

# The Apartment Group

## MEMORANDUM

To: Clients of The Apartment Group (TAG)  
From: Jeff Price  
Date: Updated November 10, 2009  
RE: **MULTIFAMILY PROPERTY OPERATIONS - TAG RECOMMENDATIONS**

I decided that it made sense to update this memo given our experiences of the past year or so. While there are not substantive changes to the content of this memo, I thought it made sense to reaffirm certain concepts and amend others. Hopefully some of our thoughts/concepts are beneficial to you!

Texas appears to have caught the same operational cold as most of the rest of the country, although to a much lesser degree. Many properties are challenged by new construction, a shrinking of the universe of available residents, and the incessant shopping of properties by residents as they attempt to craft the best economic deal. For some, property operations are steady with no signs of significant deterioration in performance. We recently marketed and sold a property in Plano in which effective rental rates improved during the sales process. Multifamily properties in many submarkets have been adversely impacted by the economic contraction as the result of continued job losses.

On a positive note, while property operations will be difficult for the next 12 to 18 months, given the lack of new construction starts and hopefully some modest job growth, the future for multifamily looks very bright. Please see my October 21, 2009 memo to TAG clients entitled "DFW Housing Shortage" which can be found on the TAG web site.

Some of the more likely impacts to property performance are:

- Diminishment of resident traffic.
- Lesser qualified prospective residents.
- Residents' tendencies to double-up to save money.
- Higher delinquency rates.
- Greater use of locators.
- Increased use of concessions.
- Lower occupancy rates.
- Higher advertising costs.
- Higher turnover and related costs.
- Higher employee turnover.

I recognize that it is easy for me to make suggestions relative to operational procedures and philosophy (many of which may be obvious) from the confines of an office. Nevertheless, I do not like watching owners unduly impair the value of their assets by employing interim fixes which often have very negative long-term implications. My overriding philosophy is that owners should do all reasonably possible to sustain and enhance the fiscal performance and physical integrity of their properties.

Some ideas for your consideration:

- **Leasing Agents:** Expend extra effort in re-training leasing agents to deal with a “renters’ market”. Too often leasing agents merely sell the rental rate (or concession as the case may be) rather than the virtues of the property. While most renters will be price sensitive, it is worth the effort to distinguish your asset from the competition and extol the virtues of living at your property. Believe it or not, some residents would prefer not to move on a recurring basis.
- **Lease Terms:** Longer lease terms should be considered particularly for one-bedroom units (or correspondingly, those units with high exposure or high turnover). Doubling-up will likely accelerate, freeing up more one-bedroom units. Further, rent growth during the next 12 to 18 months will be virtually non-existent or limited, at best. 18+ month leases should be part of the program, irrespective of the leasing software that you employ. Longer lease terms can mitigate some of the costs of turnover.
- **Marketing:** Many properties often respond to a lower level of traffic with more lease concessions, which is the wrong response in most cases. Lower traffic does not necessarily reflect incorrect pricing. Further, locator fees are increased as well. While higher locator fees may stimulate some additional traffic, marketing efforts by the staff seem to make the most sense. After all, if traffic is slow, the leasing staff has time on their hands.

Maintaining vacancies in rent-ready condition is important to the process and units need to be in impeccable condition to ensure opportunities with prospective renters are realized in new leases.

- **Impact of Technology:** Between 75% and 80% of prospective residents screen properties via the Internet before they physically come to the properties. Competitive environments demand that property management companies advertise in the most effective electronic leasing services, as well as have the most effective, user-friendly and captivating web sites for potential residents to browse. Statistically:
  - 90% of people researching rental information use the Internet as a resource versus 50% for print guides.
  - 189 million Internet users in the United States.
  - 78% of people say the Internet is the most useful source of rental housing information.
  - 66% of all renters have Internet service at home.
  - Prospective renters viewing current apartment availability online increased 144% from 2005 to 2007.

*(Thanks to Richard Furr and his team at The Milestone Group for this concept!)*

- **Qualifying Prospects:** While it may be tempting to meet the market relative to securing new leases from otherwise unqualified prospects, resist the temptation at all costs or it will cost you in the end. First and foremost, lesser qualified residents (from an income perspective and rental payment history) know that they are not qualified and therefore have less of a stake in maintenance of the unit and paying their rent on time or in full. Do not buy a problem. Measure the cost of vacancy versus the higher turnover rate exhibited by unqualified residents.

Most importantly, how do unqualified residents adversely impact your qualified residents? How do they impact your ability to garner qualified residents? I recognize that in economic downturns a higher percentage of resident traffic is unqualified and if you turn everyone down, your occupancy wanes. Develop a back-stop method beyond income qualification that enables you to make certain rare exceptions.

- **On-Site Staff:** I think that we can all agree that management often has expectations that exceed the capabilities of their on-site staff. Clearly, the challenges of leasing, rent collection and physical maintenance of properties will be exacerbated by a slowing economy, and now you must ask the staff to go above and beyond the norm. Paycheck to paycheck employees are already nervous about their ability to pay their bills every month coupled with the concern of losing their job. Therefore, increase the bonus program based upon whatever metrics are important to you. The prospect of a bigger bonus (maybe as much as the actual realization of it) should give them a boost; it also tells them that they matter to you! The next 12 to 18 months appear to be the most significant challenge to property operations. The staff needs to bring their “A game” with a lot of support from supervisory staff.
- **Rent Roll Management:** While many employ the Yieldstar or LRO systems, management of the rent roll during the next few years is of critical import. As a broker, dealing with a messed up rent roll is hard to overcome during the sales process, and rent rolls that are messed up often take years to untangle. The primary components in my mind are lease expirations, exposure and concessions, all of which will be challenging to manage as the market softens.

Maintaining your corporate standard for lease expirations should not be abandoned. Once the expirations get out of kilter they are difficult to realign. Some modest fudging can usually be overcome. Sixty (60) day exposure in a normal market is usually optimal at 10% or less. Why would it be different as the market weakens? Do all that you can to keep this number in check as it will forestall or potentially eliminate a significant deterioration in performance.

Concessions are an easy fix to every ill that a property suffers; they can also be a drug which is difficult to quit using. I am not suggesting that slower traffic volume and a lesser qualified resident pool does not necessitate capturing your fair share of qualified residents. Merely recognize that you are changing the rent roll dynamic for as long as leases with extra concessions exist. Concessions are the biggest impairment to real estate values, in many cases having a more decisive impact than vacancy. While you cannot reasonably allow vacancy to get out of hand, consideration should be given to operating at a lower occupancy rate versus offering excessive concessions. Once again, easy to say, hard to do.

While savvy residents will likely want prorated concessions, up front concessions are far easier to unwind and far easier to sell around in the future. Cash remuneration or gift cards in lieu of a specific lease concession should be tested early on in the process; still a concession, but one time. Inevitably, some owners will be forced to offer prorated concessions, or in essence lower their rental rates. Try offering a prorated concession for a lesser time frame than the lease term in an attempt to wean the resident off the concession.

- **Resident Turnover:** I believe that resident turnover adversely impacts virtually every line item on the P & L. High turnover often keeps owners from realizing their budget, places greater physical stress on the property, and is generally very expensive. Each unit that turns often costs the owner in excess of two months' rent for that unit, maybe even more given the high level of new lease concessions at some properties.

While increased renewal concessions are generally unappealing, I suggest that in many cases they are cheaper than the cost of turnover. Further, while continuing to reduce rental rates likely ensures turnover in the future (the current resident in many cases cannot afford higher rental rates as the market recovers), it seems likely that turnover will be high when economic conditions improve. Residents will move up, down or un-double as market strengthening occurs. Deferring turnover might have an immediate positive impact.

In the end, irrespective of whether your disposition plans suggest a sale in the short run (12 to 24 months) or in the long run, maintaining your properties in optimum form will be important to sustaining and enhancing value, and ensuring that you preserve the desired exit price. I look forward to your comments and feedback as I do not pretend to have all of the answers; just wanted to share my thoughts. Thank you for taking the time to read this memo!