



## **New Multifamily Investment Property Buyers and How They Are Changing the World**

**By James Kilpatrick, Managing Broker of Kilpatrick & Company**

There is a common theme to most of the questions we get these days:

“Who’s buying these buildings?!” “Who is paying these record prices?” “What is their plan for the properties they’re buying?” “How do they deal with rent control?”

I was in a meeting recently with roughly ten owners who control thousands of rent controlled apartment units in the bay area. A surprising number of them expressed strong concern over the sales prices of properties changing hands right now, and wondered how these buyers are going to make ends meet. While some of their logic is sound, I believe that one of the reasons more seasoned investors often make these comments is that they are frustrated at being out-bid by less experienced buyers. In the old days the bargain hunters had far less competition; today they are sometimes left out in the cold with cash making no return because they are holding out for a great deal that may never materialize.

The only general description I can give of the new buyers is that they do not fit any stereotype. They are typically not the big landlords adding to their holdings and they are not real estate professionals or syndicates putting together groups.

Many of them are people wishing to defer taxes by exchanging from smaller buildings or houses into larger buildings. An 8 unit building for \$1.75 Million doesn’t seem so outrageous to someone who has just sold a house for \$1.2 Million. Addressing the cash flow dilemma raised above, we note that since a rented single family home may have large negative cash flow for years, an apartment building that breaks even may seem to be a welcome change for this group. Finally, less experienced investors have inheritances or the stock market as their source of cash. Psychologically they are able to tolerate little or no cash return.

This shift in buyer profile has a lot to do with technology and advancement in business strategies. More effective marketing has brought previously less accessible income properties to less savvy buyers. It means more work for real estate agents to educate potential buyers and it also means more deals that “do not go through”. Less educated buyers get scared away more often and are far less likely to have done their homework

(due diligence) properly and early. They are also easily scared by issues like written reports of deferred maintenance.

This shift has forced commercial real estate brokers who historically have not always been cooperative with residential agents to work far more closely with such agents. Firms that have been cooperating fully for years have flourished and their reputation helps them sell deals quickly and at high prices. More agents also are realizing that the new buyer has email, blackberrys, PDAs, and that both high tech and low tech are essential to list and sell properties.

So what will happen to all of these novice buyers if the tides turn suddenly? I suspect most of the income property owners will be fine. Real Estate down cycles happen much more slowly than stock market crashes, and the reasons a lot of the people had for buying will still exist.

Berkeley, Santa Monica and other rent-controlled jurisdictions present unique issues. Buyers are obviously reluctant to pay market rates where a particular building is filled with long time tenants paying below market rents. Also to be considered is the added costs and hassle occasioned by registration fees, elevated business license charges, increased property taxes, and the potential of having to retrofit soft story buildings. In a city where tenants are essentially guaranteed a life estate at protected rates, the chances of recovering these costs from cash flow are much less.

All that said, UC Berkeley and other major employers are not going away, and people are not leaving the bay area, which is still a wonderful place to live. There are also major barriers to entry as far as development being difficult and expensive and land being scarce, and rents will inevitably go back up.

Add the fact that as interest rates rise on adjustable mortgages, fewer renters will be tempted to jump into home ownership. By many measures rents are around where they were in 2001, and while they may stay low for longer than some think, most would agree that rents in the bay area should continue to outpace inflation over the long haul. This trend will ultimately reach Berkeley, though there will be a few bumps along the way.

I suspect the bargain hunters will continue to be left out and the pro-active, innovative and entrepreneurial owners who communicate top industry professionals will continue to be successful.

*Please keep in mind that my area of expertise is Real Estate Brokerage. The tax consequences, exchange validity, accounting rules and legality of various strategies are best discussed with the appropriate professional. I have several that I will be happy to recommend. If you missed last month's installment, you may contact me for a copy of the last issue.*

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