Explaining To Investors Why Distributions May Shrink

Ellen Calmas Forbes Councils Member
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Well-managed real estate funds typically provide annual above-market returns for limited partners (LPs), justifying the requirement that investors qualify with a substantial amount of upfront cash. The ability to provide big upfront commitments makes high net worth individuals in hot demand as funds look to grow their assets under management. This arrangement works out well for investors looking to generate greater, more consistent income, as long as quarterly disbursements remain steady.

While qualified investors are certainly not in short supply, the ability of some real estate funds to continue to deliver outsized returns may be shrinking due to current market conditions. How operators manage today's market challenges will impact the performance of their funds for investors, their ability to attract new LPs and their ability to increase asset values for future liquidation events.

Fund operators simply bemusing their potential 2020 losses do nothing to appease investors who depend on quarterly income checks. As such, strategies to stay ahead in even these most tenuous of times are being deployed, albeit in a rather bifurcated manner. For those who take a slow and steady approach, slow and steadily declining revenue may result from a resident base empowered by current renter protections. For operators who want to be more proactive in preserving economic occupancy (i.e., residents paying on time), prescriptive measures are available to protect revenue while also assisting residents in need of help. These measures are typically standardized across operations for new applicants as well as existing residents at renewal who have a history of outstanding balances, or for those struggling with a current outstanding balance. In each instance, cost savings for residents are offered in exchange for payment assurances through payroll direct deposit for property operations.

While these measures are gaining traction, the end of supplemental income from the CARES Act has been the impetus many fund managers needed to find better safeguards to protect steady cash flow and investor dividends.

Why more real estate funds aren't adopting prescriptive measures is dumbfounding given the state of personal finances today as well as recent government actions that hamstring property owners and managers from implementing normal business practices. Adding to current woes, multifamily platform leader RealPage estimates that the ability of renters to pay reliably will continue to decline, especially in markets where unemployment is outpacing benefits, such as California and Florida where renters receiving benefits are left with less than $500 to live on after subtracting average effective rent. Look no further than the National Multifamily Housing Council's tracking of early September rent payments at 76.4% for the first six days of the month, and it's easy to predict that action is needed to keep cash flowing in.

I spent some time looking at what fund managers are saying about market conditions this year and what they're telling investors that returns will look like in the months ahead. After reading through countless pages of economic gibberish from fund managers who liken themselves to leading economists, a few messages shine through:

• We are in unprecedented times.

• Investments were made in physical plant and technology to safeguard residents' well-being and enable hands-free delivery of rent and other services.

• Staff has gone above and beyond.

• The industry as we know it may never be the same.

• Quarterly disbursements will either be protected due to strong management planning and effective communications with residents, *or* disbursements will be reduced by X% due to the unforeseeable added expenses of operating during the pandemic when government interventions and changes in employment have altered cash flow.

Given the generic nature of some of the communication — and despite and/or because of the goodwill spent to protect residents in physical spaces — serious questions should be asked about how any funds will be able to deliver returns as promised. Deep pockets and great management planning will surely be the drivers of success.

For investors, the time is now to hold tight to the funds that are able to stay the course without decreasing quarterly payouts. These will be the funds that are making it easier and more cost-effective for residents to pay rent in a timely manner, while incentivizing renewals and continued occupancy without delinquency. They'll be the funds that are finding new sources of ancillary income that make sense to residents who are now captive to the safety of their apartment homes. And, to paraphrase Winston Churchill, they'll be the funds that recognize that a good crisis should never go to waste when changes in operations can add to profitability for all involved.

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