
LESSON 2 - VALUE ADDED REAL ESTATE

VALUE ADDED BASICS

Investors must think about the following key items in value-added investing:

- Current NOI
- Project or future stabilized NOI
- Cost to improve the property
- Occupancy (current and at stabilization)
- Lease rate (current and after improvements are completed)
- Bridge loan financing during the value-enhancement phase (also known as interim financing)
- Loan-to-value (LTV) and debt service coverage (DSC) metrics for a take-out loan or a permanent loan, after the property is stabilized
- Time required to complete the property improvements

VALUE ADDED BASICS

Value added investing allows for the opportunity to hit the real estate grand slam, which encompasses the following:

- Invest in a property
- Improve it
- Refinance out all of the equity
- Own a cash flowing asset with no equity investment

VALUE ADDED INVESTING VS. STABILIZED INVESTING

A value-added transaction always include a plan for how to make the property better and more valuable. Successful value added real estate investing is one of the greatest wealth builders available. Below is a sample transaction for a value added property:

ACQUISITION ASSUMPTIONS		AMOUNT	PSF (\$)
Purchase Price	(including closing costs):		
	Improvement Cost:	\$13,000,000	\$130
	Interest Reserve:	\$500,000	\$5
	Total:	\$400,000	\$4
		\$13,900,000	\$139

THE RULE OF SAMS

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SPONSOR:

The person doing the work needs to be qualified and honest.

ASSET:

The asset needs to have positive qualities (location, physical condition, and upside potential)

MARKET:

The market should have positive characteristics of growth or recovery.

STRUCTURE:

upside.

The investment structure should align interests and reward those taking the risk and who have the

VALUE-ADDED INVESTING – UNDERWRITING 101

The key to analyzing the market is how the perspective rents and occupancy compare to the current market. There are three main types of transactions.

The first is a **CONSERVATIVE TRANSACTION**. With this transaction, pro forma rents and occupancy are below the current market. This profile provides the most upside to the investor.

The second is **BASE CASE TRANSACTION**. Pro forma rents and occupancy are right at market. These are good transactions, but have the potential risk of market deterioration.

The final type is **PIONEERING TRANSACTION**. Pro forma rents and occupancy are above market, and the transaction needs these above-market metrics to reach its business plan. The investor should be well compensated for these transactions.

THE SECRET TO ALL VALUE ADDED INVESTING – INCREASING NET OPERATING INCOME

THE FIRST STEP IN VALUE ADDED UNDERWRITING IS TO UNDERSTAND THE BASIC NOI NUMBERS:

1. Current NOI: What is the as-is NOI?
2. Stabilized NOI: What is the NOI after all improvements are made and after all repositioning is complete?

The NOI delta or change: Every good value added investment has a significant change in the NOI; from current to stabilized.

3. Otherwise, no value is being added.