SFG Seattle Funding Group

The Source

Business Edition

Evaluating Apartments – Over The Phone

Ok, so you are trying to get an apartment deal funded for your client. Knowing how to quickly screen value and see if the request is practical or not is key to being an efficient and valued broker. Cutting through the ridiculous and latching on to the transactions that have real merit is the primary skill to prosperity and service. If you know what you are doing, five minutes can save you five weeks. These basic principles are designed solely to cut through the fat, or fools gold, so you can determine if the property has the merit, and the loan request has probability. Let's quickly review the basics of cursory apartment valuation.

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Apartments can be broken down to gross possible (potential) income, minus vacancy (including free rent concessions) and all expenses to run the property (see chart on page 2). The number you end up with is the apartment's Net Operating Income, or NOI. Some refer to this number as "net before debt" since this is the amount remaining before debt service. If you divide the NOI into the prevailing rate of return investors are looking for when investing in that asset class (capitalization rate or "Cap Rate"), you will find the basic value of the subject property. Of course the cap rate (rate of return) investors expect varies depending on the area demographics, asset age and property condition, future expectations for the area (positive or negative) and the current interest rate environment. Generally, investors like the cap rate to be higher than the interest rate they would pay to mortgage the asset, creating positive leverage. Cap rates today range from about 5% for the very best properties, to around 12% for riskier assets and declining areas. The higher the Cap Rate the better, all other things being equal. If the area is rough, investors will expect a higher cap rate than if the area is in a proven growth location with prosperous demographics. Much like a growth stock with a lower PE ratio. If investors believe the property's future is bright, they will accept less income today and a lower cap rate. The elephant in the room however, is expenses. How can you know the property's cost of operation with only five minutes on the phone? Like everything else, there are general rules of thumb to help.

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Quickly Calculating Expenses

For years the prevailing way to generalize apartment expenses was a percentage of the gross income. Many would say: expenses are about 35% of gross income, or 40% of gross income. The problem with this philosophy is that expenses don't always correlate to gross income. The properties gross income could drop substantially and at the same time expenses go up. Expenses could rise due to: the extra marketing required to capture potential tenants, extra security required to watch over vacant units, utilities on the rise, rent concessions needed and property taxes could elevate because...well just because. Today, a more accurate way to measure expenses is on a per unit, per year basis. Expenses generally run from $4,000 to $6,000 per unit per year, assuming all units are separately metered so tenants pay their own utilities. If the landlord pays utilities, this expense must be added. Some properties can be run for as little as $3,500 per unit if taxes are low, amenities are minimal and the building is inexpensive to fix. Luxury properties with large club houses and plenty of amenities may be $6,000 per unit or higher. Anything less than $3,500 per unit per year and something is odd. Either the owner has bought themselves a job and is acting as the handyman and manager, or the property is being neglected. Again, this is all general brackets for intelligent conversation to capture the deal. To fully underwrite the transaction warrants an inspection of the property, an analysis of the books and records as well as insuring a competent management team. We will handle all that for you once the borrower is on board.

To keep this article brief, we made generalizations. However this should give you the basics for a good conversation with the borrower, and help you capture more apartment transactions. ■

Cheers to a great 2012!

In next quarter's issue we will discuss "phone evaluating" office buildings.

"Over the Phone" Apartment Valuation Calculation

Input Fields

Annual Gross Potential Income	$540,000
Vacancy Rate	8.00%
Concessions/Promotions Rate	0.00%
Number of Units	50
Annual Operating Expense per Unit	$4,000

Area Demographics (Subjects to discuss)

Asset Age (in years)
Property Condition
Future Growth Expectations

Est. Net Operating Income (NOI)

Gross Potential Income	$540,000
Less:	
Vacancy	($43,200)
Concessions/Promotions	$0
Operating Expenses	($200,000)
Est. Net Operating Income (NOI)	**$296,800**

Est. Value of Subject Property

(NOI Divided by expected cap rate)

Cap Rate	Value
12%	$2,473,333
11%	$2,698,182
10%	$2,968,000
9%	$3,297,778
8%	$3,710,000
7%	$4,240,000
6%	$4,946,667
5%	$5,936,000

Synergy towards a Common Goal

At times, brokers and borrower clients new to Seattle Funding Group (SFG) have questioned our practice of requiring modest deposits upon acceptance of our LOI's.

These deposits are most often nominal in size and are intended to insure we have the applicant's undivided attention as we allocate significant time, money and resources toward a now shared objective – your timely closing. It should be stated and clarified that SFG's deposits (typically $2,500 to $5,000) are a far cry from the much larger deposits ($25,000 to $100,000, plus) required by those firms which have abused the deposit process in the past. Brokers and borrowers must remember, it is unhealthy to engage a team of people on closing a, typically urgent, transaction when the borrower has not made a similar commitment. After 25 years in the business and well over a billion dollars in closings, we have learned appropriate deposits, with reputable firms, are a healthy part of synergizing everyone towards a common goal.

SFG is a brand- a trusted brand of quality and reliability. We highly value our reputation, and would never jeopardize or tarnish the SFG reputation, let alone over a few thousand dollars. We can and do provide references of others who had similar questions, overcame them, and joined us at the closing table. We ask that our brokers and applicants act in accordance with their representations and promises, and you may rely upon the fact that SFG will act likewise.

Standing alone at the altar, ready to close, is an uncomfortable experience. While the deposits don't begin to compensate for the lost opportunity and staff time, they help defray the hard costs incurred through the highly accelerated, often complex process. Each LOI is meaningful to SFG, and when accepted, you may bank upon the fact that you have our undivided attention; we, in turn, want yours. ■

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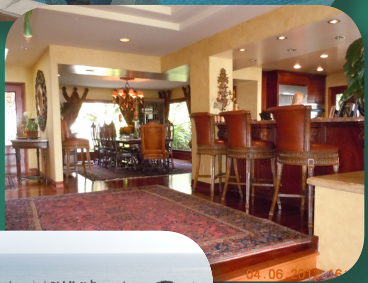
Let's meet again, at the closing table!

Success Story

Irreplaceable View in La Jolla

$1,900,000 | La Jolla, CA

A high net worth borrower took over this La Jolla California luxury home as part of a business settlement. With views of downtown San Diego and 180 degree views of the ocean, the subject property maintained an irreplaceable and high demand location. The value of the subject property is a strong $3,000,000. Our SFG loan is $1,900,000. We are holding back $100,000 of the loan proceeds to ensure completion of some repairs necessary to maximize value. The borrower's exit strategy is to prepare the home for resale and put it on the market. This is a classic example of a high credit borrower recognizing the appeal of a short term transitional loan from SFG. The value they receive is well worth the interest premium.



Building Great Relationships

After well over a decade with our company, Jim McBride is in large part responsible for the tremendous success of our construction loan department and builder relationships. Since starting with Seattle Funding Group, Jim has managed hundreds of millions in construction loans with amazingly few challenges; even during the teeth of the recession. Jim reviews budgets, plans, site layouts, dispersal schedules and makes recommendations towards crafting a loan that works. Builders find the construction loan process smooth and efficient and the draws quick and responsive. Once builders and contractors begin to work with Jim, they recognize they are in the hands of a pro; an asset towards their successful project conclusion. Seattle Funding Group takes great pride in offering perhaps the finest private money construction product on the market today, while building relationships that last for years.

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As Jim McBride begins another successful year with our firm, we would like to thank him for his enormous contribution. In addition, we would like to thank you, the brokerage community, for continuously turning to Seattle Funding Group for your construction loans. We recognize that highly responsive construction capital is a key component to any successful builder. Jim McBride and the Seattle Funding Group team remain committed to serving this market segment at the highest level. We appreciate the business, your loyalty and the great relationships we have built over the years.

To see some of the construction loans we have been funding, please visit our website at www.SeattleFundingGroup.com then click on successes from the menu bar. ■

Favorite Quotes

The goddess of luck favors those of action.
~ From the Richest Man of Babylon

Desire is the key to motivation, but it is the determination and commitment to an unrelenting pursuit of your goal – a commitment to excellence – that will enable you to attain the success you seek.
~ Mario Andretti

If you have any favorite quotes you'd like to see in the News of Interest, please pass them along to John Odegard. We'd even be happy to mention in our newsletter where they came from. E-mail your favorite quotes to: jodegard@sfgfunds.com.

Thank You!

We'd like to thank some of our key third party associates who have contributed to the success we have had, especially the last few years. Whether it be selling an REO asset out of our portfolio, or helping us evaluate the collateral for new loan activity, these are some of the best in the business. Thank you for your contribution to our success.

1) **Rick Shand,** *Prudential Utah RE, Park City, UT*
2) **Foundation Bank,** *Bellevue, WA*
3) **Carole Schumacher,** *BRC Real Estate, Highlands Ranch, CO*
4) **Andrew Rothstien,** *Andrew Rothstein MAI, Honolulu, HI*
5) **Bruce Fine,** *Fine, P.S., Seattle, WA*
6) **Sedona Management,** *Sedona, AZ*
7) **Peter Nisbet,** *Marcus & Millichap, Seattle, WA*
8) **Valery Neuman,** *Desert Estates Network, Indian Wells, CA*
9) **CBRE** *all Western States*
10) **David Bolhuis,** *Bolhuis Appraisal, Beaverton, OR*
11) **Dominique Ruybal,** *Windermere, Seattle, WA*
12) **Paul Holland,** *Colliers International, Phoenix, AZ*
13) **Bryan Byrne,** *C+ Build, Seattle WA*
14) **Penny McLaughlin,** *Penny's Team (Realtor), Kitsap County, WA*
15) **John Reich,** *Windermere Real Estate/ H.H. Inc., Edmonds, WA*
16) **Clinton Textor,** *Marcus & Millichap, San Francisco, CA*

Because our thank you list is extensive, more names will be printed in next quarter's issue.