The MULTIFAMILY MILLIONAIRE

Create Generational Wealth by Investing in Large Multifamily Real Estate

Vol. II

BRIAN MURRAY *and*

Author of CRUSHING IT IN APARTMENTS AND COMMERCIAL REAL ESTATE

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INTRODUCTION

> *If people aren't calling you crazy, you aren't thinking big enough.*
>
> —RICHARD BRANSON

"I just don't want to see you ruin your life," the broker said in a patronizing tone that made me want to reach across the table and strangle him. "You seem like a nice guy," he continued, "but it's pretty obvious you haven't done this before. Some very experienced investors have looked at this property and passed on it. You just don't know what you're getting yourself into."

Maybe he had a point. After all, he was the big-shot broker from out of town in a fancy suit who had been doing this for decades. And he was right—I (this is Brian Murray, by the way, and it usually will be my stories throughout the book unless stated otherwise) didn't have a lot of experience, and the property I had under contract was in distress. I certainly didn't fit the profile of a typical buyer. In fact, a small investor acquiring a property of this size was far enough outside the norm that some might consider it reckless and inappropriate.

Still, the way he said it really irked me—and that infuriating smile of his, I decided, was just a little too big. He may have been well intentioned, but he struck me as a bit too smug and condescending. I imagined if he had a puppy at home, he'd speak to it the same way he was speaking to me. In fact, I half expected him to reach over and pat me on the head... maybe offer me a treat. As if on cue, his voice interrupted my thoughts. "Would you like another donut?" he asked, still beaming.

In hindsight, I realize my negative reaction probably had less to do with his demeanor and more to do with my own insecurities and the hard truth of his words. Despite any displays of outward calm, under the surface I was waging an internal war—fighting to suppress a cacophony of doubts and fears. I was trying to buy my largest property to date, and a lot of naysayers were making me second-guess myself.

Fortunately, while the broker's words played on my anxieties, they didn't deter me. I moved forward with the deal and eventually managed to turn that property around, creating massive value as occupancy improved, income climbed, and expenses came down. Even so, the broker was at least partially right, because when you take on a challenging project, it's never really as easy as just "turning the property around"—which almost makes it sound like flipping a switch.

Although most aspects of multifamily investing aren't complex, it takes a lot of work and can be a bumpy road, to say the least. You can expect lots of trial and error, and plenty of setbacks along the way. I did make a lot of mistakes, just as people thought I would—not only on my first multifamily but on all the others that followed. Some mistakes were small, some were big, and while some may have been unavoidable, others were downright embarrassing. All in all, I've gotten a real education.

The lessons I learned as I grew my portfolio would prove valuable over the long run, but they didn't pay the bills. Still, if I messed up so many times, how did I manage to pull it off? How did I avoid bankruptcy and not ruin my life, as some people had predicted?

While many factors contributed to my positive outcome, the most important is this: *Multifamily investments are forgiving by their very nature* and offer a number of benefits that are unique within the investment world.

The Benefits of Large Multifamily

Large multifamily investments share the same advantages as most rental real estate, including wealth creation through cash flow, appreciation (forced and passive), tax savings, and amortization, which result in the accumulation of equity as you pay down your debt. Brandon calls these the four wealth generators of real estate—and for good reason. Given enough time, these four glorious generators can be further magnified through leverage and compounding to create abundant wealth.

In addition, multifamily assets can serve as an effective hedge against inflation, provide diversification to your investment portfolio, and offer a degree of recession resistance not found in other asset classes, which we will explore in more depth in a later chapter.

These are all advantageous, but let's not overlook the obvious. The benefits you can realize by owning investment real estate are directly proportional to the size of your holdings. All things being equal, owning a multifamily property that is ten times as large will generate ten times the cash flow, ten times the tax benefits, and so on. What *won't* increase by a factor of ten? The work that goes into it.

That's not to say that investing in large multifamily properties isn't a lot of work, but efficiencies of scale do come into play. For example, the work that goes into the underwriting, due diligence, and closing of a 150-unit apartment complex is not ten times as much as for a 15-unit complex. It might be closer to 50 percent more work, if that.

Other benefits of investing in larger multifamily properties include:

- Better lending terms than you can get for smaller multifamily properties
- Diversification of income across more tenants
- Efficiencies of scale in operations
- More opportunity to force appreciation through value-add
- More leverage and negotiating power with vendors
- More well-qualified buyers when it's time to sell
- Greater interest from people who would like to invest in your projects

The income diversification aspect of large multifamily properties is particularly important. Let's say you own a hundred-unit apartment building and you make a mistake that causes you to lose a tenant—or three. Most likely the resulting 1 to 3 percent drop in income is something you can learn from without missing a beat.

Most new property owners have at least a 25 percent cushion built into their cash flow, which, if necessary, can help them muddle through some pretty big gaffes, surprises, or dismal circumstances. On top of that, if you have an amortizing mortgage, you're paying down your debt every month, which is building equity, in effect creating a reserve that could be cashed in someday in a time of need.

Finally, large multifamily properties offer the advantage of allowing owners to force appreciation on an even larger scale by taking steps to boost income or reduce expenses. A change that might yield modest results in a smaller property, such as the installation of low-flow plumbing fixtures or a modest increase in rents, can create surprising amounts of equity in a large multifamily.

As already stated, multifamily properties tend to be forgiving by nature. They operate with momentum and once they're headed in the right direction, they can power through most setbacks without significant consequences. If you make as many mistakes as I have, it's reassuring to know that it's going to take a lot to derail the train.

Even though we took somewhat different paths, Brandon and I shared a penchant for finding ways to make improvements that paid some pretty big dividends right from the start. We both overcompensated for our blunders by constantly identifying problems and coming up with solutions; unlocking value by fixing things, improving things, making things more efficient. It might be something as simple as installing higher-efficiency lightbulbs. Or it might involve mustering up the fortitude to deal with unsavory situations. We have both tackled problems that would make most people's skin crawl—all along, showing lots of love and attentiveness where before there was neglect.

This value-add approach turned out to be one of the keys to surviving and then thriving for both of us, especially early in our investing careers. By incessantly seeking out and implementing strategies to boost income and cut expenses, we were able to generate the cash we needed not only to overcome our mistakes and setbacks but also to purchase additional properties and grow our portfolios. After we added enough value to a property, we would refinance it and pull cash out to do more deals, which in turn continued to fuel our growth.

That said, while focusing on value-add real estate investments can be lucrative and allow you to grow without raising outside capital, it isn't easy and it's not for everyone. Over the years, as Brandon and I have grown our respective portfolios and expanded geographically, we've both learned how to invest more passively by relying on the knowledge and experience of partners and third-party associates to get things done. Our earlier hands-on experience has proven invaluable as we underwrite deals and oversee property managers. We've also realized the benefits of raising capital to fund our acquisitions, which has accelerated our ability to buy large multifamily properties while providing the satisfaction of creating wealth for others who invest in our deals.

The Downsides of Large Multifamily

After hearing all the benefits of investing in large multifamily real estate, perhaps you're motivated to dive in. If so, we wouldn't blame you. It's a decision we've both made—but if large multifamily properties are so wonderful, why doesn't everyone invest in them? There are many reasons, but let's review the most common and legitimate ones.

First and foremost, while investing in large multifamily properties can be lucrative, it's no walk in the park. This type of investing requires a lot of hard work and sacrifice. We've had the pleasure of meeting dozens of investors who have grown portfolios of 1,000-plus units. The one thing they all have in common? A strong work ethic.

This should not be surprising, as hard work is a powerful force that can lead to positive results in any field of endeavor. In an interview with *60 Minutes*, the actor Will Smith said, "I've never really viewed myself as particularly talented. I've viewed myself as slightly above average in talent. Where I excel is ridiculous, sickening, work ethic." Among the highest achievers in real estate, you'll often find this same level of determination, sometimes bordering on obsession.

Even when the work is divided among a team of partners, there is always more to be done. That said, you have a choice about how far and how fast you grow a business. You don't need to have 500 units in the first year or 2,000 in the second—and you certainly wouldn't be expected to do everything yourself, nor should you. There are plenty of excellent property management firms and other vendors out there who can make your life easier.

Investors who are in it for the long haul need to have balance in their lives. Just know going in that if you want to excel in the multifamily world, you can't offload everything. That may be disheartening for people who were under the illusion that real estate investing is an entirely passive activity. However, real estate is a business like any other and it doesn't magically run itself, especially in growth mode.

Are there passive paths to wealth in multifamily investing? Absolutely. If you want to invest on a large scale but don't want to put in the work, you can invest in other people's deals. There are lots of syndicators out there looking for limited partners who are willing to invest in their multifamily projects. These investments come with no responsibilities or authority—you just have to write a check.

The downside of this passive approach? You won't have any control over the outcome, and there is generally less upside. That said, these limitations can be a fair tradeoff for people whose commitments or priorities won't allow for active involvement.

The Myths of Large Multifamily

In an ideal world, decisions regarding whether to invest in multifamily would be driven by an objective evaluation of the pros and cons, in conjunction with one's own personal goals and circumstances. Unfortunately, decisions about large properties are often made for the wrong reasons. There are many convincing myths out there. Let's take a look at four of the most pervasive.

Myth No. 1: Large Multifamily Is Too Complex

While there are more moving parts to large properties and analyzing them is more involved, in most cases they really aren't that much more complex than small ones. Most aspiring investors have heard this at one point or another, but few actually believe it.

When a new investor first enters a large apartment complex with an eye toward owning and operating it, they are likely to feel overwhelmed. The sheer vastness of the asset and fear of the unknown create anxiety, which can drive people to discard the idea.

When that same investor considers a single-family home, a condo, or a duplex, they probably feel a greater sense of familiarity and comfort. They have probably lived in a similar property, and it seems more manageable. Most new investors feel they can handle a small condo. How complicated could it be?

What is a 150-unit apartment complex? It's 150 single apartments. It's seventy-five duplexes or fifty triplexes. At a high level, the issues you deal with are the same. If you can manage a single condo unit, you can manage a large apartment complex—especially since you're most likely going to have a third-party management company to handle day-to-day operations. You can hire people to help with anything else you don't have the time for, don't have the knowledge or skills for, or just don't want to do yourself. You can also partner. When you invest in a large multifamily deal, there's a lot more potential profit to split with other people.

Myth No. 2: Most Investors Can't Afford to Buy a Large Property

This is a particularly powerful and prevalent myth, primarily because it is rooted in a grain of truth. Most people *don't* have enough money to buy a large apartment building. In fact, even investors who have already accumulated a respectable portfolio of smaller multifamily assets may not be able to make the leap on their own.

But here is the *real* truth: The vast majority of people buying these large assets are not using their own money. They raise money from others and keep some of the equity for their trouble. In fact, in the world of large multifamily, the rarity is the investor who has enough cash to *not* need other people's money.

There are many ways to structure the acquisition of large assets, and we'll review those in more detail later. Just know that cash is not a prerequisite for making a large multifamily acquisition.

Myth No. 3: There Are No Good Deals

The market moves in cycles, and valuations can be high or low relative to other periods in time. However, at every stage in the cycle, there's a seemingly incessant chorus of people predicting a pending decline or complaining that things are overpriced. The truth is that there are *always* good deals, regardless of where we may be in the market cycle.

Of course, we should clarify what a "good deal" actually is, since that can clearly be subjective. We would define a good deal as one that cash flows at a high enough level to generate returns satisfactory to the investor, with enough of a cushion built in to weather any storms you're likely to encounter along the way. If you have a long-term horizon and can lock in debt at an interest rate that will achieve these results, your downside is limited. A good deal should also have a potential upside that will allow you to force appreciation and increase the value of your investment.

Are there deals out there that can achieve these kinds of returns? While it can seem impossible at times, the answer to this question is *always* yes. The question is, how difficult are they to find, and how hard are you willing to search to find them? If you're relying entirely on public sources like the internet and broker listings, finding strong deals can be challenging and you're likely to get discouraged. But there are many other ways to find deals, which we'll delve into later on.

Myth No. 4: You Need a Ton of Experience

This myth is also rooted in a grain of truth. Real estate investment experience is undoubtedly a valuable asset for diving into the world of large multifamily, but lack of it is not a deal breaker.

We've observed that prominent investors can travel a wide array of paths to achieve their goals. Some start with smaller properties and work their way up, using "The Stack" method, which we outlined in Volume I. These investors begin with a small property and exponentially grow their portfolio by making increasingly larger acquisitions, gaining knowledge, experience, and capital along the way. Other investors team up with partners who have the experience they lack. Still others leverage valuable skills they acquired through an education or career that, on the surface, may seem entirely unrelated to real estate.

Is experience valuable? Undoubtedly. Does a lack of experience preclude you from buying a large multifamily property? Absolutely not.

Large Multifamily Is Within Your Reach

One of the greatest takeaways from all my experience with larger properties is a conviction that investing in large multifamily deals is within the reach of most real estate investors. There are ways to overcome any limitations you may face as well as the mistakes you'll undoubtedly make.

If you currently own rental real estate or have owned rentals in the past, you've almost certainly laid a solid foundation for moving up to larger multifamily properties. Everything you've learned and experienced will improve your chances of success.

What if you haven't owned rental real estate and are just getting started? You'll need to dig in and really educate yourself—a process that, by the way, should never stop. If you haven't already done so, read Volume I of *The Multifamily Millionaire*, then read this book, then go back and read them both again.

You'll also need to network and build relationships, because going it alone as a newbie is a recipe for disaster. You'll need to do a ton of work and take on the things that others aren't willing to. However, if you're determined enough, patient enough, and prepared to do whatever work is necessary, becoming a large multifamily investor and creating generational wealth is almost certainly within your reach.

In the first volume of *The Multifamily Millionaire*, we discussed a common problem: Many real estate investors stay within their comfort zone for far too long. They get comfortable with their small portfolio—or with no portfolio—and although their heart and soul yearn for growth and expansion, they stay small because their fear speaks louder than their ambition. This book is designed to be an antidote to fear. We want to arm you with the detailed, tried, tested, and true knowledge you need to rise to your full potential.

A decade ago, I didn't listen to Mr. Condescending Smile. Instead, I stepped outside my comfort zone and discovered an incredible life on the other side. May this book be your guide as you take your business to the next level—toward becoming a multifamily millionaire and creating generational wealth.

KEY TAKEAWAYS

- Before deciding whether to invest in large multifamily properties, you'll need to weigh a number of advantages and disadvantages.
- Common myths about large multifamily real estate are that it's too complicated, the properties are not affordable, there are no good deals, and you need a lot of experience. All of these may have a grain of truth but are simply challenges that can be overcome.
- Despite what many people may say or believe, investing in large multifamily deals is within the reach of most small real estate investors.

Note from the authors: Throughout this book, we wanted to not only "tell" you about the path to large multifamily success—we wanted to share actual examples from our experience. The following is the first in a series of end-of-chapter anecdotes that chronicle real-life examples of large multifamily projects. We hope these ongoing stories leave you inspired, educated, and entertained.

River Apartments: Part I

I still remember the phone call. The CEO of a real estate investment firm was going to be in town soon and wanted to meet me. His company owned River Apartments, a 115-unit multifamily project in the area, and they'd decided it was time to sell—hopefully to me.

The call was not entirely unexpected. The multifamily property in question had caught my attention several years earlier, so I had reached out to see if they might be willing to sell. When they said no, I continued to reach out every six months or so. The message was the same every time I checked in: "No, and if we change our mind, we'll let you know." Well, true to his word, the CEO was now letting me know.

It can be difficult to find good multifamily deals, so I make it a point to plant seeds like this all the time. When the owner of a property I'm interested in eventually decides to sell, I'll be the first one they call, and I can reap what I sowed. It's worked for me before, and it worked again this time.

During my meeting with the CEO, I discovered that the property was an affordable housing project that was currently operating under a contract with the U.S. Department of Housing and Urban Development (HUD). This meant that the government was subsidizing the rent to help the residents afford their housing, and in exchange the property owner was subject to a wide range of operating restrictions, inspections, and reporting requirements. However, the CEO explained that the contract was about to expire. Knowing the local rental market, I thought that converting the apartments from HUD to market-rate housing could be a great opportunity to unlock some value.

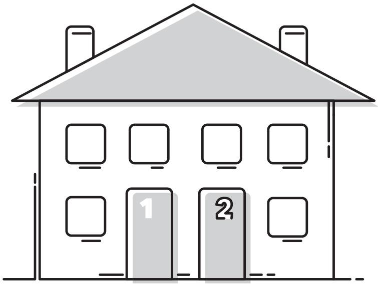
Soon after our meeting, I entered into negotiations and started doing some preliminary underwriting. What I found wasn't pretty on the surface. Staffing was literally double what it should have been for a project of this size, and maintenance costs were exorbitant beyond reason.

The CEO acknowledged that there were plenty of opportunities to cut costs and used this angle to try to persuade me that there was upside potential—something I was already sold on. He explained that his company was ready to pull up stakes in the area and wanted to make a deal soon so they could redeploy the proceeds to another project they had lined up. He encouraged me to look beyond the numbers, which were ugly.

As it turned out, the seller didn't know the half of it—things were worse than either of us could have imagined. Since the property was local, I asked around. Eventually, I tracked down some of the contractors who were routinely doing work there, one of which I had an excellent relationship with. It was a painting contractor who gave me the first clue as to what was really going on at River Apartments, and it was shocking.

What a mess this project was. Why did I like this property again? It was about to become a lot harder to remember.

To be continued…



Chapter One
DEFINING YOUR INVESTMENT CRITERIA

The successful warrior is the average man, with laser-like focus.

—BRUCE LEE

One of the wonderful things about real estate investing is that there are so many different types of properties and ways to create wealth by investing in them. Even within the world of large multifamily investing you have a wide range of property types, classes, sizes, values, and markets. While it's great to have so many choices available, the breadth of possibilities can also be overwhelming.

One of the keys to improving your chances of success in multifamily investing is to narrow your focus by defining your investment criteria. In Volume I we talked about the importance of establishing crystal-clear criteria—CCC. This means thinking through all the possible investment