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Should You Average Down Your Apartment Portfolio? How To Make Money Even In a Recession

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My stock broker first introduced me to the concept of averaging down. I remember the conversation well. "So Dave, you really did like ABC Company at \$100 per share so consider it on sale at \$50.00 per share. By buying an equal amount of shares at the current value your average cost of ownership is \$75.00 per share."

It sounded wicked and perverse at first, but I really did like the stock. It turned out to be the right decision.

I spoke to a client yesterday who had a property in a good solid blue collar area in metro Detroit. Occupancy in the area has been holding reasonably well. That is, it had been holding well except for the client's competition across the street. That property, due to mismanagement, had below par occupancy resulting in a downward spiral we all have seen too often. The property went back to the lender.

At first, the demise of the competition was considered a good thing. As tenants left, many of them moved in to my client's property. You might say that life was good. Perhaps life was a bit too good. Both properties had been sold at comparable values 10 years ago. Each property had about \$28,000 of debt per unit which was reasonable for the time.

But in today's market, the brokers valued the property at \$20K per unit with anticipation that a cash offer might be as low as \$12k per unit.

The client knew exactly what this meant. The new owner would have a substantially lower cost basis, which he could use to his advantage by lowering rents and draining the stabilized occupancy of its neighbors.

The threat was real and imminent. My client's entire equity investment was at risk.

My advice was simple:

Buy the property and average down your overall investment. Either that or the new buyer may very well average down your portfolio with no upside to you.

The client liked the neighborhood and he understood the market well. He knew the building across from him. He knew what had been fixed and not over the past ten years. You might say he had an inside track.

Let's face it, you know what your neighbors house is worth (the good and the bad) much better than the across town buyer.

As we discussed the idea, we also began to explore the efficiencies. We considered that perhaps consolidating personnel due to the proximity of the properties could eliminate tens of

thousands of dollars of annual expense, and, of course, cross marketing the properties could save even more.

The net result as we modeled the purchase was that the "new" property would have a substantially larger NOI. By virtue of owning both, the client had some degree of control over the market rents.

Yes, it made sense. Perhaps the same could be said of you. ■

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