



# NEW YORK REAL ESTATE JOURNAL

Tuesday, October 26, 2004

COVERING THE ENTIRE STATE OF NEW YORK

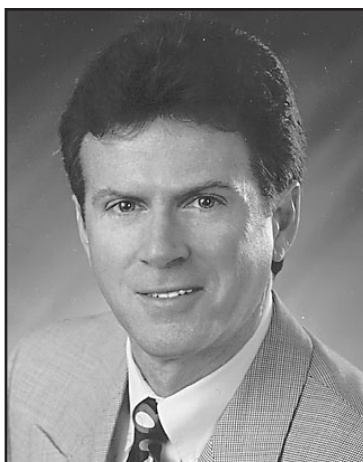
## Attention: Apartment buyer's top ten concerns of due diligence

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 agreed time period to keep the contract in effect and on track toward a closing. Five key concerns regarding the physical contingency are addressed here and five key concerns of the financial contingency will be addressed in the next issue.

**Time period:** Allow sufficient time to accomplish your inspection tasks. 14 days is typically sufficient for smaller properties (under 20 units) for instance. However for most larger buildings over 20 units and complexes with hundreds of units will require at least 30 days.

**Deposits:** The tenant's deposits held in escrow by the seller will be credited to the buyer at closing. Therefore reconcile the leases with the amounts held by the seller. The potential problem arises when vacating tenants demand return of deposits you do not possess. If records are sloppy or leases are non-existent it might take a bit more detective work. Though it is impractical to secure corroborating statements from all tenants attesting to their deposits if the property involves hundreds of units, for smaller properties it may not be too great a chore.

**Documents:** Buyers should require the following documents from



the seller: Leases & current Rent Roll must be supplied for the aforementioned deposit information but more importantly to confirm occupancy and monthly collectible revenue. *IRS Schedule E or 8825 Form* for the past 2-3 years must be reviewed to determine the performance history of the property. These statements divulge what the seller is telling the IRS regarding what it collected in annual revenues and the complete breakdown of all expenses attributable to operating the property. Since many if not most sellers tend to minimize their stated revenue and exaggerate their expenses, these statements are usually taken as a worst case scenario by a potential buyer. Frequently the buyer can expect the property to perform better than these statements portray. Never, never, never accept just a seller prepared written or typed operating statement as fact. Banks and appraisers will not accept this and neither should you.

Existing Appraisal, Environmental Study, Survey. If the seller has

any of these on hand even though dated, it is a good idea to gather them. The contractors hired to appraise the property, perform environmental reports and survey the property will be able to perform their task quicker and in most cases cheaper if they already have previous data to confirm or update.

**Inspections:** Even the most seasoned apartment buyers will rely on a professional contractor to inspect the physical premises and in some cases will use a variety of specialists for various components. Though not a complete list the areas of major concern in no particular order should be: foundation, roof, plumbing, electrical, windows, siding, appliances, furnaces-A/C-water heaters, and paving. In addition to the functional status of these components, inspectors should be looking for moisture, wood rot, and pest problems. Pulling a code violations report from the local municipality is wise and requiring the seller to supply any code compliance certificates if required by local law is a must. Here is a word of caution about choosing an inspector. Frequently residential home inspectors are used if the property is smaller or there are no commercial property contractors available. Because they usually represent the interests of someone about to move into the property as their home, they tend to be overly fussy about GFI switches, dripping faucets and other details that may be important to a home owner but not to an apartment investor. If you must use them, instruct them to focus on the big picture and forget about the small stuff. Otherwise they may take all day making long

lists of minor flaws and minutia jeopardizing the deal while running up their fee.

**Environmental:** Although just another physical inspection and report it really should be considered a third contingency because of its magnitude and importance to closing the deal. Your lender will require a satisfactory report to fund your mortgage, plain and simple. If they are not happy with the environmental report neither should you and even if could pay cash for the property, don't! Unless the environmental concern can be corrected, you would be buying a property that nobody else would ever want to buy from you. The majority of environmental reports range from a simple disclaimer form filled out and signed by the seller disavowing any knowledge of pre-existing environmental hazards, to a cursory walk-through inspection by a bank representative, to a Phase I inspection which involves a site visit by a professional. In most cases nothing of consequence is found but if some evidence of asbestos, lead paint, underground fuel tanks, or mold is found then the next Phase II inspection starts to get expensive and may call into question the practicality of going ahead with the contract under the current terms. Other than securing a suggested Alta survey, marketable title, and a warranty deed at closing the five aforementioned guidelines should keep apartment buyers from making any major mistakes in their next acquisition.

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