Property Management Essentials:

Assessing Small Multifamily Properties for Investment

There are a many things to consider when purchasing a multifamily property. This paper will cover some key considerations when investing in the multifamily apartment rental market.

Key Topics

- ***Purpose of the purchase***
- ***Capital outlays***
- ***Level of management***
- ***Economies of scale***

Consideration # 1: Amount of capital to invest and in how many units
There are several categories of multifamily units. The first category is considered "small" containing buildings that range in size of 2 to 4 units. The medium size category has buildings with 5 to 30 units. It's at this threshold that the financing changes dramatically. Apartment buildings above 30 units are considered in the large category. There will be another white paper to address these larger categories of multifamily properties.

Consideration # 2: What is the purpose of purchasing the property?
Obviously the most important reason is usually to make money. However there are many other reasons for entering the multifamily arena. The investment could be a long-term buy and hold to act as an annuity for future cash flow. Another reason could be purchasing the property because it has the potential to be repositioned and upgraded to affect the demographic composition of the tenants, and possibly if big enough, the neighborhood. A third purpose could be as a fix and flip. Although, more common in single family homes, this can happen in multifamily as well depending on the purchase price and how that drives the economics of the project.

Consideration # 3: How much money is needed?
This third component is related to the purchase price and where significant differences begin to emerge between single family and multifamily. Most lender, unless it is going to be a owner-occupied property will require 25% down. So, if the property sells for $400,000 then at least $100,000 cash will be required for the down payment. Then the concern is to ensure there are adequate reserves on hand for the operating of the property. A very strong recommendation is to have at least 1 to 3 months of cash reserves on the side that would be able to handle principle, interest and taxes, etc. The other reserve account recommended is to have additional cash set aside to handle one major event. This could be prolonged vacancy, major appliance replacement or structural damage. These kinds of expenses could range from a few thousand dollars up to ten to fifteen thousand dollars. It is very important to keep a cushion of cash available for a major event. Murphy's Law can and does come into play so keep peace of mind by having additional cash reserves.

Consideration # 4: Level of involvement in the property
Another important factor is deciding on the level of involvement in the managing of the property. The books and infomercials make it sound glamorous and easy…..wait until evictions, mold or water damage come into play. Unlike a single family home when there is damage or other problems this could affect several families at once. Having a property management company in place reduces a lot of headaches.

Consideration #5: Economies of scale
Though the financial investment is viewed as significant in the eyes of the purchaser(s), in the world of banks, vendors and insurance companies the investment, $400,000 in the above example, means almost nothing to this entities. These types of companies will view the owner as a "small operator" in which the property owner will not get or qualify for any discounts. So getting efficiencies or economies of scale is very difficult with the purchase of just one or two small multifamily properties.

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