GUIDE TO DEVELOPING AND OPERATING SMALL SCALE RENTAL PROPERTIES

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November 2012
GUIDETODEVELOPINGAND
OPERATINGSMALLSCALE
RENTALPROPERTIES

ABOUT THIS GUIDE

A majority of the nation’s rental housing stock is made up of properties with less than 20 units and most of these units serve low income tenants. Over time, these properties have become difficult to operate sustainably, limiting housing choices in many communities. This guide gives some direction to affordable housing organizations on how to evaluate small scale rental deals and develop and manage them successfully.

The guide is the result of a three year project sponsored by the MacArthur Foundation through a grant to the Florida Housing Coalition. Efforts were initially focused on developing the capacity of nonprofit housing providers in Florida to acquire, rehabilitate and operate aging rental properties with project based rental assistance. Several pilot projects were selected and completed. The process of selection for eventual management and operation revealed a gap in the decision making and analysis that revealed the pitfalls of operating small scale rental projects as opposed to larger standardized developments. The nature of smaller rental projects can doom success if not viewed in this context. Financing, project selection, organizational capacity, and management are scrutinized in this guide with the scale of the project in the forefront.
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INTRODUCTION

The growing inventory of small rental properties has been noticed in the past several years as they became available as bank owned real estate and eligible for purchase under the Neighborhood Stabilization Program (NSP). Other funding sources such as housing credits in Florida have prioritized existing properties over new construction. Market changes have led long established housing providers experienced in developing new homeowner housing to consider acquiring, rehabilitating and operating small rental properties. This is a market niche demanding a specialized focus, especially before jumping in to this market segment. With careful consideration in advance, projects can be seriously evaluated and projections made on revenues, expenses and maintenance.

This guide is prepared for nonprofit affordable housing providers or their grantees who are considering owning and operating small scale rental properties. This guide is not a comprehensive guide to the development of affordable rental or supportive housing. There are other resources that provide excellent guidance on the big picture. The focus of this guide highlights specific areas in the small scale rental industry where planning and decision making can be pivotal to the success of the projects, both in the short term and over time. While scattered site rental housing is frequently described in this guide, it is also not a comprehensive overview of that particular affordable housing challenge that has received increased attention over the past several years mainly in the Neighborhood Stabilization Program (NSP).
PART 1: SMALL SCALE RENTAL PROJECTS: AN OVERVIEW

Rental properties with less than 20 units make up most of our nation’s rental stock. According to the 2010 American Community Survey, 75 percent of all renters in the U.S. live in buildings with 19 or fewer units. Just over 52 percent of all renters live in buildings with one to four units.

Florida’s numbers are similar to the country at large. Again, according to the 2010 American Communities Survey, 72 percent of Florida’s 2.2 million renters live in buildings with fewer than 20 units. Just over 49 percent live in buildings with one to four units.

With small rental deals making up most of the rental stock in the country, it is no surprise that small rental developments house most of the nation’s lower income renters. According to Multifamily Rental Housing, a background paper for the Millennial Housing Commission Finance Task Force, over 70 percent of all lower-income households live in one- to four-family properties. (Donovan, 2002)

1.1 IS THERE A PROBLEM WITH SMALL SCALE DEALS?

Small scale rental deals are more likely to be less well managed and less well maintained than larger developments. As Apgar notes, owners of small-scale rental units are less well-capitalized and are excluded from the economies of scale that are so important to making tenant and property management economically viable. As a result, small scale owners typically have little if any reserves available for unexpected or even predictable repairs. It is therefore not surprising that Stegman’s research on Baltimore rental property owners in the 1970s found a correlation between small-scale ownership; poorly maintained, physically deteriorated properties; and abandonment. Some more recent data has also confirmed the difficulty with receiving a positive cash flow from a small details.

According to a 1995 Census report fewer than half of the owners of two- to four-family properties made an operating profit from their buildings, compared with nearly three-quarters of the owners of apartment buildings with 50 or more units. This same study showed that even those that are profitable tend to have total expenses only slightly lower than total income. Such budget stress adversely affects the maintenance and repair activities of absentee-owners of 1 to 9 family structures. Despite the fact that their units are most likely among all property types to have structural deficiencies, 14 percent report spending nothing on maintenance, while 22 percent defer required major and minor repair.

While larger apartment buildings are often owned by partnerships, real estate investment trusts (REITs), or corporations, small rental properties are truly “mom and pop” operations. Nearly 90 percent of one- to four-family properties and three-quarters of five- to nine-family properties are owned by an individual or a couple. In addition, few private owners of small rental properties are full-time landlords. The majority hold
other jobs from which they make most of their living. Indeed, fewer than half of the owners of two- to four-family properties made an operating profit from their buildings, compared with nearly three-quarters of the owners of apartment buildings with 50 or more units.

Less than 40 percent of the owners of one- to four-family properties made an operating profit from their buildings, compared with nearly three-quarters of the owners of apartment buildings with 50 or more units. This lack of profitability results in small, if any, reserves for unanticipated expenses. It is this budget stress that adversely affects the maintenance and repair activities of absentee-owners of small scale deals.

1.2 A MOVE TOWARD LARGER, HIGHER PRICED DEVELOPMENTS

Given the difficulty in earning a profit on small scale affordable rental developments, it should come as no surprise that as these complexes age they are coming off line, and are not being replaced with new affordable small scale developments. More than one in 10 single-family detached homes, which made up over a quarter of the low-rent housing stock in 1999, were permanently removed by 2009. Loss rates for multifamily properties with 2–4 units, accounting for a quarter of the 1999 low-cost stock, were even higher at 15.1 percent.

Low-cost units (renting for less than $400 in 2009 dollars) are most at risk of permanent loss because, as we have seen, the modest rent they earn is often insufficient to maintain the properties in good condition. In 1999 - 2009, 11.9 percent of low-cost rentals were permanently removed from the stock—nearly twice the share of units renting for $400–799 and four times the share of units renting for more than $800. In addition, decade-long loss rates for vacant low-cost units (20.6 percent) were nearly twice those for occupied units (10.9 percent).

As these smaller, less expensive units are lost, the market is replacing them with higher priced units in larger developments. According to the Joint Center for Housing Studies, in 1999, 13 percent of new rental apartments were in buildings with 50 or more units. By 2009, this share had tripled to 39 percent. In 2009, construction and land costs for units in new multifamily structures averaged about $110,000, and the median asking rent was $1,067. To be affordable to the median renter in 2009 (at the 30-percent-of-income standard), the rent would have to be at $775 or less.

At the same time, many of the lowest-cost rentals are being permanently lost from the stock, largely because the rents they earn cannot cover the costs of adequate maintenance. In fact, the American Housing Survey indicates that despite the net addition of 2.6 million rentals, the number of units with rents of $400 or less in 2009 inflation-adjusted dollars fell from 6.2 million in 1999 to 5.6 million in 2009. Many of the losses were due to demolition and other forms of permanent removal. By 2009, nearly 12 percent of the low-cost rentals that existed in 1999 had been lost—twice the share for units renting for $400–799, and four times the share of units renting for $800
or more. Many of the low-cost rental units that remain are in older, more at-risk buildings.

1.3 WHAT TO DO?

So, most of the affordable rental housing in this country is in small developments that are being lost, and replaced with larger more expensive options, pricing out the low income renter. As noted previously the operating expenses of these small developments often exceeds the receipts. How can this stock be kept affordable? One option is for nonprofit developers interested in this business line to acquire a number of small developments. By having at least 70-100 units in a portfolio, the owner can begin to realize the economies of scale that come with managing a large number of units. Central to this strategy are that the units are located in reasonable proximity to one another, and to the greatest extent feasible, the units have similar fixtures and finishes. This simplifies maintenance and allows for bulk purchase of parts for repairs as well as at the time of replacement.

Another option would be to create a Real Estate Investment Trust (REIT) that specializes in small scale affordable developments. This would facilitate the transfer of ownership from individual to institutional, producing enough scale to obtain professional management and, potentially, more flexible capital.

References:

PART 2: IS SMALL SCALE AND SCATTERED SITE RENTAL A GOOD FIT FOR MY ORGANIZATION?

New construction of affordable for sale housing was the bread and butter of a majority of housing nonprofits in Florida for the past 20 years. Now, these same organizations
are finding they need to expand their business lines to succeed in the “post bubble” housing environment and scattered site rental housing may be a good option for some.

Some housing organizations may have become inadvertent landlords due to an inventory of unsold NSP homes, while others may be thinking of a strategic way to enter the world of small scale rental by acquiring single family homes, 2-4 family properties or small apartment complexes.

Social Service and support organizations might see a need for affordable rental housing for the low income clients they serve and may be contemplating acquiring their own rental units to fill that need.

Here are some questions to ask before you add small scale rental to your business line.

2.1 DOES RENTAL HOUSING MESH WITH THE ORGANIZATION’S CURRENT MISSION?

Expanding your mission to add rental housing is generally in line with the goals of nonprofits who have previously focused on for sale housing to low income buyers. However, social service organizations will likely need to restructure their mission to include affordable rental housing. Consider a nonprofit that provides job training to veterans and finds their clients are unable to locate decent, safe affordable apartments. To develop, own and operate rental housing, this organization would need to rewrite their mission, obtain board approval, amend their bylaws, seek different funding sources and develop staff capacity. Some organizations find it is easier to partner with existing affordable housing nonprofits to develop appropriate rentals for their clients or set aside units in existing properties, rather than getting into the rental housing business themselves.

2.2 DO YOU HAVE THE RIGHT STAFF?

Acquisition, development and management of rental housing require a specific set of skills. Do you have the time and money to bring on additional staff with the necessary expertise? Also consider new accounting needs. Properly tracking rental income is more complex than reconciling the sale of a single family home and you’ll need to make sure whoever does your books understands how to properly account for this ongoing revenue stream.

2.3 HOW WILL YOU FINANCE RENTAL UNITS?

In order to charge lower, more affordable rents, yet still be able to pay operating expenses, you will need to secure grant subsidy during the acquisition and development phases. The funding sources used to fund these projects have regulations that can be more complex that those used to finance ownership housing. For nonprofits just entering the housing arena, there is bound to be a steep learning curve not only regarding regulations, but in identifying and competing for these limited resources.
In addition to public and private grant financing, you will often need to fill funding gaps by obtaining bank loans. Is your organization prepared to meet rigorous underwriting standards? Typically a lender will want to review current financial statements and your most recent audit. These documents should show you are a stable, solvent, credit worthy business.

You’ll have significant startup costs as well. It takes time to fully lease up and you’ll have expenses in the interim. Do you have sufficient cash on hand to operate the property until then?

2.4 HOW WILL YOU PLAN FOR SUSTAINABILITY?

It is crucial that rental housing be sustainable over the long term. This requires a careful evaluation of the operating proforma to ensure expenses are properly estimated before you buy even one unit. Failure to properly forecast expenses or budget for future repairs may mean an additional infusion of grant funding or a restructuring of the project’s finances. It is important that qualified staff carefully monitors the property’s financial performance over time and be prepared to take action when needed.

2.5 HOW WILL THE PROPERTY BE MANAGED?

Whether you plan to manage the property yourself or hire a management company, you’ll have a lot of decisions to make. You’ll need to start thinking about how you will use background checks, how much you’ll charge for late fees, and who will handle evictions, just to name a few. You will need staff expertise to guide your organization in these decisions and oversee the management of the property for the long term. You can probably make do with a good Excel spreadsheet if you are operating 25 units or less, but more than that requires a professional property management system which adds to your startup costs.

2.6 DO YOU HAVE CLEARLY WRITTEN GOALS?

Short and long term goals of a nonprofit organization are commonly summarized in a Strategic Plan. The plan should be thoughtfully crafted so there is a clear picture of the type and number of rental units planned for your portfolio. While there are distinct economic advantages to having a portfolio of 70+ units, the consideration of your organizational capacity (time, money, staff) in determining how large and how fast to grow your rental housing business is essential. Too many projects in the pipeline at one time can be a drain on finances and staff time, while too few may not be an effective use of resources. The strategic plan should be reviewed every year and adjusted as needed based on development progress.

Another consideration is the availability of suitable properties. While an organization may have staff time and money, if there are no properties/land for sale in your target area, at your target price, your Strategic Plan should be adjusted accordingly.
2.7 **DO YOU HAVE GOOD WRITTEN POLICIES AND PROCEDURES?**

From creating the feasibility analysis for a potential property to collecting past due rent, there are a myriad of rental housing policies and procedures that need to be created. Policies are working documents, so in addition to the initial version, they should be reviewed and improved on an annual basis. Below is a sample list of policies and procedures that need to be drafted.

- **Real Estate Acquisition**
  - How is the decision to buy a particular property reached?
  - What due diligence is needed and who will be responsible?
  - Who will create the feasibility analysis/proforma and what parameters will be used (rents, vacancy rate, debt service coverage, operating expenses)?
  - Will you retain an attorney/realtor/title company/capital needs inspection firm?
  - What funding sources are anticipated?

- **Renovation**
  - Scope of work/energy efficiency
  - Solicitation and bid process for contractor(s)/architect
  - Project management (inspections, lien releases)

- **Marketing**
  - How will you advertise for initial lease up?
  - How will you document affirmative marketing efforts?
  - How much is budgeted for marketing expense?

- **Property Management**
  - Hire a professional management company or manage in house?
  - Tenant rules and regulations
  - Tenant selection plan and criteria
  - Lease execution
  - Income certification and recertification
  - Rent collection procedures
  - Security deposit procedures
  - Late fees
  - Partial rent/security payment guidelines
  - Eviction procedures
  - Handling tenant complaints
  - Repairs and maintenance
  - Long and short term capital needs review
  - Budget and property performance
  - Property turn over

2.8 **DO YOU HAVE A CLEARLY WRITTEN AND PERTINENT DOCUMENT SET?**

One of the advantages of hiring a professional property management company is that they typically have a stock set of documents. If you are doing the management in
house and install property management software some of the forms below may be included. Regardless, you’ll need:

- Rental Application
- Credit release form
- Background check document
- Lease
- Income certification forms
- Rent logs/tracking system
- Security deposit logs/tracking system
- Work order/completion forms
- Invoice tracking system
- 3 and 7 day tenant notices
- Lease renewal/income recertification letter
- Move In /Move out forms

2.9 **DO YOU HAVE AN EXIT STRATEGY?**

Owning and managing rental property is a long term commitment not without potential pitfalls. A property generating positive cash flow in year 4 may be one leaky roof away from running in the red by year 10. Maintaining a healthy operating reserve that can pay for unexpected repairs is crucial. In addition, having good relationships with your funders is important should you need to restructure debt or obtain an additional grant to fix that roof. Sometimes rental property owners have unrealistic expectations on the rents that can be attained, lowering the monthly $25/month to achieve full occupancy can be devastating to the bottom line in an affordable property.

Regardless of the reason, it is a good idea to think about an exit strategy should things turn south. Transferring title to another, better positioned nonprofit or housing authority may be an option. Refinancing outstanding loans is another. Depending on the funding sources and any outstanding affordability periods, selling the property may be the way to go. The key to success is keeping a close eye on property performance and making quick adjustments as needed. A form that can be used to evaluate an organization’s capacity to develop and manage scattered site rental housing can be found in Error! Reference source not found. 2.1.
### TABLE 2.1 - ASSESSMENT OF CAPACITY TO DEVELOP AND MANAGE SCATTERED SITE RENTAL PROPERTIES

<table>
<thead>
<tr>
<th>ASSESSMENT CATEGORY</th>
<th>ASSESSMENT CRITERIA</th>
<th>ASSESSMENT</th>
<th>Notes</th>
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</thead>
<tbody>
<tr>
<td><strong>Organizational Experience</strong></td>
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<tr>
<td>Affordable housing development experience</td>
<td>Number of rental and single family homes completed. Current pipeline. Performance of completed deals.</td>
<td></td>
<td></td>
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<tr>
<td>Complexity of deals</td>
<td>Number and type of financing sources</td>
<td></td>
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<tr>
<td>ED and Senior Management experience</td>
<td>Detailed summary of experience</td>
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<tr>
<td>Staff Experience</td>
<td>Detailed summary of experience</td>
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<tr>
<td><strong>Roles/Responsibilities</strong></td>
<td></td>
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<tr>
<td>Organizational structure</td>
<td>Functional org chart demonstrating authority and communication</td>
<td></td>
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<tr>
<td>Housing Department</td>
<td>Dedicated to housing, report to ED.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Job Descriptions</td>
<td>Demonstrates relevant experience</td>
<td></td>
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<tr>
<td>Dedicated project staff</td>
<td>Assigned staff has time allocated to project. Minimum .5 FTE</td>
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<tr>
<td>Contract Execution</td>
<td>ED or designee has contract signing authority</td>
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<tr>
<td>Board</td>
<td>Active, knowledgeable Real Estate committee evaluates deals</td>
<td></td>
<td></td>
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<tr>
<td>Policies and Procedures</td>
<td>Written procedures detail decision making process and policies include appropriate geographic and demographic targets and feasibility analysis parameters.</td>
<td></td>
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<tr>
<td>Progress updates</td>
<td>Regular time dedicated to project progress report to ED, Real Estate Committee and Board. Mechanism for troubleshooting, re-evaluation in place if needed.</td>
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<tr>
<td>ASSESSMENT CATEGORY</td>
<td>ASSESSMENT CRITERIA</td>
<td>ASSESSMENT</td>
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<tr>
<td>Internal Staff Expertise</td>
<td>Financing Mechanisms - Acquisition and Rehabilitation</td>
<td>Staff understands appropriate funding sources, application cycles and processes, regulations.</td>
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<tr>
<td></td>
<td>Capital Needs Assessment</td>
<td>Staff has capacity to perform C.N.A. for multifamily Real Estate</td>
<td></td>
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<tr>
<td></td>
<td>Real Estate Acquisition Process</td>
<td>Staff understands process, has checklist</td>
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<tr>
<td></td>
<td>Knowledge of Local Government Regulations</td>
<td>Staff knows regulations or knows where to find them and how to interpret them.</td>
<td></td>
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<tr>
<td></td>
<td>Knowledge of Predevelopment and Planning Tasks (exercising due diligence)</td>
<td>Staff understands predevelopment process, has checklist</td>
<td></td>
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<tr>
<td></td>
<td>Knowledge of Site and Property Selection Criteria</td>
<td>Staff has clear direction on location/size/price...</td>
<td></td>
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<tr>
<td></td>
<td>Knowledge of How to Manage Contractual Relationships with Qualified Third Party Experts</td>
<td>Staff understands that when internal expertise is lacking, vendors &amp; consultants can be hired. Clear process for engagement (RFP, RPQ, established relationship...)</td>
<td></td>
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<tr>
<td></td>
<td>Co-Developer Needed / Identified</td>
<td>Staff can evaluate complexity of funding and project to determine need for co-developer. Understand how to locate development partner and negotiate contracts.</td>
<td></td>
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<tr>
<td>ASSESSMENT CATEGORY</td>
<td>ASSESSMENT CRITERIA</td>
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<tr>
<td>Network Relationships</td>
<td>Established Relationships with Experts</td>
<td>Developed network of housing and development experts (environmental, engineers, architects, attorneys, development consultants...). Mechanism for evaluating and contracting.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Established Relationships with Government</td>
<td>Has good relationship with HUD field office, local government staff (housing, planning, building depts.)</td>
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<tr>
<td></td>
<td>Established Peer Network</td>
<td>Has relationships with other housing developers, technical assistance providers, nonprofit advocacy networks</td>
<td></td>
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<tr>
<td></td>
<td>Educational and Training Networks</td>
<td>Has training budget, staff and management attend HUD trainings and FHC Annual Conference</td>
<td></td>
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<tr>
<td>Organizational Management</td>
<td>Personnel Policies</td>
<td>Written organizational policies exist and are regularly updated. Policies include conflict of interest provisions</td>
<td></td>
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<tr>
<td></td>
<td>Board Policies</td>
<td>Written Board policies exist and are regularly updated and include conflict of interest provisions</td>
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<tr>
<td></td>
<td>Monitoring &amp; Audits</td>
<td>Monitoring reports from funders are reviewed and guide internal operations. Organization undergoes professional audit annually and uses outcomes to improve controls</td>
<td></td>
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<tr>
<td></td>
<td>Property Management Policies</td>
<td>Written procedures detailing tenant selection, maintenance procedures, rent collection, fee schedule and eviction process exist and are regularly updated</td>
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<tr>
<td>ASSESSMENT CATEGORY</td>
<td>ASSESSMENT CRITERIA</td>
<td>ASSESSMENT</td>
<td>Notes</td>
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<tr>
<td>Financial Policies</td>
<td>Written policies exist and include internal controls and accounting, relative authority for disbursements and reconciliation procedures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technological Resources</td>
<td>Internal Accounting system</td>
<td>Sophisticated accounting system in place and utilized</td>
<td></td>
</tr>
<tr>
<td>IT Capacity</td>
<td>Updated hardware and software in place that is functional and adequate for reporting and daily needs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Management</td>
<td>Professional property management software in place and utilized</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Resources</td>
<td>Board Committee</td>
<td>Qualified Board Finance committee meets regularly to review finances including cash flow and budget variances</td>
<td></td>
</tr>
<tr>
<td>Internal Capital</td>
<td>Cash on hand sufficient to meet operating expenses, reserve requirement and to invest in predevelopment. Line of credit in place for cashflow.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to Outside Capital</td>
<td>Financial statements and balance sheets prepared and reviewed regularly. Credit and cashflow sufficient to attract outside capital.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fundraising</td>
<td>Formal plan to raise operating funds and fill project gaps</td>
<td></td>
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<tr>
<td>Grant Writing</td>
<td>Expert staff in place or contracted to research and write grants.</td>
<td></td>
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</tr>
</tbody>
</table>
PART 3: EARLY DECISION- MAKING THE “GO” OR “NO-GO” DECISION

When a project is being initially considered, there are several situations that should raise red flags and could provide enough information to terminate the inquiry. Some of these are based on the property and some on management and operations. This review should not be considered a comprehensive due diligence checklist but rather specific areas where characteristics of a small scale project would raise a red flag requiring further review.

3.1 SITE AND USE APPROVALS

Zoning, land use and site plan approval can be lengthy, expensive and contentious. Some older properties are non-conforming to current zoning or land use restrictions. If the density or other site characteristics such as setbacks, number of parking spaces, or lot coverage do not meet current standards, it will be very difficult or prohibitively expensive to get the permits needed to do a full rehabilitation. If rehabilitation of the property triggers a requirement for re-zoning and land use changes, the deal might be infeasible given anticipated timeframes and available cash on hand. Another concern is if the intended use is an authorized use of federal housing dollars as defined as a need or strategy in the Consolidated Plan. If not, federal funds may not be eligible until the plan can be amended.

3.2 INFRASTRUCTURE

Upgrading water and sewer are high cost improvements that could sink an otherwise feasible budget. Even if funds are available but the installation expense increases the level of debt service, this could have a negative impact on the future operation of the project. Double check the availability of water, sewer, electric, cable, phone, and recycled water for irrigation. Check the local capital improvements plan to see if there are improvements planned that will result in an assessment that could be an unexpected expense.

Sewer and water connection fees could be a cost not anticipated or included in budgeted funds. A new project or newly rehabilitated may be required to pay these connection fees if the property is converted from a single to individual meters. Impact fees may be incurred if the number of units is increased. These expenses can be quite significant in some areas and should be carefully considered as part of the rehab budget.

3.3 SCATTERED SITE OR REMOTE PROPERTIES

If a property is part of a portfolio of other small rental projects, it is important to consider the distance separating the properties. The cost of inspections, showing the property to perspective tenants and maintenance calls can increase operating expenses whether the management is being done in-house or through a third party management
company. Map the properties and measure the mileage between them - an outlying property may decrease efficiency in management.

As we have noted, having enough units to benefit from property management economies of scale is essential for a successful scattered site rental program. A portfolio in the range of 60-80 units typically allows for sufficient cash flow to cover the cost of property management and often provides enough revenue for maintenance staff. The geographic location of the properties is very important. Units that are in close proximity to one another results in reduced travel time for both property management and maintenance staff.

3.4 PROPERTY CONDITION

If a building or site will require extensive rehabilitation, both the time to complete the work as well as the expense should be carefully considered. Before committing resources to the extensive analysis that should be done on a property in poor condition, the decision to walk away from the project might be the best. The length of time for any special permitting or local approvals should be considered. Conducting a Capital Needs Assessment is critical to determine the current and future repairs and maintenance needs of the property. (See Part 4)

3.5 CONSTRUCTION STANDARDS

In addition to meeting the locally designated construction standards, the building materials composition and interior elements should be sustainable and require normal maintenance and replacement treatments. Many developers avoid stick built buildings, favoring only concrete or masonry. The age and condition of major systems including windows, HVAC, electrical and plumbing may be too costly to replace upon purchase or will require replacement in the future with more efficient but higher cost components.

3.6 REHABILITATION STANDARDS

As with any rehab program, rehab standards are extremely important when acquiring and rehabilitating units for a scattered site rental program. However, unlike with owner occupied rehab programs, when replacing components, scattered site rental standards should not replace like with like. Instead, scattered site rental programs should focus on universal components for all units. This helps reduce the cost of maintenance. In some instances it is not possible or practical to use the same components in all units. In these cases the developer should develop a database that lists the type and year of each appliance, HVAC system, plumbing fixtures, etc. for each unit. This database can be used by maintenance staff when service calls are received, and asset management staff when planning for capital expenditures.
3.7 HISTORIC PROPERTIES

Some older small scale properties may be located in a historic district or be listed as historic. While this in and of itself should not be a deal killer, the future rehab requirements should be investigated by reviewing the standards and the process for permit approval. Often there are grants available to help offset the additional costs of meeting historic rehabilitation standards. Some communities offer zoning or building code relief (non-safety related) for the preservation of historic properties. In the proper treatment of historic buildings, it will be essential to build an experienced team including the architect and the builder.

3.8 COMPLIANCE PERIOD

Will the property physically survive and cash flow for the compliance period? The Capital Needs Assessment should indicate any major issues that would predict serious expenditures required during the affordability period. Surrounding land uses may give some insight into the future marketability of the property. Future infrastructure assessments should be considered by checking the Capital Improvements Plan of the local government.

3.9 PROJECTS OF LAST RESORT

If you are offered a property that has been turned down by multiple investors, there is probably a good reason. Inspections and evaluations should be carefully reviewed. Unless it is within the mission of the organization to pursue such projects, then red flags should be heeded.

3.10 MARKETING CONCERNS

The number of bedrooms along with other characteristics such as parking, fencing, storage space, outdoor patios or decks, stairs vs. elevators, and security are features that your target market will consider when deciding to rent a unit. For example, if your target market is seniors or people with special needs, 1 and 2 bedroom units will be most marketable, along with security and easy access.

PART 4: FINANCIAL CONSIDERATIONS

4.1 CASH FLOW – UNIT-BY-UNIT BASIS VS. PORTFOLIO

For a variety of reasons, not the least of which is legal liability, large rental developments are often owned by a single asset, Limited Liability Corporation. Because of this, property owners are used to determining the cash flow of a rental project on a property-by-property basis. With small scale scattered site properties, it is also important to know whether each property has a positive cash flow. However, as
has been noted elsewhere in this guide, owning a large number of properties enables nonprofits to benefit from the economies of scale that are vital for a successful business line. Small scale owners therefore need to not only evaluate the financial health of each property, they should also look at the overall financial health of their entire portfolio.

There are factors beyond the control of management that can result in a rental unit experiencing a negative cash flow. Let’s look at an example of a single family unit that rents for $850 per month and has a positive annual cash flow of $1,800 per year. If two months of rent are lost due to an eviction, and $1,000 is needed to make repairs, that unit will go from $1,800 of positive cash flow for the year to operating $900 in the red. However, if the developer has 50 units, and they each average $1,800 of cash flow for the year, the other 49 units will make up for the $900 loss on the unit in our example.

Unanticipated repairs and having units occasionally offline is inevitable when owning rental housing, and our operating proformas are designed to account for this. While the financing of each property needs to be structured so that it generates a positive annual cash flow, when dealing with single family and small scale properties, some years will be positive and others will be negative. A property that operates in the red for a year should be evaluated to make sure the operations of the property are not flawed and that the shortfall is not repeated annually. Individual small scale properties will occasionally have an off year. It is therefore important to annually evaluate the overall financial health of the portfolio and not make decisions based on one property having an off year.

4.2 THE CAPITAL NEEDS ASSESSMENT AND REPLACEMENT RESERVE ANALYSIS

A Capital Needs Assessment (CNA) provides an extensive analysis of building systems, recommendations for specific improvements, and funding estimates for long term maintenance. This analysis, also known as a Physical Needs Assessment (PNA) estimates a property’s repair and replacement needs over an extended period of time, often analyzing the way in which resources need to be accumulated to pay for these needs (reserve analysis). When acquiring existing buildings, a high quality CNA, with a replacement reserve analysis, is a critical part of the due diligence process.

4.2.1 REPLACEMENT RESERVES ANALYSIS

With new construction, property owners and lenders have historically used a standard rule of thumb for allocating annual contributions to reserves. For many years people in the industry have been using $360/unit/year ($30/unit/month) as a guideline. This in fact was the first standard used by the Massachusetts Housing Finance Agency (MassHousing) when it began requiring reserve studies in the mid-1980s (Daily and Whiston, 2005). Being over 30 years old, it is not surprising that this number is no longer sufficient to cover the replacement cost of components as they wear out. In market rate housing, paying down first mortgage debt, combined with annual rent increases offers the owner the ability to borrow money when components need to be
replaced. Affordable housing developments can rarely support much debt; the majority of the financing for an affordable housing rental deal comes from subsidy, which usually does not disappear over time. Even if it did, rent restrictions needed to maintain long term affordability, continues to limit the amount of debt a property can support. A high quality reserve analysis is therefore extremely important when acquiring existing affordable rental units.

A replacement reserve analysis should list the inventory of components, the estimated remaining life of each component and the estimated future replacement costs. This information is then used to establish the per unit per year amount that needs to be deposited into a replacement reserve escrow account.

4.2.2 TYPICAL REPLACEMENT ITEMS

The items below are the typical types of repairs/replacements that are considered capital items and are therefore eligible expenses from a replacement reserve escrow fund. The list can also be used as a checklist when reviewing the completeness of a capital needs analysis conducted prior to acquisition.

1) Replacement of refrigerators, ranges, and other major appliances in the dwelling units
2) Extensive replacement of kitchen and bathroom sinks and countertops, bathroom tubs, water closets and interior and exterior doors
3) Major roof repairs, including major replacements of gutters, downspouts and related eaves or soffits
4) Major plumbing and sanitary system repairs- including septic, sewer or package systems
5) Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, furnaces, temperature controls, boilers, and fuel storage tanks
6) Major overhaul of elevator systems
7) Major repaving/resurfacing/seal coating of sidewalks, parking lots and driveways
8) Major repainting of the building exterior and interior common areas.
9) Extensive replacement of siding
10) Extensive replacement of exterior (lawn) sprinkler systems
11) Replacement of or major repairs to a swimming pool
12) Projects involving finished floors, floor tile and floor coverings, which are not “routine maintenance” in nature
13) Glass replacement projects
14) Significant replacement of windows, including jambs, casing, sash, aprons and sills
15) Significant upgrading or replacement of fire alarm systems, components and fire stop systems
16) Certain payables. e.g. to avoid utility shut off “in extreme cases”
17) Consultations with Engineering, Architectural and other necessary professional firms for design services, bid preparation and third party construction monitoring of capital projects
18) Capital Needs Study
19) Common area refurbishment and renovation
20) Fencing replacement projects

Source: https://www.masshousingrental.com/portal/server.pt/gateway/PTARGS_0_12725_9561_0_0_18/Replacement_Resolve_Policy.pdf

4.2.3 ANTICIPATED CAPITAL REPAIRS- EXAMPLE

Table 4.1 is a summary of the anticipated capital repairs/replacements, by type, by year, for a 40 plus year old, 32 unit multi-family building that is for sale. Future costs are based on historical inflation rates for each type of repair. Over the 20 year planning horizon, the building is expected to need $1,364,106 in repairs.

4.2.4 REPLACEMENT RESERVE ANALYSIS EXAMPLE AND DISCUSSION

Table 4.2 is an example of a replacement reserve analysis for the building in Table 4.1. It shows that the building currently has a reserve balance of $15,172 and the current reserve contribution is $288 per unit per year. Not only is the current reserve balance insufficient to cover current year improvements, the replacement reserve contribution will only result in $184,320 over the next 20 years, well short of the estimated replacement costs during this same timeframe.

One possibility for the successful acquisition of this building would be to capitalize a replacement reserve fund with $763,760 and increase the replacement reserve contribution from $288 per unit per year to $450, with an annual increase of 3 percent. Capitalizing a reserve with such a large amount can be difficult to do under most affordable housing programs. Another alternative would be to undertake at acquisition the repairs identified as needing to be completed over the next five years. This would enable the public sector housing dollars to be used in a timely manner and would still result in anticipated replacement reserves being sufficient to cover replacement needs over the next 20 years.

In some instances, the affordable rent structure may make it impossible for the replacement reserve contribution to be increased. In this example, if the year 1 replacement reserve contribution is kept at $288, and the $763,760 worth of repairs are completed at acquisition, $156,241 would have to be deposited into a replacement reserve account. While it varies by the source, affordable housing programs will often allow their funds to be used to capitalize a reserve, provided the funding of the reserves is required by the conditions of a first mortgage from a lender. This usually cannot be done if the only financing source is public sector affordable housing funds.
It is important to note that the results of this analysis should be used when deciding whether a deal is viable. Acquiring an existing building without adequate money for current and future repairs may simply result in a new owner for the same slum property.
Table 4.1 - Sample Replacement Needs Summary

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<td>$2,752</td>
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<td>$15,827</td>
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<td>Units Subtotal</td>
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<td>$9,637</td>
<td>$9,927</td>
<td>$10,224</td>
<td>$3,778</td>
<td>$21,697</td>
<td>$22,498</td>
<td>$28,323</td>
<td>$29,173</td>
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<tr>
<td>Total Capital Costs</td>
<td>$72,836</td>
<td>$9,637</td>
<td>$26,454</td>
<td>$11,105</td>
<td>$3,778</td>
<td>$46,773</td>
<td>$176,284</td>
<td>$28,323</td>
<td>$63,801</td>
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### Table 4.2 - Replacement Reserve Analysis

<table>
<thead>
<tr>
<th></th>
<th>Year1</th>
<th>Year2</th>
<th>Year3</th>
<th>Year4</th>
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<tbody>
<tr>
<td><strong>A) Reserve Balances</strong></td>
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<tr>
<td>Starting Replacement Reserves</td>
<td>$15,172</td>
<td>$498,361</td>
<td>$288,170</td>
<td>$205,849</td>
<td>$115,760</td>
<td>$121,612</td>
<td>$120,671</td>
<td>$136,257</td>
<td>$145,490</td>
<td>$140,653</td>
</tr>
<tr>
<td><strong>B) Annual Funding</strong></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Contributions Indexed at 3%</td>
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<td>$492</td>
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<td>$522</td>
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<td>$554</td>
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<td><strong>C) Total Annual Reserve Funding</strong></td>
<td>$9,204</td>
<td>$14,848</td>
<td>$15,296</td>
<td>$15,744</td>
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<td><strong>D) Interest on Reserves at 1.0%</strong></td>
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<td><strong>Total Funds Available</strong></td>
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<tr>
<td><strong>F) Total Capital Cost</strong></td>
<td>$290,367</td>
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<td>$106,274</td>
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<td>$17,646</td>
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<tr>
<td><strong>G) Reserve Balances</strong></td>
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<tr>
<td>Outside Funds</td>
<td>$763,759</td>
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<tr>
<td>Adjusted Reserve Balances</td>
<td>$498,361</td>
<td>$288,170</td>
<td>$205,849</td>
<td>$115,760</td>
<td>$121,612</td>
<td>$120,671</td>
<td>$136,257</td>
<td>$145,490</td>
<td>$140,653</td>
<td>$148,464</td>
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</table>
## Table 4.2 - Replacement Reserve Analysis (continued)

<table>
<thead>
<tr>
<th>Year 11</th>
<th>Year 12</th>
<th>Year 13</th>
<th>Year 14</th>
<th>Year 15</th>
<th>Year 16</th>
<th>Year 17</th>
<th>Year 18</th>
<th>Year 19</th>
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</thead>
<tbody>
<tr>
<td>A) Reserve Balances</td>
<td></td>
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<tr>
<td>$148,464</td>
<td>$103,817</td>
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<td>$158,759</td>
<td>$15,921</td>
<td>$20,580</td>
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<tr>
<td>B) Annual Funding</td>
<td></td>
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<tr>
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<tr>
<td>C) Total Annual Reserve Funding</td>
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<td>$19,392</td>
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</tr>
<tr>
<td>D) Interest on Reserves at 1.5%</td>
<td></td>
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<td>$8,797</td>
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<td>E) Total Capital Cost</td>
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<td></td>
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<td>$72,836</td>
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<td>$28,323</td>
<td>$53,801</td>
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<tr>
<td>F) Adjusted Reserve Balances</td>
<td></td>
<td></td>
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<td>$103,817</td>
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<td>$158,759</td>
<td>$15,921</td>
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<td>$776</td>
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PART 5: PROPERTY MANAGEMENT CONSIDERATIONS FOR SMALL SCALE RENTAL PROJECTS

The residential property manager oversees an income-producing residential property on behalf of the owner. Properties can be one unified site, scattered site, detached single family homes, condominiums or mixed residential and commercial. Property management companies vary in experience and services with some focusing only on large scale multifamily properties and some managing portfolios of small, scattered site properties. This section describes the responsibilities of residential property management in the context of smaller properties, and compares fee based professional companies to property management done in-house by the nonprofit owner.

5.1 WHAT IS THE JOB OF THE PROPERTY MANAGEMENT COMPANY?

Property management duties include all aspects of marketing, leasing and operating. Management duties begin during the pre-development and development period. Management decisions should be carefully evaluated because the results can determine the eventual success or failure of the venture. Perhaps the most critical decision for any owner of rental units is whether or not to manage the property or properties in house or to hire a third party management company. Property Management Companies serve clients of all types including for profit investors, nonprofit organizations, and supportive housing organizations.

The following summarizes the activities and responsibilities of property management.

5.1.2 PRE-OCCUPANCY AND LEASE UP

Develop a marketing plan during the development phase. Identify a target market income level, demographic characteristics and geographic area and decide how best to reach out. Prepare a marketing budget for pre-leasing advertising and marketing and during lease-up. Identify competition and develop a plan to be competitive. Identify incentives that will ensure timely lease-up with the desired mix of tenants. Prepare materials and media for production.

Establish leasing policies and procedures. Develop operating policies and procedures, application forms, agreements and riders. Decide the level of maintenance that will be required of the tenants and what will be handled by the owner. If this is a lease purchase program, prepare policies and agreements as needed.

Prepare for meeting Fair Housing and Affirmative Marketing requirements. A plan will have been required during underwriting but make sure the full board of the organization is aware of its content and responsibilities. Make sure all notices and statements are placed appropriately. Make sure ADA (Americans with Disabilities Act) and Section 504 accessibility requirements are being met as appropriate.

Establish monitoring plan and checklists. Determine what entities will be monitoring the loans and grants supporting the project. Examine all loans, grants, and applications made to
determine responsibilities and commitments made, such as computer rooms, playground equipment, tenant services and unit mix.

**Establish Utility Allowance.** Identify the most current utility allowance and rent levels allowed based on subsidies. The local public housing authority utility allowance is acceptable unless a customized amount is prepared in conjunction with the local utility. Small scale properties often vary widely in type of construction materials, age and energy efficiency measures which can require a closer analysis when establishing the utility allowance.

**Establish Rent Levels and Fixed/Floating Units.** Rent levels also may vary depending on the funding source. The property manager establishes the rent levels according to the loan or funding document requirements. When there are a variety of sources and vouchers involved, the calculations are critical not only in compliance but making sure adequate income is received. Small scale properties are very sensitive to rent levels. If the project is mixed income the fixed units must be identified with assurances that they are equal in amenities, scale and location.

**Show Units to Prospective Tenants.** The leasing agent is responsible for showing units to potential tenants and taking applications. The leasing agent is the point person with the tenant applicants. It is important to select quality tenants that meet income qualifications. The leasing agent negotiates the lease period and terms. The lease terms must contain the appropriate program information. Information collected must meet compliance requirements in anticipation of monitoring. The leasing agent also assists the new tenant with move-in and utility connections. The leasing agent is responsible for the move-out when the process begins again.

### 5.1.3 MAINTENANCE AND TENANT SERVICES

Appoint someone (property manager or staff contact) to serve as the point of contact for tenants when they move in or out, and on a day to day basis. Ensure they respond in a timely manner to requests and anything that impacts the building or premises.

The property manager or designated staff should work with maintenance personnel or contractors on routine maintenance and repairs, keeping records of unit, date, event, expense, and completion. They should also maintain and manage record keeping for payroll, insurance, loan payments, contractors, taxes, and budgeting.

The property manager is responsible for regular contacts with the owners including reports, expenses, and property events. It is the owner’s responsibility to ensure the communication remains abundant and on a regular basis.

The manager is responsible for implementing the tenant services commitments found in the loan documents. This is an important compliance issue that can be difficult for owners of small projects to oversee. Scattered site properties that do not have a centralized location on site for these legal documents need a system for easy access to them for both managers and monitors.
5.1.4 PROPERTY MANAGEMENT CONCERNS

Whether small scale rental projects are managed in house or outsourced, there are some common concerns that affect the successful operation of properties.

**Staffing.** Smaller properties and portfolios may not have the income needed for full time staff for leasing and maintaining the units. It is difficult to find experienced staff who are willing to work part time. Sharing staff among organizations is a possible solution. Hiring bi-lingual staff is a plus. This can help with marketing and in establishing good tenant relations. In larger multifamily properties, leasing agents are paid a commission and bonus for leasing up units and keeping them occupied. This is not affordable in smaller projects. Smaller projects also may not be able to afford a vehicle for maintenance or for inspections and site visits to geographically dispersed properties. An allowance paid to the staff for the vehicle is a common solution.

**Building permits.** As municipalities seek more revenue, many are requiring permits for ordinary repair items that did not previously need a permit. This can break the budget of a small scale property if contractors must be hired to replace hot water heaters or AC condensers, for example. These items will need to be replaced at some point, so it is important to budget for these costs.

**Supportive service funding for case workers.** As state budgets reduce funding for these services, the impacts can be felt by both supportive housing organizations and property management companies. The lack of case workers may mean that certain types of housing, such as group homes, are no longer feasible. Projects with a committed set-aside of special needs units are at increased risk as tenants may not have the services needed or units may not be leased in bulk by designated support agencies. Better networking and coordination will be required to offset this shortage.

**Tenants.** The most critical item affordable housing program monitors consider is the income eligibility of tenants. This must be correctly certified and available for inspection. However, property managers often find that while it is not difficult to find renters with the right income, they cannot afford the designated rents. Layering multiple funding sources can result in a slim definition of income eligibility and this, along with the property location or demographic target may hinder full occupancy. In small scale projects, occupancy is of great concern. A ten percent vacancy rate in a ten unit complex can be devastating to the operating budget. Rental pro formas typically use a 5 percent to 7 percent vacancy/collection loss rate to project net operating income. In this 10 unit deal, a 10 percent vacancy rate could be realized with only one un-rented unit. It is critical to ensure in the planning stages that there is an adequate market for the desired tenants to ensure not only compliance but full occupancy.

A small nonprofit owner may not have the legal expertise to handle evictions and lease violations. It is especially important to have this covered because non-payment of rent or lengthy eviction battles in small projects can cause serious budget problems. Tenants have
access to free legal assistance in most areas but for the landlord, good legal counsel and proper training are essential.

5.2 PROPERTY MANAGEMENT: IN-HOUSE OR OUT SOURCE?

Property managers operate income producing rental housing on behalf of the owner with the objective of protecting and maintaining the investment. Affordable housing is operated with the objective of providing safe and decent housing for low income tenants, but the lenders and funders also expect the investment to be protected and enhanced. Each rental property owner or perspective property owner must make the critical decision of deciding whether or not to outsource property management. The ongoing management of the project will determine its success or failure in the future. This is why choosing the right type of management is so important.

Factors to consider include:

- Experience and staff capacity
- Project size and scale
- Monitoring
- Location
- Maintenance
- Supportive Housing

5.2.1 EXPERIENCE AND CAPACITY

If the owner lacks experience in property management and does not have available staff resources to undertake the activities described in section 5.1, then outsourcing is probably the best decision at least in the initial years of operation.

The mission of many nonprofit affordable housing providers is to increase the inventory of affordable housing opportunities in a given community. This broad vision encompasses fund raising, advocacy, partnership building and development. Once the housing is financed, developed and ready to occupy, some find that current staff do not have the same skill sets that the operation and maintenance of housing requires. Many housing providers are experienced in homeownership development or purchase assistance but are not prepared for the ongoing day to day maintenance of rental housing.

The promises and commitments made at the time of application for funding from affordable housing programs are contained in the loan documents as well as the Land Use Restriction Agreement (LURA) or Extended Use Agreement (EUA.) Program monitors often find that inexperienced property management or owners do not maintain those commitments that were made upon application for the funding. These shortfalls involve tenant services or amenities as well as maintaining uniform physical condition standards. Small scale properties have a tight budget for operating and if there were commitments for such items that are not adhered to either due to budget issues or management oversight, findings by the monitor can lead to negative consequences.
In an effort to contain costs, owners of small scale rental developments are often tempted to hire inexperienced, and therefore less expensive, property managers. Unfortunately this often leads to even higher costs. Untrained property managers can make mistakes when calculating income and end up renting to a family that is over income. This can result in serious consequences that could require the repayment of subsidy funds.

Inexperienced property management personnel also tend to go astray in adhering to Fair Housing laws by their actions or by not maintaining the proper documentation on site. These shortfalls can lead to costly problems that may diminish operating capacity for some time due to legal fees or the cancellation of loans.

Other problems with inexperienced property management personnel occur when there may be property management experience but not in affordable housing. Occupancy ratios will be a priority, rather than proper selection of income eligible tenants. Another occupancy problem with a small scale property is that one or two vacancies can seriously impact the operational capacity of the project. One long term vacancy in a ten unit complex causes a tenth less income which could be devastating.

Maintenance is an important consideration when delegating these duties to inexperienced or low cost staff. The lack of proper training can lead to poor decision making such as disconnecting smoke alarms or taking down amenities that were guaranteed in the loan documents and LURA. These can be corrected but it is not desirable to have them observed by monitors.

Finally professional management companies have in place operations manuals, systems and policies. The new entrant into small scale rental ownership will require the preparation of the legal documents, leases, maintenance schedules, management plan, compliance and monitoring plans, etc. The cost of developing these policies, procedures and documents must be included when making property management decisions.

5.2.2 PROJECT SIZE AND SCALE

Larger projects most often hire a fee based property management company that specializes in all aspects of managing and operating affordable multifamily properties. New entrants into the business must evaluate the scale of their operation and in-house experience in making this important decision. This should be a decision made in the very early stages of considering the acquisition of properties. Small scale property owners who own one or more properties that may be on scattered sites need to carefully evaluate their staff capacity as well as operating budget to determine if they outsource the management during the planning stages. This should be part of the due diligence and feasibility evaluation when considering a project.

Small scale properties are much more critically impacted by vacancy than larger sized properties. One vacancy out of ten results in a ten percent reduction in income. Indirect operating expenses however, remain the same. An experienced and capable manager,
whether in house or not, will be sensitive to this and strive to maintain the highest occupancy possible.

5.2.3 MONITORING AND COMPLIANCE

One of the areas for consideration is how the project will be monitored. It is informative to understand the role of project monitors and what their main concerns are for small scale properties. Basically when a project undergoes credit underwriting and receives financing from public sources, in particular HUD or tax credits, monitoring is part of the program for the life of the affordability period. The main job of the monitor is first to ensure that the occupants meet income qualifications. Closely following income certification is the determination that the project is meeting the requirements of the loan documents, the LURA or the EUA.

Monitoring entities do not draw a distinction between the owner and manager- errors by management are viewed as an error by the owner. The management entity, either by in house staff or third party is extremely important to maintaining the program requirements. The outcome of the monitoring process is to determine if the property is in compliance with the funding source and other requirements. Monitors may note a concern that indicates a problem is looming, or a finding that indicates a violation of a rule or procedure. Monitors report to funders and lenders and a finding of non-compliance is a serious issue that can result in the repayment of funds. For small scale properties the requirements are the same but there are fewer staff to make sure documentation is correct and that project rules and commitments are being followed.

Monitoring occurs either remotely or on-site and follows a regular schedule. It is important that property managers provide monitors access to materials and properties.

Monitors examine documents and policies governing the items in the list below. While a small number of units may mean a shorter monitoring visit, it does not mean that the monitor will review fewer items.

- Recordkeeping
- Eligible Costs/Subsidy Layering/Cost Allocation
- Initial and Ongoing Rents, Incomes and Occupancy
- Property Standards
- Eligible Costs
- Construction Management
- Loan Servicing

5.2.4 GEOGRAPHIC LOCATION AND PROPERTY MANAGEMENT

Ideally, property managers should be located in reasonably close geographic proximity to the properties they manage. Long travel times result in higher costs when showing or checking on units. Being able to conveniently drive by the properties allows the manager to check for rule violations and some maintenance issues.
5.2.5 MAINTENANCE AND REPAIRS

Whether properties are managed in house or by a property management company, it is more cost effective to have employed staff available to respond to repair requests, clean and prepare units for move-in, and maintain building and grounds. Work requiring permits will require licensed contractors which will either mean outsourcing the work or employing licensed staff. Leases should specify what, if any, maintenance responsibilities are to be handled by the tenants. Some organizations specifically assign tenants to various maintenance duties to cultivate skills in preparation of homeownership or as part of the program to enhance life skills.

Maintenance staff not only respond to repair calls, but also pressure wash, paint, remove trash, and make basic repairs when units turn. While the cost of hiring a company to paint a unit could exceed $1,500, the in house cost is estimated at $300 for materials, and the time for staff to complete the job. Lawn care and landscaping may be one example that it is cost effective to hire out due to the expense of maintaining and transporting equipment.

Some municipalities are requiring permits for repairs that previously did not. The cost of hiring a contractor to replace a hot water heater or air conditioning condenser can greatly affect a budget for small scale rental properties. It is optimal to begin with fully rehabilitated or newly constructed properties.

Owners of multiple properties maintain an inventory of standardized fixtures and equipment. Property management companies with multiple clients will maintain separate inventories of specialized items but will draw from company inventory for common items to avoid excessive tracking of expenses. Larger properties will have a storage area on site to keep equipment and supplies, but for smaller properties a common warehouse is needed to store not only supplies such as light bulbs and air conditioning filters, but landscaping equipment, if applicable.

5.2.6 SUPPORTIVE HOUSING

It is presumed that the target market for the property is well established in the mission of the organization. Supportive housing projects must also decide whether to use in house staff for management or to outsource it. Monitors often find that supportive housing organization staff are more committed to the mission of serving people with special needs than in adhering to the complex array of affordable housing rules. This can result in lapses in compliance and basic management needs of occupancy, maintenance and collection of rents and fees.

Property managers find that it is easier to manage when the demographics of the tenants is similar, for example, all elderly or physical disabilities. Some properties have a certain percentage of units set-aside for tenants with special needs. It is optimal if those units are rented in full by a support agency as this will not only stabilize revenue, but ensure there are case managers available to assist the residents. Another consideration is the capacity of
supportive housing staff to carry out the impersonal duties of rent collection, rule enforcement, and eviction.

The table below compares these considerations among a large for profit property management company and a large nonprofit housing provider. The property management company manages properties for both nonprofit and for profit clients. The nonprofit housing organization manages its units in house with staff employees. The comparison shows how each responds to common management concerns. The size and scale of the nonprofit and its programs is an indication of the importance for smaller programs with less experience to exercise great caution in going it alone with their housing units.

**TABLE 5.1 - MANAGEMENT CONSIDERATIONS OUT-SOURCE VS. IN-HOUSE**

<table>
<thead>
<tr>
<th>Management Consideration</th>
<th>Sample Real Estate Property Management Company (for profit)</th>
<th>Sample Nonprofit Supportive Housing Organization Managing In-House</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experience and Capacity</td>
<td>Begun in 1969 as developer, managed own portfolio and clients. Today manages over 13,000 units nationwide. Independent agent in Florida manages close to 3,000 units of subsidized or supportive housing. Hires leasing agents and maintenance staff to cover multiple properties in estimated ratio of 2 staff per 150 units.</td>
<td>Begun in 1970 as nonprofit to serve people with mental disabilities with services and housing. Today serves 1,200 residents in over 40 properties in six Florida counties. In house services and property management by team of 25 employees, 14 of whom directly in housing property management and maintenance.</td>
</tr>
<tr>
<td>Project Size and Scale</td>
<td>Parent corporation manages projects with over 300 units but Florida agent manages units ranging in size from 4 to 62. Approximately 65% of parent corporation’s clients are nonprofits.</td>
<td>Management duties include administration of approximately 200 vouchers, 12 HUD 811’s with maximum number of units in a property 20. Housing types include group homes, supervised apartments, permanent supportive housing.</td>
</tr>
<tr>
<td>Monitoring and Compliance</td>
<td>In house compliance department reviews and approves every move in. Annual re-certification of ALL residents, all files audited internally annually. Copies of LURAs and program requirements kept on site. All leasing staff attend fair housing training annually. Each</td>
<td>Property managers are assigned units based on funding source, ex. HUD 811, HOPWA, ESG, Safe Haven. Managers develop file for monitors and prepare for all scheduled visits or desk reviews. Managers maintain program requirements for each property assigned. Multiple</td>
</tr>
<tr>
<td>SMALL SCALE RENTAL PROPERTIES</td>
<td></td>
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<tr>
<td>--------------------------------</td>
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</tr>
<tr>
<td><strong>Property</strong></td>
<td>has an operating manual and set of documents. Manuals are customized by lender requirements as needed.</td>
<td>funding sources results in frequent monitoring visits by different agencies. The nonprofit is a fair housing and ADA advocate and staff are trained in compliance.</td>
</tr>
<tr>
<td><strong>Location</strong></td>
<td>Large distances between properties require coordinated appointment of leasing agents and maintenance staff. Staff receive an auto allowance and use personal vehicles. Some properties have resident managers. Quarterly inspections made of each unit interspersed with monthly pest control inspections.</td>
<td>Units are scattered over six counties with large distances. All units inspected annually with some twice per year. Assisting move-in’s and move-out’s provides more access to units.</td>
</tr>
<tr>
<td><strong>Maintenance and Repairs</strong></td>
<td>Full and part time maintenance staff are employed and assigned to certain properties. They use their own vehicles and receive an allowance. Staff cleans and maintains units and grounds. There is a customized maintenance schedule for each property. The parent company provides expertise in replacement reserve analysis, capital needs analysis and HUD inspections.</td>
<td>Full time maintenance staff and a supervisor are employed. Personal vehicles are used but there are also vehicles owned by the organization. Long term financial forecasting for replacement and operating reserves is conducted in-house by staff and augmented with consultants as needed.</td>
</tr>
<tr>
<td><strong>Supportive Housing</strong></td>
<td>Many of the units managed are supportive housing- either by set-aside or the client is a supportive housing provider. Financial planning in the pre-development stage ensured that the rents would cover the outsourcing of property management expenses. In some cases the set-aside units are rented in bulk from the support agency. Reductions in funding levels for supports threaten programs with abandonment of units and non-compliance with set-asides.</td>
<td>Property managers are assigned to units according to type. Case workers are in house social services staff. Most residents are part of a program with the agency. Sometimes residents have to be moved to other locations due to health or other issues. Recent reductions in funding for support services resulted in the closing of a group home with residents moved to other housing. Maintenance staff assist with transporting residents in vans owned by organization.</td>
</tr>
</tbody>
</table>
PART 6: PROPERTY MANAGEMENT SOFTWARE

In-house property management requires the purchase of a good property management software package, one of the best investments you will make. While it is technically possible to keep track of rent payments, security deposits and repair invoices with a series of excel spreadsheets, the ability to automate rent collection and expense records with your general accounting system is an invaluable and time saving tool.

Property management software provides a wide array of services ranging from organizational tools and printable forms, to tracking income and expenses, and generating reports. Free basic software is available for download on the Internet, but do consider investing in a more sophisticated system to gain the maximum benefit. A good property management system can track rent payments, monitor work orders, automate bill paying, consolidate information for taxes and insurance, organize income and expenses by tenant, unit, building or portfolio; create application forms and lease agreements, automate credit and background checks, and generate notices and letters. To ensure your asset is being managed properly, this software can easily create long and short term financial performance reports so you can make adjustments as needed.

A quick internet search for “affordable housing property management software” will yield the names of many firms that provide this service. RentRight, Yardi Systems, LandlordMax and CornerStone are a few examples. RentRight, currently boasts more than 23,000 users worldwide and Yardi Systems, has won numerous awards for its property management applications. CornerStone is a Windows based accounting and affordable housing property management software which claims to integrate rent, accounts payable and general ledger entries, track subsidy information and fully automate the income certification process. The system has a Wizard component, a built in feature to check for compliance errors and offers online help with live chat.

To select the software that is right for your organization:

- Make sure the program specializes in affordable housing and can capture the data you’ll need for compliance reports on all the different layers of funding that may be in the project.
- Ask about start up training and ongoing technical support. Investing in a system that staff cannot successfully operate is a waste of resources.
- Take advantage of the free trials offered by most vendors. Make sure that end users have a chance to test each software package under consideration, or you may find that you’ve chosen a system that is more complex than you need.
- Ask other owners of affordable rental properties for recommendations. Try to arrange a visit to their property management office so you can see the system “live”. Ask what they like and dislike about their current system.
- Consider a system that allows data to be reviewed before it is entered into the accounting system to safeguard against incorrect entries. Some software packages automatically populate the general ledger and if a mistake is made, then both the compliance data and accounting data is wrong. A “stop and review” approach is preferable.
As a guide, ask about integration fees. Some firms charge a separate annual fee to integrate other software packages with your property management software. For instance, some software companies charge to integrate the property management software with your current accounting software or applicant screening tools.

- **Match your software to the size of your portfolio.** Some software is priced per-unit and some have an annual fee. While you want your property management software to be sophisticated enough to handle a growing portfolio, you don't want to pay now for features you won't need for years.

## PART 7: THE CASE FOR CONSOLIDATED MANAGEMENT OF SMALL SCALE RENTAL PROJECTS

This guide has covered many areas of heightened risk and responsibility for the owner of small scale affordable rental properties. One of the major areas of concern is management and operations. For organizations new to owning affordable housing or for those who own few units, outsourcing property management is the best option. However, depending on your location, you may find that a property management company specializing in small scale rentals is not available. Would it be possible to coordinate with other affordable housing providers in a region to form a management company that would serve all the projects of the participating organizations? Costs would likely be reduced since, instead of having four different people at four different agencies managing 12 units each, for example, you would be able to have one person managing 48. Increasing the number of units may also provide enough property management fees to hire a professional property manager, as opposed to having the duties tacked on to the workload of an already busy person.