It’s a Great Time to
Buy & Sell

Real estate experts haven’t seen such a strong market since the 1980’s

BY JOHN CARONNA

It is a great time to buy an investment property in the East Bay, and at the same time, it is also a great time to sell. All of us who live in the Bay Area know that rents have been on the upsurge for the last 12 months. A quick search of Craigslist rentals is an eye opening experience, as renters are paying in excess of $2,100-$2,600 for a two bedroom in many areas of Oakland, Berkeley, Walnut Creek and Pleasanton. In very desirable areas, such as Piedmont, Lafayette or Moraga, rents are even higher.

I just helped clients rent an 800-square-foot one bedroom unit in their duplex in Lafayette for over $2,100. It was only a year ago that they bought their duplex, and calculated $1,600 as market rent for each unit.

At the EBRHA Trade Expo last fall, a term for our current situation that accurately described many East Bay renters was “San Francisco Rental Refugees.” In an effort to live in a desirable area, and at the same time try to save money for a down payment, many young professionals are moving east of San Francisco, where our rents seem so reasonable. They have good jobs and they expect services that will continue to evolve and improve in the East Bay from wanting to live near the Whole Foods in Oakland, to the vibrant scene in Uptown, to being walking distance from BART.

For Sellers

The large number of very motivated buyers means that prices for apartment buildings are up 30-45% in just the last 6-9 months. In discussions with colleagues — many with over 30 years of experience — we have never seen an investment market that has turned around this quickly and aggressively since the 1980s.

In simple terms, market rents are up 20-35% in most of the East Bay. At the same time, investors are willing to pay more for that rent. How does this add up? Well, here is the simple math: let’s take a four-plex in a very strong rental location of the East Bay, for example, near Lake Merritt in Oakland, or in Moraga/Lafayette in Contra Costa County. In the fall of 2011, two to four-unit buildings in these areas sold for about 11 times annual gross rent. So, if you had four 2 bedroom apartments renting for an average of $1,500 per month, and an annual gross rent of $72,000, your building (in good condition) was worth $792,000.

Currently buyers are paying 14 times gross annual rent for buildings in these areas. If you didn’t pass through any rent increases, and you didn’t have any tenant turnovers, then your building is now worth $1,008,000.

Of course, most likely you have passed through the allowable rent increase (in rent control markets) or increased your tenants rents by 3-5%. This coupled with a tenant turnover or two could easily increase your average rents from $1,500 per unit to $1,750 per unit. Note: one new tenant at current market rent of $2,100 brings the average to almost that level alone.

Now, your four-plex that was worth $792,000 in the fall of 2011 is worth $1,176,000. This four-plex is worth 48.4% more than it was a mere 16 months ago! Please read this again. Same building, same location, same neighborhood, same floor plans and this four-plex is worth $384,000 more today.

Sellers, to maximize your value there are a few basic things that you should always do. Some of these may seem obvious, but surprisingly, this is not always the case when I look at properties that are for sale.

1) Landscaping and exterior painting. I always advise my clients that if a property is not well-maintained on the outside, expect many additional examples of “deferred maintenance” upon further inspection. Landlords who don’t take care of the common areas and...
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exterior don’t spend money on other general maintenance.

2) *Laundry room income.* It’s a tenant amenity, and its
   count towards your annual gross income.

3) **Clean out the basement, storage, and parking areas.** New
   buyers paying top dollar don’t want to take over a building
   with excess junk from old or current tenants.

4) **Get all your paperwork in order.** These should include at
   a minimum, last year’s expenses broken down into basic catego-
   ries: utilities, repairs and upgrade, maintenance, property taxes,
   insurance, business tax and licenses, if appropriate. Lastly, the
   buyer is going to want copies of your tenant leases with deposit
   amounts, plus estoppels. It’s important to give buyers the cur-
   rent lease terms, as many buyers today are looking to live in one
   unit and collect rent for the other units.

5) **Last, and most important: pass through all rent increases
   that are allowable.** If you are in a non-rent controlled market,
   spend some time visiting open house opportunities in the neigh-
   borhood and check Craigslist for rentals in your area. This is a
   business, and a very profitable one if you treat it like a business.

   Remember, the amount that buyers will pay for your
   building is rapidly accelerating. The most important rule for
   landlords is to pass through all possible rent increases. Buyers
   are going to pay a multiple of your annual rents. Period. All
   potential rental income between your current rents and market
   rents are just opportunities for your buyer.

   So, when you analyze your property, if it is a business, then it
   is imperative to thoroughly research the rental market for your
   neighborhood to get the highest possible rent.

**For Buyers**

The incredibly low interest rate environment allows for returns
15-20 times higher than your investment than comparable returns
from a money market or CD account. Many buyers with cash
in the bank are realizing that the best returns available are
through an investment property purchase. Also, the deprecia-

tion deduction on investment property can mean that your net
income can dramatically increase.

Now, with rents rising so rapidly, it is usually much cheaper
to buy than rent. I have recently worked on two transactions (a
 duplex and a fourplex) where the buyer was going to occupy
one unit and rent the others. In both cases, the buyer’s total
monthly costs were much lower than market rent for their
unit. The buyer also gets tax write offs, and there is a monthly
principal reduction on their loan. For all these reasons, many
smaller investment properties are selling to buyers who plan to
live in one unit and rent the others. It’s a great way to begin the
strategy of becoming an investment property owner.

**There are two basic categories that most buildings fall into. It’s important to do some
analysis to see what you are looking for, as owning an apartment building is going to
require some level of work, whether or not you hire a property management firm.**

1) **Properties in good rental areas, which sell for a premium.** Long term potential
   for appreciation and a long term strategy will generate good appreciation and loan
   principal reduction. Examples: Rockridge, Elmwood, Adams
   Point, and Piedmont Avenue in Oakland, as well as Piedmont in
   Contra Costa County, Moraga, Walnut Creek, Pleasanton, and
   Concord are most desirable.

2) **Properties that are in “up and coming” areas.** The East
   Bay has seen a tremendous improvement in many areas. Some
   neighborhoods have been very desirable by renters (and owners)
   for years. Examples that are now — but only recently — very
   desirable would be Temescal in Oakland, Pleasant Hill and
   Martinez in Contra Costa County.

   The first group may not generate great cash flow in the begin-
   ning, but they will appreciate more consistently, and always be
desirable to renters. For example, the four-plex we purchased in
2001, one block off of Piedmont Avenue, is getting over $1,900
per month for one bedroom units. Since we purchased the build-
ing in 2001, we’ve averaged less than 1/2 of 1% in vacancy per
year or less.

   The second group has more inherent risk. The current tenants
may not have the income and credit scores that you will seek
moving forward, the current rents may be below market, and if
you own in a rent control market, it may take years to get the
units all to market rents. Eventually, through rent appreciation,
your equity in the property can dramatically increase.

**Property Management**

Management companies charge 6-8% of your rent to manage
your property. Their level of control can be 100%; they deposit
your net rental income into your checking account and send you
a monthly spreadsheet. They can pay your mortgage, monthly
bills, property tax, do your open houses, and even hire contrac-
tors to do repairs.

Depending on the state of your building and the number of
units, it may make sense to have a professional company handle
all your rental property affairs. It’s a good idea to think about
this before you analyze your return on investment, as it does
have an impact on the bottom line.

Self-managing your property is a great learning experience,
but keep in mind you may not want to learn how to change a
leaking kitchen sink, get pennies out of the garage disposal, hold
open houses, run credit reports, etc.

Another option may be a combination. Perhaps you hire a
maintenance person and gardener, but you handle marketing,
tenant screening, collections and accounting. Property manage-
ment software, like Buildium, can also make the job much easier.

**Maintenance**

When considering property to purchase, looking at all deferred
Maintenance issues is extremely important. Most investment property owners, myself included, don’t set aside monthly allowances for items that only need major attention every 10-15 years or so. New roofs and new exterior paint are very expensive, but putting them off doesn’t save money, it only costs more money in the end. There is also the possibility of extra expenses to pay for damage caused by the old roof, peeling stucco or paint.

The best strategy is to sit down with your financial professional, other multi-unit property owners, and a real estate agent that has experience with investment properties. Begin to learn about the process, advantages, potential challenges, past experiences of those you are meeting with, and then get out and look at properties for sale.

Imagine yourself as the owner, and do a realistic checklist of what and how much time this investment will entail weekly and monthly. Weigh the return with both professional property management and doing it yourself.

Rents
My strategy is to offer attractive, well-maintained units to carefully screened tenants who meet my rental standards, with the goal of getting market rents as soon as possible. This is my business, and the bottom line is my priority. However, every owner has different goals, depending on the number of units they own, their financial picture, and their business philosophy. Dream tenants who pay rent on time, do not disturb others, take care of your property, and alert you to problems are worth their weight in gold. You may not want to risk losing them due to a big rent increase (in non-rent controlled areas). This does not mean you should never raise rents, but there may be other considerations. In rent-controlled areas, unit turnover is your opportunity to update your units, increase rents, and maximize your return. RH