

THE VALUATION REPORT

A MONTHLY PUBLICATION ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

July 2003, Volume II, Issue VII, Published By Novogradac & Company LLP

97 Percent Occupied and No Cash Flow ...

By John J. Lisella III and Robert J. Wasserman

Apartment owners, developers and investors are all concerned about the aesthetics of their multifamily projects. However, the most beautiful words describing their apartment complexes are "100 percent Occupied."

Although the focus is often on the physical occupancy of the project, it is more important to concentrate on the economic occupancy of the communities in order to maximize cash flows and investment returns. The purpose of this article is to summarize the typical components that are used to calculate the economic occupancy of an apartment community. Please refer to the example on page three.

The example identifies that the project is 97 percent physically occupied for a given month. However, economic occupancy is only 83 percent. This large difference causes a substantial negative impact to the cash return for the owners and investors.

| ECONOMIC OCCUPANCY | Apartment Complex | |
|---|-------------------|----------|
| | Monthly | % OF GPR |
| GROSS POTENTIAL RENT(GPR) 65 Units @ \$650 | \$42,250 | 100.00% |
| VACANCY/CONCESSION/NO-N-REVENUE UNITS | | |
| VACANCY LOSS | (\$1,400) | 3.33% |
| RENTAL CONCESSIONS | (\$300) | 0.71% |
| RESIDENT/LEASING REFERRALS | (\$50) | 0.12% |
| EMPLOYEE UNITS | (\$650) | 1.54% |
| MODEL/OFFICE | (\$650) | 1.54% |
| SUBTOTAL | (\$3,050) | 7.24% |
| DELINQUENCY/BAD DEBT | | |
| BAD DEBT WRITE-OFFS | (\$4,500) | 10.65% |
| RECOVERY OF PREVIOUS BAD DEBT | \$500 | 1.18% |
| SUBTOTAL | (\$4,000) | 9.47% |
| TOTAL COLLECTIONS | \$35,192 | 83.29% |
| ECONOMIC OCCUPANCY | 83.29% | |
| PHYSICAL OCCUPANCY | | |
| # of Units | 65 | |
| # of Occupied Units | 63 | |
| Occupancy % | 96.92% | |
| Difference between Physical and Economic Occupancy | 13.63% | |

(continued on page two)

BRIEFS & RESOURCES

An appraiser's lack of knowledge of federal and state housing programs significantly undermined the credibility of his appraisal of a debtor's property, which relied on income from subsidized units, according to the U.S. Bankruptcy Court for the Eastern District of New York. (*In re Vanderveer Estates Holding, LLC, NO. 01-*

(continued on page six)

IN THIS ISSUE

Page 2
Study: Multifamily Housing More Beneficial than Detrimental in Working Communities

Page 4
Focus On: New Orleans, Louisiana

Page 11
Facts & Figures

Page 12
Determining Market Rent for New Developments in an Older Neighborhood

www.taxcredithousing.com

97 Percent Occupied

(continued from page one)

Revenue

An analysis of economic occupancy begins with an understanding of Gross Potential Rent (GPR). The monthly GPR is calculated by summing the contract rents of every unit. In the above example, the apartment community consists of 65 two-bedroom units renting for \$650 per month.

Adjustments to Revenue

The operative word in GPR is "potential." Although it is conceivable that \$42,250 per month in rent could be generated, the rent needs to be collected. Below are the primary adjusters to revenue.

Vacancy Loss

When a tenant moves out, there is often a period of time that passes before a new tenant moves in. This period can be quantified as a loss of income, or vacancy loss, for such month. For example, the chart below explains the economic impact of such loss.

| Vacancy Loss | | | | | | | |
|--------------------|------------------|------------------|-------------|---------------|-------------|-----------|-------------------|
| | Day of Move Out | Day of Move In | Days Vacant | Days in Month | Unit Vacant | Unit Rent | Loss in Occupancy |
| Move Out/Move In | | | | | | | |
| Unit A | 2 nd | 16 th | 13 | 30 | 43% | \$650 | \$ 282 |
| Unit B | 5 th | 19 th | 13 | 30 | 43% | \$650 | \$ 282 |
| Unit C | 9 th | Vacant | 21 | 30 | 70% | \$650 | \$ 455 |
| Unit D | 12 th | Vacant | 18 | 30 | 60% | \$650 | \$ 390 |
| Total Vacancy Loss | | | | | | | \$ 1,408 |

Rental Concession/Leasing Referrals

Another reduction in GPR occurs in "soft" markets in which owners offer rental concessions as incentives to attract tenants. These incentives often come in the form a discount to the lease contract rent. For example, an owner may offer a \$300 discount to the first month's rent if a tenant commits to a 12-month lease at the current asking rent. Even though the lease contract rent may be \$650 per month, the effective rental rate is \$625 per month after taking into account the effect of the concession.

Non-revenue Unit

It is common for the on-site property managers to live at the properties they manage. As part of their compensation, they might receive a discount from the asking rent. Since the employee's rent discount is usually a component of their compensation, the discount is typically reflected as an expense on the property's monthly operating statement versus a reduction in GPR. For purposes of calculating the economic occupancy, this expense is reflected as a reduction in GPR; however, there is no effect to net operating income. Furthermore, it is common for a unit to be converted to a leasing office (if there is not an on-site community building). Furthermore, in large apartment communities and/or in times of higher vacancy periods, a unit may be converted to a model, which assists the leasing staff in marketing the vacant units. When the occupancy increases, the unit may be converted back into a rental unit in order to maximize the project's revenue.

(continued on page three)

THE VALUATION REPORT EDITORIAL BOARD

Publisher

Michael J. Novogradac,
CPA

Editor

Jane Bowar Zastrow

Assignment Editor/Staff Writer

Alex Ruiz

Contributing Writers

David Boisture

Brandi Day

Technical Editors

Brad E. Weinberg, MAI,

CCIM

Blair Kincer, MAI

Production

Alex Ruiz

TVR INFORMATION

Address all correspondence
and editorial submissions
to:

Jane Bowar Zastrow

Novogradac & Company
LLP

246 First Street, 5th Floor

San Francisco, CA 94105

Telephone: 415.356.8034

E-mail: cpas@novoco.com

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property valuation or any other material covered in this publication can only be obtained from your tax advisor. For further information visit www.taxcredithousing.com No portion of this material may be reprinted without written permission of Novogradac & Company LLP. For reprint information and prices, contact Alex Ruiz at 415.356.8088 or alex.ruiz@novoco.com.

© Novogradac & Company
LLP, 2003

All rights reserved.

ISSN 1541-2474

**THE VALUATION REPORT
ADVISORY BOARD**

David Bartlett
**Georgia Department
of Community Affairs**

Peter H. Bell
**National Housing &
Rehabilitation
Association**

Bud Clarke III, MAI
**Lend Lease Real Estate
Investments**

Steve English
**Suntrust/Regency
Group**

Leslie Houston
Paramount Financial

Noel Khalil
Columbia Residential

Marnin Lebovits
**Chambers Dunhill
Rubin & Company**

David Finkel
CRI Inc.

John Lisella
**SunAmerica
Affordable Housing
Partners Inc.**

Phil Melton
**Collateral Mortgage
Capital LLC**

Molly Pearman
CW Capital

Michael F. Wagar
**Apollo Housing
Capital LLC**

Stephen J. Wallace
Nixon Peabody LLP

Robert Wasserman
**Simpson Housing
Solutions LLC**

Jump Head

(continued from page one)

Delinquency/Bad Debt

When tenants fail to pay their rent and continue to live in their unit, owners classify this loss in revenue as rental delinquency. Once the tenant is evicted, this loss in revenue will be classified as bad debt and will be expensed. Occasionally, a tenant will pay off the amount that was previously owed. When previously written off bad debt is later collected, such collection of cash is referred to as a recovery of bad debt.

Conclusion

Although it is important for apartment owners and investors to maintain a high level of physical occupancy in their communities, it is more important to manage the project's economic occupancy. Therefore, owners should carefully evaluate the financial impact of rental concession packages, along with monitoring the tenant approval criteria and bad debt collections policy on a regular basis to assist in maintaining a high level of economic occupancy. ❖

Robert J. Wasserman is an attorney and project manager in the acquisitions department at Simpson Housing Solutions LLC, one of America's leading partners in the investment and development of affordable multifamily and senior rental communities.

John J. Lisella III is an assistant vice-president in the acquisitions department of SunAmerica Affordable Housing Partners Inc., one of the largest investors of affordable housing in the country.

This article first appeared in the July 2003 issue of Novogradac & Company's The Valuation Report and is reproduced here with the permission of Novogradac & Company LLP.

© Novogradac & Company LLP 2003 - All Rights Reserved.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.taxcredithousing.com.