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Changing Tides: The End of Concessions

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"Most apartment managers are now having a hard time changing gears and focusing on the achievement of higher pricing levels in a recovering market."

While many high-profile, low-barrier-to-entry apartment markets on the West Coast and in the Mid-Atlantic have enjoyed strong results over the past five years, apartment operators in other parts of the country have been struggling to keep their heads above water during this same time period. As an owner/manager operating more than 16,000 units throughout the Southeast and Midwest, we have witnessed these challenges firsthand as many of our high-quality residents have departed to pursue the American Dream of home ownership in recent years.

Fortunately, the tide is changing in these markets as 2005 represented one of the few positive growth years since the late 1990s, and first-quarter results of this year reveal that momentum is building as favorable market circumstances—higher interest rates, improved job growth and declining new apartment starts—are taking over. In order to fully take advantage of these improving supply/demand factors, apartment managers will need to take a new approach to how they operate their properties in a recovering market.

During the past four to five years, most apartment managers have been conditioned by market circumstances to continually offer concessions and have implemented a strategy that entails matching or beating the best deal being offered in the market. During this period of weakness, tremendous focus has also been placed on maintaining or exceeding specified physical occupancy goals, without proper attention to the income or pricing results that correlate with these levels.

Due to these circumstances, most apartment managers are now having a hard time switching gears and focusing on the achievement of higher pricing levels in a recovering market, even if physical occupancy levels are somewhat sacrificed. It is imperative that senior level management meet these challenges head-on and work to change the culture and operating environment that has prevailed during the past few years. While we always hope that all of our valued associates will buy in, there will be associates who aren't able to make this transition and it will be necessary to determine if they can lead the property and company into the future.

With an increasing number of apartment renters in the market and a stable-to-declining supply of available units, it is prime time to begin increasing unit pricing and cutting back on concessions. Over the past year, most market participants in these formerly struggling markets began experimenting with higher pricing on specific floorplans and then moved to across-the-board pricing improvements after their initial success. Now that the recovery is well underway, it is important that apartment operators are focused on achieving a meaningful positive net spread on new move-ins versus move-outs, which simply means that you need to ensure that all new residents moving into your property are paying a higher rate than previous residents who occupied a specific unit.

These increases can range from 1 to 2 percent in certain markets that have just begun their recovery, all the way up to 6 to 10 percent in markets that are in a full recovery mode and exhibiting very strong economic fundamentals on a local level. You must also ensure that you have the technology that allows you to properly monitor and implement your pricing strategy, whether through an on-site operating system or a third-party revenue management product.

Unit pricing improvements also need to be extended to your current resident base during the lease renewal process, although it's always prudent to continue to offer your longer-term customers some pricing break versus the levels being paid by new residents coming off the street.

Fortunately, a meaningful pricing gap will exist between your current resident rent levels and market (new resident) rent levels, if the pricing strategies mentioned above are being followed. There is no doubt that it's difficult to communicate a rate increase to a long-term customer, but it's something that must be done as we are exiting such an extended period of depressed rent levels.

With proper planning on how the message is delivered and continued emphasis on the extraordinary service that is being provided to your customers, your staff can succeed at this difficult assignment. In many instances, we have seen a current resident react negatively to a rent increase, only to eventually return to sign their lease renewal after examining overall pricing levels in the area. I also would like to once again emphasize the need to have adequate technology available that will allow you to properly monitor and implement your renewal pricing strategy.

In a recovering market, it is also necessary to re-examine the compensation structure in place for sales associates who typically have a meaningful percentage of their compensation tied to commissions earned from leasing/renewal results.

It would be prudent to consider new alternatives to the traditional flat commission or per-lease commission paid to sales associates and instead implement a compensation program that better ties leasing commissions to the actual pricing level achieved per lease or the actual increase in rent paid by the new resident versus the former occupant of a specific unit.

While there are many different options for compensation programs, the ultimate goal is to make sure everyone on the team is pushing in the same direction, and extra rewards (commissions) are earned when the property experiences improved financial results.

It is truly an exciting time to be in the apartment industry and as our markets continue to recover, there is great opportunity for enhanced operating results if you can be alert and take advantage of the opportunities being presented. Good luck, have fun and make sure that every member of your team can share in your success. MHN

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