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MULTIFAMILY
EXECUTIVE



The Apartment Whisperer

Jim Lippman helps JRK Property Holdings to redefine the concept and upshot of multifamily value-add.

BY CHRIS WOOD

OPERATING MANUAL: JRK Property Holdings founder, chairman, and CEO Jim Lippman says the quest to double the size of JRK's multifamily value-add portfolio will be driven by operations more than makeovers.

Jim Lippman is an apartment whisperer.

Ask him and he'll tell you: One of the best ways to heal an underperforming multifamily property is to visit the asset, just stand there—and listen. Over the past 20 years, the founder, chairman, and CEO of Los Angeles-based JRK Property Holdings has developed an acumen for multifamily asset management that he says marries the creative with the analytical—and the operational with the underwritten—in a way that the dominant majority of current industry players have eschewed. Value-add, he argues, is not plug and play, is no longer driven by arbitrary market arbitrage pops, and is extremely less effectuated by financiers who farm out their property management than the owner/operators who roll up their sleeves and put an ear to the ground to hear what their assets are telling them. “Stanford and Harvard degrees are great,” says Lippman, who graduated from Schenectady, N.Y.’s Union College in 1979. “But you need to feel real estate in your gut. The properties will talk to you and tell you what they actually need. Value-add is not a cookie-cutter cap-ex approach from one property to another. It’s easy to look at a property and tell if it needs paint, but how can you immediately tell if the leasing office needs to be redesigned for better traffic flow, or if you need to move the gym from one side of the property to another? You need to stop and listen.”

That—and possess decades of operational real estate experience; a cadre of asset managers, as well as national and regional maintenance professionals; and a proprietary database that tracks and compares daily, weekly, and annual line item costs on all company investments, capital expenditures, and cost centers. These so-called “Green Book” reports (see “Little Green Book” on page 29) are generated every Friday and made available to all JRK asset and on-site managers, as well as the executive team. They show “where the property has been, where it is today, and where it is going on a real-time basis,” Lippman says.



PHOTOS BY ROBERT BENSON/AURORA



TOP UNIT: The JRK executive team includes (L to R): JRK Property Holdings executive vice president John McKee; JRK Birchmont Advisors fund president Bobby Lee; and JRK Residential Group president Laretta Collins.

Want to know how much an asset spent last Thursday per lineal foot on Benjamin Moore primer versus a historical average of paint costs for that asset—and even a portfolio-average primer cost? It's in the Green Book, right after the page showing last month's leasing special compared to market comps, traffic, signed leases, and cost per marketing lead and per signed lease.

JRK's use of the Green Book is just one example of the firm's evolution toward the micro-management of assets as part of a value-add multifamily model. While that model is still fundamentally arbitrage driven, it is also fueled by operational expense reduction and a 20 percent ROI target average for capital expenditures. As a result, JRK is no longer looking exclusively for market pop. "Three years ago, value-add players would put \$5,000 per unit into a Class C or B deal, try to get \$150 more in rent, and after two years of turning 50 percent of the units, they'd flip it," explains Bobby Lee, president of the firm's JRK Birchmont Advisors fund and acquisitions division. "We're not looking at below-market rents and occupancies in this market and trying to boost an 80 [percent occupancy level] to a 90 [percent one]. We approach the deal income-to-income, assume we can't do better on fundamentals than the current owner, and hang our hat on what we can bring to the table on expense reduction. We think that is in the realm of 20 percent to 25 percent."

Lee is right to a certain extent: There is indeed a niche market of multifamily players with a singular focus on purchasing assets below replacement costs with the intention of refreshing, restabilizing, and reselling on improved fundamentals at better cap rates. JRK is not one

of them. For JRK, value-add has become as much about machinations as it is about makeovers. In fact, Lippman and his team think they can even value-add Class A multifamily properties and have set out to do just that. Their goal? To more than double the firm's national portfolio of 42,000 units of conventional and affordable apartments in 27 states to 100,000 multifamily units by the end of 2013.

FUELED BY PASSION

Reaching that goal is going to require listening to the needs and wants of a lot of apartment assets, and the JRK team's talent in doing so has been a long time coming. When Lippman first entered the real estate arena in the late '80s following a successful but unimpassioned run in commodities and options arbitrage trading, he was attracted to the physicality of underlying property and the possibilities of creative asset management as compared to pure bare-knuckled numbers crunching.

"I'm a huge New York Giants fan, and as an arbitrager, I would sit there on Sundays with my stomach wrenching in preparation for the week ahead to the point where I couldn't even enjoy the games, enjoy my life," Lippman says. "With the exception of my family, I've not found a greater passion in life than real estate. And to this day, I'll stress that to anyone coming to JRK: Please don't come here if you are looking to punch a clock. If you come here, this is going to become a part of your life."

Founded in 1991, JRK was born with the purchase of five multifamily properties from an RTC pool of Executive Life assets that Lippman

had been managing via receivership. With partners John McKee [now executive vice president] and Jay Schulman [now CFO] and an administrative staff of two, the company went to work building a portfolio of multifamily, hotel, and self-storage assets at an annual growth pace of 500 to 1,000 apartment units. Funded primarily via Lippman's personal network of high-net-worth individual investors, by 2005, JRK had amassed a national portfolio of some 8,000 multifamily units, four hotels, and a self-storage facility in Long Island. Today, those numbers have ballooned to 42,000 units in 27 states, plus nine office buildings, four hotels, one industrial property, and 1,800 self-storage units.

Although originally dependant on third-party fee managers for on-site operations, JRK's penchant for squeezing fixed and variable costs from property P&Ls, coupled with the company's growing scale and organizational depth, necessitated a move to a more traditional owner/operator model. "Ultimately, third-party managers enable disconnect," says Lippman, who notes a competitive advantage in minding one's own shop. "We think a large portion of multifamily asset purchasers and owners today are financially-related institutions that rely on third-party managers, and we think non-operation of the asset leads to a disconnect between the arbitrage and an understanding of the real estate itself."

Indeed JRK's personnel philosophy—which is heavy on asset managers and light on on-site employment—creates a rub with traditional property management staffing models. "We have a somewhat unique way of looking at staffing," Lee says. "We've been tracking for some time on a per-unit basis how many people we need in the leasing center per traffic and per lead, and we are typically able to cut staff by 30 percent or so compared to some of the larger REITs that are using third-party property managers."

Those staffing reductions play heavily into JRK's on-site expense reduction targets of 20 percent to 25 percent, which are generally achieved within 12 to 16 months post-acquisition, and in turn provide the company with about 100 basis points worth of cushion when bidding on properties for acquisition.

IMMEDIATE VALUE

Underwriting for acquisitions is, in fact, where JRK begins the value-add process—first by identifying line-item reductions in all expense and cost centers (see "Unfixing Expenses" on page 6) and then by

determining where capital expenditures on the asset are warranted and what the expected ROI on those expenditures might be from both a rent uplift and asset preservation and improvement standpoint. "We don't buy with the expectation that rents are going to go up," Lippman says. "It's a very common approach to project where real estate is going over the next five years—and people have made a lot of money doing it for the past 18 years—but we only buy assets that we feel we can add value to immediately."

On the cap-ex side, asset improvement and value creation starts with immediate aesthetics and drills deeper into asset repositioning and preservation. A six-person team that might be comprised of a JRK executive manager, national maintenance staffers, as well as local asset managers, will identify, underwrite, and prioritize all capital expenses individually, and then do a comparison to find best bang-for-the-buck improvements. Capital renovations run anywhere from \$100 per unit to \$6,000 per unit.

"Curb appeal is still one of our first focus areas," says executive vice president McKee. "I don't care who you are—first impressions drive decisions: nice clubhouse, nice staff, fresh paint and signage, flowers. It's not magic." After focusing on curb appeal, the JRK team then advances to more complex value-add investments as determined by their priority analysis. Depending on the asset, this might include new paint, roof and structural improvements, resurfacing, kitchen and bath upgrades, closet expansions, clubhouse remodeling, community signage, and other amenities.

Budgets are front-loaded for all capital expenses to occur in the first half of the year prior to the vital summer lease-up, and all line items go through a dual approval process—once when the budget is first approved and again at the time of expenditure to determine if resources could be better allocated elsewhere on the property. "Anything we do on the capital side is looked at from an ROI standpoint unless it is asset preservation," Lippman says. "We look for a minimum ROI of 20 percent when it comes to putting additional dollars into a property. We don't go in and over-improve in hopes of a return on the dollar, and we look to complete all cap-ex by May or June so you can get the benefit during the prime leasing season and not wait for the ensuing year to get a return."

While JRK's overhaul tactics seem aggressive, Lippman says the returns are worth it. And his investors agree. Take the company's

LITTLE GREEN BOOK

Last year, JRK Property Holdings invested \$1 million into its systems, which include a proprietary database of matrices that generates weekly reports on individual assets.

JRK PROPERTY HOLDINGS founder, chairman, and CEO Jim Lippman calls his company "a marriage of the analytical and the operational," and you need not look further than the firm's weekly "Green Book" asset reports to see the truth behind his words. Created every Friday and available on-site

every Monday morning, the reports offer a weekly, monthly, and year-over-year macro and micro snapshot of a property's P&L, cost centers, NOI, and rent fundamentals.

"It's our matrix on comparing every property relative to itself and the portfolio and includes work or-

ders, leasing traffic, and rents," says JRK executive vice president John McKee. "It's the plotted history of a community."

The list of what's included in every weekly report covers the gamut of available data: a topline P&L and line items on unit turnover; landscaping costs; occupancy; pre-lease activity; exposure to vacancies in light of notices and evictions; leads by marketing source per traffic and per week; gross and net leases; concessions; net effective rent; application cancellations and rejections; upcoming move-ins and move-outs; and week-over-week, monthly, and annual traffic, leasing, and conversion percentages.

Green Book data obviously assists on-site staff with managing rent fundamentals but also lets maintenance negotiate better pricing on materials and labor (relative to the JRK historical and national average costs) and streamlines executive, asset management, and property management analysis of any given property.

"Whenever we visit a property, we review the last month or so of Green Books so we understand the issues going in," says Bobby Lee, president of the firm's JRK Birchmont Advisors acquisitions fund. "For an owner/operator, one of the worst things about a site visit is wasting valuable time reviewing and redoing the work that we did during the last five visits."

[LEADERSHIP LESSONS]

Jim Lippman

- ▶ TITLE: Founder, Chairman, and CEO
- ▶ AGE: 52
- ▶ FIRST PROFESSIONAL JOB: Equities trader at Oppenheimer & Co.
- ▶ BEST BUSINESS DECISION: "Leaving a successful Wall Street career to pursue real estate, where I was able to combine my creative and analytical sides. Other than my family, real estate has become the most important passion in my life."
- ▶ FAVORITE QUOTE: "Failure is not so much a physical state as a state of mind. Success is falling down and getting up one more time, without end." —Jim Collins
- ▶ GREATEST BUSINESS CHALLENGE: "Maintaining our entrepreneurial and hands-on culture while becoming one of the largest private multifamily owners in the United States. Although the number of properties in our portfolio has grown significantly, our people work very hard to eliminate bureaucracy in the decision-making process and know what is happening at our properties all of the time."
- ▶ PEOPLE YOU MOST ADMIRE: Robert George Lippman, my father, and my friend John D. Hastie, a great attorney
- ▶ LEADERSHIP PHILOSOPHY: "A perfectionist by nature, I have high expectations of everyone I work with. I will not, however, ever ask for something that I am not willing to do myself. I strongly believe that the best leaders lead by example."
- ▶ BEST ADVICE EVER RECEIVED: "To go seek out my passion in life."
- ▶ LAST BOOK READ: *Open, An Autobiography* by Andre Agassi (Alfred A. Knopf, 2009)
- ▶ ON YOUR IPOD: Sting, Seal, The Beatles



purchase last year of a 17-property AIMCO portfolio spread across Atlanta; Charleston, S.C.; Cincinnati, Ohio; Columbus, Ohio; Fort Collins, Colo.; and Richmond, Va. Since closing that deal in January 2009, JRK's operational slash-and-burn has helped increase NOI by 21 percent in a market of falling rents.

"That is in one year and is almost exclusively from savings on operational efficiencies [including reduction of fixed expenses, staffing, and lease-to-lead marketing costs]," Lippman says. "Our returns, which have been our hallmark, are exemplary. We have 35 percent IRRs [internal rates of return] with an average hold of 10 years. People have invested with us and generally made over four times their money. Most importantly, on a risk-adjusted basis, we've never had a losing transaction."

Bill Powers, a managing director and a senior member of global investment firm PIMCO's portfolio management and investment strategy groups in the company's Newport Beach, Calif., office, has been investing in real estate for 19 years and investing in JRK for the past five. Powers says cash flow from JRK investments is about as close to a fixed-income instrument as an investor can get, and returns despite the weak economy continue to prove out the JRK model.

"They consistently add quality to their investments and have regularly achieved managerial efficiencies by leveraging fully-integrated, vertical skill sets," Powers says. "They have made the IRR on the investment higher than the cash-on-cash returns, which is obviously added

value. Plus, they understand what they do well and don't do well and are conservative—there's no forecasting that beanstalks grow to the sky. I've been very pleased with the results, particularly through the crisis. The investment results have been outstanding when something less would have been understandable."

ACQUISITION MINDED

Of course, for JRK to generate such impressive returns, the firm has to continuously be on the lookout for new properties, which hasn't been easy in the past year as transaction volumes in the multifamily sector plummeted to historical lows due to economic uncertainty and a widening gap between buyer and seller expectations. REIT deleveraging via asset sales in 2007 and 2008 brought some opportunities—notably via deals with AIMCO—but JRK has some ground to make up if the company is to hit Lippman's 30-month, 100,000 unit goal.

Cash generation likely won't be part of that problem. Although a \$200 million equity fund raised in 2006 has been almost entirely deployed (70 percent into multifamily, 80 percent of which—or 60 percent of the overall—is invested in JRK sole-sponsored apartment deals, with the remainder deployed into joint ventures and hotel assets), the company is preparing for an additional equity raise to meet opportunities in the acquisition market.

"Moving forward, all of our deals will either be hotel or multifamily and will all be owned and operated entirely by JRK," Lee says. "All of



JRK Property Holdings

- ▶ HEADQUARTERS: Los Angeles ▶ FOUNDED: 1991
- ▶ NO. OF EMPLOYEES: 1,500 ▶ UNITS OWNED/MANAGED: 42,000
- ▶ MARKET COVERAGE: National, covering 27 states in the West, Southwest, Midwest, Southeast, and Mid-Atlantic

sets in [non-core markets] like Atlanta and Dallas, we are buyers,” Lippman says. “We are buyers in any markets that we think have long-term growth and where the REITs are discouraged from playing. We are not interested in getting into competitive bidding situations—we are interested in paying fair market performance subject to our underwriting where we feel we can reposition the asset on both an operational side and a capital side or both.”

Determining just how and when to reposition those assets is also benefited by JRK’s underwritten hold period of seven years (although the company often holds assets longer). With cap rate compression between A and B assets currently at about a 100 basis point difference, price per pound on acquisitions as well as the arbitrage upshot as cap rates return to more traditional asset class spreads will provide a double-hit return for JRK investors.

In the meantime, JRK will look to boost NOI at Class A properties through value-add expense reduction, and if market rents begin to increase, so much the better. “We don’t expect industry NOI growth in 2010, but we are budgeting for 10 percent NOI growth in the JRK portfolio,” Lippman says. “We have seen a lot of companies both public and private enter this industry over the past decade that may understand brick-and-mortar but don’t understand that apartment properties are living, breathing pieces of real estate. As long as that disconnect continues, it will create significant opportunities [for us] across asset classes to do value-add.” All JRK needs to do is lend an ear and listen. **[M]**

our invested equity will be for deals in our own account.” The firm’s next equity raise, which is currently in the works, will be primarily through JRK’s historical network of around 100 high-net-worth individual investors and about 20 institutional (i.e. banks and investment fund) investors.

If that seems too ambitious for this environment, think again, Lee says. “At any given time, we feel we have access to between \$50 million and \$100 million in equity,” Lee says. While the target size of the fund remains confidential, where monies will be deployed is open book. JRK will continue to opportunistically add assets to the portfolio that can be operated on for traditional cap-ex value-add pop, but the company is moving away from Class Cs and Bs to target Class A properties in the country’s top 20 MSAs as its value-add play evolves.

Competition for those assets will come primarily from apartment REITs, and JRK may very well concede the top five or six U.S. rental markets to public and institutional buyers and focus on markets that may have short-term pain but long-term upside from an employment and absorption standpoint.

“We’re a private company, and we don’t have to follow the herd mentality. So where the REITs are looking to dispose of as-

UNFIXING EXPENSES

At JRK, no fee, tax, or bill is off the table when it comes to managing expenses.

JRK PROPERTY HOLDINGS executive vice president John McKee has a 19-year history of slicing fat out of the firm’s fixed cost centers.

“We don’t even use the words ‘fixed expenses’ at JRK,” says McKee of his no-holds-barred audit, review, and appeal of virtually every fee, tax, and bill submitted to the company for payment. “People think you get an insurance bill or a real estate tax, and you’re stuck, but you’re not. All pricing is negotiable, and for the most part, people will be receptive to open and honest communication.”

McKee’s efforts annually net JRK \$100 million to \$200 million in savings on a capitalized basis. Here are three of

McKee’s go-to favorites for eliminating inefficiency in fixed expense structures.

Insurance. “Insurance is one of the biggest areas to save on fixed expenses,” says McKee, who flew to London last year to meet with Lloyds of London for a policy rewrite. “Insurance pricing is really relationship-based, and we make a big effort to know who is writing our coverage. We don’t always accept terms and conditions, and with the size of our portfolio, we are able to negotiate fairly aggressive rate structures.” One of JRK’s top insurance cost cutters has been to cross-collateralize the entire portfolio on losses in anticipation of

the fact that claims will be singular or regional in nature. So, barring a nationwide catastrophe, risk is not increased, but policy costs are reduced by 30 percent to 40 percent.

Utilities. “Focusing on the utility side has always been one of my expense cutting strategies, and it starts with usage,” McKee says. “One of the big things you can control is water usage by installing water-saving devices and watching for water line leaks or breaks.”

JRK monitors usage monthly and compares year-over-year pricing and volume to identify spikes in usage. In a large apartment portfolio, it’s also natural for meters to malfunction. “That’s no one’s fault—after 10 or 20 years, you’ll simply find a meter’s ability to read usage is compromised, and the result will be wild billing. Just watch for it.” JRK also takes advantage of states that have deregulated utilities to buy

electricity and gas at bulk pricing on the open market.

Taxes. “I contest every tax bill unless it is cheaper than the year before,” McKee says. In fact, JRK has two full-time staffers who prepare tax appeal packages with photos of the property, basic property info, the rental history, and an income analysis that includes deferred maintenance expenses.

“The county typically calls a couple of comps, determines your market rent is \$800, multiplies that by the number of units, and that is your taxable income base,” McKee warns. “They don’t figure concessions or occupancy into that calculation. They just do the math.”

Although tax board meetings are laborious, the upshot for JRK is often a 20 percent to 30 percent tax reduction on newly acquired properties. “When you walk into a tax board meeting, they know you are serious,” he says. “Face-to-face in this world still makes a big difference.”