HOW TO MAKE A MILLION

Cash flow is a nice bonus, but true wealth starts with equity. *CREW* asked four seasoned investors for their strategies for supercharging equity build-up, challenging them to turn $100,000 in capital into $1 million in equity in 10 years or less

Equity is where it's at. In terms of manoeuvrability, greater access to credit and boosting net worth, the more equity you have built up in a property – or properties, ideally – the better off you'll be. But building equity requires time and, in the case of sweat equity, considerable effort. It's the warm, inspiring light at the end of what can seem like an interminably long tunnel.

To help speed your journey from one end of that tunnel to the other, *CREW* asked four passionate, successful investors to share their strategies for intensifying equity build-up. We gave them each a theoretical nest egg of $100,000 and asked them to turn it into $1 million in equity in 10 years or less.

Their strategies make up what is arguably the most diverse edition of "How to Make a Million" *CREW* has ever produced. There's something here for everyone, from novices to seasoned vets. One of them might just be your ideal path to building the kind of equity that allows you to live life on your terms.

HOW TO MAKE A MILLION ...

WITH COMMERCIAL MULTI-FAMILY DEVELOPMENT

Chris Thorne, the owner of Winnipeg-based Spruce Properties, outlines how experienced investors can supercharge their portfolio by overseeing the development of a brand-new apartment building

Chris Thorne

Commercial multi-family development is not for the first-time investor. It's best suited for investors with a few years of experience under their belt – someone who has done a few flips or smaller builds and has at least a basic understanding of construction, financing and deal analysis.

However, a successful development project like the one I'm about to describe can give you a brand-new property designed and built to your specifications that requires very little to no capital in the deal, excellent monthly cash flow, and strong appreciation and mortgage pay-down. (One important thing to note is that banks consider multi-family properties with five or more doors to be commercial and four doors or less to be residential. This is an important distinction when it comes to financing.)

In order to turn your $100,000 of starting capital into $1 million in equity in 10 years, you will likely need to contribute the full $100,000 to the first project and team up with a JV partner who can bring the rest of the cash required. Once you've built a track record in development, you can start asking future JV partners to fund the entire deal.

Step 1: Site selection and deal analysis

Before selecting a site for your project, you will need to familiarize yourself with the development landscape in your local community. Find out who the players are and ask them for a coffee; drive or walk the neighbourhood and look at how projects are designed; check your municipality's development applications to see where upcoming developments are happening; and become familiar with your local zoning bylaws. I would also encourage you to do some basic deal analysis on teardowns and vacant land opportunities so you get the experience under your belt, even if you're not ready to buy yet.

You should also talk to builders, developers and Realtors in your area to get some of these figures for your local market:

COST PER UNIT/DOOR FOR LAND. This is a rough cost per unit that developers in your area are willing to pay based on the potential of a project. For example, a developer might be willing to pay only $20,000 per door in a rougher area, but they might be willing to fork over $50,000 per door in a nicer area.

CONSTRUCTION COSTS PER SQUARE FOOT. This is a good way to do a quick calculation of what a building will cost, even if it is an oversimplification and there are a lot of other factors that affect the cost. For example, for a basic wood-framed building with entry-level finishes, the cost per square foot might be $150, whereas an upgraded wood-framed building with a better building envelope and upgraded finishes might cost closer to $200 per square foot.

INCOME AND EXPENSES FOR THE LEASED PROPERTY. It's important to have a realistic picture of what the incomes and expenses will be once your property is completed. Be conservative with your numbers, but not so conservative that the project looks bad.

Once you've given yourself this basic education in development in your area, it's time to start looking for a site. I suggest using a deal-finding strategy that you're comfortable with already, whether it's working with a Realtor, sending letters or door-knocking. You can be successful finding properties suitable for multi-family development in a variety of different ways.

The key to finding a deal is to recognize areas or streets where your municipality will support the type of multi-family project you want to undertake. From my experience, it's best to take the path of least resistance, especially in terms of risk, and to make sure your municipality will be fully supportive of your project from the start.

Let's say you find a run-down single-family home on a busy street where there are other multi-family projects up and down the block already. You talk to the city planners, who confirm they would support up to five residential units on the site. You then get the property under contract for $105,000, including closing costs, with you contributing $52,500 and your JV partner contributing the other $52,500.

It's not uncommon for the planning phase of a development project to take longer than the actual construction. Stay patient, have a plan, and you'll eventually reach your objectives

Step 2: Planning

Now that you've got your first development project under contract, it's time to make things happen. The planning stage is your opportunity to set your project up for success. It's not uncommon for the planning phase of a development project to take longer than the actual construction. Stay patient, have a plan, and you'll eventually reach your objectives.

To start with, you'll be hiring a designer familiar with your municipality's requirements to create a basic plan for your project. Once you have this plan, you can formally apply to your municipality for any changes to the property that will be required for your development. This could include subdividing or merging your property, varying the yard setbacks, parking requirements – any number of things. Remember, you should have already spoken to your municipality about your project, so the only negotiations at this stage should be about smaller details like landscaping and exterior finishes.

Once these changes have been approved by the municipality, your designer can complete the permit set of construction drawings, and you can submit your demolition and building permit applications.

Another important thing to consider is that municipalities have different requirements for additional plans, reports or testing as part of your development application. This might include things like asbestos testing and removal, geotechnical reports, environmental testing, land drainage – the list goes on. Make sure you are aware of these requirements, how long they take to complete and what order they need to be completed in.

Once you have your final set of construction drawings, you can decide how you would like to manage the construction of your project. I recommend having a few general contractors bid on the project. Don't necessarily go with the lowest price. Consider their track record, the quality of their builds and your instinct on whether they're a good fit. For this example, let's say you select a well-known local builder with a strong track record who submitted a fixed-price bid of $570,000. You'll also need to put aside $30,000 as a contingency fund.

The final stage before you can begin your project is to arrange for construction financing. Basically, this is short-term financing where you pay interest on the funds, which are advanced to you by the bank as predetermined milestones of the project are completed.

Once you have your permits approved, construction financing in place and a plan to execute the construction of your project, you're ready to start building.

Step 3: Construction

During the construction phase, remember to maintain realistic timelines and budget expectations and have a contingency plan in the event your project goes over schedule or over budget, which is not uncommon in development. Developments can falter or fail for a number of reasons, and exhausting your cash reserves during the build is certainly one of them. You'll want to ensure you're able to comfortably fund the project between construction draws (payments from your lender), meaning that it might be necessary to carry the cost of the project up to the predefined stages like completion of the foundation, framing, electrical and plumbing rough-ins, and so on.

As construction begins to wind down, you'll need to start planning for the final stage: leasing the property and arranging for your take-out (long-term) financing.

Step 4: Lease up and apply for take-out financing

Depending on the size of your portfolio and your other obligations, you can choose to either self-manage your new multi-family building or hire a professional property manager. I recommend hiring a property management company so you can focus on growing your portfolio by investing in more development projects.

Regardless of who manages your property, I recommend that you do everything you can to elevate your suites above others in the market. By having a show suite, you will be able to tour prospective tenants through a finished space, helping to sell them on the dream of living in your building. Also, using a professional photographer and staging company is relatively inexpensive and the best way to position your property in the marketplace. Having professional photographs of a staged suite for online ads will ensure your suite shines above others. Remember, you have these photos forever and can use them again when vacancies come up.

Once you've leased a certain percentage of suites and have the signed lease agreements to prove it, you can apply for your take-out, or long-term, financing. This is where the bank's distinction of commercial versus residential multi-family financing is crucial. With commercial multi-family (five or more units), you're able to access CMHC-insured financing, which has very attractive rates and terms.

Property 1 after completion

Land and closing costs	$105,000
Direct costs	$600,000
Soft costs	$50,000
Total project cost	**$755,000**

Rent roll	$67,512
Operating expenses	$20,952
Net operating income	**$46,560**

As you can see from the table below, the CMHC-insured financing option is the clear winner if you're trying to build a large portfolio. With this project, you only leave $11,250 of capital in the deal, allowing you to take nearly all of your and your investor's capital and roll it into the next project. Additionally, you have created nearly $95,000 in equity, which will grow over time as the property appreciates in value and the mortgage is paid down. The positive cash flow of $14,000 per year also adds to your already strong returns for the property.

By continuing to follow this strategy and taking on a new project every other year, you can comfortably turn your initial $100,000 investment into $1 million within 10 years.

Traditional financing versus CMHC

	Traditional financing	CMHC-insured financing
Appraised value	$875,000	$875,000
Mortgage amount (75% LTV)	$656,250	$782,796.88
Interest rate	4.25%	2.75%
Amortization	25 years	40 years
Total yearly mortgage payments	$42,661.88	$32,288.29
Cash remaining in deal	$98,750.00	$11,250.00
Annual cash flow	**$3,898.12**	**$14,271.71**
Cash-on-cash return	**3.95%**	**126.86%**

Commercial multi-family: the 10-year strategy

TOTAL EQUITY VALUE AND CASH FLOW										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Project 1: Five-plex	$0	$67,750	$82,650	$97,535	$113,400	$129,300	$145,550	$162,200	$179,150	$196,500
Project 2: Six-plex	$0	$0	$0	$135,000	$158,900	$182,400	$206,400	$230,900	$255,950	$281,550
Project 3: Eight-plex	$0	$0	$0	$0	$0	$180,000	$211,867	$243,200	$275,200	$307,867
Project 4: 10-plex	$0	$0	$0	$0	$0	$0	$0	$135,500	$165,300	$195,070
Project 5: 12-plex	$0	$0	$0	$0	$0	$0	$0	$0	$0	$270,000
	$0	**$67,750**	**$82,650**	**$232,535**	**$272,300**	**$491,700**	**$563,817**	**$771,800**	**$875,600**	**$1,250,987**