

**REAL ESTATE
ASSET ENHANCEMENT PROGRAM
*MULTI-FAMILY***



*A CASE STUDY FROM
AMERICAN REALTY
ADVISORSSM*



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REAL ESTATE ASSET ENHANCEMENT PROGRAM

MULTI-FAMILY

PACIFICA, CA

Investment Background

In 2006, American Realty Advisors made a \$21.4 million equity investment to acquire and interest in a 260 unit 163,410 square foot multi-family property located in Pacifica, CA. The property is located just south of the city of San Francisco. Situated on a bluff directly on the Pacific Ocean, it offers unobstructed ocean views and convenient access to major employers on the peninsula and in Silicon Valley. The site is a distinctive community in an irreplaceable location with direct beach access and is the only large beachfront property between Marin County and Santa Cruz. The investment was made on behalf of American's closed-end value commingled fund, the Building for America Fund III.

At the time of investment, the city of Pacifica had only nine apartment properties with greater than 60 units, for a total of 1,124 units with an average age of 30 years. The common theme for development planning in this coastal area is one of controlled residential growth, the need to protect open space, and limited new construction to avoid the adverse impacts generated by increased traffic.

Pacifica enjoys an affluent demographic profile. In 2005, the average family household income within a one-mile radius of the property was \$104,882 and demographics are expected to move from a younger to an older profile with household incomes in excess of \$150,000 annually. A survey of the residents' average income revealed it was between \$75,000 and \$90,000 annually, and that in-place residents could easily qualify for post-restoration rental rates.

Recognized Value Opportunity

The property presented a substantial value-added opportunity. It was purchased by the prior owner for tax-planning purposes and lacked a renovation plan, so the upside potential of the location

had yet to be recognized. American proposed to reposition the asset as one of the premier oceanfront communities in the Bay Area, receiving a complete upgrade to both the exteriors and unit interiors. Interior improvements plans included adding washer/dryers to all floor plans, slate and marble entries, granite countertops, stainless appliances, new windows, and two-tone paint. Exterior improvements featured new roofs, architectural enhancements, a new color scheme, glass enclosed patios, an infinity pool, a remodeled clubhouse and fitness center, upgraded drainage and landscaping, a business center, and wireless internet. Post restoration pro-forma rental rates were projected below those achieved during the 2000-2001 peak and at investment rent levels that were approximately 30% below historical averages.



Strategy Implementation

Financing was accomplished through a national bank, which provided first mortgage of \$31 million in two phases, for acquisition and subsequent renovation, at LIBOR +1.5%. This enabled American to use short term aggressive-term financing to enhance the projected return on investment through positive leverage. The loan had an open prepayment option to preserve maximum flexibility for an exit strategy of sale or recapitalization, depending on interest rate changes. At closing, American chose to mitigate its interest rate exposure by swapping the loan for a two-year period, thereby fixing its cost at a (now) below market rate of 5.49%.

Shortly after acquisition, a template for all unit interior renovations was completed and work began renovating all vacant units to provide management with a supply of units to market to existing and prospective residents. A resident function was held to allow existing residents to tour the renovated interiors and sign up on a waiting list

to transfer. All of the deferred maintenance identified during due diligence were immediately addressed simultaneous to interior unit renovations. Management re-evaluated the entire marketing program and established a new aggressive strategy that catered to targeted demographics for the post-restoration property. Each area of the renovation upgrade program (interiors, exteriors and common areas) was evaluated from a return-on-cost perspective and the initial plan was adjusted to maximize investor returns through targeted upgrades that would generate the highest rent premium.

As with most renovations, the initial turns were slower until the unit renovation process was fine-tuned and accelerated, by forcing turnover, to progress through the renovation. As unit turns built up critical mass and the exterior and common area improvements were completed, it became easier for management to justify the significant rent increase for post-restoration units. Market rents at the property were increased from \$364,780 at acquisition to \$430,805 currently; an increase of 18%, reflective of impact of the renovation.

During the repositioning of the asset, demand from large investors for multi-family product in the San Francisco Bay Area sharpened, significantly increasing the exit pricing expectations and altering the planned holding period. Due to the vintage of the asset and the demand for value-added transactions, it was determined that optimal pricing would be achieved by marketing the asset with all common area and exterior renovation complete but with only 65% of the unit interiors complete. This strategy allows a prospective buyer to position the property as a value-add transaction and helps to justify strong disposition pricing.

With this strategy in mind, management ceased renovating units in January of 2007 to allow for a lease-up of the property from the low 80% range, due to units offline during construction, to a market level occupancy. Once renovation of the units was halted, occupancy increased to its current level of 97% in a short period of time. Prospective buyers were able to see the significant increase in collections and gain "buy into" to the future potential of the property with strong market conditions and through completion of the already proven interior renovation. As a result of the renovation, total monthly collections were increased from \$297,000 to \$405,000 currently, representing an increase of 36%. The asset is currently being marketed

for sale with the expectation of a gross profit of \$6.5 million over the investment cost upon sale.

American Realty Advisors

American Realty Advisors, a California corporation, is an SEC-registered investment advisor under the Investment Advisers Act of 1940 and a leading provider of real estate investment management services to institutional investors. With more than \$3.4 billion in gross assets under management (excluding partners' share of equity and partners' share of debt on partnership investments) as of September 30, 2009, American has provided real estate investment management services to institutional investors for over 21 years utilizing core and value-added commingled funds and separate accounts.

The Firm's portfolios include office, industrial, multi-family, and retail properties nationwide. Additional information regarding American can be found online at www.americanreal.com.

In addition, American is a significant originator of debt financing for real estate investments utilizing various structures from senior debt to highly structured mezzanine or preferred equity formats, secured by mortgages or other interests in real estate. We believe there is substantial market opportunity for structured financing lending due to a fragmented and underserved market. Our conservative cash flow underwriting, proactive investment management and ability to structure transactions has produced superior risk-adjusted returns on behalf of our clients.



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