VALUE ADD MULTIFAMILY

CASE STUDY OF HUTCHINS PALMS APARTMENTS

ACHIEVE INVESTMENT GROUP

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Imagine getting a “free” property that continues to churn out double-digit cash on cash returns? Wouldn’t that be awesome? Well here is the deal.

Hutchins Palms Apartment complex is a multifamily real estate, consisting of 45 unit apartment in San Antonio. It was refinanced in 2016 and this resulted in a triple-digit cash on cash returns to our investors after only 12 months of operations. Wonderful right? Wait for the best part. Before the refinance, the property paid out double-digit cash flow returns and projected to continue doing so even after the refinance.

Based on current market conditions, the Internal Rate of Return (IRR) is expected to be more than 44% for a 5-year investment. Also when compared to single-family real estate, multifamily real estate gives you the ability to increase the value of your asset by improving its operations.

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THE SCIENCE (NUMBERS)

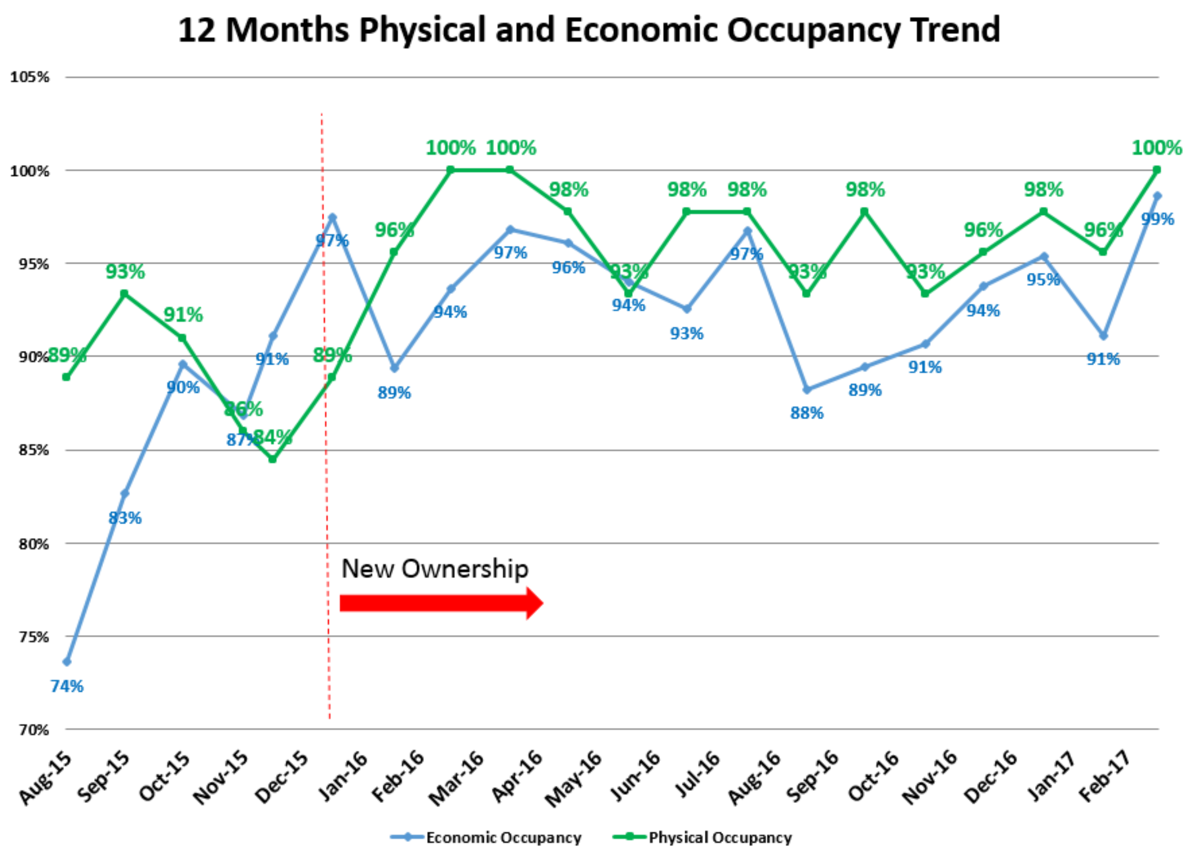
The property has a great potential, which was primarily due to built-in equity that existed in it. This rather than the market swings helped realize the potential of the property.

The value-add components in this deal consist of:

1. Installing Great Property Management
2. Injecting Capital to Increase Net Operating Income (NOI)
3. Reduction of operating expenses

1. GREAT PROPERTY MANAGEMENT

Below is a chart that shows the physical occupancy of the property and how the new owners were able to stabilize the wild swings that existed during the previous ownership.



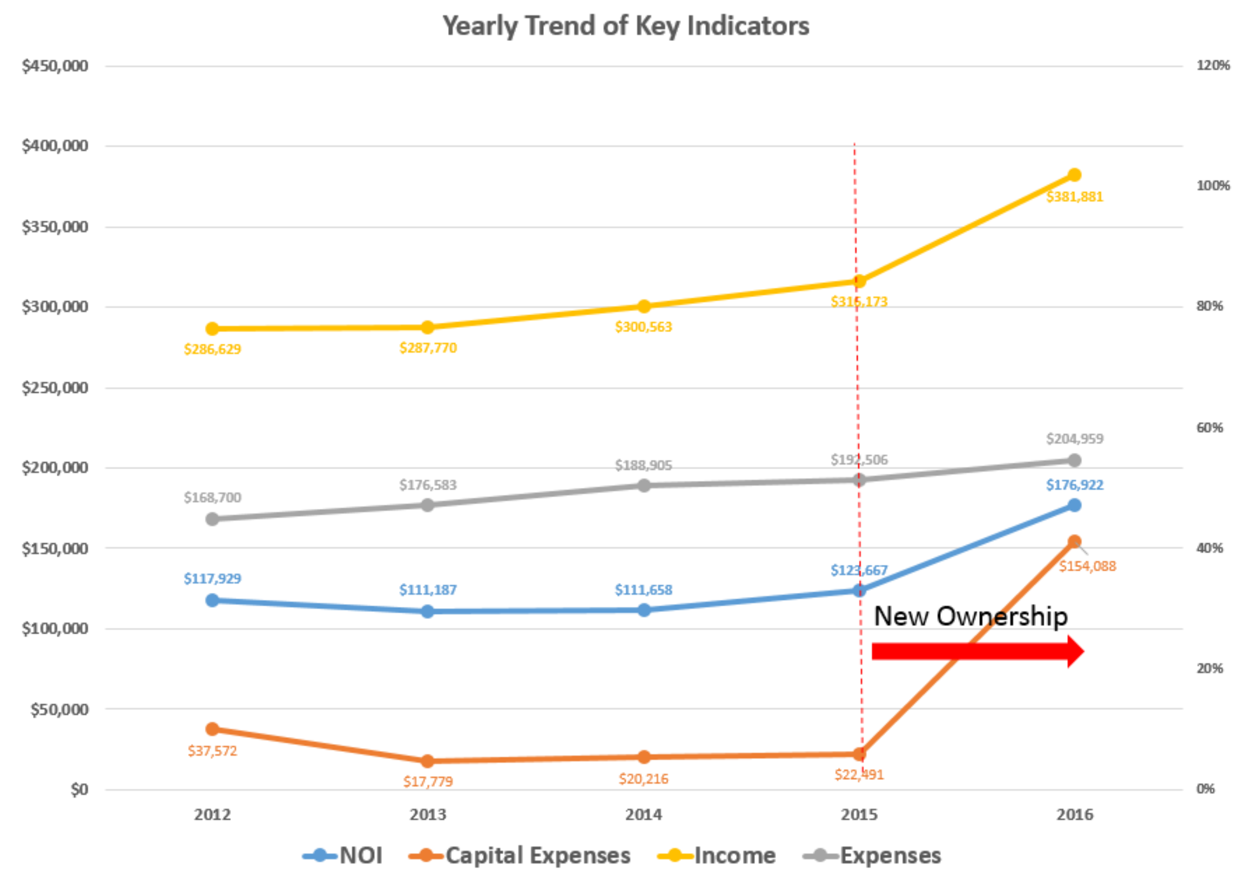
We were able to stabilize the physical occupancy after we took over due to the fact that

1. Strict tenant selection and screening policies were implemented.

2. A better demography of tenants were introduced to the community. During the refinancing, we learnt that newly rehabilitated units are in high demand among a specific demographics who usually do not mind paying more for a better place to live.
3. Also, strict collection policies was implemented. We reduced monthly delinquency from $4,000 per month (15%) to less than $100 per month (0.3%) thereby training our tenants to be paymasters!

2. CAPITAL INJECTION TO INCREASE OPERATING INCOME

Since we bought the property in 2016, $154K of capital expenses has been invested, which has enabled us to increase rents and reduce expenses. This resulted in an increase in NOI from $123K to $176K (43% increase). The primary expenditure was the interior unit upgrade which also resulted in an ability to increase rents by $86 per door. The chart below shows the difference of the capital investment that resulted in NOI increase.



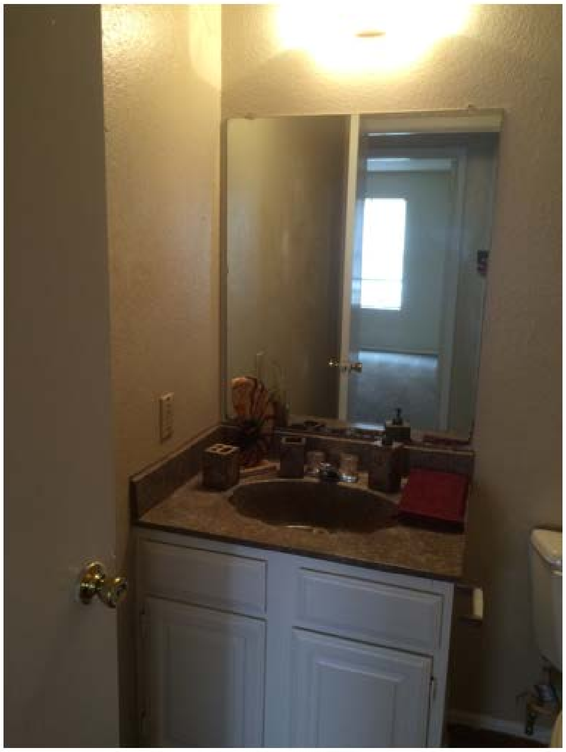
The basic capital improvements are:

1. 25 units (56%) of 3K/door interior were rehabbed within 8 months of takeover
2. New amenities such as laundry machines, BBQ pits and a dog park were installed
3. The driveway, porch and breezeway were also lighted and rehabilitated.

Below are the details in pictures.

Interior Pictures

Before



After

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Interior Pictures

Before | **After**

Exterior Pictures

Before | **After**

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Exterior Pictures (Night)

Before | **After**

Dark Driveways and Porches

Lighted Driveways and Porches

Dark Breezeway

Lighted up Breezeway

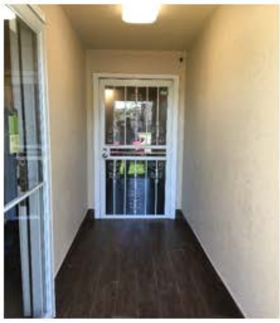
Amenities Pictures

Before | **After**

Old Laundry machines

New Stacked Laundry Machines

Laundry room entrance



Laundry room Entrance

Amenities Pictures

Before

Empty Breezeway

Vacant spot beside Building

After

Dog Park in Breezeway

Picnic Area with BBQ Pits

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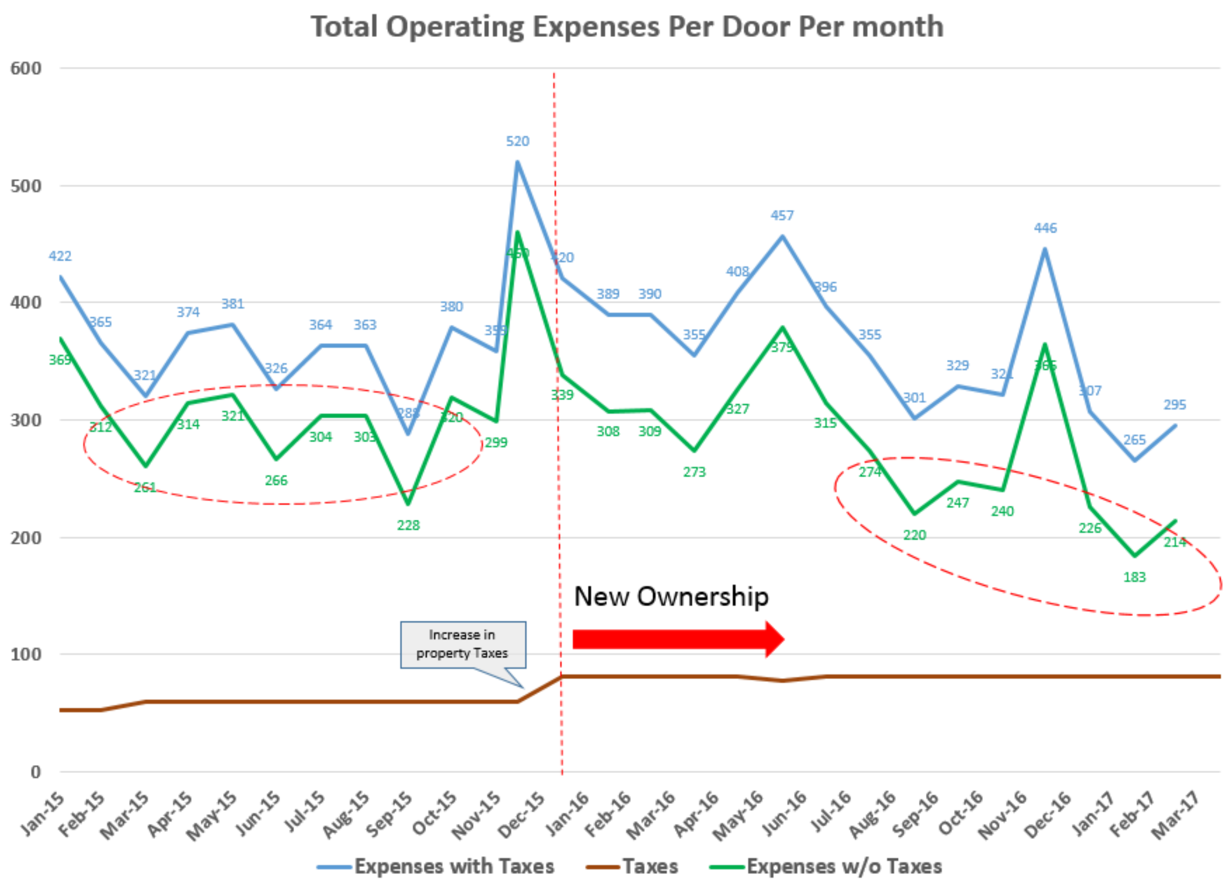
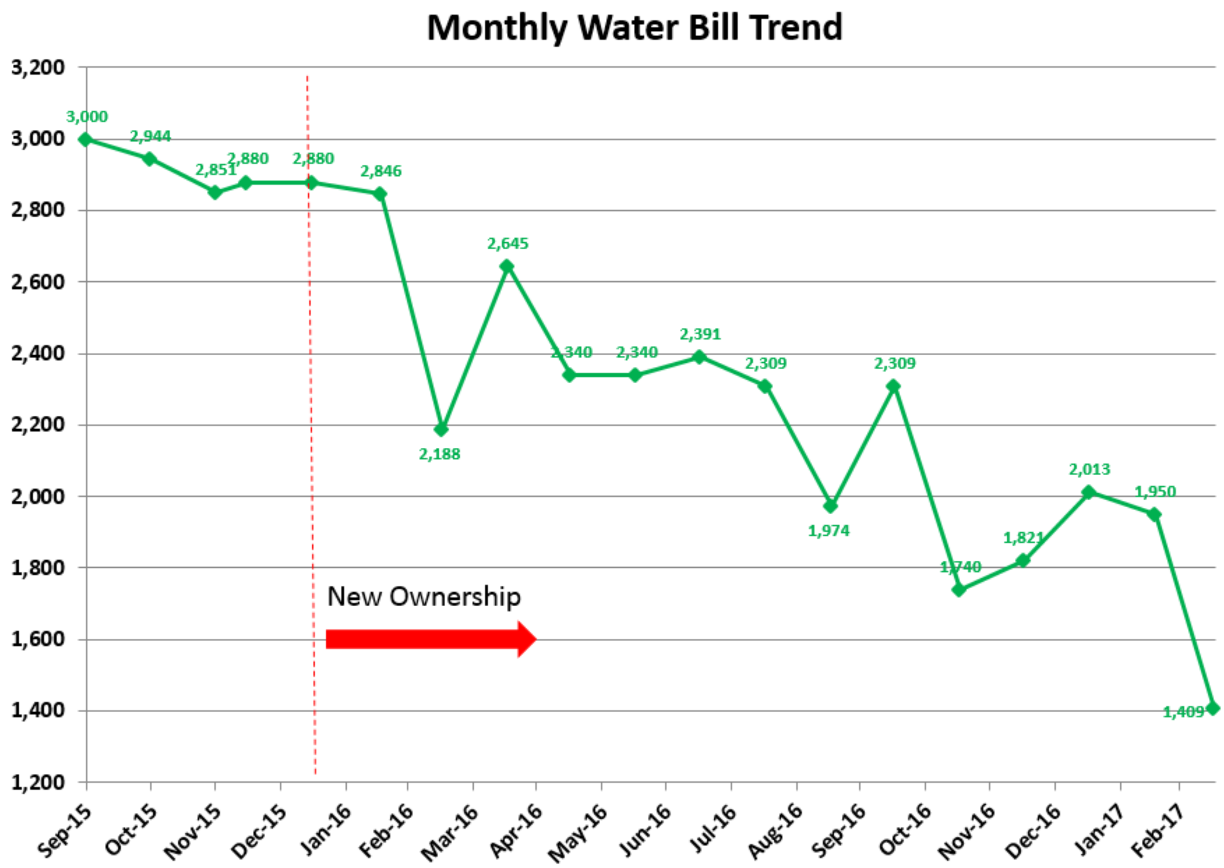
3. REDUCTION OF OPERATING EXPENSES

Increase in property tax usually results in a simultaneous increase in operation cost. However, after the takeover, there was a significant reduction in our overall expenses per door. The chart below gives a vivid detail of the expenses per door before and after the takeover.



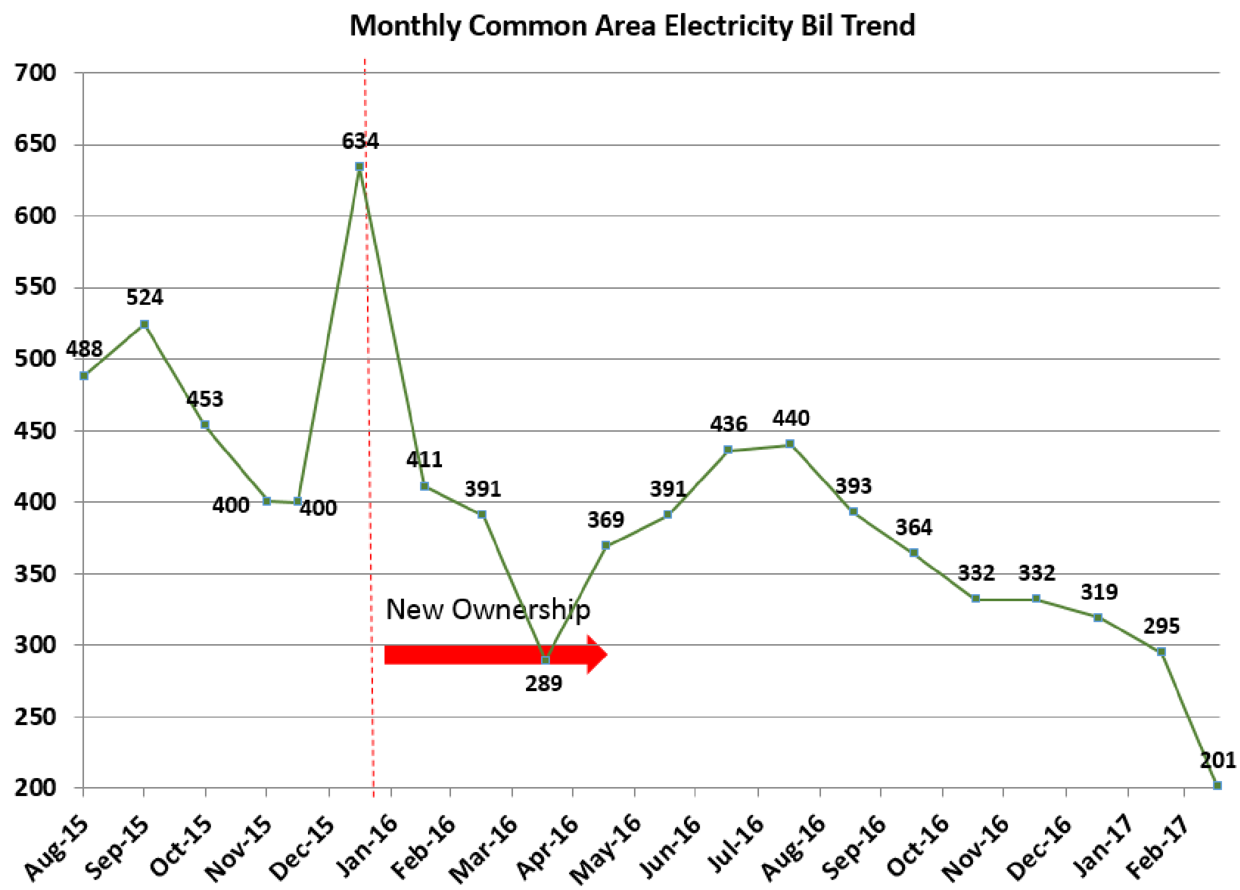
We were able to reduce expenses by doing the following:

1. The existing property management company were relieved of their duties.
2. The full-time property manager was replaced with a part-time property manager.
3. All long outstanding "bandit" maintenance issues were taken care of appropriately.
4. Stalled maintenance contracts were renegotiated.
5. Water leaks were fixed.
6. Cost of electricity was reduced by replacing all common area light with LED light.



The chart above gives a graphic meaning to the saying "Flushing money down the drain". When we took over the property in 2016, one of the things we discovered was that the water bill consumed a lot of money, so we had to look for the cause and find a way to fix it. We found the cause to be water leaks that had been left unrepaired for years, this in turn had made the water bills high. By fixing the leaks, we were able to reduce the overall water bill by more than $700-$800 per month (25%) since takeover.

The effect of this is that even though the water bill is being paid by the tenants, the reduction counts towards the affordability measures put in place for them. They were willing to pay more in rent since their overall cost of renting was reduced or virtually remained the same.



We also worked on the electricity bill and were able to reduce cost due to the fact that:

1. We realized that some buildings have had their lights on 24 hours for many years before we took over the property. So we fixed a defective light sensor to regulate that.
2. Patio area lights were changed to LED lights.

3. We also requested the city to change the non-functional streetlights to LED lights. This was a free service.

All these shows that if a methodological approach to increase income and reduce expenses is taken, the NOI of an apartment investment can be increased drastically. This type of approach can be used for any value-add apartment deals, regardless of the timeline which may be as long as 4-5 years. The trick to quick turnaround lies in the ART form that comes with the deal and the sponsor. We will cover the ART form in the next section.

THE ART

In the section **"The Science,"** we clearly demonstrated how the science of numbers works in value-add investing. It is a pretty simple concept: we buy an apartment, renovate it to increase income, and reduce expenses -resulting in an increase in NOI. In this section, we will talk about the ART form, which shows the non-monetary aspects of the deal that allows us to get triple-digit returns within 1-3 years.

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FINDING THE DEAL

The Hutchins Palms Apartment is no an ordinary deal; it had 50% built in equity on the day we closed the deal. The only way to find this kind of deal is to source for it off-market. In this case, off-market literally means we bought directly from the seller with no broker involvement.

When we bought the Hutchins Palms Apartment, the seller was frustrated with the property management company as the investment was going south, around 4 units were down (that's 9% occupancy yield loss) and the expense ratio was at 63%. There was also a frequent change of property managers by the current property management company due to various reasons. All these had an effect on the deal.

Based on the NOI, we did buy the property at market cap rate. However, the huge potential to bring up the down units by reducing the expense ratio from 63% to 50%, and rehabbing the interior/exterior to increase rent rate was imminent.

FINANCING STRUCTURE

The selection of the financing structure is often based on the exit strategy for a particular deal. For this deal, it was obvious that it had a huge potential based on the built-in equity existing in the property. Even though the property could qualify for a Freddie/Fannie Mae loan, we decided to get a conventional bank loan with good rates and a zero pre-payment penalty. We obtained a loan to finance the renovation from a small bank at 80% LTV, 4.3% interest rate (fixed for 3 years), 25 year amortization, 1 year interest only, and no prepayment penalty. The terms allowed us to refinance into a longer term Freddie Mac loan after 1 year. We could have refinanced 100% of our cash in the deal within 6 months, but we waited 1 year to allow for loan seasoning. Usually, Freddie Mac & Fannie Mae do not allow refinance of property less than 18 months after acquisition. We had built up so much value by increasing NOI, and so they allowed us to refinance.

STRONG REHAB EXPERIENCE

To turnaround 55% of the units within 6-8 months, we needed strong rehab experience. We had built up that experience with our single-family rental experience, including experience in selecting and managing contractors. In fact, most of the contractors that worked with us in single-family rental turnarounds followed us into the multifamily space. This is where most newbie apartment deal sponsors stumble in accomplishing value-add deals as they either make use of a general contractor (which usually increases rehab costs) or they struggle to get the right contractors that will do a good job.

STRONG PROPERTY MANAGEMENT

The property management is vital to the success of any deal; it really doesn't matter if you have a great multifamily deal, if the property management is weak it can quickly turn sour. Even if you get a third-party management company, there is a slim chance that it can turnaround this type of property quickly. Deals like this usually require strong people with good project management skills and ability to pay attention to details. That's why we decided to self-manage this property. Of course, we had an onsite staff, but we closely monitored the day to day operations to ensure high efficiency turnaround operations. We also had the right project and people management skills plus plenty of sweat equity.

MARKET FUNDAMENTALS

To get great returns within a short timeframe, the market fundamentals need to be strong. San Antonio is a strong market with steady flow of jobs and a slow injection of supply. Hutchins Palms is located on the south side of San Antonio which is considered to have a working class community tenant demographics. Part of the skills of the deal sponsor is to identify markets with strong analysis for market and submarket demand.

Multifamily Value add investing is hard work; it needs a deal sponsor that is willing to put in his best and be persistent. One needs the right skills in finding the deal in a market, manage rehabs effectively and have strong property management. These are the traits of every successful deal sponsor who is able to consistently produce great multifamily investment returns.

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