page and transmittal letter may not be necessary.

7. Property Acquisition (45 minutes)

When an owner acquires a property, they may rely heavily on your property supervisory skills to oversee the transition in ownership and daily operations of the newly acquired property. While the actual tasks that must be performed may vary according to size and depth of the management company, you will want to be as organized and professional as possible to ensure a smooth and successful transition.

This chapter discusses a multi site supervisor's responsibilities and action plans for supervising the transition.

The CAPS leads the transition from old ownership to new, works to make it as smooth as possible, and makes sure that property and staff are up to the standards of the new owner and manager.

Management

Change of Management

If the new owner has decided to use another management company to manage the property, you will want to gather and organize as much information as possible to hand over to the new property manager. Be thorough and cooperative. Remember, your reputation and that of your company's is involved in this transition. You do not want to create situations where complications, errors or misunderstandings put you or your company at risk.

- Organize property, resident, maintenance and vendor files.
- Make inventory lists of all furniture, equipment, tools, machines, etc.
- Have all financial information as current as possible, including delinquencies and unpaid bills.
- Notify the bank, utility companies and vendors of the change in ownership.
- Notify residents of the change in ownership.

In-house Management

If your company will manage the soon to be acquired property, there are several important tasks that can be completed before actually being on-site. You will be better informed, prepared and organized if you complete the following action items. And, the first days of transition will be less traumatic for all involved. It is recommended that these tasks be completed prior to transition by as much as 30 days. A cooperative relationship with the seller and departing management company is essential and may allow this pre-close preparation. If this is not possible pre-close, complete these tasks as soon as possible.

- **Insurance**: Determine who is responsible for providing insurance coverage for the property. If the owner is responsible, make sure your management company's name is added to the policy as "additional insured." The owner must furnish the name and phone number of the insurance contact should a claim arise.
- Prepare and later send **a notice to residents** about the change in management.
- **Print new forms**, leases and applications to replace the former management company material.
- **Notify** utility companies. Determine when and if any service deposits are due. If there is simply a management change, there is no need to close and open new accounts – but confirm correct mailing address for your payables processing.

- **Notify vendors** of the management change and establish accounts in the name of the new owner, if necessary.
- **Notify the bank(**s). Open new accounts, order new bank account checks, deposit slips and endorsement stamps. It can be a good idea to change banking institutions so that errors are not made based on the name of a community and funds deposited into "old" accounts**.**
- **Order new office forms** and stationery if there is a name change.
- **Prepare new leasing material for use by leasing staff**.
- **Review collateral and leasing presentation material** to ensure company and property names are correct and that fair housing and accessibility logos appear. Make professional looking modifications to material you wish to retain.
- **Review** or **develop job descriptions** and employee handbooks for distribution at the proper time.
- **Review staffing and meet with each staff member, if possible.**
- **Recruit replacement staff**, if necessary, to have adequate personnel to cover the property the first day.
- **Create checklists** for action items to be completed the first day and the first week following after acquisition.
- **Alert group plan**, worker's compensation and other benefit providers of additional staff coming on board.

Closing Documents

Some or all of the following documents will be provided to the new management company.

- The **current rent roll** at closing. It should include information about all residents and details about vacancies and delinquencies.
- **All original lease agreements**, if not maintained on-site, and resident files, applications, and pertinent correspondence.
- **Security deposit** list and funding instructions.
- **Property tax records**.
- **Utility accounts list** and unpaid bills.
- **All outstanding bills** if the purchaser agreed to assume them as a condition of closing.
- **List of vendors** used by the property.
- Current **vendor and service contracts**.
- **Pest inspection records**.
- Inventory of **personal property**.
- **Physical inspection** reports written for the owner.
- **Legal records** including **pending evictions and/or any litigation**.

First Days at the Property

First Day of Onsite Supervision

- Secure all keys from the seller. Identify and label master keys, if used, with the help of on-site staff. It is recommended that master keys not be used.
- Change the office, maintenance shop and vacant unit keys.
- Create a key authorization list for signing out keys.
- Establish procedures for cash control and rent deposit practices. Audit the petty cash.
- Meet with on-site personnel. If the staff is large, you may want to meet separately with office and maintenance personnel. The property manager and maintenance supervisor should attend both meetings.
- Inform employees of their job status – permanent or temporary. In some states, employees may be considered permanent if they work even one day without being told they have a temporary status.
- If the staff will be retained, or new employees are in place, inform them of the new company's employment policies regarding salaries, pay periods, timekeeping, payroll processing, incentive programs, vacations, apartment discounts, insurance and other company benefits.
- Gather data and forms from each employee, including basic employment application, W-4s, I-9 information, and copies of support material, employee leases, and addenda.
- Explain the new owner's immediate priorities, the company's goals, code of ethics and other professional requirements.
- Explain emergency procedures and provide key staff members with emergency telephone numbers of upper management or support maintenance personnel. Emphasize procedures to follow in the event of fire or other emergencies.
- Physically inspect the property with the maintenance supervisor, noting any hazards and scheduling immediate repairs. Consult the pre acquisition inspection checklists.

The First Week at the Property

- **Send notices to all residents about the new ownership and management** and include status of rental payments and security deposit, if required by law.
- **Implement new office procedures**.
- **Establish and post office hours** along with the fair housing poster, leasing requirements, occupancy criteria and company logos.
- **Address uniform/dress codes for staff**.
- **Initiate office procedures** and introduce in-company systems and schedules.
- Make sure **all necessary office supplies have been ordered** and that the new applications, leases, inventory move-in forms, etc. are on-site.
- **Notify the answering service**, if applicable, of the change in management.
- **Send a list of home phone numbers, cell phone numbers,** and beeper numbers of property personnel to the corporate office.
- Review delinquency reports.
  - Reconcile the delinquency report received at closing with current collections.
  - Make sure action is being taken on delinquent rents and set goals for collections.
- Review delinquency policies and procedures with the community manager and determine if any changes should be made.
- Employees new to your organization or to the property:
  - Conduct new hire processing, drug screening and any pre-employment testing. If drug testing is required at one property, it is legally required at all properties for all employees.
  - Arrange orientation session. Schedule training as needed
  - Distribute employee handbooks and review job descriptions with each new employee.
- **Inspect all vacant units and list all make-ready tasks.** If necessary, consult with staff to explain your make-ready standards. Compare the vacancy list with the rent roll received from the seller at closing. Note any discrepancies and report them to the owner.

- **Prepare a lease file audit** or update if performed prior to acquisition. Compare to any pre-acquisition file audit information.
    - Review each lease and resident file. Confirm that all required documents are in each resident file. Review lease addenda for pets, employee discounts, etc.
    - Verify security deposits and balances on leases and rent rolls.
- Review leasing procedures.
    - Review and confirm rental rates for each unit type.
    - Establish leasing terms to include term of lease, security deposit amounts, and number of residents permitted in each unit type, etc.
    - Determine new resident income requirements, credit check and application approval procedures.
- Property inspection.
    - Inspect the property and recheck the physical inspection report made prior to closing.
    - Check again for hazards and liabilities and prepare a repair schedule.
    - Review the hazardous material management plan.
    - Prepare and schedule capital improvements or major repairs with the community manager and maintenance supervisor or advise who in the management company will be handling this if not property management.
    - Explain the new owner's requirements and policies regarding the property's physical appearance.
- Review the status of onsite maintenance
    - Schedule maintenance for all outstanding service requests.
    - Locate, review and file all warranties and guarantees for equipment and appliances.
    - Prepare, if not provided, a master list of meter numbers.
    - Make sure all chemicals in the maintenance shop are identified and labeled per OSHA guidelines.
    - Make sure all logs required by OSHA or EPA, such as Freon recovery, are being kept and are current.

The First Week at the Property (continued)

- Schedule immediate clean up of grounds, parking areas and common areas, if needed, to demonstrate the new management’s dedication and professionalism to residents.
- Implement a purchasing procedure and define the limitations.
- Issue petty cash and explain procedures for its use.
- Review necessary operating permits, and obtain any that are required, if missing.
- Review the vendor listing and make sure all vendors have been notified of the new ownership and management.
- Establish contact with key vendors

Debrief Questions

Have participants discuss their experiences with property acquisition.

1. In assuming the new managerial position of a recently acquired property, how does the staff usually respond when you approach them?

2. Following to the previous question, how do you usually approach current residents?

8. Property Renovation (30 minutes)

Some owners/investors opt to renovate instead of selling their properties in order to buy another. Often, renovation is more cost-effective than buying/selling. It also means an owner/investor is willing to work on the property's modernization or upgrading.

Activity

Before starting this next chapter, lead the participants in this brief activity.

Tell your colleague next to you in brief an experience in the past where you had second guesses about your final advice to your client if the renovation should have gone through or not. Explain the scenario and what reason made you deeply reflective on your decision.

The CAPS Role

The potential renovation must be evaluated to make sure it is compatible with owner investment goals.

For that purpose you must assess the need for the renovation, project cost and benefits, participate in the bid process and handle the leasing and marketing during renovation. In larger companies, it is possible that property management will have a lesser role. Asset management personnel may assess property needs, prepare the renovation budget, and complete the bid process and contract execution work. In other instances, construction personnel or third party renovation specialists may be used for the sole purpose of supervising and managing the renovation.

- Projecting the costs and benefits, including the property's repositioning that might result
- Participating in the bid and contract process
- Handling leasing and marketing during renovation

Based on the evaluation and the recommendations that result, the investor/owner may **improve the current property** by increasing its size or by making major capital improvements to upgrade construction quality and/or reduce operating costs.

This might include:

- Re-siding
- Repainting
- Appliance replacement
- Energy efficiency projects such as window replacement or more energy efficient appliances
- Re-roofing
- New unit cabinetry
- Countertops
- Bathroom modernization

It is important to know and advise the owner/investor that these improvements which are intended to produce **higher rents and/or lower operating costs** for the property will do so and to quantify the potential result. For more on working with contractors and contracts, see the Legal Responsibilities and Risk Management module.

Renovation could also include **conversion to a different use** such as rental apartments to condominiums. Such a study is often undertaken by third party appraisal or renovation specialists.

The owner/investor will want **to consider the factors below:**

- How long the property might be held?
- What would be the cost of financing the improvements?
- What might be the tax consequences from new borrowing costs and improved cash flow? Remember, however, you are not a qualified tax accountant or attorney and any recommendations should be qualified as such
- What will be the anticipated return on the additional equity?
- How will cash flow compare post renovation to current cash flow?

Performing a Needs Assessment (continued)

- Are tax credits for rehabilitation expenditures available to reduce investor tax liability (because of property age, historic status or because it is low to moderate income housing developed under Section 42 of the Tax Reform Act of 1986)? Tax credits are more beneficial to investors than are tax deductions.
- If environmental or energy retrofits are a part of the plan – what municipal or other payback programs are available.
- Will there be significant costs to comply with new building codes? Do these costs include impact fees?

Residents

Renovation projects directly impact residents one way or another, so you will want to do all you can to keep them informed and prepared for coping with the noise and inconvenience of the project. Tell residents about the renovation work before it begins and emphasize that the work will provide a better a place to live.

Make sure to give residents sufficient, and any required legal, notice about particular renovations to their building and parking and sidewalk areas so they experience as little inconvenience as possible. Be aware of all environmental hazards. If any renovation work involves entering occupied apartments, always be sure to provide adequate notice as required by law and common courtesy.

Leasing During Renovation

If renovation is scheduled for weeks or months, there may be the temptation to focus only on the renovation. However, this is the time when there should be aggressive marketing and leasing activity. Instruct the staff to emphasize what has been improved and describe with positive imagery what will be renovated soon.

Make sure the leasing office is accessible to both residents and prospects during renovation. You may have to temporarily relocate the office and post signs to direct residents and prospects.

Generate some excitement about the renovation – particularly if the name of the community is changing. Use bright banners or signs to attract attention and create interest.

Personal Protection Awareness and OSHA Issues

Obviously, during renovation, residents, staff, and sub-contractors need to be aware of potential risks and hazards.

- Use community newsletters and special notices to make residents aware about potential risks and hazards.
- Place adequate signage and barriers around working areas.
- Make sure contractors keep their work areas clean and orderly.
- Make sure proper lockout/tag out procedures are followed.
- Identify potential dangerous activities or situations and discuss them with the contractor to ensure all OSHA requirements are met.

Debrief Activity

Going back to the initial activity at the beginning of this chapter, where you described an experience in the past where you had second thoughts about your final advice to your client if the renovation should have gone through or not.

After going through this chapter, would you have taken a different decision? Explain why.

9. Property Disposition or Refinancing (30 minutes)

The owner/investor may decide to sell a property or you might propose this option after conducting a property evaluation and determining the costs and benefits associated with such a plan. They may also decide to refinance the asset. Investors purchase apartment communities for the benefits they expect to receive over the period of time they plan on owning the property.

At the time of the property's acquisition, certain performance expectations were assumed. Results may have differed or the anticipated holding period has concluded. During ownership, the owner/investor is constantly evaluating whether a property is meeting investment goals.

With time, however, **changes affecting the property's performance during the ownership period take place**. For example, tax laws may change, neighborhood conditions may decline, or market rent increases are more limited than anticipated in the pro-forma or original evaluation performed at the time of acquisition.

The periodic evaluation of market conditions and property physical and economic conditions can be important factors in an owner's decision to dispose of or refinance a property. Even if projections at the time of acquisition or development are being met, there are other factors to be considered.

Key Factors to Consider Before a Property Disposition Decision

Know that even if in your evaluation you find that a property's disposition is the best option, there are other important factors to consider.

First, consider the potential benefit of leverage:

- **With positive amortization**, the outstanding mortgage balance decreases annually and the investor's equity position increases.
- **Advantages**: Although positive in terms of receiving more cash at the time of sale, it also means that each year the investor/owner has more funds committed to the property. This increase in value increases the investor's equity buildup and represents the opportunity cost of not selling the property because funds could be used for another investment if the property were sold. A greater portion of equity capital remains committed compared to the cash flow being received from continuing property operations. Additionally, lower tax deductions are available since the interest portion of the mortgage payment decreases each year.

Second, consider expected future property performance.

- Whether the property performed as well as expected, it **still may be a good investment for the future**. Current sale price will depend on the expected performance of the asset in the future and that future performance will not necessarily relate to prior historical outcomes. Both buyers and sellers must evaluate anticipated future property performance.
- **Incentives for property ownership** will differ from investor to investor even if evaluations result in the same projections for future income, expenses, and investment return.

Refinancing

As equity builds over time due to increase in value and loan amortization, the loan balance relative to current value will be less than at the time of original property purchase.

There is thus **less financial leverage than when the property was initially financed** and the investor may consider refinancing as an alternative to selling.

The investor could then **increase the property's financial leverage.** This could provide additional investment funds and might provide a sales alternative.

The new **loan can be based on the property's increase in value**. This current value increase would likely be based on a professional appraisal. Although new loan fees would be incurred, there would be no taxes on the funds from the additional borrowing whereas if the property were sold taxes would be paid.

The borrower **must evaluate the incremental cost** of the refinancing.

- If the interest rate on the new funds borrowed is **higher** than the interest rate on the current loan, the incremental cost is even higher than rate on the new funds.
- If the rate were **lower**, there would also be a lower incremental cost of the additional funds.

Additional funds available from refinancing, either due to property value increase or a reduced loan balance from amortization, represent additional resources that can be invested in another property. This has the additional benefit of providing diversification with the ownership of additional apartment properties. In general, refinancing should produce an effective debt cost that is less than the unleveraged return on the property being financed.

10. New Development Feasibility (30 minutes)

Aside from acquisition, disposition, refinancing and renovation you may also evaluate a potential, to-be-built property by assessing the feasibility of a new development. In this case, a particularly vital part of your job is to understand the proposed development's market supply and demand.

Understand that such an evaluation must be undertaken to determine the level of vacancies, rents, new construction underway, apartment units permitted and planned in the market, and the availability for occupancy of units coming into the inventory. Once you perform this evaluation you can prepare a forecast of rents, vacancies, and operating expenses.

You must be aware of all stages involved in the process of new apartment development:

- Land acquisition
- Construction of the apartment community
- Completion
- Occupancy of the community over a time period including construction and stabilized occupancy that can take 12-36 months depending on size and complexity of the project
- Management phase, which depending on owner objectives may be long term or short term.

A final stage would be the eventual sale of the property.

Role of Property Management

The information gathering process involves tasks that will likely be the responsibility of the multi property supervisor because of multiple property experience, level of knowledge, and background in regional and neighborhood market analysis.

For the study of new development feasibility it's both necessary and advisable to have property management involved for the most realistic projection of income and rents.

It is property management that is best prepared to provide basic market information on local conditions, rents, and operating expenses. This is particularly true if the management company already operates in the market in question with the availability of historical operating data and in depth knowledge of the market in question.

It is also important to **include management** even if it is new development feasibility in a market where the management company would be new as well.

Property management personnel are most likely to best interact with other property management personnel from different companies when entering a new market and thus are better able to gather and evaluate the necessary information.

Areas of Feasibility Analysis

Supply and demand issues

To begin the analysis of a new property's supply and demand status you have to look closely at the following factors:

- Local occupancy rates
- Interest rates and available financing
- Age and type of existing apartment inventory
- Construction costs
- Land cost
- Potential supply of new apartments under construction, permitted, or planned

Be sure that when working with property management personnel you don't rely on them for all feasibility analysis because they are less likely to know construction and land costs for example.

Demand factors that need to be considered when evaluating investment decisions include:

- Number of households
- New household formations, age, size and gender
- Job growth and job quality (higher paying job opportunities)
- Household income levels
- Interest rates
- Affordability of both single family and multifamily housing options
- Local rent levels at potential competitors existing and proposed
- Absorption of under construction units
- Historical occupancy trends.

In apartment development, many **companies begin projects with the intent** of owning and managing these apartment communities for long periods of time after completion. Leasing and management is a significant part of the business of these companies as well as development.

Other **developers intend to sell their developments** after the lease up phase is completed and stabilized occupancy (often 93-95%) is achieved.

Such sales are often made to large institutional investors or larger owner/managers such as REITs, who will also manage the acquisition. Some companies are retained to manage these properties; in other instances new fee management companies are hired to manage the property.

Cost Feasibility

In the **preliminary feasibility evaluation**, physical feasibility and economic feasibility are analyzed. Here are some questions that need to be asked:

- Does the potential project meet zoning and building code requirements?
- Are building densities, heights, finishes, boundary line setbacks, floor to area ratios, and parking ratios satisfied?
- Will the project be able to obtain the necessary building permit to commence construction?
- What is the land cost and the anticipated construction cost per unit?
- What is the initial “rough” estimate of revenue and expenses?
- What is the anticipated return on cost and anticipated value at various cap rates?

This initial, “rough’ feasibility analysis might conclude that no additional evaluation effort should be done and the project should not go forward—or it may conclude that the evaluation process should proceed to a more detailed level. Not all this information to be gathered and analyzed will be the responsibility of property management.

Other Feasibility Assumptions

During the development of a new property, there are **several risks that must be evaluated**. You should include in these:

- **General market** demand and potential absorption
- Location as it relates to the anticipated demand for the new product and competing product in the same area.

If you assume that the better the location the greater the anticipated value of the site, then just know that the higher land cost will likely result in a higher quality apartment community that will cost more to develop.

Financing the Apartment Development Construction Loan

Be attentive to the construction requirement of an interim loan along with owner equity/investment in the project. The construction loan will differ from the permanent loan provided at the time of completion. It may be from different lending sources or one source may provide both. Personal liability for the construction loan is often a feature of such loans until the project achieves lease up.

Lease up may be defined as a certain percentage occupancy, but usually is determined based on the achievement of a defined monthly dollar rent level.

This protects the lender against the developer “filling” the property to achieve a certain occupancy level by deeply discounting move in rents to reach occupancy goals. Construction loan amount repayment obligations will vary as construction progresses since “draws” are provided on construction loan availability as money is advanced to build the project based on progress to date.

Such construction loans are used to fund hard costs (building materials and labor) and soft costs (permits, fees, and construction administration). In some instances, such loans will also finance necessary lease up costs (personnel, marketing, etc.) until the property reaches stabilized occupancy.

Income and Expense Projections

This is the most necessary part of the property management role and is the most logical since property management is often best positioned because of market knowledge and operating experience to provide this information.

Property management is sometimes asked to prepare this information initially and in other instances is asked to evaluate the numbers provided by development personnel.

Give and take between development and management is often the norm in order to produce “realistic” numbers that allow the development to go forward and when stabilized be operated in a profitable manner that meets owner investment goals.

Be aware that the definition of “realistic” can vary between management and development personnel. The goal is to find the appropriate base to allow a project to go forward.

Lease Up Projections

Lease up assumptions that project the leasing of units received from construction is another vital role for property management personnel and especially the multi property supervisor.

It projects how quickly property units will be leased and at what rent levels. This information is necessary for property stabilization to be able to receive the permanent loan from the lender. There are usually contingency requirements associated with obtaining a **loan to provide permanent financing and "take out" (pay off) the interim or construction loan**.

A developer usually obtains such a permanent loan commitment **prior to commencing construction** and often even before obtaining construction financing. If the developer fails to meet these contingencies it will allow the lender not to fund the permanent loan.

Such contingencies include:

- Certain time period to acquire a construction loan
- Construction completion date
- Minimum rent up requirements
- Provisions for gap financing if rent up targets are not accomplished
- Expiration date and extension provisions for permanent loan commitment
- Lender approval of any proposed design changes or building material substitutions to prevent a quality "downgrade" to reduce costs.

Thus the developer is agreeing to certain performance goals in return for the permanent financing. Lenders will not loan without requiring developers to carry out these responsibilities.

As is evident, property management and in particular the multi-property supervisor can and should play a significant role in assessing new apartment development feasibility.

This major role is a likely responsibility of the CAPS level person in companies involved in new apartment development.

Some companies do not build new developments and thus this possible responsibility is not present in companies that only manage. However, even management only companies are sometimes called upon to evaluate new development feasibility especially if they are to eventually manage the asset.

Debrief Questions

In the latest news, you've witnessed a crisis in the housing market that likely to continue for the next couple of years.

During the last year, have you experienced a situation where your client has opted to develop a new property and by the time you had to sell it the current housing crisis has affected your performance somehow?

11. Key Takeaways and Closing (15 minutes)

Participants have just spent an entire day learning about property evaluation and due diligence. It's time for them to make the most of their newfound knowledge by taking action on what they have learned.

Suggested Opening

Well, you've come a long way today. In just one day, we've covered these all these property evaluation and due diligence topics:

- Why owners buy, sell and renovate properties
- Market Analysis
- Property Inspections
- Operational and Financial Analysis
- Analyzing and Reporting Property Evaluation Results
- Property Acquisition
- Property Renovation
- Property Disposition or Refinancing
- New Development Feasibility

Now, to cross the finish line for this course, there are just two things remaining—taking a look at the key takeaways for this course, and writing a brief action plan.

Let's start with the key takeaways. Turn to page 11-2 in your *Participant Guide*.

Key Takeaways

As a multifamily housing professional, you are the owner's partner in evaluating and recommending acquisitions, renovations and dispositions. Your ability to perform these functions is directly related to the degree of success of the project and attainment of the owner's goals. Therefore, critical focus is required in the following areas:

1. **Due diligence <u>is</u> risk management.** You must evaluate and assign risk to a multitude of factors while you ensure that ownership strategies are being met. The better and more fully you perform due diligence, the higher the likelihood of success.
2. **Establish consistent procedures to ensure your research, audit and evaluation functions are completed in full each and every time.** While properties, needs and strategies differ, a regularly prescribed formula that is carefully executed provides sound and reliable recommendations.
3. **Physical property inspections are the backbone of the due diligence process.** Whether the goal is acquisition, renovation, refinance or disposition, your full knowledge of the physical asset is the basis upon which all other due diligence aspects rest.
4. **Keep complete and accurate records.** Due diligence files are critical support documents for closing, job scoping and budgeting. This is especially true when dealing with legal issues and the possibility of legal action.
5. **Be alert and aware. Look for opportunities that may not have been previously seen or considered.** As you complete your research and analysis and while you are focused on the owner's assignment, look for the hidden opportunity that everyone else missed and will enhance the property's value.

With these takeaways in mind, let's now move on to having you write an action plan. Turn to the next page in your *Participant Guide*.

"Start/Stop/Continue" Action Plan

The point of an action plan is simple. It gets you thinking about what you've learned today, and then asks you to write down a few things you'll do differently back on the job.

You'll be doing a simple and realistic action plan today called "Start/Stop/Continue." All you need to do is reflect on the things you've learned in this course, and based on that, write one thing you want to start doing, stop doing, and continue doing when you return to your apartment community.

Then, if you can work on these three things for the next month, you'll most likely improve your on-the-job skills, feel more confident, and just enjoy your time as a multi-property supervisor even more.

I'm going to give you five minutes now to work on your "Start/Stop/Continue" plan, and remember, this plan is for you and you alone. You don't need to share it with anyone, unless you'd like to.

Leader's Instructions:

Give participants five minutes to work on their "Start/Stop/Continue" action plans, and answer any questions along the way.

Thank you for taking the time to work on your plan. I wish you all the best as you work on it over the next month.

Closing

Thank you for being a part of today's Property Evaluation and Due Diligence course.

If You Are Teaching the Financial Management Course...

If you have no further questions or comments, let's call today a wrap.

If You Are Not Teaching the Financial Management Course...

If you have no further questions or comments, let's call today a wrap. I wish you the best of luck as you pursue your CAPS designation, and all the best back on the job, too. It's been my pleasure to be your instructor.

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