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Revenue management & effective underwriting

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One of the most salient components of prudent, multifamily underwriting is the accurate assessment of current income potential. In today's environment, this analysis has become more challenging due to possible variations in prior rental rates, market asking rents and true net effective rents (after concessions). Current economic conditions have exerted downward pressure on rents in almost every tri-state market; that trend is stabilizing and we expect rents to begin to trend up in Q2/Q3 next year.

For the investor analyzing a property being operated under a Revenue Management System or LRO (Lease Rent Options) System, determining true net effective rent and real income stream can get tricky. LRO Systems optimize rents through statistic management of unit type and availability, time on market and exposure to lease - in theory creating consistent pricing methodology 24/7. In my opinion, LRO Systems are very effective at maximizing unit rents. However, they do create challenges for the investor. The typical revenue management system will, in a low vacancy market, push rents aggressively (sometimes above the market). Unfortunately, when vacancy and lease exposure grow, these same systems may unnecessarily compress rents below true market.

The quagmire buyers find themselves in today is reconciling their opinion of current market rent and judiciously applying those rents to various unit types to create a pragmatic opinion of Gross Potential Income. A buyer imputing rents that may be reduced below true market due to a reactionary LRO System will not be a competitive bidder, while evaluating an asset that may have rents driven above market, without making appropriate adjustments, will be a recipe for failure.

A comprehensive assessment of current rents, commissions and direct competition within a market will allow investors to reap the benefits of utilizing LRO Systems while producing a current financial model that meets yield expectations.

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