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Who is minding the store? Examining what you should expect from your property management team

bg Barry Gruebbel

TIC Properties Management

The tenant-in-common (TIC) investment model has gained widespread use throughout the real estate community, and as a firm that acquires, structures and syndicates TIC offerings we have seen the industry expand dramatically during the past seven years. And while the manner in which real estate is bought and sold may vary, the key to successful real estate doesn't–property management. The TIC model, with up to 35 co-owners in each property, can create some management challenges and only the best management expertise will aid investors in achieving their goals as real estate investors.

While TIC investing eliminates property management headaches for the individual investor and transfers that management to a professional property management firm, each owner is still very much a part of the management process (or should be). Historically, not much focus has been placed on this aspect of TIC investing, instead, investors concentrate on property location, income projections and preservation of capital. While these should be among the highest priorities when analyzing a potential investment, property management cannot and should not be overlooked. Without a quality property management team to execute the plan of the property, location and projections do not matter.

During the ups and downs of every real estate cycle, it is critical that the property management team works with the best interest of the owners in mind when "actively" managing a property. Therefore, what should you expect from your professional property management team if you are considering passing that responsibility of your investment over in a TIC investment?

A full service property management company handles day-to-day management, leasing, accounting and strategic planning of your asset. This includes developing customized property operations programs with a focus on proactive strategies, cost efficient operations, and tenant retention. Your management company shouldn't be just a "rent collector." If your property management team is not focused on customer service and property enhancement, your property may not realize its financial goals.

For instance, a property management firm should review day-to-day operations to uncover operating efficiencies; perform comprehensive budgeting with capital improvement planning, establish preventive maintenance programs to maintain building quality and extend the effective life of building components, and manage third party vendors to achieve economies of scale. These remain the backbone, the "critical functions" of property management. These strategies improve the physical condition of the property, enhance service delivery to the tenants and should lead to increased financial strength of the asset, which in turn will help to enhance tenant relationships, your sole income source with most properties.

A property management firm is only as strong as the team members they employ. There are a variety of designations that employees can earn to remain at the forefront of the property management industry. Among them are certified public accountant, real property administrator, certified commercial investment member, certified property manager, facilities management administrator, systems maintenance administrator and systems maintenance technician. These designations are affiliated with such venerable institutions as The Institute of Real Estate Management, Certified Commercial Investment Member Institute, Building Owners and Managers Association, National Association of Realtors and the Boards of Accountancy for each state.

Team members who take the time to earn additional credentials reinforce the concept that the property management firm is committed to managing properties as a profession and dedicated to maintaining the asset to its highest level. Are any of these highly educated and certified individuals minding the store for you?

In addition to the individuals, organizations too have the opportunity to enhance their skill sets and credentials at a corporate level. The highest level of certification a property management firm can achieve is the Accredited Management Organization (AMO) designation from the Institute of Real Estate Management, an affiliate of the National Association of Realtors.

This accreditation demonstrates a company's commitment to the highest level of performance, experience and financial stability in order to exceed its clients' expectations. There are currently only 511 property management firms worldwide that have earned this distinguished accreditation. AMO management companies excel in market knowledge, tenant satisfaction and retention, and have the ability to provide exceptional service in all aspects of property management. In addition, AMO firms must have a certified property manager directing and supervising the management team.

To qualify for the AMO certified property management designation, real estate management professionals must complete extensive course study, meet experience requirements in both fiscal and operations management, and adhere to a professional code of ethics. The AMO designation signifies excellence within the industry.

Credentials and structure of investment aside, at the end of the day where the rubber truly meets the road is in performance. It's easy to show successes in up markets, but how has an operation worked during periods of economic turbulence and unpredictability? It is important to not only look to a firm's success during those good times, but how have they handled issues at properties, preserved investor capital and even turned properties that may have once been in trouble? Your property management firm should have a stellar track record, and make it available to investors for review. Historical returns do not guarantee future results, but they can certainly provide some insight into how a firm handles their responsibilities over the long term especially if your property management firm is experienced through differing real estate cycles.

When taking the time to review potential real estate investments, simply looking at the initial underwriting models and current market data is not enough, especially when considering a fractional ownership interest with multiple owners unknown to you. Real estate investors should thoroughly review the property management firm and team before acquiring a property to best take advantage of prosperous times and have faith the management firm is able to help mitigate risk during market downturns and that your property will be managed and maintained to the highest levels of excellence.

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The "what" of buying multifamily properties

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Lately, I've found myself speaking with investors from across the country about the state of the economy, the debt markets and other issues relating to the "how, when, and where" of buying commercial real estate property. Surprisingly, however, those subjects have recently taken a back seat to conversations based around the "what" of buying properties.

It's human nature to stick to what you know. If you've made money owning multi-tenant office property in the past, why stray when searching for an exchange property today?

I say it is time to open up to the idea of diversification by strategically investing in assets classed that you may not have owned before. When the property types are viewed historically from an asset class perspective, we find that each sector has unique, enduring characteristics that differentiate it from the others. Commercial real estate is traditionally divided into five sectors/asset classes: multifamily, office, industrial, retail and alternative (hotels, golf courses, marinas, etc.).

We will start with what is probably the most popular type of investor-owned real estate in the country: multifamily. Multifamily properties have historically benefited investors with a low volatility of physical occupancy, enhanced tax sheltering and superior rent flexibility.

Multifamily properties can be as small a duplex or as large as Starrett City, one of the largest residential complexes in the U.S., with 6,000 units across 46 buildings in Brooklyn. Due to the wide range in size and price of multi-unit residential properties, there is accessibility and selection for nearly all levels of investor experience and level of financial resources.

Properties are further divided into urban high-rise, suburban garden-style and small properties. The main problem with small properties is that a single unleased unit can represent a large portion of the total rentable space. By investing in a multifamily property with numerous tenants, investors can realize a stability that other asset classes often can't provide.

Apartments do not generally see the volatility in vacancy rates that are experienced in multi-tenant retail or office because they have more units and the units themselves are smaller in size. How likely is it, for example, that an owner of a 400-unit apartment complex would lose 20% of his tenants in one month? However, it's quite typical to have a single tenant represent that much space in an anchored retail center. If the end of their lease comes around and they choose not to renew, the impact of vacancy and lost income would be severe.

Regardless of how many units are in the property, when it comes to cost recovery (also known as depreciation), the entire residential asset class receives a shorter 27.5 year schedule versus 39 years for all other non-residential classes of real property. This is valuable information to keep in mind when evaluating multiple investment options and calculating returns for a residential project versus an office, retail or industrial property.

Another distinct benefit that owning multifamily properties provides is the ability to raise rents to correspond with inflation and the competitive properties surrounding you. As opposed to a long-term corporate retail or office lease with minimal or no annual escalations, owners of apartment buildings can change their rents every day or even throughout the day if they wish.

The major pitfall in multifamily investing is that apartments tend to be management-intensive. The "terrible T's" of being a landlord (tenants, trash, toilets) often catch up to novice investors who are inexperienced with handling the day-to-day needs of apartment buildings and their occupants. This issue can be easily overcome in the form of hiring a professional management company.

In addition to the aforementioned long-standing advantages of multifamily ownership, many market factors make the case to invest in apartments even more compelling in today's market. Tighter mortgage lending standards, steady immigration rates, and the large "Echo-Boomer" demographic (ages 18-28) that are unable to afford home ownership should help the demand for apartment rentals stay high.

Successful real estate investors can, of course make an argument to stick with what they know. But with some additional self-education through research and the guidance of a competent advisor or broker, investors who haven't owned a multifamily asset before should consider the benefits of including this asset in an investment allocation. If you're not ready to jump in with both feet and buy yourself an apartment home on your own, there are many ways to get started on a smaller scale. A number of apartment REITs, funds, LLCs and tenant-in-common programs exist to help you dip your toes in the water.

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