



*Real value in a changing world*

# Operating Expenses Underwriting

September 8, 2011

# General Slides

# Operating Expense Considerations

- Representative sample of drivers of operating expenses
  - Geography (climate, likelihood of insurable events)
  - Market (urban vs. rural, cost of living/salaries, competitive supply, union vs. non-union)
  - Occupancy (fixed vs. variable costs)
  - Age of units (maintenance requirements, energy efficiency)
  - Types of units (apartment, townhome, SF)
  - Square footage / number of bedrooms / occupancy type (seniors vs. high-density family)
  - Number of bathrooms (utilities consumption and maintenance)
  - Common area expenses (green space, meeting space, elevators, hallways)
  - Parking (availability, type)
  - Centralized vs. decentralized services (trash collection, mail delivery)
  - Rental rates (expectations of residents, costs based on % of income)
  - Land density (campus setting vs. high-rise)
  - Utilities (energy efficiency, rate dynamics, infrastructure demands)
  - Tax rates (property, income, sales, excise, other taxes unique to localities)

# Operating Expense Considerations

- Additional Underwriting Considerations
  - Ongoing development and renovation
  - Capital repair and replacement requirements
  - Ensuring marketability of units

Per Unit Per Month	Illustrative Example of Impact of Considerations		
	Comparable	Subject Property	Considerations
Income	\$1,000	\$1,200	<ul style="list-style-type: none"> <li>• Larger units, more desirable area, new property</li> </ul>
Expenses			
Maintenance	\$100	\$125	<ul style="list-style-type: none"> <li>• Increased sales tax, new construction, 2BA vs 1 BA</li> </ul>
Utilities	\$175	\$200	<ul style="list-style-type: none"> <li>• Larger units, 25% rate increase, more efficient</li> </ul>
Admin / Mgt / Services	\$75	\$100	<ul style="list-style-type: none"> <li>• Increased benefits/COLA, higher mgt fee, more services</li> </ul>
Taxes & Insurance	\$125	\$150	<ul style="list-style-type: none"> <li>• Higher tax basis, competitive insurance</li> </ul>
Total	\$475	\$575	
% of Income	47.5%	47.9%	

# Military Housing Case Study

# What is Military Housing Privatization?

- 1996 Defense Authorization Act included the Military Housing Privatization Initiative (MHPI), which enabled private sector engagement in housing ownership, operation and development at military installations
- To-date, the Services have privatized approximately 200,000 homes across the US
- Army portfolio of privatized housing is comprised of:
  - Over 84,000 homes across 34 projects at 44 military installations
  - \$11.3 B in initial development scope
  - \$1.3 B in annual revenue, \$550 M in annual operating expenses



# Operating Expense Analyses

- Due Diligence / Developer Selection
- Underwriting and Financial Closing
- Ongoing Monitoring and Reporting
  - Monthly reports / dashboards (benchmarked to budget)
  - Quarterly reports (benchmarked to budget, pro forma, portfolio and comparable projects)
  - Annual site visits (in-depth review of operating expense variance and drivers)
  - Operations Reviews (ad-hoc, in-depth review of operations at a specific project)
  - Restructuring, refinancing and expansion underwriting
  - Incentive fee reviews
- Annual Budget Reviews
  - Expenses are benchmarked relative to (1) prior year budget, (2) prior year actuals, (3) pro forma, (4) portfolio and (5) comparable projects
  - Charts of accounts are normalized/mapped to ensure apples to apples comparison between different property managers
  - Extensive historical data enables robust analyses and drives efficiency

# In-Depth Operating Expense Review

- Army Leadership sought to set “bands” for expenses
  - Operating expenses outside set bands would be at the expense of the Property Manager
  - Bands would be based on NAA/IREM data and would be either absolute or as a percent of income
- In response to this request, we conducted an in-depth analysis of operating expenses across the portfolio
- Based on analyses and presentations, concept of “bands” was deemed to not be feasible and Army Leadership was educated on various drivers of operating expenses