



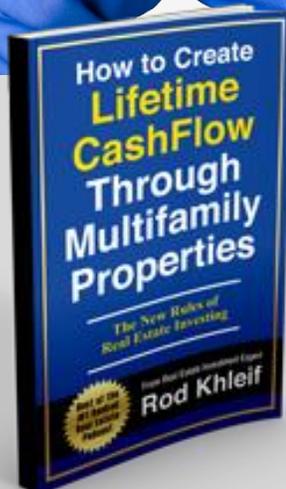
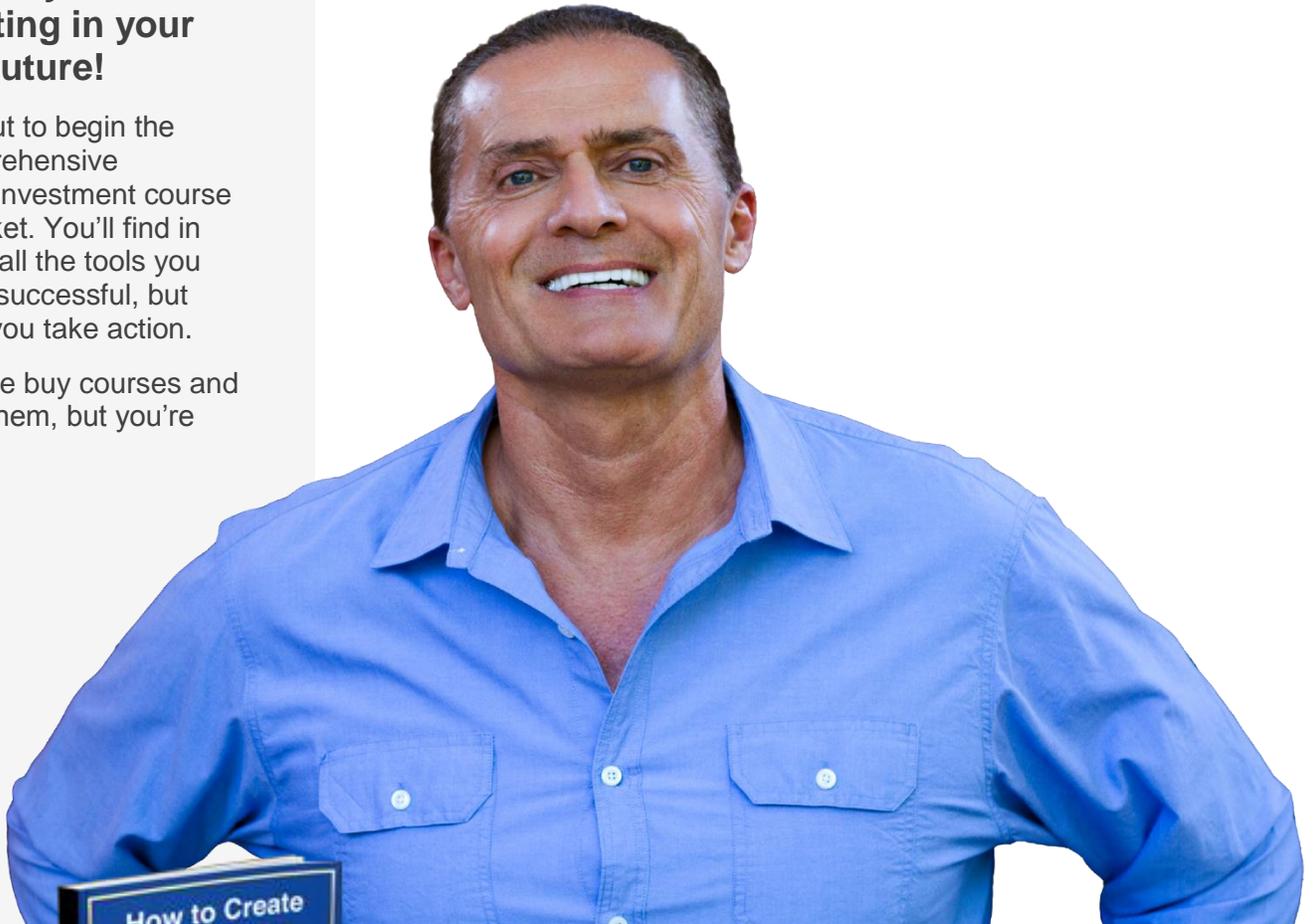
The
Lifetime CashFlow
Academy

Lifetime CashFlow Through Multifamily Properties

**Thank you for
investing in your
future!**

You're about to begin the most comprehensive multifamily investment course on the market. You'll find in this course all the tools you need to be successful, but only when you take action.

Many people buy courses and never use them, but you're different!



Rod Khleif

*Author of **How to Create Lifetime CashFlow Through Multifamily Properties***

*Host of the #1 ranked Real Estate Podcast on iTunes:
Lifetime CashFlow Through Real Estate Investing*

MODULE

6

**Preliminary Evaluation & Research
and Key Financial Formulas**



Rod Khleif

Lifetime CashFlow

Through Multifamily Properties



The
Lifetime CashFlow
Academy

Preliminary Evaluation & Research and Key Financial Formulas

Key Points

- Developing Habits for Success
- Preliminary Evaluation & Research
- Evaluating Worst Case Scenario
- Analyzing the Trailing 12 Months Income & Expenses
- Key Financial Formulas
- Fine Tuning Your Focus

Key Terms

- Pro Forma: a property's potential performance
- Actuals: a property's numbers over the last 3 years
- Non-disclosure agreement: a legal document agreeing to keep information confidential
- Value-add or Reposition Opportunities: industry terms for upgrading a property to increase its value.

Developing Habits of Success

Find the video at Module 6, Video 1 at :40.

Success is a few simple disciplines practiced every day. Excellence is not an act but a habit.

It takes 21 - 90 days to develop habit, depending on how much passion and commitment you put into the process.

Tools to Maximize the Development of Successful Habits

Decisions

It's great to have many choices, but at some point you have to decide. (See the clip in Module 1 to review more about decisions.)

"We are what we repeatedly do."

~Aristotle

"It's in your moments of decision that your destiny is shaped."

~Tony Robbins

Recommended Reading

The Slight Edge

by Jeff Olson

Self-Discipline

Don't allow doubts or limitations to stop you. Don't make excuses or let yourself off the hook. If you resolve to get up at 6am, discipline yourself to do it every day until it becomes automatic.

Accountability

Tell other people about your decision to start a new habit. When others are watching to see if you have the will power to follow through, it will drive you.

Visualization

Imagine yourself acting as if you have the new habit. This will speed up your subconscious mind's acceptance of the new behavior.

Affirmations

Repeat affirmations like this to yourself: "I get up and get going at 6am every day!" Repeat it before you fall asleep, and it will help speed up your new habit.

Commit

Commit and persist until you form each new habit. Keep working at it until you feel uncomfortable when you don't do it.

Reward Yourself

Rewarding yourself for practicing a new behavior reinforces that behavior. Even if you just give yourself a pat on the back, you'll soon associate a feeling of pleasure with the behavior. You can set up your own positive consequences that you look forward to.

Small shifts over time become huge changes. So get started on developing a new habit of success today.

Preliminary Property Evaluation & Research

When you identify a property that may be a good investment, it's time to evaluate it thoroughly.

Never work from a broker's pro forma numbers, though they will typically be in the package the broker sends you.

Always work from actual numbers, which are what the property has done historically. Get the trailing 12 months' income and expenses in writing. Also get the rent roll.

Expect to be asked to sign a non-disclosure agreement (NDA) relating to this information.

Look for Opportunities to Increase a Property's Value

- High vacancy
- Poor management
- Below market rents

Screen Share

See the screen share for a demonstration on how to analyze market rents using www.rentometer.com, www.apartments.com, www.craigslist.com, and www.zillow.com.

- Higher than normal expenses, a commonly overlooked opportunity
- Lots of owner paid utilities. You can separate and bill back to tenants.
- High turnover (always the highest expense in my experience). You want to keep tenants happy and in your property.
- Tired landlord, giving up on property
- Deferred maintenance, needs repairs

Questions for Preliminary Evaluation & Research

The first questions you should ask when you look at a deal are:

Specific to the property:

What is the property's age? With experience, you'll know what to expect with a property of a certain age.

What is the occupancy? Is the property stabilized with at least 80% occupancy? Many banks require that.

What is the overall condition?

What is the expense ratio? This is the ratio of income to expenses. Is it greater than 45-50%? If the expense ratio is over 50%, you want to know why. Is there a specific reason the expenses are so high? Is there an opportunity to improve there?

Are there any value-add or reposition opportunities? These are industry terms for making improvements to a property.

Will the NOI be sufficient to cover the debt service? We'll go over the Debt Service Coverage Ratio (DSCR) in this module.

Is there a good unit mix? How many 1, 2, and 3 bedroom units are there? This should match the demographics and needs of the community, whether it's a family, student or another kind of area.



Screen Share

You'll also want to be aware of the recent sales prices of similar multifamily properties. This information is not only part of your due diligence, but will be useful when you start your negotiations and when you need to prepare a prospectus for your investors. See the screen share for how to use the county property appraiser's website to find these comps.

Questions about the area:

How's the location/area of the property?



Screen Share

What's the crime rate? (Make sure to watch the screen share on how to use www.spotcrime.com.)

What is the condition of nearby similar properties? Are they run down?

Is this property the nicest or worst in the area? Ideally you don't want the nicest one. If you can fix it up to fit the quality of the location, you'll add value.

Is the property in an appealing or emerging market? As we talked about in Module 3, you'll want to know what the employment rates and whether the population and incomes are growing.

What is the vacancy rate for the area and how does it compare to the subject property? If the property is 40% vacant, but the area's vacancy rate is 8%, there's an opportunity to improve it. But if the percentages are the opposite, you wouldn't be interested.

What is the market rate for rents in the area? Here are some resources for answering this question:

- Apartments.com
- Call property management companies
- Mystery shop
- Call brokers
- Call competitors
- Craigslist (You can quickly measure market demand by putting a teaser ad on Craigslist. If you don't get any calls, it could be a red flag.)

Make sure you compare apples to apples when evaluating a property. See how it measures up against buildings with similar sizes, amenities, and age.

What is the neighborhood like? You can find out a lot by using Google Earth. Its aerial and street views, can show you if the property is in a residential area or surrounded by warehouses. You can even see what kind of cars are parked at the apartment building.

Screen Share

Also see our screen share on how to use www.walkscore.com to see the walkability of the neighborhood and even how this site can help you advertise your rentals.

Evaluating Worst Case Scenario

Look at the trailing 12 months income and expenses.

Estimate what your debt service will be.

Assume 75% Loan to Value (LTV). For example if you're paying \$100,000, you assume a \$75,000 loan.

Go to www.bankrate.com to get a quick mortgage estimate to determine what your monthly and balloon mortgage payment amounts would be.

(Balloon mortgages are a way to finance properties with 5 units or more. Terms range from 5 to 10 years with a large balloon payment when the term is up. At that time, the property is usually refinanced or sold.)

Screen Share

See the screen shares for a demonstration of how to use Bankrate.com.

Subtract the mortgage payment from the past year's NOI and make sure you have a positive cashflow. If so, move on to the next step.

What is the lowest annual NOI the property has earned in the past 3-4 years? Get income statements or tax returns from the seller to determine this.

In that lowest year, would you still have a positive cash flow if you factor in your new debt?

What is DSCR?

Divide the NOI by the debt. You want a number over 1. Banks look for 1.25 to 1.4. You need to leave a cushion for unexpected expenses. The property has to support the debt.

Economic Vacancy

Economic vacancy tells you the actual rent amounts coming in. Some tenants may not be paying their rent.

To determine this, look at the gross scheduled rent on the rent roll, subtract the actual rent collected. That will give you the Economic Vacancy. Be very careful to not miss this.

Review the Trailing 12 Months Income & Expenses

Expenses

Expect to see total operating expenses run between 40-60%. If it's over 50%, are there ways to lower it?

When analyzing the expenses, just as you did with the rent roll, you want to look for anomalies and get explanations.

Additional Value/Income Opportunities

Look for ways you can use the property to increase income for you and value for your tenants.

Is there extra land where you could build more apartments or storage units to rent?

Could you charge for parking? (Do this only if the competition does.)

Could you build covered parking?

How about adding a vending and/or laundry room?

Charging \$10 a month for a valet service to pick up bags right outside tenants' doors can really add up too.

Are there other buildings like a clubhouse that are not being used? You could add more units there.

Key Financial Formulas

I hated math in high school. But these are simple formulas. You can do it! You just need to practice. Do the practice problems, which you can find in the course materials. If you need help, please reach out to us!

Loan to Value (LTV)

The mortgage amount divided by the property value will give you the LTV.

Ask your lenders how much they will lend based on this value. You can expect to see banks loan an average of 70%-80%.

$$\text{Loan-to-Value (LTV)} = \frac{\text{Mortgage Amount}}{\text{Property Value}} = \text{LTV}$$

Net Operating Income (NOI)

The gross income minus the operating expenses (not including debt service) will give you the NOI.

This is the most important number for determining the value of the investment.

Net Operating Income (NOI)

Gross Income - Operating Expenses = NOI

Capitalization Rate (Cap Rate)

The capitalization rate is the NOI divided by the current market value or the sales price.

The cap rate is the rate at which the NOI repays the purchase price on an annual basis.

Capitalization Rate (Cap Rate)

Net Operating Income / Current Market Value = Cap Rate

Cap Rates are affected by:

- Location of the property
- Overall market condition
- Supply and demand
- Investment risk
- Property appreciation
- Level of property management
- Tax benefits associated with the property

Cap Rates and Property Classes

- Class A & B properties have very low cap rates due to stability.
- A low cap rate means a large investment for a small income stream.
- D properties have high cap rates because they're risky. The higher the cap rate the cheaper the property.
- A large cap rate means a smaller investment for a larger income stream.
- Cap rates don't take financing into consideration because it's based on paying in cash.

Average Cap Rates

Class A: 4%-7%

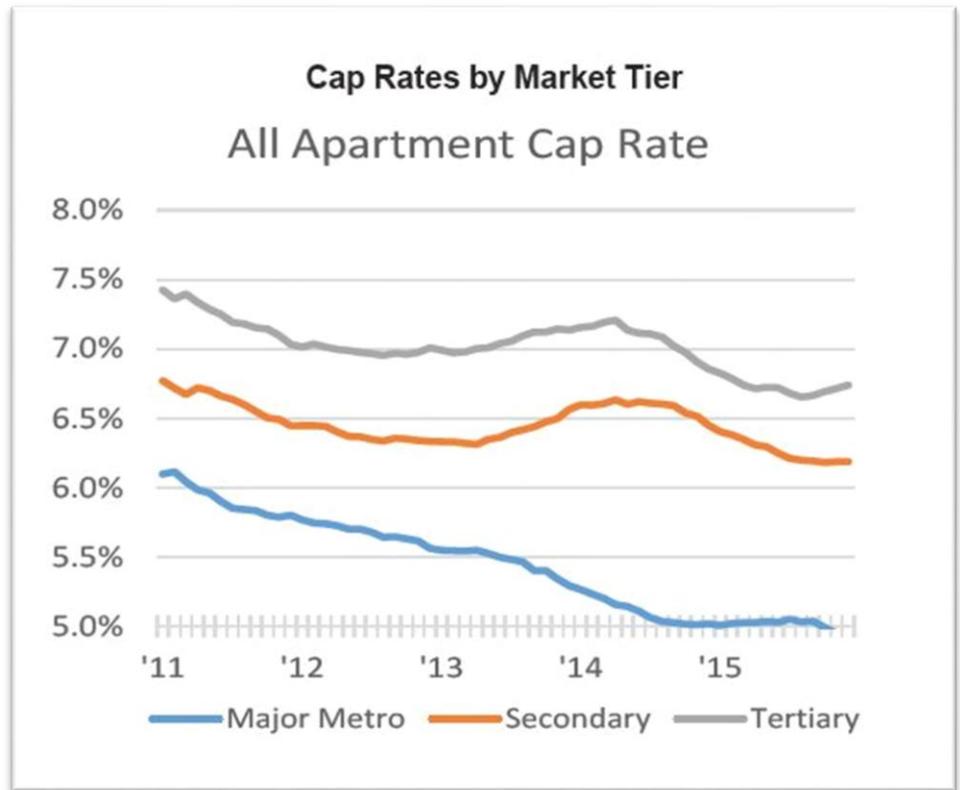
Class B: 5.5%-8%

Class C: 6.5%-11%

Class D: 12% and up

I like cap rates of 8% or better. It's harder and harder to find them. That's why those broker relationships are so important.





Cap rates in major metro areas are very low now and that means the prices are high. But there are opportunities in the secondary and tertiary markets. In these smaller cities the cap rates are still decent.

Compare these two properties:

Follow the demonstration on Module 6, Video 4 at 10:31 to see how to use the cap rate formula.

Example 1

Class D – 30 Unit Multifamily

Average Rent: \$675 per unit

Gross Income: \$243,000

NOI: \$121,500

Cap Rate: 10%

What is the value? _____

Example 2

Class B – 15 Unit Multifamily

Average Rent: \$1,100 per unit

Gross Income: \$198,000

NOI: \$99,000

Cap Rate: 8.25%

What is the value? _____

Determining Value using NOI and Cap Rate

The NOI divided by the Cap Rate gives you the Value.

Here's an example:

Property NOI = \$85,700

Subject property: Class C

Similar Class C properties trading at 9.5% cap rates

Divide NOI into Cap Rate typed as .095

$\$85,700 / .095 = \$902,105$

The market value of this property would then be \$902,105.

$$\text{NOI} / \text{Cap Rate} = \text{Value}$$

$$\text{NOI} / \text{Value} = \text{Cap Rate}$$

$$\text{Cap Rate} \times \text{Value} = \text{NOI}$$

Determining the market Cap Rate for a property:

- Check recent sales on LoopNet
- Ask other investors
- Property managers
- Lenders
- Brokers
- Appraisers

The IRV Formula

See Module 6, Video 4 at 15:22 for a demonstration of the IRV Formula with examples.

$$\frac{I}{R / V} \times$$



I = Net Operating Income (NOI)

R = Cap Rate

V = Value or Sales Price

The Effect of a Rent Increase

If you have a 12-unit building and raise the rents only \$10 per month:

\$10 X 12 units X 12 months = \$1440 increase in NOI

\$1440 divided by 8% cap rate = \$18,000 value increase

If you have a 100-unit complex and raise the rent \$20:

\$20 X 100 units X 12 = \$24,000 increased NOI

\$24,000 divided by 6% cap rate = \$400,000 increase in value!

You can achieve these small increases in NOI by either raising the rent or decreasing expenses like billing the utilities back to the tenants.

Acquisition Cost

Down payment

+ Closing Costs

+ Capital Expenditures (Cap X) like renovations or repairs

+ Acquisition Fee (3-5% of the purchase price). This is income to you for putting the deal together. You can negotiate this with your investors.

= Total Acquisition Cost

Cash on Cash Return (COC)

NOI - annual debt service - (Cap X) / Acquisition Cost

- The COC gives a much more accurate figure on return.
- It includes debt.
- I like a COC of 12% or better.

See Module 6, Video 5 at 3:10 for a demonstration.

Cash-on-Cash Return

ex: Purchase Price = \$1,000,000

Down Payment = 25% \$250,000

Bank Loan = 75% \$750,000

No Repairs Needed

NOI after debt, before taxes = \$50,000

NOI of \$50,000 / cash investment of \$250,000
= **COC of 20%**

Return on Investment (ROI)

The ROI includes all returns to the investor over the term of the investment. (Total Return)

ROI is also called Cash on Investment.

ROI includes the benefits of four things:

1. Appreciation
2. Depreciation, Tax benefits
3. Cash Flow
4. Amortization, paying down debt

We like to see 18% - 20% ROIs to our investors.

Operating Expense Ratio (OER)

Operating expenses divided by the gross income gives you OER.

You add up all of the property's expenses and divide it into the gross income.

Rule of thumb around 50%

Includes vacancy, but not property management

See Module 6, Video 5 at 7:10 for an example of how to use this formula.

$$\text{Operating Expense Ratio} = \frac{\text{Operating Expenses}}{\text{Gross Income}}$$

Debt Service Coverage Ratio (DSCR)

$$\text{NOI} - (\text{Cap X}) / \text{debt service payment} = \text{DSCR}$$

The DSCR is used by lenders to determine if a loan on this property makes sense. You need to do this yourself in your preliminary analysis.

Banks want to see a percentage of the NOI left over after the mortgage is paid. If the debt coverage is lower than 1.25% they probably won't approve the loan.

Most banks want between 1.25 and 1.45 to approve.

A DSCR of less than 1 means there's negative cash flow, and that doesn't pay the mortgage.

For example, a DSCR of .85 means the NOI can only cover 85% of the mortgage payments.

See Module 6, Video 5 at 9:26 for a demonstration of this formula.

Debt Service Coverage Ratio

$$\text{NOI} / \text{Debt Service Payment} = \text{DSCR}$$

DSCR Ideal Numbers

- I personally love to see the possibility of a debt service coverage ratio of 2.
- I want at least 1.6 or higher.
- If it's less than 1.6 I need to see that I can raise it.

With this formula you can look at deals of any size and make some initial determinations if a deal looks interesting or if there's no way it will work.

Ideally:

Cash on Cash Return: at least 12%

Debt Service Coverage Ratio at least 1.6

Cap Rate 8% or higher

The Power of Focus

Find the video, Module 6, Video 5 at 13:24

Focus is the single most important component of success in life. But what gets in the way?

Distractions:

- Advertising
- Social media
- Demands of others
- New Opportunities

“Where focus goes, energy flows.”

~Tony Robbins

You don't want to wake up after years of distraction and realize you didn't reach your goals or dreams. Unless you master your focus, life will pass you by and you'll end up with a life of regret.

“Without a vision the people perish.”

~Proverbs 29:18

Determine Your Mission

- Why are you here?
- Who are you here to help?
- What are you here to do?
- What is the purpose in your life?
- What is it you really want?

Write it down and clearly define it. What's your vision for the future?

Minimize Distractions

Stop browsing. Take a break from Facebook and Instagram for a while until you feel like you've got your focus back. It numbs your mind and hurts your focus.

Minimize Decisions

Steve Jobs wore the same kind of clothes every day to focus his decisions on more important things. Decisions fatigue your brain. You've only got so much mental energy available every day.

Minimize Activities

Getting involved in too many different activities dilutes your focus.

Resist the temptation to chase all the opportunities “shiny pennies” you see. This is a very common problem of entrepreneurs.

Get in the habit of saying “no”. Take time to evaluate the opportunity before jumping to “yes”.

Happiness comes from progress and process, not from the outcome. If your focus is off, you won't make progress and that diminishes your happiness.

How to Improve Focus

- Meditate. Close your eyes and focus on your breathing.
- Cut down on multi-tasking. Do one thing at a time.
- Exercise! Take care of your health.
- Take breaks. Get outside frequently. You get more done in less time when you're fully engaged.
- I jump on a rebounder. It's a great energy boost.
- Get plenty of sleep.
- Make to-do lists.
- Look for 20% tasks that get you 80% traction.
- Schedule your day in blocks of time.
- The simpler your life is, the more progress you'll make.

Module 6 Most Common Mistakes

- Working from a broker's and/or seller's pro forma
- Rushing through preliminary evaluation
- Analyzing properties that are missing info/expenses. Get everything!
- Analyzing last year's financials/trailing 12, and forgetting to analyze year-to-date (YTD)
- Not knowing market cap rate, and not bothering to determine it
- Quickly kicking “bad” deals to the curb before digging in and looking for value-add opportunities