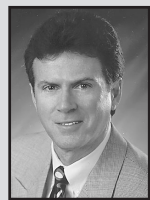


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Apartment buyer's top ten concerns of due diligence; key concerns of financial contingency

rw Upstate Apartments



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The making or breaking of any contract to acquire an apartment property usually occurs somewhere in what is called the "due diligence period". This is simply the agreed upon period of time the buyer has to inspect the property, verify the seller's information, and secure a mortgage. Due diligence is composed of the physical and financial contingencies that must be waived within the agree time period to keep the contract in effect and on track toward a closing. In the October 26, 2004 issue I covered the five key concerns of the physical contingency of a contract and now I will address the five key concerns of the financial contingency.

Time Period: It is generally considered the norm in the industry to grant the buyer anywhere from a minimum of 30 days to a maximum of 90 days to secure a mortgage commitment from a lender of the buyer's choosing. This is a negotiable point and the buyer's relationship and track record with a particular lender may often allow the buyer to secure a conditional commitment letter within a week. This conditional commitment is really just a letter attesting to the lender's willingness to fund the requested mortgage amount based upon the buyer's financials and credit history and that is all. For this letter of commitment to be converted to a for-

mal mortgage commitment, the property itself will have to conform to the lender's underwriting standards addressed further in this article. If the buyer has had no pre-history with the lender which usually speeds up the process, it is wise to require a minimum of 60 days to secure a formal written mortgage commitment with right of extension of at least two weeks in the event of delays outside of the buyer's control.

Deposit Money: The deposit money or earnest money is simply the consideration put forth as a sign of good faith to make the contract legally binding. The party holding these funds referred to as the escrow agent, can be anyone negotiated between the two parties and stated in the contract. Usually it is the attorney representing the seller, sometimes the attorney representing the buyer, and occasionally the real estate broker bringing the parties together. The amount of the deposit normally in the 1-5% of price range is also a point of negotiation. This amount in most cases is immaterial assuming the deal goes through to closing. However if it does not then a considerable amount of money could potentially be lost to the seller or frozen in the escrow account until approval from both parties is given to the escrow agent regarding its dispensation.

Lender: Know your lender! Before a buyer even begins negotiating a purchase they should already be well acquainted with at least three mortgage lenders who have already expressed a willingness to fund apartments. The buyer should also know their underwriting criterion such as: loan to value ratio or what percent of purchase price they will fund; debt coverage ratio or

what cash flow the property must generate after their debt payment is made; management fee, reserve for replacement, vacancy factor. To determine their maximum loan, lenders will impute these expense factors into the operating budget even if the seller and buyer do not. It would be a sad waste of time and money for all parties should a buyer sign a contract that could not possibly be consummated if the property cannot be funded at the price negotiated.

Qualifying: Know yourself! As important as being totally familiar with the lenders underwriting requirements, it is equally crucial that you know you are bankable. When the buyer interviews the three lenders, it is wise to begin submitting personal financial information to determine their ability to qualify for a mortgage. Lenders will want to see personal financial statements of net worth, credit rating scores, previous experience in owning and operating apartments, and ultimately bank account evidence that the buyer has the required liquid cash to close the transaction. As with the fore mentioned key concern, it would be a fruitless exercise for a buyer to sign a contract on a property totally acceptable to a lender's underwriting standards, only to fail to fulfill the financial contingency because they are not qualified for the mortgage.

Appraisal: Know your appraiser! To often this step in the process is overlooked by both buyer and seller as something of a formality over which they have no control. This can be a fatal mistake to a deal. An appraisal is nothing more than an opinion of value by someone deemed to be a professional in the industry. With all due respect to appraisers it has been my experience in twenty five years of

apartment brokerage that there is a full range in the level of professionalism in their ranks just as there is in my own industry. An appraisal is only as accurate as the talent level of the appraiser and the facts they are able to gather. The buyer frequently pays for the appraisal as part of the closing costs and therefore should have the right to choose the appraiser from the lender's list of approved appraisers. Not only should the buyer investigate the appraiser's fees but the time required for them to complete the appraisal, and their experience level with apartment valuation.

Appraisers can make or break a deal. I know that all too well as I myself recently had a sizable transaction fall apart due to a botched appraisal fraught with errors. The lender in question was a large national bank who uses in-house appraisers perhaps as a cost cutting measure but I believe this is something to be avoided by buyers. It has been my experience that private appraisal firms independent from banks are significantly more qualified in their depth of experience, have access to more data, and their judgment is not clouded by loyalty issues to an employer. To insure the appraisal meets expectations, put them in touch with your broker so that your appraiser is informed with all current market sales. Appraisers are a valued and important part of the process but they are not psychics. They need input from as many quality sources possible, so be proactive and they will appreciate it.

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