

Dollars and Sense

Downturn Makes Managers Financial Experts

By Paul Rosta

With the bottom line more of a focus than ever, boundaries are blurring in real estate management today. “We seem to be working into more of an asset manager’s position,” said Ron Goss, president of RPM Management Co. and president-elect of the Institute of Real Estate Management.

More than at any time in memory, say veteran professionals, property managers are acting like asset managers, shouldering an increasing degree of responsibility for financial and strategic tasks. On the flip side, asset managers are acting much more like property managers, taking a keen interest in the details of a property’s physical condition and other issues that affect strategic decisions.

Real estate managers are reaching deeper into their tool boxes, using sophisticated methods to analyze expenses and income. Responsibilities for financial issues like budgeting, accounting and long-term projections are no longer confined to a few professionals on the property management team.

“Before, it used to be very compartmentalized,” recalled Greg Carbone, vice president of property management with Trefoil Properties L.P. “Now, it’s the responsibility of the whole group to know this information and know the ramifications.” The old paradigm for a property manager was best summed up as “jack of all trades, master of none.” If it ever was true, that description has gone by the wayside. “You can’t be ‘master of none,’” Carbone argued. “You really have to be master of all these disciplines.”

In part, this trend stems from increasing demands from senior executives for micro-level information. “You really have to answer questions that, before, you never would be asked,” Carbone explained.

Owners and lenders are demanding more frequent and thorough financial reporting. Whereas once a quarterly update on the prop-

erty’s income might have been enough for many owners, now a monthly tally is the norm. The property management team must be prepared to provide the client with detailed data on any financial indicator. A report that the previous month’s net operating income slipped 10 percent from the prior year is apt to bring a quick call from the client’s CFO. And the

property manager for Elliott Associates Inc. “Everything we do now on a daily basis, we have to stop and think about what the effect is going to be on the loan.”

Financial issues become particularly knotty as a steady stream of properties wind up in special servicing. When a property goes to special servicing, the manager is tasked with complet-



property manager would do well to keep the lines of communication open with the client’s senior executives. “As long as we have to be at the table, we need to be in their faces,” Carbone advised.

Lenders, too, want to keep close tabs on asset performance, monitoring not only revenue but other issues that tend to affect a property’s financial health, like tenant turnover and leasing velocity. “I think I’ve spoken to more lenders in the last year than I have in the last 25 years in the business,” said Julia Muir, a senior

ing a formidable checklist of data that bears on the borrower’s ability to make monthly debt-service payments. Tenant fallouts and lease modifications will reduce the property’s revenue, so clients will need an up-to-date history of occupancy. The property may need capital improvements, whether to entice new tenants or to maintain its physical condition. Beyond information specific to the property, the manager will also need to provide background on the local market area and personal financial statements for the owner. “It’s almost like re-

financing but with even more document gathering,” Muir noted. The added responsibility also makes the list of tasks considerably longer when resources are too tight for the property manager to add staff, she added.

Hands-On Approach

Owners and special servicers are also extending their influence into day-to-day matters like tenant approvals and accounts payable. The increased control sought by special servicers is adding to the property manager’s workload by layering on a new level of approval. At a property managed by Grand Blanc, Mich.-based Bruce G. Pollack & Associates, for instance, payables of \$4,000 or more require the special servicer to sign off. As a result, the firm is submitting requests for approval almost constantly.

“It almost takes a dedicated person (in accounts receivable and accounts payable),” reported company president James Evans, who is also secretary-treasurer of the Institute of Real Estate Management.

That property, the only asset in the company’s management portfolio that is in special servicing, tends to demand more than its share of time and attention, placing a strain on the company’s staff. “If this weren’t such a good client, I don’t think I could afford to keep this property in my portfolio,” he noted.

Property managers must themselves step up scrutiny on all sources of revenue. During better times, the manager might have the discretion to cut the tenant some slack before starting to chase down a late rent payment. But managers are on the lookout for the first signs of trouble. “We’re not waiting until the 10th day (after a rent payment is due) anymore,” Carbone noted.

Owners in all property types are sensing pressure from higher up the food chain. In the retail sector, to name one example, power centers around the country lost anchors at the peak of the capital markets crisis owing to a wave of big-box retailer bankruptcies. Those departures often triggered a common provision of debt service agreements under which the property owner must furnish a letter of credit to the lender. In some cases, the owner must temporarily subsidize the property’s debt

service payments. Though a growing number of big boxes are getting new tenants, re-leasing is frequently slow. “Occupancy may rise with the re-leasing, but reduced rents may not support the mortgage that was initially based on much higher rents and overall property value,” Muir explained.

Budgeting, too, is a much bigger responsibility than it was before the downturn. “Property managers today know more about budgeting than they ever did,” observed Madeleine Abel, executive vice president of Washington, D.C.-

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—Madeleine Abel, Stoladi Property Group

based Stoladi Property Group. “Today, we really need to know those numbers and where they came from. ... The real estate manager today has to know, from soup to nuts, every single expense.”

Property managers report that projections of income and expenses are now necessarily works in progress. The main culprit is the unpredictability of many real estate markets around the country, as well as continuing economic uncertainty. “In January, our budget could be way off because a tenant fails and we didn’t expect it,” Muir explained. That shakes up estimates on both sides of the ledger. Projected rental revenue can vanish overnight. On the expense side, losing a tenant also hikes costs unexpectedly, requiring outlays for leasing brokers and tenant improvements.

At a time when managers are tasked with keeping a struggling property in the black, recovering the owner’s fair share of expenses is a priority. One target of analysis is the tenant’s share of electrical usage for a property’s common areas.

“You’re constantly looking at it and evaluat-

ing it as new tenants come in,” observed Abel. Stoladi tracks usage down to the kilowatt-hour. Fluctuating utility costs can introduce a wrinkle into this effort, she pointed out. Deregulation in Washington, D.C., now makes estimates especially challenging by causing costs to vary from year to year. The tenant’s share of common-area electricity costs is based on the cost of electricity in a given year. If rates rise above the level specified in the lease, the landlord can recapture the tenant’s share of common-area costs. But if the cost of electricity falls below the rates cited in the lease, the owner will not be able to capture a portion of those costs.

Budgeting calls for wariness in other areas, as well. An unexpected windfall may be welcome on one level, but it can also serve to hide problems that would otherwise emerge. Evans cited the example of a warmer-than-usual winter trimming a portfolio’s snow removal budget by \$12,000; while the variance makes the bottom line look better, the windfall can also hide other problems, like rising costs in other categories or a revenue shortfall. Those scenarios require the manager to review results thoroughly, then report them candidly to the client.

For the time being, property managers and their clients should expect to retool budgets more often than usual. Conservative forecasts of revenue and expenses are likely to be standard. So is an understanding of the tenant’s business and challenges. At Elliott Associates, Muir reported, “we’re hoping to educate ourselves on how retail tenants should survive and what their profit margins should be.”

At this point, it is difficult to tell whether the lines between property management and asset management will continue to blur once better times return. Whatever those respective roles look like in five years, however, at least one constant will remain. As with any other aspect of property management, financial stewardship hinges on understanding the client’s goals.

That requires formation of a true partnership with the client in order to position the asset for success, noted Goss. “If the investor has a long-term goal, the property should be maintained to be viable at the end of the time, when the person wants to sell it.”

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