INVESTOR INSIGHTS

The Fallacy of "Passive Investing" in Workforce Housing

June 2020

SPRING TIDE REAL ESTATE

We often encounter Workforce housing owners that have invested in assets in hopes of "mailbox money." These passive investors are often from out of state and take a largely hands-off approach. This is an unfortunate misunderstanding of the effort that is required to sustainably operate quality Workforce housing. Passive ownership leads to a handoff of management responsibility and is essentially the outsourcing of strategy and critical execution components to a third-party agent. As a result, owners fail to achieve expected returns and often end up with mismanaged and unprofitable assets. In our experience, property management agency risk is a primary driver of poor profitability, poor tenant living conditions, and inadequate ongoing investment.

Agency Risk with the Property Manager

Passive investing typically means passive managing and decision making. Property management companies have become accustomed to out-of-town investors handing over the keys and expecting monthly returns. This relationship breaks down fundamentally because of mis-aligned incentives between the owner and manager, sometimes called "agency risk". Property managers typically charge either a percentage of rent collected or a fixed fee per door and may also charge leasing fees for each new or renewed lease. This is important: *property management companies are paid on revenue and turnover, not profitability.*

Many issues are prevalent because of this structural misalignment: high lease turnover (remember, new leases result in higher management fees), higher operational expenses (there is little incentive to price shop for repairs and services), and poor tenant relations because of irresponsive management. These issues not only drives down profitability but also reduce quality of living for the tenants, which then leads to a lower quality tenant base and a host of new problems. It's a destructive spiral, and it can happen quickly.

When the Spiral Leads to Inadequate Property Investment

When reconciling poor financial performance, passive owners know too little about the property and tenant base to argue specifics and are left two choices: take the manager's word for it or fire the manager. A common response, particularly when keeping the manager, is to cut maintenance and repair costs (i.e., deferred maintenance). At Spring Tide we tour every unit of every property during due diligence and can't count how many times we hear about unanswered maintenance requests, sometimes for months or even years. This is a systemic issue in Workforce housing, and one that starts because a property owner believes they can be a passive investor and still achieve high returns. When we see deferred maintenance and angry tenants, we know we are touring a distressed property that has begun the downward spiral.

Control Your Strategy, Avoid the Spiral

To avoid these perils it's critical to have a realistic understanding of your role as an owner – namely, to be hands-on and to control the most important aspects to your strategy. Does this mean taking property management in-house? Not necessarily. But it does mean finding a balance between when to delegate and when to be intimately involved in the management and repositioning of the property. This can include major renovations and physical property repositioning, leasing and renewals, and ongoing maintenance, to name a few. The balance will be different for each owner and potentially even each property and it can be the difference between a well-managed property and a distressed asset. Our Vision at Spring Tide is to provide quality housing to America's workforce while delivering attractive returns for our investors. To achieve this we keep tight control of key strategic and operational elements and have a willingness to roll up our sleeves. This mindset enables us to provide professionalized investments in an often-mismanaged industry segment.

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