

Chapter 8

Moving up to a 12-unit building

Lesson 12: Make sure your sales contract stipulates what goes with the house. If you expect to get the stove and refrigerator, the draperies, the window-unit air conditioner, the washer and dryer, or the chandelier in the dining room, **PUT IT IN THE CONTRACT**. I have heard of sellers that even dug up favorite bushes from the yard and took them when they left.

Lesson 13: You cannot be a successful real estate investor and be completely safe all the time. Occasionally you must take calculated risks. Think, analyze, plan, and then act. Remember that a good opportunity usually looks better after it has passed you than it did when you had the chance.

Lesson 14: A law degree does not make a person an expert on a real estate venture. Question every appraisal that is presented to you. This is not an exact science. Member of the Appraisers Institute (MAI) is the highest designation there is for appraisers, but even they can differ widely in their valuations of the same property. Every appraisal is based on certain assumptions, and changing the assumptions will change the appraised value. Sometimes the assumptions are shaded one way or another to suit the wishes of the person paying for the appraisal. Check with other sources, as many as possible.

Lesson 15: Try to find well-located investment buildings in sound condition that need mostly cosmetic improvements. Do not go overboard on improvements. If the building is an ugly sow's ear, just make it a nice sow's ear. Do not try to make it into a silk purse, because you will tie up so much money in it you may never get it back.

Lesson 16: Don't try to steal every property you buy. If you do, you will miss out on some good deals.

Lesson 17: Unless you buy a fairly large apartment complex, plan to expend plenty of your own time and effort. Learn to do the simple management and maintenance jobs yourself. If you do not, much of your profit will be spent on management costs.

At 3004 Monument Avenue, one block from the first building, was a three-story building with four units on each floor. It was solid brick and showed no outside cracks or mortar problems. It was 50 years old, and the electric wiring had been completely renewed. Seven of the apartments were vacant, and most of them were in such bad condition they could not be rented. The owners lived in another state, and a local real estate broker managed it. Neither the owners nor the management company wanted to spend any money on it. I found out later they once had a general contractor go over it and tell them what it needed. He wanted \$50,000 to put it in first class condition. They thought that was out of the question, so it just sat there. Everybody can have 20/20 hindsight, but they should have asked for an estimate to put it only into good enough condition to rent the

apartments profitably. If an apartment is clean and well located, tenants will put up with many shortcomings in return for reasonable rent.

The kitchens had little hang-on sinks with no cabinets, and all the bathrooms had old leg tubs with no showers. (This was before those leg tubs became fashionable as antiques.) All the floors were wooden, including those in the kitchens and baths, and they were badly in need of refurnishing. The floors sagged in places, but there were no serious cracks in the walls or ceilings. A tenant in one apartment had painted all the walls black before he moved out. The building had a built-up (flat) roof with minor leaks, and it had a big basement. Steam radiators provided heat from an oil-fired furnace, converted recently from coal. A 1,000 gallon oil tank in the basement could be filled from outside the building. I could buy heating oil at that time for 25 cents a gallon.

There was no elevator. Inside the stairs led to the central hallways on each floor, and doors led from the hallways to the front porches on each level. The six apartments in the back (two on each level) each had a bedroom, a living room, a kitchen and a bath, with entrance doors at the end of the hallway. The six apartments in the front were the same, with entrance doors from the side of the hallway into the living room of each apartment. In addition, there was a second bedroom in the front of each of these apartments, each with its own bath and separate entrance from the front porch.

All the kitchens had doors leading to small wrought-iron porches and flights of metal stairs that served as fire escapes. For the front apartments the kitchen porches were on the sides of the building. For the back apartments they were on the back of the building.

All the apartments were being rented unfurnished on yearly leases. The front (two bedroom, two bath) apartments rented for \$10 a month more than the smaller ones in back. A man had been living for many years in the front bedroom of one of the ground-floor apartments. The rest of that apartment was vacant, and so were six others. At these rents the annual income would have been less than \$11,000 a year with full occupancy.

I found this building by looking around the neighborhood and then researching the public land records. It was a likely prospect because it was obviously neglected and the owners lived in another state. Public records usually show the name and address of the person who pays the taxes, but that is not necessarily the owner. Sometimes they send tax bills to a management company and the records don't reveal the name of the owner.

You can call the company, of course, but they normally want a sales commission if you buy it. I was lucky in this case, and I got the names and addresses of the two owners from the tax records. The building obviously needed better management since 7 of the 12 units were vacant. Yet it was in a great location one block from the bus line, it seemed structurally sound, and many of the problems were cosmetic.

I knew a professional appraiser who worked for the city who agreed to look at it informally for free. I had met him before in connection with land he tried to buy at an auction. He told me three-room furnished apartments near the bus line were renting

readily. I already knew that from Tommy Dickson, who quit his job at the Post Office to devote all his time to his rental apartments.

This appraiser said it had potential, but in no case should I pay more than \$40,000 for it, and I should buy it for less if possible. "It is not a nice property," he explained.

Two sisters had inherited it when their mother died a couple of years earlier, and their husbands took a hard-line attitude about the price. I went to my lawyer, Mr. Smart, and asked him to write an offer for \$40,000, contingent on financing and a couple of other things. He protested, because he thought it was too much, but I insisted. I sent a cashier's check for \$2,000 as an earnest money deposit and asked for 90 days to close. They sent it back with a note that said they would consider a serious offer when they got one. Mr. Smart was obviously relieved that they didn't make a counter-offer, but he almost fainted when I told him to raise the offer to \$50,000.

They sent that offer back with a letter saying they would not take a penny less than the assessed valuation of \$55,000. They said I could reduce the deposit to \$1,000 and have three months to produce the rest of the cash, but there would be no contingencies except for the good title. Tommy Dickson wanted to share the deal with me, but his wife vetoed it. She did not want a partner and neither did I.

Before making another offer, I consulted various moonlighters: a plumber, a floor refinisher, a roofer, a linoleum man, and a painter. I got a free termite inspection and found there had been an infestation in the past, but there was no serious damage and there were no termites now. I got written estimates from all these moonlighters and arrived at an approximate cost to put the property in condition to rent. I had been warned not to spend too much, because I would not get enough additional rent to make a difference. And I wanted to avoid unnecessary improvements known as "gold door knobs" in the appraising trade. This means they cost extra money but add very little to the market value.

I went to my banker at the First and Merchants bank where we kept our personal account. I was lucky that he had some vision and imagination. He said that if I could get a commitment for the permanent financing he could make me a temporary loan to buy it. Then when the improvements were made, I could place the permanent loan and pay him off. He referred me to the Home Beneficial Life Insurance Company, a small, privately-owned company with headquarters in Richmond.

We still had the house in Fairfax County, Virginia, and I was sure we could sell it within a couple of months. I presented to Home Beneficial the projections for cost of improvements, rental income, and operating expenses. They said they felt sure they would lend me \$45,000 once I made the improvements and rented the apartments. They could not process a loan application, however, until I had a contract to buy it.

Next I went to Cameron Brown, a second-mortgage specialist in Richmond. The local manager had a problem with his teeth or his gums, and he had his jaws temporarily wired

together. He looked the building over and listened to my plans. He said he thought I was going to have a gold mine there. His words were like music to me, even though he had to speak them with his teeth clenched. He agreed to lend the other \$10,000 on a second mortgage once I made all the improvements and rented the apartments.

The money from the sale of the Fairfax County house was to be used for improvements. First and Merchants Bank and Cameron Brown would lend me enough to cover the purchase price and also give me 90 days to make the improvements for the permanent financing. Jeff Fell, one of my friends at the office, was keenly interested in what I was doing.

“What happens if you can’t get your first mortgage?”

“I lose my deposit.”

“What happens if you can’t get your second mortgage?”

“I lose my deposit.”

“Why didn’t you make the contract contingent on getting these mortgages?”

“I tried, but the owners would not agree to it.”

“How can you risk your deposit with no more protection than you have?”

I told him I had studied this from every angle, and I believed there was a 90 percent chance everything would work out fine. I asked him if he would be willing to bet a thousand dollars that he could pick a white marble out of a box blindfolded, if he knew there were nine white marbles in the box and only one black one. He thought about it for a long time. “I guess I would bet,” he finally said, “but I would be scared to death.” I told him I was scared too, but there was no way to be successful without taking some risks.

After doing all this, I went back to my lawyer and told him to prepare the contract for the amount of the assessed valuation with \$1,000 earnest money deposit for settlement in 90 days and no contingencies except for marketable title. He was visibly shaken when I told him. He wrote it under protest, all the time muttering under his breath as if it were his own money at risk. After the contract was signed by all parties, Tommy Dickson offered me \$1,500 cash if I would assign the contract to him.

“Boy, you are lucky,” Mr. Smart said. “You made money on it.” I told him I had refused the offer, and he just shook his head and walked off. I guess he was thinking, “That’s when two fools met.” I learned later that some other people in Richmond had been trying to buy the building at about the same time. If I had not gone ahead and paid the price, I could easily have lost the deal.

We set a below-market price on the house in Fairfax County and easily sold it within two weeks. It was much more important to have a quick sale than to milk another 10 percent out of the price. We then went to settlement on the building. The bank loaned most of the money on a 90-day note secured by a first mortgage on both the building and our home, with the home to be released from the mortgage after the improvements were made.

The building had only six parking spaces. That was all the zoning required when it was built, but the laws had since changed. The current use was allowed under a grandfather clause; but if the building had been destroyed, it could not have been rebuilt without major changes. Since a man had been living in one of the front rooms for about 15 years, using it as an efficiency unit, I went out to the city zoning authorities and asked for a new use permit to allow me to rent the six front bedrooms as efficiency apartments. The lack of parking spaces was not a serious problem, because the bus stop was one block away and most of the tenants did not have cars.

After we had the title, we had 90 more days to improve and convert the apartments in order to place the permanent financing. For that, we used the money from the sale of the house. I could buy a good used bedroom set with box springs and a mattress for a \$150, a used apartment-sized refrigerator for \$40, and a sofa, coffee table, easy chair, and two end tables for not much over \$100. I had to buy refrigerators for all the efficiencies, but the other apartments already had refrigerators and gas stoves. I learned I could buy a used but serviceable gas stove for about \$25; so if a thermostat went bad on one, I just replaced the stove instead of calling a repair service.

No cooking was allowed in the six efficiencies. But I put a small used refrigerator in each one, along with a sofa, coffee table, and a couple of chairs the sofa was a twin bed with a bolster next to the wall. With the bolster on, it was a sofa. With the bolster off, it was a bed. All six efficiencies had private baths and entrances from the front porch. They also had a door to the other bedroom, but we nailed those doors shut. That converted the building from 12 units to 18 units. Some of the tenants in the efficiencies later got hotplates, but I never had official notice of that, and I chose to look the other way.

I ran ads in the paper and bought used stuff from homes, and I went to estate sales and garage sales until I got all that I needed. I had plenty of annual leave available, so I took two weeks off from my job to do all this. I used U-Haul trailers, and sometimes a rented truck, to move stuff to all the apartments. I hired a couple of out-of-work laborers to help me.

I rented all of them furnished and by the week. That produced twice as much income as when I bought it, even if it had been full then. I owned that building eight years and got the annual income up another 50 percent by the time I sold it. I had to pay all the utility bills, but that still left a substantial profit.

The money from the Fairfax house sale paid for enough improvements to place the permanent financing. The first mortgage was at 9 percent for 15 years. That was high interest and short term, but I was happy to get it. I paid 10 percent interest on the second mortgage, and had much of it paid off before we sold. The bank used Home Beneficial's mortgage forms to make the temporary loan, and that made it easier to switch over when Home Beneficial took over the permanent financing. Cameron-Brown released the second mortgage on our home as soon as the improvements were made and the permanent financing was in place.

We refinished all the floors, repaired the roof, put inlaid linoleum in all the kitchens and baths, and painted the apartment walls. We painted everything with latex paint in oyster white. It took four coats of white to completely hide the black paint in that one apartment. Luckily, the plaster walls were in good condition throughout the building and all the electric wiring was fairly new.

We replaced the hang-on sinks with self-contained metal units by Youngstown Kitchens. They each had a sink, drainboards on either side, storage space underneath, and two cabinets above—all in one unit. In some settings they would have looked cheap and tinny; but they were inexpensive and much nicer than what was there before. I put shower rings, mounted on poles, over the bathtubs, installed shower curtains, and ran flexible metal hoses from the faucets to the shower heads.

I eventually got a personal signature loan from the bank to finish all we wanted to do and buy the rest of the used furniture. I had an adequate income to live on from my job in the Immigration Service, so we had plenty of rental income to make improvements and to repay the loans. I did all the collecting and renting for about a year, and then made a deal with one of the tenants to do that in return for free rent.

Several of the tenants let their empty bottles collect on their back porches, so I asked if they would like me to remove them. Most of them agreed. From then on, I took my kids there once a week and let them gather up all the bottles that were outside the building on the back porches. We took them to a store where the kids turned them in for extra spending money. Soft drinks came in glass bottles in those days and they charged a two-cent deposit on each bottle if you took it out of the store.

For the last four years of ownership, I lived in another city. I kept in touch with things through the resident manager, but I had a problem with him. His name was Owens, and I wondered about him from the first, because he never talked about where he came from and he always had an unlisted phone number. He was living with a woman who passed as his wife, but I sometimes wondered about that too.

Because of my concern, I bought a big receipt book that provided three copies of each receipt. They were about five inches long and three inches wide, and they were color

coded according to where each copy went. I instructed him to give one copy to the tenant, keep one copy for his records, and send the other copy to me along with the bank deposit slips.

About a year after I had moved to Washington, I noticed we were having an unusual number of vacancies. I called Tommy Dickson to see if he was having the same problem, and he was surprised by my question. He said he had no vacancy problems whatever. I then analyzed the records for the past several months, and found one apartment that showed a vacancy three times, and each vacancy lasted exactly two weeks. Other apartments had similar records.

I made a surprise visit to the building one evening and knocked on the door of that apartment. The tenant told me he had lived there for more than a year, and he had never missed a rent payment during that time. He showed me rent receipts for several months, and each one was from a little dime-store receipt book.

My manager had been keeping a separate set of books for me, and giving receipts to the tenants from a different receipt book. He reported to me only what he did not keep for himself. When he kept the money from one of the apartments, he showed it as a vacant in my records and wrote one of his own little receipts for the occupant. I later figured he embezzled several hundred dollars, and possibly a lot more.

I thought about having him arrested, but finally decided against it. His wife didn't always seem to be all there, and I was uneasy about going to court against them. Also, I had a good job in the headquarters of the immigration service in Washington. My bosses knew about the apartment building, and there was nothing illegal or unethical about it. But any legal action would have brought publicity that might have been embarrassing to the government. Any judgment I might get against him would be worthless, so I decided to eat my losses and chalk it up to experience. "If you have to eat a live frog, eat it quick."

I went to see him at his apartment one morning and told him I wanted the receipt books and all the rent money he had collected and I wanted him out by midnight that night. I told him I had conclusive evidence he had been stealing from me. And if he didn't move out by that night, I would prosecute him for grand theft. I also warned him not to take any more rent payments from the tenants. I guess he could not resist one more caper, and he collected and kept the rent from three more tenants before he left. He left no forwarding address and had his new telephone unlisted, so I suppose he thought I could not find him.

But he had lived in one of the two-bedroom, two-bath apartments on the ground floor, and I had allowed him to put a washing machine in the front bathroom on the condition that he pay his own electric deposit and pay the monthly bills himself. After he moved, he applied for a refund of his deposit. That made it easy for me to find him, and the electric company even had his phone number. When I called him at his unlisted number and told him I knew where he lived, he sent me the rest of my money at once.

After that I used a couple named Chevrette as managers, and I never had a minute's trouble with them. They rarely reported a vacancy, and even then it was usually filled within a couple of days. He worked full-time and she did not, so she was there during the day to show apartments to prospective tenants. They kept the job until I sold the building, and I recommended them highly to the buyers.

I bought that building in 1966 and sold it in 1974. I used the money from the sale of the house in Fairfax County and borrowed the rest to buy it. The income from it paid back my loans and put our oldest son through college, and I sold it for two-and-a-half times what I paid for it. The cashier's check from the sale was enough for the down payment on the 30 units I later bought in Florida.

Yet, I had to fight with my lawyer to make him submit the contracts to buy it, and I paid \$15,000 more for it than the highest price my professional appraiser said I should pay. But John Elam told me I stole it, and Tommy Dickson, who already owned several buildings, offered me \$1,500 for my contract. "Expert" advice can sometimes be wrong.

A man who had been successful in the stock market once said you cannot expect to buy at the bottom of the market and to sell at the top. He said many times he felt he had paid too much for stocks and sold them too soon. The same applies to real estate. If you buy only when you can get a price below the market you won't buy much real estate. And if you buy only property that is in apple-pie condition, you will have a difficult time increasing its market value. You have to pay prime prices to buy prime properties, and then you have to wait for inflation to raise the market value.

A man named Nickerson had the right idea in the book he wrote about 40 years ago. He said the best bargains are sound, well-located buildings that are priced lower because they need cosmetic improvements. Then, every dollar spent on improvements can add two or three dollars to the market value. On the other hand, you could spend many thousands of dollars on hidden structural repairs without making the property look any better. It is best to avoid buildings like that.

Owning an apartment building is not an easy way to get rich. One reason I am writing this is to show how much work, worry, and aggravation can be involved. If big profits could be realized by passive investments in real estate, the banks and insurance companies would own most of it. There was a saying in Florida that the footprints of the owner are the best fertilizer an orange grove could have. If he is on the scene an owner

can see the problems and take measures to correct them. The same logic applies to apartment buildings.

If there are only 30 or 40 units in an apartment building, a professional management company will take a substantial share of the profits. They will want a resident manager to show the apartments and collect the rent. They will give the manager free rent and a salary in addition. Management companies charge a percentage of total rents for overseeing the operation, and they often also charge a percentage of anything they spend on repairs and maintenance. They may hide the charges with the bills, but they will be there. Each time a faucet starts to drip, it will cost an hour's pay for a plumber to come and replace a 10-cent washer.

A large complex needs an office staffed with professional managers. It may also need a maintenance staff to take care of day-to-day problems. Even though the management costs will be significant, the percentage of these costs in relation to total income will be lower than with a small complex. Most major investors in apartments will not consider anything with fewer than 100 units, and more is better.

After we had been in Washington a few months, I heard of a job opportunity in Richmond at a higher grade than I had when I was there before. I was told I would get the job and my wife did not like living in Washington, so we went back to Richmond to look at houses. We found a house on Monmouth Court with four bedrooms, two baths, and a one-car garage, all on one level and on a tree-covered lot. It was for sale by the owners, and we negotiated with them in their living room. We were about \$1,000 apart, and I did not want to go any higher because my wife hated the chartreuse wall-to-wall carpet in the living room and I knew we would have to replace it. They would not accept my offer because they said they had just spent over \$1,000 on the new carpet. I could not tell them we didn't like it and would have to rip it out, because that would have been criticizing their taste. So I offered to let them keep it if they would accept our offer, and they agreed. They may have no use for that carpet in the future, but at least they saved face. I would have paid them to take it out if it had been necessary.

Because of some changed circumstances, I did not get the job in Richmond. So I was still working in Washington while living 100 miles away. At first, I rented a small apartment and came home on weekends and on Wednesday nights, to break up the week. In the meantime, Ken Temple, who had worked in Richmond for years, got promoted to Washington. We decided to carpool together and we commuted daily to Washington for several months, over 100 miles each way. Finally, we brought another house that was near Washington and sold the one in Richmond. We made some money on the sale, but not much.
