

financial

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Hitting the Sweet Spot in Real Estate

Invest Wisely & Avoid Liability



Wise buyers of apartments should know about the mid-'50s-early-'70s "sweet spot" and how to minimize liability, save money on insurance, and make financing easier to get. A comprehensive approach, including all of the significant factors – price, tenant profile, location, building design and materials, building condition, and the lot on which the building is located – is necessary.

The "sweet spot" involves toxic materials, or more specifically, their absence. The use of lead-based paint declined rapidly in the '50s as latex paints replaced oil-based paints. Lead-based paint is rare in the '60s. It evaporated by the mid '70s. The peak usage period for asbestos in buildings is the mid '60s-late '70s as drywall replaced plaster. Significant asbestos usage ended by 1990.

Savvy buyers can buy some older buildings that contain little or no asbestos, and little or no lead-based paint, taking advantage of the fact that many people incorrectly assume that their buildings are loaded with lead-based paint and asbestos. If you

know the difference, you need not suffer the added expense of dealing with those toxic and highly-regulated materials, will not need to worry about the increasing interest of insurance companies in lead-based paint, and will not suffer decreases in value caused

Prudent buyers will not be bullied or sweet-talked into skimping on due diligence. Some real estate agents have actually discouraged adequate due diligence, claiming that "ignorance is bliss." Good luck with that. What will buyers who fail to perform adequate due diligence do when they encounter savvy insurers, lenders, and future buyers? Sellers also are wise to conduct due diligence investigations prior to listing their properties, rather than being at the mercy of buyers with good consultants.

by increasing regulation and awareness of those materials.

The best way to find out what materials are present is to have a good consultant inspect the building during the pre-purchase, due-diligence period.

If you buy a toxic-laden property, you can be on the hook for the entire cost of cleaning it up, even if you have only owned it for a short time. A Phase I Environmental Site Assessment is vital to avoid liability for owning or having owned a property with soil or groundwater con-

tamination. ASTM International's E1527-05 standard and the Environmental Protection Agency's All Appropriate Inquiries regulations lay out the procedures to properly perform pre-purchase due diligence (www.astm.org/Standards/E1527.htm). I'm actively involved as a member of task groups working to revise these standards. Be sure to demand that a person qualified as an "Environmental Professional" performs the site inspection and analysis, not beginners or trainees.

You may choose to buy a building with defects, plumbing, electrical, roofing, pavement, and such, but you certainly want to know about the problems before you buy. I helped write the original ASTM E2018 standard for Property Condition Assessments, which involve visual inspections of a building and building systems (www.astm.org/Standards/E2018.htm). Some buyers bring in specialists to perform testing, especially in larger and more complex structures.

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While many contractors are capable of performing good evaluations, some may focus on items that are most profitable for them to address. A third-party consultant has no such biases.

In another vein, a seismic evaluation by an appropriate engineer, a specialist, is an inexpensive way to avoid buying into that kind of a shaky expensive liability. Many lenders and insurance companies demand seismic evaluations.

Some people mistakenly believe that a building that has survived many past earthquakes is fine. They ignore the fact that there has not yet been strong ground motion in the area in which it is located. While some cities require basic retrofit work on unreinforced masonry (brick and block) buildings, many concrete-frame buildings can crumble catastrophically. Wood-frame buildings over flimsy crawl spaces also need to be retrofitted to avoid collapse.

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consultants.

Once a potential buyer conducts an investigation and the report is shared with the seller, they must disclose the findings to other potential buyers. It is difficult to imagine a seller who wants to encounter difficulties with toxic materials or property defects during a sale, rather than planning and managing to best position the property prior to listing it.

Proper due diligence is not expensive, and saves multiples of what it costs. For example, a platinum Phase I Environmental Site Assessment, Property Condition Assessment, Asbestos Survey, Lead-Based Paint Inspection, and seismic evaluation of a \$7.2 million, 36-unit building built in 1969 should only cost about \$12,000. The best way to save money on due diligence is to hire one company that provides the full range of services needed, and to hire a small or medium-size company.

Knowledge is power in real estate investing, and proper due diligence to investigate buildings and property is a key factor in successful investing. The advice of a good consultant will give you a significant competitive advantage in buying the best buildings at the best prices.

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