High-Vacancy High-Wire Act

Multifamily owners search for a balance between preserving value and producing cash flow.

by Daniel Duggan from CCIM CIRE Magazine, Sept/Oct 2010

As the nation continues its jobless recovery, all commercial real estate sectors are suffering. However, many market experts thought multifamily demand would pick up by midyear — the result of more robust job creation.

“But the numbers from the second quarter aren’t coming out where we thought,” says Linwood Thompson, director of Marcus & Millchap’s multi-housing group. “And it seems there is a lot of apprehension by employers.”
As a result, multifamily property managers and investors are still locked in a bare-knuckle brawl, especially in high-vacancy markets, looking at fewer renters, less income, and no chance of refinancing.

The solution, say seasoned property managers, is simple. Cut costs, but not so much that it is apparent to potential renters. Lower rents, but just enough to undercut the competition. Beef up marketing, but don’t spend money doing it. The solution is as simple as walking a tightrope, as landlords try to maintain the precarious balance between investing in property value and producing cash flow. Their tactics can be as elaborate as instituting a system to purchase items in bulk and as basic as changing the policy to allow pets in units. While rental concessions are an easy choice, some managers offset lower rents with additional monthly fees. Others save money by marketing units inexpensively through social networking sites such as Facebook.

The Technology Touch

Technology can become an important tool in nearly every aspect of apartment management, says Terry Schwartz, managing partner of Dover Realty Advisors in Bingham Farms, Mich., whose firm manages a portfolio of 6,500 units. On the operations side, property management software lets users build real-time budget models, so a property on a razor-thin budget can watch every dime. “We build a system with a dollar value attached to everything on a property, inside and out,” Schwartz says. “We send people around the property with tablet PCs and build a complete picture of what’s going on — repairs, replacements, whatever. We download that, put it into the budget, and it eliminates the guesswork.”

He uses a software package from Santa Barbara, Calif.-based Yardi Systems to crunch the numbers.
Beyond operations, property managers should use technology for marketing, Schwartz says. And social networking is a key area. His company added social networking components to their property Web sites. This online environment where users can log in and interact has increased the number of monthly hits from 2,500 to 25,000. In addition, “friend” networks were created on Facebook and other social networking sites.

The challenge of marketing units through social networking channels is that it’s not as easy to figure out where new tenants are hearing about the unit, Schwartz says. He has used a product from Westlake Village, Calif.-based CallSource, which assigns a different phone number for every type of media used. It also tracks which outlet is the most successful. “It’s tough to do that through social networking, because they might see something on a friend’s page, then search it out themselves,” Schwartz says.

Keeping Up Appearances

But even in a world of smartphones and Google’s street-level views, one of property managers’ most important tools always will be the car. It’s crucial to be aware of a property’s image and to keep it updated, says Ernest L. Brown IV, CCIM, executive vice president and managing director of Grubb & Ellis San Antonio and co-head of the firm’s multi-housing group.

Simple things can make a big difference, especially in high-vacancy markets that give renters a lot of choices. “If you drive by five apartment complexes and they all look pretty much the same, you’ll start thinking harder about what makes one stand out,” Brown says. “If there’s newer coat of paint, nice flowers around the pool, you’ll say to yourself: ‘They must take care of this property better.’

Another thing that owners tend to skimp on when cash flow isn’t strong is having clean, updated units ready to be leased, also called “make-readies.”“I’ve gone by properties, maybe 65 percent occupied, and said, ‘Show me a make-ready,’ and they don’t have any,” Brown says. “They’ll say, ‘We’ll fix it up if we get a lease.’ People won’t use their imagination to know what the unit will be like with new carpet and fresh paint. You need something to show them.”

Doing the Numbers

Another way to cut costs is by instituting a process for tenants to pay for their own water, Brown says. Not only does it bring in extra revenue, but it also cuts down on waste. “They’re not going to use as much water when they know they have to pay for it,” he says.

In properties where the landlord pays for gas but the tenant pays for electricity, converting to electric stoves can save money as well, Brown says. “If you save $10 per unit per month on gas, and you have 100 units, that’s $12,000 a year. And if you were to sell that on a 9 percent cap rate, that’s $133,000 in value,” he says. “It adds up pretty quickly when you have a lot of units. And that’s just stoves.”

When replacing items in units, consider purchasing in bulk, says Ronald Goss, CPM, president of RPM Management Co. in Little Rock, Ark., which manages a portfolio of 3,000 units. Goss also is president-elect of the Institute of Real Estate Management.

“We have so many units that we can work with one vendor exclusively and get a good break on the price,” he says. “It’s the same thing with insurance. We can go through one company and get them to come down in price.”
Even when buying in bulk, it’s important to do periodic market checks to ensure that what seems like a good deal is indeed a good deal, Goss says.

That same level of research also needs to go into the rental rates in a given market area, he says. “We do market surveys every single week to see what the competition is doing,” he says. “So then we can stay just a little below where the market is.”

Use fees in conjunction with rent as another tool to keep rental rates down, says Jesse Holland, CPM, president of Sunrise Management and Counseling in Latham, N.Y., whose firm manages 1,600 units. “A lot of places are switching to the marketing strategy of adding fees to keep the rental rate down,” he says. “Keep the rent number low, but add a pool fee or an activity fee. Then, if everyone else’s rent is $800, you can say your rent is $700.”
An “inventory blowout,” is another rent tactic used in some markets, Holland says. “They’ll find they have a large number of vacant units, drop the rent to a lower level, fill up the units, and then raise rent again.”

Reality Check

Especially in the high-vacancy markets, operators need to deal with the economic issues of people in a market area. That means walking a fine line with credit checks, says Goss. The generation of people in their mid-20s to early 30s who were expected to be entering the job market and looking for apartments is still living with their parents in many cases, he says. So, the demographic largely filling apartment units right now are people who would like to own a house but either cannot afford to or do not have good enough credit to qualify for a mortgage under the current tight underwriting standards.

Dover Realty’s Schwartz says there are ways to ease credit restrictions without taking too much risk. For example, a credit score that eliminates a bad mark from student loans or a bankruptcy filed more than three years ago is a good way to be flexible but still have confidence in the tenant’s ability to pay, he says. But in return for leniency on the credit side, a higher security deposit is needed.

“In the old days, maybe one out of 10 applications had some hair on it,” Schwartz says. “Now, it’s more like five out of 10, so it’s something you have to deal with.”With difficulties on the demand side for apartments, the options for owners to finance new deals or refinance existing deals are limited.

Insurance companies are interested in multifamily deals, but only high-quality properties, says Thompson of Marcus & Millichap. He predicts it will be another 18 months to 24 months before commercial mortgage-backed securities financing is a major part of multifamily financing. Some owners are getting creative, refinancing their properties by reaching out to third-party private equity firms who lend money in exchange for a portion of ownership, he says.
But owners are taking a creative approach to refinancing largely because they are very optimistic about the future, he adds. The main reason for optimism is the amount of pent-up demand that exists for apartments. With couples doubling up in apartments and younger people living with parents, a turn for the better in national jobs will have an immediate effect on apartment vacancies. “The demographic group from 20 to 34 years old has found it extremely difficult to get jobs,” Thompson says. “When the economy turns, all of a sudden, you’re going to see a turbo effect on the apartment numbers. It’s going to push people into their own apartments.”

ROI

“I have been very successful in passing on not only water costs but also sewer and garbage costs to tenants with little objection. In those cases where it is difficult or impossible to separately meter each tenant’s water consumption, I have sent out the average water bill per apartment unit charges by the local water company and passed on about 60 percent of that bill to the tenants. I did the same thing with the garbage and sewer costs. By showing the tenants what the average was for each item, I was able to increase the rent about 4.5 percent with little or no opposition and did not lose any tenants.” — Donald G. Arsenault, CCIM, Tacoma, Wash.