The ABC's of Asset Management

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WHAT IS ASSET MANAGEMENT?

ASSET MANAGEMENT CAN BE DEFINED as *the process of overseeing property performance with the goal of enhancing value and maximizing return to the owner*. Asset management does not consist of a single activity that takes place at a discrete moment in time. It takes place over the life cycle of a property (from acquisition to disposition). It is **a process**. Asset Management is about maintaining and creating value consistent with ownership objectives. It blends both a "big picture perspective" and a "hands-on" approach to day-to-day operational issues *and* decision-making. This is done through an *efficient balance* of landlord/tenant relations, budgeting, operating expense analysis and control, real estate tax and insurance reviews, capital improvements, energy management programs, lease analysis and market awareness. Based on these various factors, Asset Managers determine ways to increase the profitability of the various properties under their stewardship.

The Asset Manager's functions will also vary depending on the size of the owner's property holdings. However, in all cases, Asset Managers take on the role of CEO of their respective portfolios. Each property is in reality a business unto itself, and heading up the conglomerate which those businesses form is the Asset Manager. Envision an orchestra. At the conductor's podium is the Asset Manager, setting strategy and monitoring property performance in concurrence with the owner's objectives. In order to effectively execute their function, Asset Managers must be like true entrepreneurs, coordinating the activities of a broad range of disciplines which compose the various musical groups of the orchestra. Sitting in the seat of first violin is the Property Manager. Next is the Leasing Agent. The other sections of the orchestra consist of:

- Environmental Health and Safety Consultants (who deal with issues such as radon, mold, asbestos & underground storage tanks)
- Property Tax Specialists (see also "Attorneys" below)
- Construction Managers (who are called in to consult on issues such as structural problems, leaks, settling and to perform due diligence on new properties)
- Attorneys (who get involved with rent collection from deadbeat tenants, leasing, and various property liability matters, i.e. slips and falls)
- Architects
- Security Consultants
- Energy Consultants (who inspect equipment and make recommendations on how to make properties run more efficiently
- Appraisers (who help develop and confirm market value for the properties)

About the Author

I. Henry Glickman, J.D., C.C.I.M., has written extensively in the fields of corporate real estate, property management and land use. In addition, he is on the faculty at the Steven L. Newman Real Estate Institute, City University of New York and is a member of BOMA's Asset Management Roundtable.

Drawing upon the input of these specialists, the Asset Manager analyzes a given situation and makes recommendations to ownership in accordance with market trends and conditions.

To avoid confusion, it's necessary to clarify the difference between the role of the Property Manager and that of the Asset Manager. The Property Manager monitors the on-site staff at a building to make sure that the operational objectives for the property as set out in the strategic plan which the Asset Manager puts together are being carried out. The Property Manager is the primary point-of-contact with respect to tenant relations. Property Managers are responsible for facility staffing, bill payment, rent collection, lease administration, building maintenance and execution of work orders. They are also responsible for purchasing supplies and achieving competitive pricing on goods & services used at the building. Additional duties may include approving service contracts (elevator, rubbish removal, cleaning) and preparing a first-cut annual budget.

Asset Managers take a more global approach, recognizing that the properties in their portfolio represent a significant investment and it is their responsibility to create a plan for each property which establishes realistic performance goals. Their role is to select and hire Property Managers, consultants and brokers who will work with him/her to enhance the competitive position of a project by ensuring that each property is leased, marketed, staffed and maintained. They closely monitor the financial performance of their portfolio and possess an "internal audit mentality," checking to see that leases are billed correctly and that expenses are both justified and kept in check.

Asset Managers are charged with building value during a property's holding period, analyzing and making recommendations regarding their portfolio in accordance with market trends and conditions. In short, the Asset Manager oversees the operation of the properties in their portfolio *as if they were their own*.

Originally, many Asset Managers were hired as employees by financial institutions and were charged with "cleaning up" their disaster-laden portfolios caused by both overbuilding and greed. Their principal focus was to analyze the market and make recommendations as to major capital improvements, lease negotiations, and changes in use (if viable) in order to ultimately transform these properties from non-productive to productive assets. Eventually, this business was supplemented by private consultants. As the bulk of these properties was eventually turned around, owners began to realize that there was a need, going forward, for someone to act as the owners' eyes and ears on a macro level, apart from the day-to-day role of the Property Manager. As a result, both small and large owner/investors started hiring Asset Managers to examine, evaluate and implement programs to maximize their real estate portfolios and to aid in decision-making regarding potential acquisitions and dispositions. In performing these various functions, the Asset Manager essentially wears two hats-both a financial and a non-financial one. Let's turn first to the financial side.

BUDGETING & FORECASTING

The Asset Manager's bible is the budget. This document, which reflects the Asset Manager's—and by extension, the owner's—best guess as to the timing and magnitude of income and expenditures associated with the property during the year, is used as a yardstick against which actual progress is measured. Since the Asset Manager is the primary decision-maker with regard to maintaining a property's profitability, the budget serves as a basic tool in this regard. Typically compiled 3-4 months prior to the start of each fiscal year, a first generation document is usually prepared by the individual Property Manager. The assumptions used by the Property Manager are then tested and refined by the Asset Manager through a series of iterations. By adequately anticipating expenses, a budget helps to project a calamity before it happens.

In terms of structure, the budget consists primarily of two elements:

1. Operating Budget, with a so-called "Top Line" (consisting of current revenue), a "Middle Line" (consisting of current expenses) , and a "Bottom Line" which reflects the net income resulting from the day-to-day operations of a property; and

2. Capital Budget, (consisting of large dollar expenditures which extend the property's life or productivity and are depreciated over time).

When both the Operating and Capital Budgets are combined, they yield the resulting cash flow generated by the property.

When all current expenses for a property are added together and then subtracted from current revenue, the result yields Net Operating Income (“NOI”). The concept of NOI is one of the most important terms in the Asset Manager's vocabulary. It is the determinant of real estate profitability unrelated to the level of debt which the owner took on to purchase the property and ultimately is the source for establishing its value. If the Asset Manager's job could be boiled down to one simple mantra, it would be this: “Increase NOI.”

FINANCIAL REPORTING

In addition to overseeing the budget process, the Asset Manager is involved in periodically reviewing a number of additional reports in order to assess the property's financial well-being and take corrective measures where warranted.

Foremost among these is the monthly Variance Report, which compares budgeted to actual income and expense.

Typically, only variances in excess of a 5% differential from the budget are tracked and explained. By doing so, the Asset Manager is able to better understand, analyze and control the cause of unexpected deviations from the budget, both in terms of timing and amount. Based on this information, Asset Managers can then refine their forecasts, especially with regard to projected cash flow, and revisit current year goals and objectives as well as incorporate these changes into subsequent year budgets.

In conducting monthly reviews of a property's operational and financial performance against plan (i.e. budgetary parameters), the Asset Manager will also want to look at a number of additional reports. These include:

- Rent Roll
- Aged Receivables
- Vacancies
- Profit & Loss (P&L)
- Accumulated NOI
- Cash Account
- Security Deposits
- Balance Sheet
- Check Register
- General Ledger
- Payroll
- Current Payables
- Escrows
- Accumulated Depreciation
- Tenant Retail Sales
- Taxable Income Projection

Other items usually tracked are leasing and marketing activities, pending litigation, move-ins and move-outs and major construction and maintenance projects.

Since it can take several days to compile these reports after the end of the monthly accounting cycle, the Asset Manager will typically not be in a position to review this information until the first or second week of the following month. Based on the Asset Manager's careful analysis, a written report may be prepared for ownership, summarizing their contents, pointing out any implications going forward, and making recommendations for future action as required.

BUSINESS PLAN

With the overall objective to maximize value, the Asset Manager's role can be seen consisting of three main steps:

1. Analyzing the portfolio
2. Formulating a strategy to increase cash flow
3. Implementation.

To guide this process, the Asset Manager will prepare a blueprint or business plan for each property which s/he will monitor and update on a quarterly basis. The plan will include a mix of financial, marketing and operating strategies which the Asset Manager will develop based on each property's specific situation. It should reflect both the owner's investment objectives as well as the realities of the local economic environment. For overseas investors, this information is especially important as the Asset manager is relied on to be ownership's eyes and ears, providing sound advice based on accurate and current knowledge.

In essence, the business plan should address a property's capacity to generate NOI and outline the steps to be taken to resolve any related issues. Generally, the following elements should be included:

- Property Description
- Historical Background
- Loan Information (if any)
- Legal Issues
- Management Operational Review
- Physical Operational Overview
- Market Competition Survey (e.g. challenges & opportunities)
- Leasing Issues
- Marketing Plan

The business plan may also identify several possible alternatives for ownership's consideration along with the financial feasibility of each. These may include maintaining the status quo, undertaking a remodeling, refinancing an existing above-market rate, relaxing/tightening credit standards for tenants, shortening or lengthening lease terms, changing a property's use or liquidating the property altogether.

TROUBLED ASSETS

In extreme situations, Asset Managers may find themselves working with what can be generally described as troubled assets. These properties may be sound assets in weak markets, assets that underperform relative to the market or both. Since the distressed nature of such properties affects their value, the Asset Manager must minimize or eliminate the problems which detract from their potential and characterize them as "troubled." Many times, these assets are on the balance sheets of financial institutions, which take them back as a result of borrower default. Properties acquired in this fashion are known as Other Real Estate Owned ("OREO"). In such cases, ownership's primary objective is to either convert them from non-performing to performing assets or to liquidate.

Upon acquisition of an OREO property, it is recommended that the Asset Manager undertake the following steps:

1. Secure the property
2. Insure the property with hazard and liability coverage
3. Activate/change utilities to name of new owner
4. Check mechanical systems
5. Check for environmental problems (mold, asbestos, radon)
6. Prioritize damage repair schedule
7. Repair physical deficiencies

From there, the Asset Manager will be closely involved in decisions regarding the property's future status. These include whether improvements are warranted at additional cost, whether there will be a buyer for the building in its current condition and if so, what is an appropriate price. Some properties, when taken back, are still unfinished and the issue for the lender then is whether it should hold the asset until completion.

In formulating a strategy, the Asset Manager will want to consult with a host of individuals such as property managers, brokers, appraisers, contractors and potential buyers to solicit their opinions. In some cases, the decision will be made to stabilize the property, usually defined as 95% occupancy, before a sale is made. In other cases, the institution holding the property will want to avoid any continuing liability, such as maintenance and repair and taxes, and will be willing to sell at a discount. Where an "as-is" sale is contemplated, an allowance will usually be given for any deferred maintenance such as HVAC repairs, broken windows or a leaky roof. Other techniques used to incentivize the marketplace include increasing brokerage commissions, guaranteeing existing leaseholds and paying the buyer's closing costs (i.e., title insurance, legal fees and transfer taxes). Usually, a lender will prefer an all cash sale to minimize its risk of tying up the property while buyer financing is sought. Understandably, lenders are reluctant to make new loans to new borrowers on properties which have already been the subject of failed loans. However, sometimes the only way to sell a troubled asset is if the seller takes back paper.

REPOSITIONING

Where a strong case can be made for eventually recapturing additional investment based on expected returns, the Asset Manager will want to devise a repositioning strategy. Properly executed, such a strategy can overcome negative perceptions associated with a property due to poor location, difficult layout, obsolete infrastructure or unattractive spaces. Ultimately, the program's objective is to increase market share and secure additional tenancy.

Before embarking on such a program, it's a good idea for the Asset Manager to identify those property characteristics, such as unique architectural features, that may be used to help reposition the asset. Oftentimes, these can suggest a name change which, in itself, will serve to burnish the property's image.

A repositioning itself can be cosmetic as well as structural. Typical elements can include interior and exterior painting, lighting, landscaping and parking lot re-striping. These can be combined with a major redesign where walls are moved out, storefronts projected and windows and skylights added. Alternative opportunities exist where unfinished basements, attics or large public spaces are reconfigured to recapture additional leasable area. Retail space with poor visibility can be converted to office. Large stores can be subdivided into smaller ones or L-shaped configurations created; since smaller spaces usually rent for more per square foot than larger spaces, additional visibility can be opened up to allow for smaller tenants. Other common projects include lobby renovations, mall kiosks, restroom upgrades and elevator cab replacements. While not as conspicuous, the addition of an energy management system or updated HVAC plant can serve to reduce operating costs, thereby also adding to NOI.

The phenomenon of converting existing uses to more economically productive ones is known as "adaptive reuse." In many instances, a property's former use is no longer viable due to technological or social change. In those cases, the Asset Manager, paired with the ingenuity of a creative architect, can maximize property value by capitalizing on current market trends and local need. Examples of such adaptive reuse abound, from factory loft conversion to apartments or warehouse conversion to office space. Other such opportunities include apartments becoming dormitories, hotel rooms or assisted living units. Large spaces, formerly anchoring now defunct strip centers, have been turned into auto showrooms, skating rinks, health clubs and movie theatres, while smaller spaces located in out of the way corners of shopping malls, have found new life as children's museums, art galleries, libraries and walk-in medical care centers.

Prior to the start of construction, the Asset Manager should review those factors which may affect the work schedule, such as materials availability, environmental issues or labor problems, and plan accordingly. The work itself should be phased so as minimize the potential impact on existing tenants, with unoccupied spaces, if any, slated first. The Asset Manager should not only provide supervision on a regular basis, but also keep tenants abreast of progress made, such as in periodic newsletters, telling them what to expect in terms of noise or disruptions (i.e. closed entrances or elevators).

The construction process can be as much a marketing tool as the end result contemplated. Press releases should be prepared for frequent distribution to the real estate community. At the commencement of construction, the Asset Manager should host a kick-off party for both current tenants as well as local brokers where the scope of the project can be dimensioned and renderings displayed. At the end of construction, another event should be planned capping off the project.

MANAGEMENT EFFICIENCIES

Beyond the prospects for revenue enhancement inherent in a well executed repositioning, several additional profit centers are available to the resourceful Asset Manager. These range from the installation of vending machines to rooftop antennae to opening up amenities, such as off-street parking and health clubs, to non-tenants. Other opportunities include charging for exterior signage rights and special services, renting out common areas for special events or using the property as a backdrop for television or movie shoots. Locating a property's third party leasing broker in an on-site office can also generate additional rental income. Also, by negotiating an early termination or buy-out of an existing tenant's below-market lease, the Asset Manager may be able to install a new tenant at a higher rate. However, it should be kept in mind that any attempt to merely raise rents in order to boost income may end up playing into the hands of competitors who will inevitably counter such moves with aggressive pricing of their own.

WHAT MAKES A GOOD ASSET MANAGER?

An Asset Manager is by definition a generalist, who must be able to marshal a broad spectrum of talents and resources on a daily basis. Academically, these include leasing, finance, marketing, property management, human resources, law and construction. Because of this diversity of expertise, it is important that the asset manager stay current with developments in these various disciplines. Beyond this, however, is a basic curiosity about the world around him/her and a knack for creative problem-solving. The Asset Manager must at once be a good communicator with tenants while being able to maintain the owner's interest at heart. People skills are therefore indispensable. For those who choose this career path, Asset Management can be a rewarding profession. ■