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A MILLION IN MULTI-FAMILY

Paul Kondakos illustrates how aggressive investing in the multi-family market can hit the take you to the $1m summit

THE CASE STUDY:

Maria has been on the property ladder for a few years and although she wants to make that million-dollar list, she also wants to acquire just a few buildings that can be managed by others while she keeps her day job. She earns $70,000 annually. She already owns a condo in Mississauga, Ont., that is mortgage-free and currently valued at $250,000. She also owns a single-family home with a basement suite in Scarborough that generates $2,500 in rental income. The property was bought in 2009 for $300,000 at 80 per cent LTV with a 30-year loan term at 3 per cent. The property is currently valued at $500,000.

We must first analyze Maria's financial position to identify her assets, liabilities and cash to establish how much equity she has available to invest in multi-family.

1 EQUITY AVAILABLE IN RENTAL PROPERTY (SCARBOROUGH)

CURRENT VALUE: **$500,000**

CURRENT MORTGAGE: **$215,000**

NEW MORTGAGE: **$400,000**
(re-finance at 80% LTV on 5-year term, 30 year amortization at 3% interest rate)

EQUITY AVAILABLE: **$185,000**

*After the re-finance, the new mortgage payment will be approx. $1,680 per month. Even with the re-finance, the rental property will remain cash flow positive after all expenses and mortgage payments.

2 EQUITY AVAILABLE IN PRINCIPAL RESIDENCE (MISSISSAUGA)

CURRENT VALUE: **$250,000**

CURRENT MORTGAGE: **$0**

NEW MORTGAGE: **$200,000**
(re-finance at 80% LTV on 5-year term, 30 year amortization. at 3% interest rate)

EQUITY AVAILABLE: **$200,000**

*After the re-finance, the new mortgage payment will be approx. $840 per month. Maria should be able to easily service this debt with her $70,000 annual salary.

After re-financing both of her properties, Maria will have access to $385,000 to fund her real estate investment plan.

THE PARAMETERS

Why Multi-Unit Residential Property (MUR)?

The benefits of the MUR are that it contributes to investor wealth in three ways, primarily cash flow, mortgage pay-down, and appreciation.

The best markets for such properties are in small urban centres with strong fundamentals as high prices in most of the major cities have impacted both on cash flow and cap rates. Maria should focus on cities within Ontario, such as Hamilton, Barrie, Kitchener-Waterloo, Guelph, Cambridge, Durham Region and Kingston.

These areas offer higher cap rates (6 to 7 per cent) which will translate into stronger cash flow. MUR's in these areas tend to sell for approx. $90,000 per door, translating into a purchase price of approx. $1,080,000.

1 Invest in a 12-unit MUR

The mid-size MUR typically offers better cap rates and stronger cash flow than smaller MURs, such as duplexes and triplexes. This allows the investor to hire a superintendent and/or property manager to manage the property should they choose not to manage it themselves.

Maria should use one of two methods for enhanced leverage. It can be a vendor takeback (VTB) where the seller holds up to 10 per cent of the purchase price as a second mortgage or CMHC Insurance, where the investor, after paying an insurance premium (which is added to the mortgage), can put down as little as 15 per cent on their purchase. In both scenarios, the goal is for our investor to only put 15% down.

Maria now needs to find a property that fits the following parameters;

- **Size:** 12 units
- **Price:** ~$1,080,000
- **Down Payment:** 15% (achieved with either VTB or through CMHC insurance)
- **Area:** Smaller urban centre in Ontario with strong fundamentals
- **Cap Rate:** 6.5%+

* This is an overly simplistic guideline which doesn't take into account other important factors such as location, age of property, condition, tenant profile, etc.

THE STRATEGY

Based on the above parameters, Maria has enough capital to purchase two 12-unit MURs. She should purchase the two properties six months apart to get acclimatized and comfortable with the first property before moving on to the second one.

① PURCHASE 12-UNIT MUR PROPERTY

PURCHASE PRICE: $1,080,000
DOWN PAYMENT (15%): $162,000
VTB (10% - INTEREST ONLY PAYMENTS): $108,000
MORTGAGE: (75% LTV at 5-year term; 25 year amortization 4.5%): $810,000
CLOSING COSTS: $28,000
POSITIVE CASH FLOW: $1,500 per month
APPRECIATION: 2% per year

TOTAL CASH REQUIRED: $190,000

② PURCHASE SECOND 12-UNIT MUR PROPERTY

PURCHASE PRICE: $1,080,000
DOWN PAYMENT (15%): $162,000
CMHC INSURED MORTGAGE: (85% LTV at 5 year-term; 25 year amort at 2.7%) $959,000*
CLOSING COSTS: $33,000
POSITIVE CASH FLOW: $1,500 per month
APPRECIATION: 2% per year
*Includes CMHC insurance premium

TOTAL CASH REQUIRED: $195,000
TOTAL INVESTMENT (Property No. 1 and No. 2): $385,000

RESULTS IN 5 YEARS

INVESTMENT PROPERTY NO. 1

MORTGAGE PAY-DOWN: $99,000
APPRECIATION: $108,000
CASH FLOW: $90,000
WEALTH CREATION: $297,000

INVESTMENT PROPERTY NO. 2

MORTGAGE PAY-DOWN: $103,000 (adjusted for CMHC premium)
APPRECIATION: $110,000
CASH FLOW: $90,000
WEALTH CREATION: $303,000

In just five years, Maria is on her way to her first million. Each investment property generated approx. $300,000 in real estate wealth for a combined total of $600,000.

Both mortgages have matured through this period and so it is an ideal time to re-finance and draw capital to make a further acquisition to generate $1 million.

REFINANCE PROPERTY NO. 1

Maria will be able to draw approx. $180,000 in equity through re-financing. She will have to pay back the original VTB of $108,000, which will leave her with $72,000 to use towards next purchase.

VALUE AFTER 5 YEARS: $1,188,000
MORTGAGE AFTER 5 YEARS: $711,000
VTB: $108,000

NEW MORTGAGE: (75% LTV – 5 yr term, 25 yr am, 5%) $891,000
PAYBACK VTB: $108,000
REMAINING FUNDS: $72,000

REFINANCE PROPERTY NO. 2

Maria will have to pay a CMHC premium for the additional equity drawn from the property which will be added to her mortgage. She will be able to draw approx. $195,000 in equity from the re-finance.

VALUE AFTER 5 YEARS: $1,188,000
MORTGAGE AFTER 5 YEARS: $815,000
NEW CMHC INSURED MORTGAGE: (85% LTV – 5 yr term, 25 yr am, 3.5%) $1,020,000*
REMAINING FUNDS: $195,000

*Includes CMHC insurance premium

TOTAL CAPITAL AVAILABLE FROM BOTH INVESTMENT PROPERTIES AFTER RE-FINANCE: : $267,000

ACQUIRE PROPERTY NO. 3

With the $267,000 through re-financing, she can purchase a 15-unit MUR.

PURCHASE PRICE: $1,500,000
DOWN PAYMENT (15%): $225,000
CMHC INSURED MORTGAGE: (85% LTV – 5 yr term, 25 yr am, 3.5%) $1,332,000*
CLOSING COSTS: $35,000
POSITIVE CASH FLOW: $1,800 per month
APPRECIATION: 2% per year

*Includes CMHC insurance premium

RESULTS IN 8 YEARS

PROPERTY NO. 1

VALUE: $1,235,000
MORTGAGE: $832,000
EQUITY: $403,000
CASH FLOW: $144,000
EQUITY + CASH FLOW: $547,000

PROPERTY NO. 2

VALUE: $1,235,000
MORTGAGE: $939,000
EQUITY: $296,000
CASH FLOW: $144,000
EQUITY + CASH FLOW: $440,000

PROPERTY NO. 3

VALUE: $1,560,000
MORTGAGE: $1,226,000
EQUITY: $334,000
CASH FLOW: $65,000
EQUITY + CASH FLOW: $399,000

Total equity + cash flow: $1,386,000
Subtract initial investment: $385,000
Total wealth generated: $1,000,001

While an aggressive plan, Maria was able to achieve her $1 million benchmark in just eight years.