



# Investing in apartment buildings

**Apartments have been one of the most solid investments in Canada and have held their value through the recession. But how about buying an entire apartment building? Christine Otsuka looks at how small time investors can buy big**

Investing in homes and multiple properties is usually the first step for property investors. But if you're looking for a higher return, investing in apartment blocks may be the logical next step.

Investing in apartments makes sense if you have the capital to afford the initial investment and upkeep. Apartment buildings offer a higher rate of return than individual or revenue properties and they are available for

purchase at sometimes 50 to 60 per cent under replacement value. Apartment buildings are incredibly expensive to build from scratch, making resale buildings inherently a good deal.

"In certain areas of the country, it's impossible to replace the buildings that are standing compared to other asset classes," says Vancouver-based David Goodman who's been active in Vancouver's real estate market for nearly 40 years and is co-author of an

apartment-focused newsletter called *The Goodman Report*. He adds that shopping centres and other commercial real estate are easier to replace than apartment buildings, because of unfavourable tax concessions on new apartment building development and a lower return (ie. You could charge \$30 to \$40 a foot for office or retail space and in apartments you're lucky to get \$20 a foot).

Apartment buildings are a wise investment because even in this downturn, they have not dropped in price, according to Derek Lobo, chairman and CEO of Rock Apartment Advisors Inc., the largest apartment consulting company in Canada.

"Apartments are the most stable real estate form you can buy," says Lobo. "While apartment buildings typically get about the same real estate return as other forms, the volatility is considerably lower, meaning they don't swing up and down like crazy, making them ideal for a small investor."

One downside is that you won't find many bargains in this segment of the property market because prices rarely drop. But that's also what makes it a good investment.

While purchasing large-scale apartment buildings could yield a bigger return on investment, unless you have the capital – (multi-millions) – and the know-how, it's probably best to start with something smaller.

That's where small apartment blocks with eight to 10 units come in.

## Apartment buildings defined

For clarity, a revenue property is typically a large, older home that is permitted by the city to contain three to six self-contained suites. The building may be 60 to 80 years old and converted into apartments. The building may or may not contain a housekeeping suite. Tenants may or may not share a bathroom.

Apartment buildings can house seven to 500 suites. They're generally termed multi-residential units. Smaller buildings typically house seven to 10 well-defined suites. They have a common hallway, a separate area

for the furnace room, laundry, and typically lockers and parking. They're built as an apartment building as opposed to a conversion project, and will contain bachelor units from 450 to 500 sq. ft., about 650 sq. ft. for one-bedroom suites and 750 to 1,000 sq. ft. for two-bedroom units.

### Costs to consider

While the area you buy the building will dictate the price you'll pay, Goodman says you should expect to pay \$1 million for a small eight-suite building in British Columbia's largest metropolitan centre.

But when you buy an apartment building regardless of the area, there are certain costs you should take into consideration including:

- ▶ Property purchase tax  
**Cost:** Varies. In B.C. it's about two per cent of the purchase price
- ▶ Legal fees  
**Cost:** \$1,000 to \$2,000
- ▶ Property appraisal  
**Cost:** \$2,500 to \$3,000
- ▶ Environmental impact study to ensure no asbestos or hidden oil tanks  
**Cost:** \$1,000
- ▶ Property inspection and report to check each individual unit as well as the building and exterior  
**Cost:** \$1,000 to \$1,500
- ▶ Engineer inspection and report (While this may seem redundant to some, Goodman says having an engineer inspect your building to ensure there are no stability issues may help with financing)  
**Cost:** \$1,000 to \$1,500

### The selection process

The same rules apply to scouting prime real estate whether it be in the residential housing category or apartment building category.

This means location is king. Where you buy the apartment building will dictate how much capital growth and yield you are going to get. To maximize your chances, look at buying near transportation and employment nodes. Apartment dwellers like convenience such as being close to amenities so apartments near these

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facilities will attract a larger pool of buyers as well as tenants.

Buying in a barrier-to-entry market is also a way to go as it allows you to control the rise of new competition to some extent.

Lobo says while job growth, population growth, tenant income, house prices, a diversified economy and vacancy rates are important considerations in all buy-and-hold investment purchases, you'll want to also consider how apartment and condo construction will impact your rent. In large part, new construction means new competition and may impact your prospective tenant pool and cause you to lower your rent.

While you may be able to locate a market that stacks up well to this list, if you're a small investor you have to

think practically.

Buying close to home, on your first apartment building purchase, is ideal.

### Making it work

Before you buy your first apartment building, you need a plan. Lobo suggests determining what type of niche market you want to target – student housing, seniors, hospital staff, etc.

Smaller investors, eager to partake in this investment category, should expect to put about a third of the purchase price down and in most cases the rest could be financed. In addition, Goodman suggests the vendor or seller may be willing to carry the mortgage for three to five years.

Investment partnerships or syndicates are one option when it comes to investing in apartment buildings. More on that in an upcoming article on financing your first apartment building purchase.

Goodman suggests the way to make this investment decision work for a smaller investor is to "watch the pennies," especially when you're just starting out in the business.

"You do that by parking your ego, vacuuming the halls, taking out the

*Apartments can be purchased for 50 or 60 per cent under replacement value*



## Property management options

### Do you need a property management company?

Just as most purchases involve a cost/benefit calculation, so does the decision to hire a property management firm. At the end of the day the cost of the property manager should be more than offset by the savings.

### Examples of direct savings would be:

- Ensuring maximum rental rates are being achieved
- Ensuring vacancy loss is minimized
- Cost savings through the Management company's economies of scale purchasing power
- Not having to hire an accountant to do your books

### Examples of indirect savings would be

- Ensuring any liability exposure is minimized
- Ensuring any filings are done on time avoiding penalties
- Ensuring any invoices such as utilities are paid on time avoiding any interest charges

### Factors to consider

- Does the Management Company have experience in the type of building you own (do they specialize in apartments, office, retail etc.)?
- Does the Management Company have experience in the

geographic location of your building(s)?

- Does the Management Company have a strong accounting department?
- How much is the proposed management fee and what additional charges might there be?
- What sort of education qualifications does the Property Manager have (is he/she licensed, if required, or have a professional designation such as a CPM etc.)?
- How many years experience does the Property Manager have?

### What to ask

- How much and what type insurance does the Management Company carry? Do they have liability and Errors and Omissions insurance, are their Property Manager's bonded?
- Ask to see a sample monthly reporting package that you will receive. Is it detailed enough for your purposes?
- How are emergencies handled, in particular after hour calls?
- Get at least three references that you can follow up with.
- You would also want to discuss how the Management Company plans to run your property. A general discussion on staffing, advertising, suggested improvements to the property which would be followed up with a more detailed Management Plan should the Company be awarded the contract.

*Source: R. Scott Ullrich, president of Gateway Property Management Corporation*

garbage, making sure the garbage bin is clean, doing the landscaping, getting your son or daughter to help, getting your partner to pitch in. In other words, ideally, you don't want a caretaker when you're just starting out."

It's his advice to shoulder the burden of the day-to-day operation with some aggravation.

"If you adopt the motto of reinvesting in your building and looking after your tenant base, you'll be successful in the apartment business. At the end of the day, it's all about service. But you've got to do it. You can't delegate this stuff to a third party on your first investment unless absolutely necessary."

## "Apartments are the most stable real estate form you can buy"

Where investors get into trouble is when they're not prepared to manage their apartment building, and put in the work required. Apartment buildings, by virtue that you have more tenants, are harder to maintain on a part-time basis.

For some, working with a partner or experienced property manager is one way to make it work, says Lobo.

In any case, with your first apartment

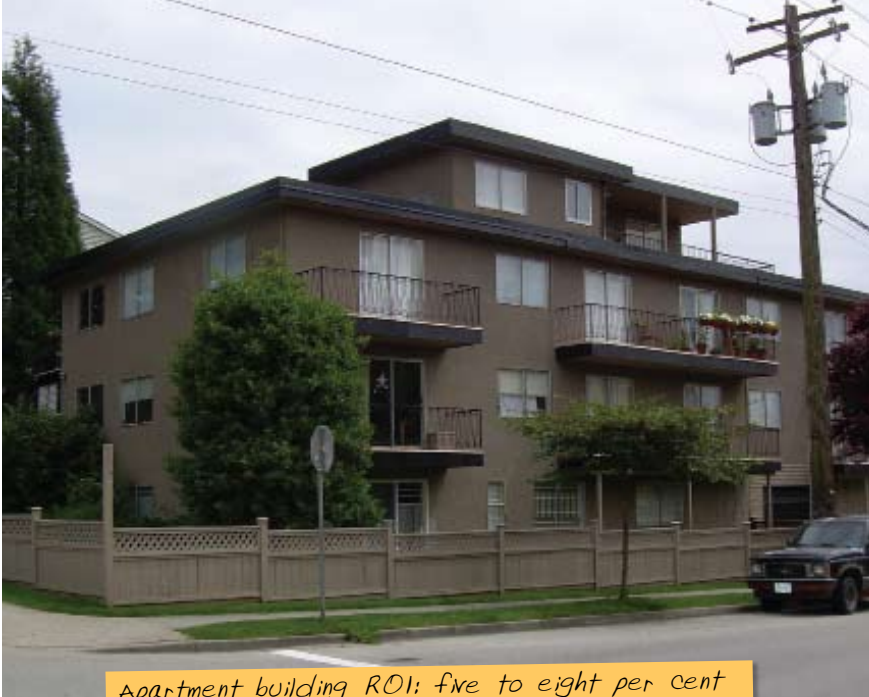
building, it's important not to get emotionally attached to the building, but also to the tenants.

One of the biggest mistakes investors make is putting their personal relationships with tenants above rent increases, says Nick Marini, asset manager for Vancouver-based Macdonald Commercial Real Estate Services Ltd. "So rather than doing yearly rent adjustments, they decide since they like the tenant or tenants, they'll cut them a break," he says. "But small increases add up. It's important to still run your building like a business."

Maintenance is also something that new apartment building investors may



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Apartment building ROI: five to eight per cent

neglect, especially if their building is relatively new.

Preventative maintenance should start in year one, because by the time you reach year five or year 10, it's too late, says Marini.

Some general maintenance Marini

suggests include changing the air conditioning filters, as well as those in the furnace, cleaning the gutters to prevent back-ups and water damage, and ensuring the condition of your roof is examined once a year.

The most common insurance claim

for buildings is water damage, says Marini. Whether it's a result of the roof, gutters or a leaky drain pipe, if they're not spotted and fixed quickly, they can damage the walls in multiple units on multiple floors.

Another tip is to ensure you get a building appraisal done each year when it's time to renew your insurance. This is important as replacement costs may rise, and your building could be worth \$3 million, even though it's only insured for \$2 million, says Marini.

While there are some things you can do yourself – such as painting and garbage disposal – others such as mechanical (heating and hot water), electrical, and building envelope items (drain, roof, plumbing) need to undergo annual maintenance. Neglecting it, could cost you more in the long run. For instance, if you neglect your hot water heater, you'll feel the damage when you receive your next electricity bill.

## Is your portfolio positioned for the remainder of the slump?



Kieran Trass  
President TMTT

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## Invest | apartment buildings

### Does bigger mean better?

Investing in apartment buildings is a solid choice because the numbers make more sense. The cost for ongoing expenses such as heating and water for a 12-unit building as opposed to 12 individual properties is far less.

So it stands to reason that investing in larger scale apartment buildings would provide a solid return, if you can afford it.

High priced apartment buildings are expensive for a reason – they often have very low vacancy rates and command higher rents. But in the apartment building business, more expensive is generally related to the number of units.

“In small apartment buildings of six to 12 units, the values are higher. The costs, the price per suite is higher and the ratio of expenses is also higher,” says Tony Di Carlo, co-founder, president and broker of record at Incompro Ltd. Real Estate Brokerage.

“The ratio is lower with more suites in the property, meaning the price per suites becomes higher with smaller properties,” he says. The ratio is lower



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With small buildings you’d have to allocate 50 to 55 per cent of income to expenses, whereas with larger

buildings you’d likely only need to allocate 45 to 50 per cent toward expenses, says Di Carlo.

### Is now the time to buy?

Goodman says now is the time to invest because the market is performing well and interest rates are low. “In many cases you can get a long-term five- or 10-year mortgage well under the cap rate or the rate or return. You can get a five-year mortgage for less than four per cent, and in most areas of Canada it should not be difficult to get a five to eight per cent return on your investment.

“It’s about buying smart,” says Lobo. “Eighty per cent of the money you make is made by buying smart. You make your money on the day you buy your building. The colour of the carpet you choose, painting the units yourself – nothing makes up for buying smart.” 🏠



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