Asset Management during Turbulent Times

The Benefits and Options for LIHTC Owners

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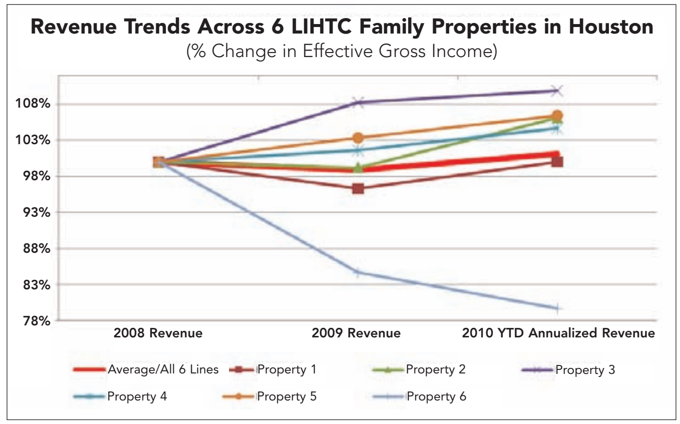
The recession technically ended more than 11 months ago, but the recovery has been slow and uneven across regions and metropolitan areas. Through August, the U.S. economy has regained only 720,000 of the 8.4 million jobs lost during the recession. Many markets have seen no or minimal job growth. As a result, low-income housing tax credit rents in many markets have yet to rebound from their 2008-2009 declines and property managers are still struggling to adjust to the reality of eroded rent advantages. During these uncertain times, proactive asset management can make an enormous difference to the performance of LIHTC developments and is more important than ever for owners.

Managing in Troubled Markets; A Case Study

Houston is one of many markets where LIHTC properties have been challenged by job losses and an oversupply of multifamily housing units. The Houston economy shed approximately 94,000 jobs in 2009 and only 17,000 jobs have returned. Even though we have seen some signs of stabilization in 2010, third-quarter job growth was well below the 30-year annual average of 1.7%. LIHTC property revenues have fallen due to an oversupply of low-priced housing alternatives in the Houston area, including market-rate apartments with lower rents and foreclosed/unsold homes and condos (the "shadow" market).

Especially in a tough market, attentive management can make a big difference. We examined the performance of six LIHTC family developments in Houston with a similar tenant base. These properties, on average, had declining revenues from 2008 to 2009, due to lower occupancy rates, higher concessions, and bad debt. In 2010 so far, their performance is improving, on average. If this trend continues, the average 2010 revenue for these properties will exceed 2009 and slightly top (1.7%) 2008.

This average improvement in performance, however, masks very different performances for the individual properties, as shown by the revenue trend lines in the chart. The average performance for the six properties (the red line) is based on one very poorly performing property, two properties that struggled in 2009 but appear to be recovering in 2010, and three star performers.



The performance differences partly reflect the varying degree to which the owners and managers of the properties adjusted their operations to address changing market conditions. The star performers had property managers that quickly put in place improvements or move-in concessions – sometimes both – to retain and attract residents when faced with lower rents from competitors and the shadow market. The struggling properties recovered when their owners changed site staff and, in one case, brought in a new property management company more experienced in handling competitive market situations. The poorly performing property continues to suffer from inadequate owner attention, making a tough situation even more expensive and endangering the long-term viability of the investment.

Property Management vs. Asset Management

Owners with experienced and focused asset management get the best results from their property managers.

Property managers direct the day-to-day operations of tax credit properties, performing such tasks as marketing and leasing; collecting rents; ensuring that the project complies with LIHTC and other applicable regulations and reporting requirements; managing opera-

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tions, capital improvements, staff, and contractors; overseeing the provision of supportive services; and monitoring the property's operating budget and reserve accounts and producing financial statements for management and ownership review.

Asset management, on the other hand, is the process of setting overall direction for the asset, including its positioning in the market; initiating major cost-reduction measures such as energy-efficiency improvements, real estate tax appeals, or debt refinancing; monitoring the market and the performance of the property and working with the property manager to adjust operations and pricing policies accordingly; and identifying ways to improve the property management. Asset managers also gather information and analyze risk and performance across markets and portfolios to help with investment decisions, and manage transactions such as sales and refinancing.

Asset Management Options

Asset management is part of an owner's repsonsibility. Asset management by a syndicator or investor monitors the performance of the investment, but this does not take the place of – nor negate the need for – separate, hands-on asset management by the owner.

Effective asset management can dramatically improve the performance of properties by helping owners and their property managers identify market competition, determine proper positioning and rent levels, and trim expenses. Asset managers can oversee, question, suggest alternatives for property management, and, where necessary, identify the need for personnel or a change in the property management company.

Options for owners are (1) performing asset management in-house, or (2) retaining third-party asset management. Both options provide owners with control and the improvements in cash flow that result from intensive property oversight. Choosing between the two options is largely a matter of cost, and the size and type of organization the owner wants to build.

The factors that should guide an owner's choice include the size of the owner's LIHTC portfolio, the geographic concentration of properties, the number of property management companies, and the operational performance of the properties. Owners with large and well-performing portfolios usually find it most cost-effective to hire in-house staff dedicated solely to asset management. Owners of small- to mid-sized portfolios are generally unwilling to hire dedicated asset managers and may use in-house finance and accounting personnel that divide their time between asset management and other duties. These owners may find it much more cost-effective to contract with outside providers to provide the asset management function, to benefit from their dedicated focus and specialized expertise to help improve the performance of properties.

Some LIHTC owners, particularly those with property management affiliates, may rely on their management companies to oversee and report on property performance. However, even here, the market challenges facing LIHTC properties today across different markets dictate the need for asset management. In fact, owners with management affiliates may have even greater need for unbiased and comprehensive property oversight.

Owners who recognize the need for asset management but don't possess, or can't assemble, the necessary resources to perform this function internally are

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increasingly outsourcing their asset management. Options as providers include: syndicators, which have LIHTC experience and often excess asset management capacity (though syndicators typically work on behalf of investors); independent firms that focus exclusively on LIHTC asset management; and commercial real estate asset management firms (which can bring real estate experience but perhaps no housing credit expertise).

LIHTC properties continue to outperform other real estate asset classes, but during this period of challenged markets and declining property revenue, experienced and focused asset management oversight remains vital for owners.

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HUD Offers $189 Million in Grants for Housing, Community Revitalization

The U.S. Department of Housing and Urban Development is soliciting electronic applications under two separate programs for up to $189 million in competitive grants. Details of each Notice of Funding Availability (NOFA) are posted at http://portal.hud.gov/portal/page/portal/HUD/program_offices/administration/grants/fundsavail.

HOPE VI NOFA

Public housing authorities may submit applications through November 22 for roughly $124 million available under a funding round for the HOPE VI program. HUD expects to award five to six grants; the maximum grant size is $22 million.

Choice Neighborhoods

HUD is making roughly $65 million available under the new Choice Neighborhoods Initiative, which is designed to succeed and build on HOPE VI.

Under the current Round 1 NOFA, eligible applicants may apply by October 26 for either a Choice Neighborhood Planning Grant or a Choice Neighborhood Implementation Grant. HUD will then select planning grant awards (est. 12-15, maximum size $250,000). HUD will also select about 10 finalists from the implementation grant applicants, and publish a Round 2 NOFA. The finalists will then submit a more detailed application. HUD will then announce 2-4 implementation grant awards (maximum size $31 million).

Eligible applicants are public housing authorities, local governments, nonprofits, and for-profit developers that apply jointly with a public entity.

The funds can be used for various purposes. According to the NOFA, "The program will transform neighborhoods by revitalizing severely distressed public and/or assisted housing and investing and leveraging investments in well-functioning services, high quality public schools and education programs, high quality early learning programs and services, public assets, public transportation, and improved access to jobs." TCA