

## Apartments: The Good, Bad & Future

BY JOE DECARLO, MBA, CPM, CCIM, CRE

The most frequent question I am asked as a college real estate instructor and property manager is “Are apartments a good investment today?” In order to answer their question we have to look at financing, jobs and the future of this rapidly changing world economy. A person needs not to only look at the number of individual apartment buildings they are considering purchasing but also the how outside factors such as financing, terms, timing & government policy & controls will affect the industry.

### Financing

In over 30 years, the financing for apartments has never been better. I remember when Jimmy Carter was in office and the 14–16% interest rates... marvel at today’s low rates of 3–4%. Thanks to the Federal Government buying 45 billion dollars of Fanny Mae loans per month, which includes apartment loans, the rate and availability of new loans is a great boost for owners to get higher prices lower CAP rates (remember the lower the CAP rate the higher the price). The Federal government wants to expand the economy and are using lower interest rates as a main tool. Real Estate has benefitted and so have apartments, by far the most of any sector, as Fanny Mae does not buy loans on shopping centers or office buildings with their rates at 6–7%.

How about long term apartment owners benefitting from lower financing costs? I am a conservative investor and my loan to values on refinances

Example 1 Current Loan with Variable Rate	
Initial Rate 5.5% — 10 yr. loan	
Variable after 5 years	
LIBOR	.50
Margin over LIBOR	2.50
Current Interest Rate	3.00

were usually 60% and I would get fixed interest rate loans. Lenders said they would not do fixed rates for 10 year loans and the best I could get was a 5 year fixed and the last 5 years converts to a variable to LIBOR rate plus margin. They forced me to take these loans, however I am now a happy camper. The interest rates on my loans dropped from 6% to the low 3% after 5 years. If my Net Operating Income (NOI) stayed the same it would have been almost a 3% difference that went to my cash flow. WOW...what a pleasant surprise and remember these smart lenders made me do it.

### Jobs

Jobs and employment reports are very confusing to understand. We get figures on number of new jobs created but not number of jobs lost. We get figures that the unemployment rate is dropping but they do not account for people who quit looking or have low paying part-time jobs because people are unable to find a good job. We have two types of unemployment:

Cyclical: Weakness in overall economy which pushes down the demand

Example 2 Annual Cash Flow Comparison		
	Initial 5.5% Loan Rate	Variable Rate After 5 Years
NOI	\$300,000	\$300,000
Debt Service	\$200,000	\$150,000
Cash Flow	\$100,000	\$150,000
<b>\$50,000 more cash flow per year</b>		

for goods and services in recession.

Structural: Deeper problems, such as mismatched between worker skills and employee needs. Doesn’t disappear when economy improves i.e., oversees outsourcing of call centers.

We are experiencing high unemployment and how it’s effects the apartment owners due to tenant (customers) need to have a good paying job to pay market rent. Tenants double and triple up when they only make \$10 per hour at McDonald’s. Hopefully the government will place restrictions and taxes on outsourcing and imports and try to keep jobs here in the United States and Orange County.

### Future


In California, we no longer have a democracy as we know it. All 12 states elected offices (governor), and legislature are the democratic party and have the monopoly on power and they can pass new laws, taxes and regulations without opposition. Remember that there are a lot more renters than owners.

Pulse — continued on page 38

**Pulse** -- continued from page 37

Does that mean State rent control is in the future for Apartments? Will Security Deposit laws become more tenant favorable? Will the Federal Government in two years stop buying Fanny Mae loans? I have no answer. Other factors to consider... The supply of apartments is increasing dramatically in Orange County. Will the oversupply effect demand and lower rents? For the most of us who own C & B apartment complexes, the answer is NO. The units

being built by the Irvine Company and REIT's are all Class A higher rent units with lots of amenities that our renters can't afford. Our supply will actually decline slightly as older properties are torn down for new mix use and commercial use properties.

In summary, the answer is YES, this is a good time to own apartments and sure beats the less than 1% return at the banks. 

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JD property Management, Inc. located in Costa Mesa, Ca. They have been managing in Southern California for over 35 years and are an AMO firm. They manage over 2,500 multifamily units and 2 million square feet of commercial space. Joe also teaches Property Management at Coastline Community College and owns units himself. He can be reached 714.751-2787 and web site is [www.jdproperty.com](http://www.jdproperty.com)

**Mayans** -- continued from page 34

Monoxide (CO) tester alarm went off with a reading of 800 PPM (parts per million) CO inside the house. (An 800 PPM level of Carbon Monoxide will affect a human by causing dizziness, nausea and convulsions within 45 minutes. After 1-2 hours it will cause unconsciousness and DEATH within

2-3 hours.) Immediately I got everyone outside into fresh air and called 911 for paramedics. It turns out the whole family (Mom, Dad, Grandma, Son and Daughter) had Carbon Monoxide (CO) poisoning. The paramedics put them on pure oxygen and transported them to the hospital for further emergency treatment. What the family thought was simply the flu was far deadlier.

Carbon Monoxide (CO) poisoning symptoms mimics the flu. It was a Christmas the family will remember forever. Thankfully they all survived and lived to tell about the incident.

Now the facts about what happened and why it happened. The family was renting the house and on Christmas Eve

**Mayans** -- continued on page 40



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