

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /
Or Sponsoring Organization Is Missing

5. Market Analysis/Urban Economics/Real Estate
Process

n. "Rent Control & Apartment Management",
no date

Rent Control & Apartment Management

- I. Financial management theory defines risk as the variant between assumptions and realizations, the variance between proforma statements and the historical P & L statement.
 - A. Investment in an apartment house represents a plan, a set of assumptions about the future, and property management is then the effort to control the variance from these plans and assumptions. about marketing and finance.
 - B. The control of variance is the financial specialty of risk management
Risk management has two objectives:
 1. Primary responsibility is to protect the existing network position - thus the reluctance to sign personally and to emphasize rate of payback to reduce maximum potential loss.
 2. Less primary is the need to realize future profit expectations.
 - C. The first steps in the risk management process are:
 1. Identify significant exposures to loss - an item representing 1% ~~of gross rents~~ ~~of net~~ 5% of net income or more such as real estate taxes, energy cost, sewer and water, interest expense, and repairs.
 2. Forecast possible frequency and severity of variance.
 3. Identify and select a risk management technique.
 4. Execute and monitor the risk management program.
 - D. The tools of risk management are basic and familiar to everyone, although most people are not very systematic about it.
 1. Avoid the risk.
 2. Diversify the exposure to loss.
 3. Stabilize prices through partial monopoly.
 4. Shift the risk by contract.
 5. Shift the risk through insurance contract.
 6. Limit liability.
 7. Hedge on future contingencies
 8. Control dynamic risks with incentive contracts
 - E. Consider the mortgage loan closing process as a series of controls on variance in the assumptions. The title policy, the bonded surveyor, the mortgagee clause, guarantee insurance, as well as personal accountability.
- II. What does risk management have to do with marketing of an apartment project? Let's look at the tools of risk management in a pricing and marketing concept.
 - A. Avoidance of risk may involve a series of progressively more severe steps:
 1. More careful selection of tenants and tenant mix even at the cost of somewhat higher vacancy.
 2. Avoid certain market areas or price classes.
 3. Condominize and liquidate.
 - B. Diversification may involve:
 1. Geographic dispersion in many communities.
 2. Combination of rental unit types
 3. Selection of tenant mix by quota of certain groups

- C. The key to avoidance, selection, and diversification is creation of some elements of a monopoly.
1. Definition of the competitive standard
 2. Definition of the competitive edge
 3. a. fireplace, repair service, cleanliness, outdoor electric outlets, and reserved parking
 3. The use of the telephone survey for objective customer profiles
 4. Apartments have a retail trade area - scatter diagram of job & previous address
 5. Price competition through user charges
- D. Shifting the risk by contract relates to the frequency and severity of change in certain costs. *f*
1. Six month leases give quicker response to changing utility rates and real estate taxes
 2. More residential use of directly metered charges for electricity, water, etc.
 3. Development of incentive rent system based on number of maintenance calls per unit requires development of better computerized accounting systems - ala Rockford.
- E. Shift the risk by contract and insurance could best be done with a set insurance pool for bad debts and damages rather than the controversial damage deposit. A central insurance pool would provide identification of a tenant prone to damage property and ultimately subject to a higher loss premium or no coverage at all.
- F. Maximum loss can be limited by the financial structuring of the deal in order to minimize equity exposure or accelerate equity payback.
1. Accelerated depreciation is not a profit but a form of ~~accelerated~~ accelerated payback.
 2. Limited partnerships, exculpatory clauses, corporate shells become highly necessary in order to maintain for those who would control rents. The credibility of abandonment at the very least landlords and property managers must maintain the right to strike in order that the public can realize that residential housing is a service industry like teaching and fire-fighting.
 3. A service industry must police its members to be sure that service is rendered and quickly take sanctions against those who do not if the public is to appreciate that the capital is supplied by others while the responsibility is taken for management by the owners
 4. A limit on the ability of Latin American marxists in government to destroy real estate equities through the real estate tax must: *II* be limited by converting education and welfare revenue sources to a progressive income tax with a corresponding roll-back in rents.
- G. A land contract is the classic hedge position, a straddle, as it is both a put to the seller and a call on future equity appreciation.
1. Mortgage lenders are considering a variable rate mortgage which is indexed to some internal cost of money or external cost.
 2. Residential apartment managers may wish to consider pass-through leases for all regulated costs, such as utilities, taxes, insurance, etc. with the proration share built into the lease as it is in a condominium agreement based on *Area* and number of persons in unit

- III. The real risks to the entrepreneur in residential apartments are inherent in the dynamic risks of politics, the politics of energy pricing and in consumerism, all the way to rent control.
 - A. Dynamic risks are handled by creating incentives of a direct nature for those whose apathy or personal involvement have an impact. Condominium conversion shifts all variance
 - B. Energy costs will continue to rise and the only protection is to reduce waste, currently estimated to be approximately 25% or more of ~~total~~ residential usage. All utilities must be directly metered and charged to the tenant so that he has a personal and immediate interest in efficiency. ~~It~~ It is possible to have meters in each apartment but with all meter reading dials at a central point for convenience.
 - C. Real estate taxes should be passed through as mentioned earlier.
 - D. However, more money must be spent on higher quality management people so that service is as sensitive and responsive to the tenant as pricing is to costs.