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THE EVOLUTION OF RESIDENTIAL PROPERTY MANAGEMENT: FROM CARETAKER TO INCOME MAXIMIZATION MANAGERS

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Abstract

The professional management of residential rental real estate in the United States had its true beginning during the Great Depression; however, the evolution began much earlier and continues today. This article addressed the evolving role of rental housing resulting from economic, demographic, social, and political changes. Using this historical framework, the authors traced the evolution of the role of the property manager from "caretaker" to "emerging professional manager" to "sales and marketing manager" to the "income maximization manager" of today.

Introduction

According to Kuperberg and Patellis (2003), the professional management of residential rental real estate in the U.S. had its true beginning during the Great Depression; however, the evolution began much earlier and continues today. Multifamily development and the subsequent management of the property has now evolved into a complex operation that challenges owners to hire managers who possess sophisticated skill sets that include accounting, personnel management, marketing, and leasing. This article addresses the evolving role of rental housing resulting from economic, demographic, social, and political changes. The authors then suggest how this evolving role has impacted the evolution of the property manager from someone who focused on collecting the rent (caretaker) to someone who is responsible for the economic viability of the asset (income maximization manager) in a marketplace that heretofore was greatly influenced by government policy that supported "homeownership at all cost" (Apgar, 2004; Joint Center for Housing Studies, 2008; Krugman, 2008; Ranghelli, 2005).

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Economic, demographic, political, and social influences have all affected the development of multifamily rental housing and its management in the U.S. Landlord-tenant relations have always been part of the social context of the city and to a lesser extent in rural areas. As a profession, real estate management has been impacted by three major occurrences: (a) the legal system which developed and gave individuals the right to own property, (b) the increased complexity and size of real property assets, and (c) the historic conditions of economic change that encouraged, if not required, professional management and maintenance operations for a positive financial result for any income producing asset (Institute of Real Estate Management, 2001).

Before examining the evolution of residential property management, it is necessary to understand the historic role of rental housing in the U.S. From Colonial days to the present, renters have been viewed as second-class citizens (Drier, 1982; Mitchell, 1985b). It was not until the 1800s that a majority of states allowed men who did not own property the right to vote (Krueckeberg, 1999). Perhaps the fact that only landowners could vote helped to instill this country's strong norm for homeownership. Owning a single-family home of one's own continues to be the "American Dream." Political leaders have long favored homeownership as evidenced by favorable tax laws and mortgage policies (Drier, 2006; Hays, 1995; Shay, 2006; Woods, 1979). However, most homeowners have been renters sometime during their lifetimes.

Today one third of Americans rent their housing, which also has its advantages. Renters are more flexible in terms of being able to move when they need to, especially when they have a better job opportunity. They do not have to invest large sums of money for a downpayment, and rental rates are often more affordable and more predictable than the cost of homeownership. An incentive for many, especially singles and older persons, is the provision of both interior and exterior maintenance. Moreover, modern multifamily communities may offer services and amenities unavailable to homeowners such as fitness centers, large swimming pools, laundry pick-up, concierge services, and opportunities to interact with others in common areas and at planned social events.

Renters vary as to the type of structure that they rent. They may rent single-family homes, apartments in buildings with two to four apartments, apartments in multifamily housing units of five or more, or a variety of other options such as town homes or manufactured housing (see Figure 1). Many single-family homes, manufactured housing parks, and small apartment buildings are still owner-managed or managed by real estate firms that oversee these scattered-site units. In 2001 individuals or couples owned more than 19 million rental units—just over half of the rental housing stock (Joint Center for Housing Studies, 2007). This housing is often older, lower rent units, and these owners are less likely than other owners to have the financial resources to maintain and manage their units

(Joint Center for Housing Studies, 2006). In terms of structure type, the largest percentage of renters live in units of five or more apartments (U. S. Census Bureau, 2003). Management of that segment of the rental population is the focus of this article, unless otherwise noted.

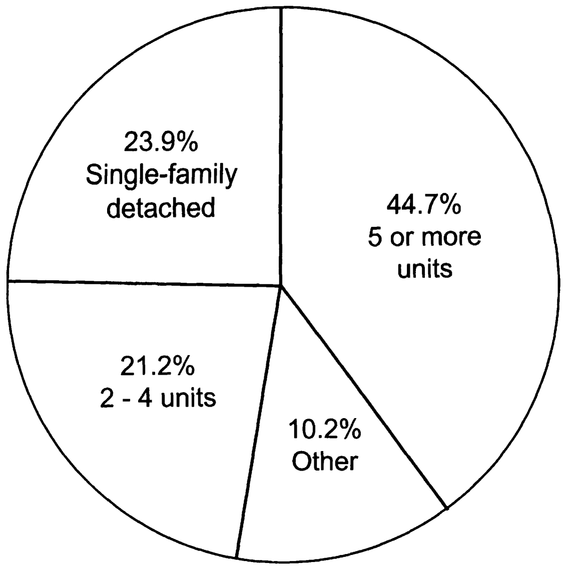


Figure 1. Rental Housing Percentage by Structure Type
(Adapted from U.S. Census Bureau, 2003)

Rental Housing Prior to the Depression

Cities in America began to grow as industrialization moved from England to other parts of Europe and then to the U.S. In 1790 only 5% of the population lived in cities (Fish, 1979). However, that changed as a result of three major population trends that impacted cities as they sought to meet the labor demands of the increasing number of factories located in urban areas. This population shift included the migration of native-born Americans from rural areas, the movement of native-born African-Americans to Northeastern cities, and the huge influx of immigrants to the port cities (Andrachek, 1979). These laborers were often uneducated and thus, filled low-paying common labor jobs. Housing this large influx of low-income families presented a problem. In New York City, the largest center of commerce, tenement houses were developed to house this group and were usually managed by the owners (Woods, 1979). In the industrial Midwest, however, townhouses were more common in factory towns such as Pullman, Illinois (Kuperberg & Patellis, 2003), while small single-family rental houses were the most common in rural company-owned mining communities in Pennsylvania and West Virginia (Eller, 1982).

Because there was an ever increasing demand for housing and very few options for both the laborers in urban areas and those in more rural company towns, real estate owners had little incentive to improve housing conditions. Management consisted primarily of collecting the rent and making only the most crucial repairs. The first record of real estate management was noted by historian Pearl Davies (1958), who reported that the first real estate company, the Cruikshank Company founded in 1794, was responsible for negotiating and making leases and collecting rent in addition to selling real estate. Evidence also exists that the management of residential properties, highly localized as it was in the late 19th Century, also included preparing advertising copy, paying utilities and taxes, inspecting dwellings upon vacancy, serving eviction notices, selecting tenants and monitoring their conduct, and even providing concessions in the form of tenant improvements and lowered rents to tenants in economic down times and seasonal (winter) weather cycles (Doucet & Weaver, 1991).

By the beginning of the 20th Century several states, even with strong resistance against the regulation of private property, had enacted regulations regarding tenements and other types of housing (Woods, 1979). Increasingly social activists from the early 1900s, such as Lawrence Veiller and Jacob Riis, relentlessly advocated for improved housing conditions for workers in urban areas. As a result, more municipalities enacted housing legislation, especially for rental housing, regulating housing with respect to safety, sanitation, and health.

As cities continued to grow, an aggressive period of residential construction began in 1909 and lasted until World War I (Walters, 1979). Improved building technology enabled developers to build up, not out. Duplexes and four-story walkups for middle- and lower-income families were joined by high-rise luxury apartments for wealthy families and smaller studio apartments for singles and couples on limited budgets. Decent rental housing was available for the urban middle class, and luxury apartments were attractive to those who wanted a more leisurely lifestyle, especially if the family was having difficulty in finding household help (Walters, 1979). Apartment managers marketed these apartments as places of comfort, quality, and independence in an attempt to disassociate these new buildings from the old "tenement" buildings.

Although many of these buildings were managed by their owners, buildings of this size could now afford to have on-site management. Throughout this period occupancy was high and turnover was minimal, so most owners continued to manage their own properties. However, as time passed more owners amassed significant portfolios, became more affluent, and wanted to get away from the everyday chores of management. Over time, there was an increase in owners hiring an apartment resident or other paid staff person to collect the rent, take care of emergency repairs, pay the bills, and serve as the liaison between the owner and tenant. In exchange for their services, this "caretaker" received a reduction in rent or a small salary if they did not live in the building (Kuperberg & Patellis, 2003).

As new property management challenges arose, managers and owners began to meet to share concerns and interests. The National Association of Building Owners and Managers held its first annual convention in 1908. Although its focus was more on commercial buildings, it formed an "apartment house" section in 1913 (Doucet & Weaver, 1991).

As the U.S. prepared for World War I, newly employed defense workers in shipyards and ammunition plants found housing to be in very short supply. The problem was compounded because as these workers flocked to factories, the government began to discourage the construction of new housing in order to conserve materials needed for the war effort (Lett, 1976; Walters, 1979). This imbalance of supply and demand resulted in the first federal rent control law being enacted in Washington, DC in 1917.

The early 1920s saw many changes in the way real estate was financed. Until this time the major source of finance was private lenders, but that changed with the initiation of income taxes in 1913. Interest income was now taxed as income so that wealthy investors recalled their real estate loans so they could invest their money in tax exempt securities. Adding to the problem was limitations placed on the national banks by the federal government. These recalled loans and additional bank restrictions resulted in a serious shortfall of capital for real estate before life insurance companies and building and loan associations emerged as vehicles for real estate financing. This new-found money led to a construction boom that peaked for apartments in 1926-1927. By 1928 the market had slowed considerably, and the nation found itself with too many large apartment and office buildings (Walters, 1979).

The Great Depression

Although there had been warning signs that the economy was not as strong as it had been, the plunge from the "Roaring Twenties" into the Great Depression after the Stock Market crash of 1929 was a shock to America as families lost their jobs, savings, and homes. Vacancy rates for apartments skyrocketed as apartment dwellers moved in with friends or relatives to save on the rent. This problem was exacerbated by the fact that there was already an oversupply of apartments from the building boom of the 1920s (Walters, 1979). As a result, many owners defaulted on their mortgages. From this historical event the real estate management business was born. Banks, insurance companies, and other lenders were now the recipients of many foreclosed properties. As a result, they began to establish their own management teams. Property managers learned "on the job" because there was no place to go for guidance or education.

Recognizing the need for professionalism in this heretofore uncharted area, the Institute of Real Estate Management (IREM) was formed in Chicago in 1933. It published its first journal, *Journal of Real Estate Management* (today known as the *Journal of Property Management or JPM)* in 1934, and conducted its first education course in 1935 (Pekala, 2003). In 1939 the precursor organization to today's National Apartment Association (NAA) was incorporated as the National Apartment Owners Association with purposes "to assemble and disseminate statistical information for the guidance of the apartment industry, to establish a department of research for operation and modernization, to study taxation and to analyze federal legislation, to assist the federal government in the study of present and future projects…." (National Apartment Owner's Association, 1939). It later changed its name to the National Apartment Association in 1967 and today is a federation of more than 200 state and local affiliates comprising 51,000 multifamily housing companies representing more than 6 million apartment homes that promotes professionalism in the multifamily housing industry (National Apartment Association, 2008).

The federal government and the Public Works Administration (PWA) Housing Division also recognized the need for competent, trained housing managers. In 1934 they began looking for "men with the necessary ability, personality, and philosophy" to become managers. They envisioned the ideal housing manager as "the merger of a business executive with a parish priest and a dynamo" (Straus & Wegg, 1934, pp. 162-163). With the exception of the "men" designation, the description would be apt for today's apartment managers. A private grant from the Rockefeller Foundation allowed the development of a training school for housing managers for the PWA and the Resettlement Administration conducted by the National Association of Housing Officials. The initial group of trainees began in December 1935 and received four months of intensive training in maintenance and operations, tenant relations, housing law, public relations, accounting, and a "background on slums and blighted areas" (Straus & Wegg, 1934). Only a small number of colleges or universities had real estate course offerings in the 1920s; by 1936, 73 institutions were offering 187 courses. Of those 73, only 8 offered "realty" majors (Gage, 1946). Although several texts on apartment management appeared in the 1930s (Doucet & Weaver, 1991), the focus of the real estate offerings was not apartment management.

One of the most significant pieces of legislation passed during this time established the Federal Housing Administration (FHA), and it revolutionized housing finance for both single-family homes and apartments. Through FHA's long term, low downpayment loans consumers again began to buy houses, and housing starts and sales accelerated. In only eight years, 25% of all home mortgages were insured by FHA (Walters, 1979). Although FHA's initial impact was on single-family homeownership, over the years FHA has had a significant impact on multifamily housing construction as well through favorable financing that insured private lenders against mortgage default. As the Depression came to an end and the economy began to strengthen, apartment occupancy improved, and rents began to increase.

World War II and the Post-War Housing Boom

The need for housing war workers became acute as the nation shifted from a growing peacetime prosperity to a war-time economy. The demand for housing exploded near shipyards, tank and aircraft factories, and ammunition plants. Recognizing that defense workers needed good housing, the government passed several pieces of legislation that resulted in housing construction that helped alleviate the shortage. Even with this new housing construction, the demand exceeded the supply, and by 1942 the Office of Price Administration (OPA) enacted rent controls (Lett, 1976).

Before World War II ended, property owners and the OPA found themselves at odds over the OPA policies regarding evictions and other issues. Congress agreed that the OPA had overstepped its authority. Even after the war ended, rent controls remained. Property owners had seen their taxes, utilities, and other operating expenses increase, but rents had not. In an effort to reduce expenses, some owners terminated their management contracts (Kuperberg & Patellis, 2003) which was made easier because demand was strong and the need for a professional manager to lease and "turn over" apartments for new renters was low.

By 1946 approximately two million rental units had been withdrawn from the rental market. It was not until the passage of the National Housing and Rent Act of 1947 that rental apartments were constructed in significant numbers (Walters, 1979). One provision of the act (FHA Section 608) offered large profit incentives to developers who would build rental apartments to house returning veterans, as well as others. By 1950 more than 465,000 apartment units were built. However, the program ended in 1954 with charges of "irregularities" (Mason, 1982). As rent controls were lifted in many locations in the early 1950s, there were more incentives for private developers to build apartments. New family formations and the subsequent "Baby Boom" continued to increase demand for all types of housing.

The Suburbanization of America

One of the greatest impacts on housing in America was the exodus from the city to the suburbs from the 1950s through the 1970s. Returning war veterans purchased cars in record numbers, thus enabling them to live outside the city and commute to work. Single-family homes were being built at a rapid pace in the suburbs, and city dwellers were buying them as fast as they were constructed (Mitchell, 1985a). In Levittown, New York, for example, Levitt and Sons constructed 17,447 homes between 1946 and 1951 (Levitt and Sons, n.d.). Homeownership rose from 55 to 61.9% between 1950 and 1960 (U.S. Census Bureau, n.d.). Young families left their apartments in the cities for "The American Dream"—a house in the suburbs with a yard and space for children to play (Gans, 1967; Sternlieb & Hughes, 1986).

Even with the great movement to single-family subdivisions, new rental housing was being constructed (Mason, 1982). FHA had made financing apartments easier, and new tax laws gave builders incentives through more favorable depreciation provisions. Before long a new form of rental housing could be found in suburbia—the garden apartment community. In contrast to the single mid to high rise apartment building in the city, these new communities contained multiple buildings that were usually three stories without an elevator. This new apartment structure was attractive, more conducive to the suburban environment, and contained many features found in single-family homes such as modern kitchens, air conditioning, dishwashers, and patios or balconies. They often had club houses with swimming pools, play areas for children, and enhanced landscaping. This new design was very popular but required managers, leasing specialists, and a full-time maintenance staff. Garden apartment communities had more buildings with more roofs and more heating systems, and there was much more landscaping to manage. The garden apartment community was spread over more land and, depending on size, required leasing professionals to take prospective residents substantial distances from the leasing center to see vacant apartment homes. As more apartment communities were built in the same area it was necessary to market these units, unlike the post World War II period where demand exceeded the supply. Instead of managing one building, the manager now managed several buildings and often a larger staff to care for them. The role of the property manager had become more complex than a person who did little more than collect the rent.

Not only did the apartment structure continue to change throughout the 1960s and 1970s, so, too, did its occupants. Traditional renters such as young families, single professionals, and those not making enough to purchase a house continued to rent. However, social and demographic changes also resulted in new rental audiences. As the first wave of Baby Boomers graduated from college, they refused to return home to live with their parents and instead many rented garden apartments in the suburbs. As the divorce rate rose, particularly in the 1970s, the newly-single adult added to the demand for apartments (Walters, 1979).

Throughout this same period, there was an increased demand for rental apartments for older adults, and the federal government's attempt to increase the supply of rental housing for low- to moderate-income families resulted in the construction of many new federally subsidized apartment buildings. One such program, Section 236 of the Housing Act of 1968, provided private developers with significant incentives to build government-subsidized apartments for low- to moderate-income families, as well as individuals over the age of 62. In many cases builders constructed the apartments, but had no knowledge of what was needed to manage the development in order to produce a profit and enhance the value of the investment. Additionally, this lack of knowledge about property management was a significant problem for developers of nonprofit sponsored housing (Hecht, Local Initiatives Support Corporation, & Stockard, 1996). The situation became so critical that in 1973, President Nixon declared a housing moratorium on the construction of all new Section 236 housing. One of the factors leading to the moratorium was that many of the previously constructed 236 projects were in foreclosure as a result of poor site selection, poor construction, and/or ineffective management (Hays, 1995).

Public housing, which came about as a result of the Housing Act of 1937, continued to be constructed throughout the 1970s, but was plagued with problems of inadequate funding, poor design, and poor management (Hayes, 1995). As a result, the federal government essentially withdrew from constructing any new housing and instead instituted a housing choice voucher program to be used by low-income individuals to provide a housing subsidy that they could apply to their rent in privately owned or subsidized housing.

New federally subsidized rental apartment programs for low- to moderate-income housing evolved during the 1970s and continued until the early 1980s. The most popular program was Section 8 that provided direct federal assistance to developers who agreed to provide subsidized housing for a specified period of time (often 17-20 years). At the conclusion of the contract, the housing could remain under Section 8 or the developer could turn the property into conventional housing.

As the 1970s came to a close, government agencies and housing experts expressed concern about the low vacancy rates and affordability issues affecting the rental housing market (Weicher, Villani, & Roistacher, 1981). Lowery (1981) explained that investors were reluctant to build new rental housing without government assistance because the increase in rent did not keep pace with increasing construction and operation costs. In addition, rent control in various forms had been enacted in many jurisdictions and was threatened in others. Investors were concerned about the financial implications for building in these communities (Lowery, 1981; Sternlieb & Hughes, 1981). Moreover, declines in investor returns led some investors to convert existing rental properties to condominiums or cooperatives (Lowery, 1981), and these properties required different management skills.

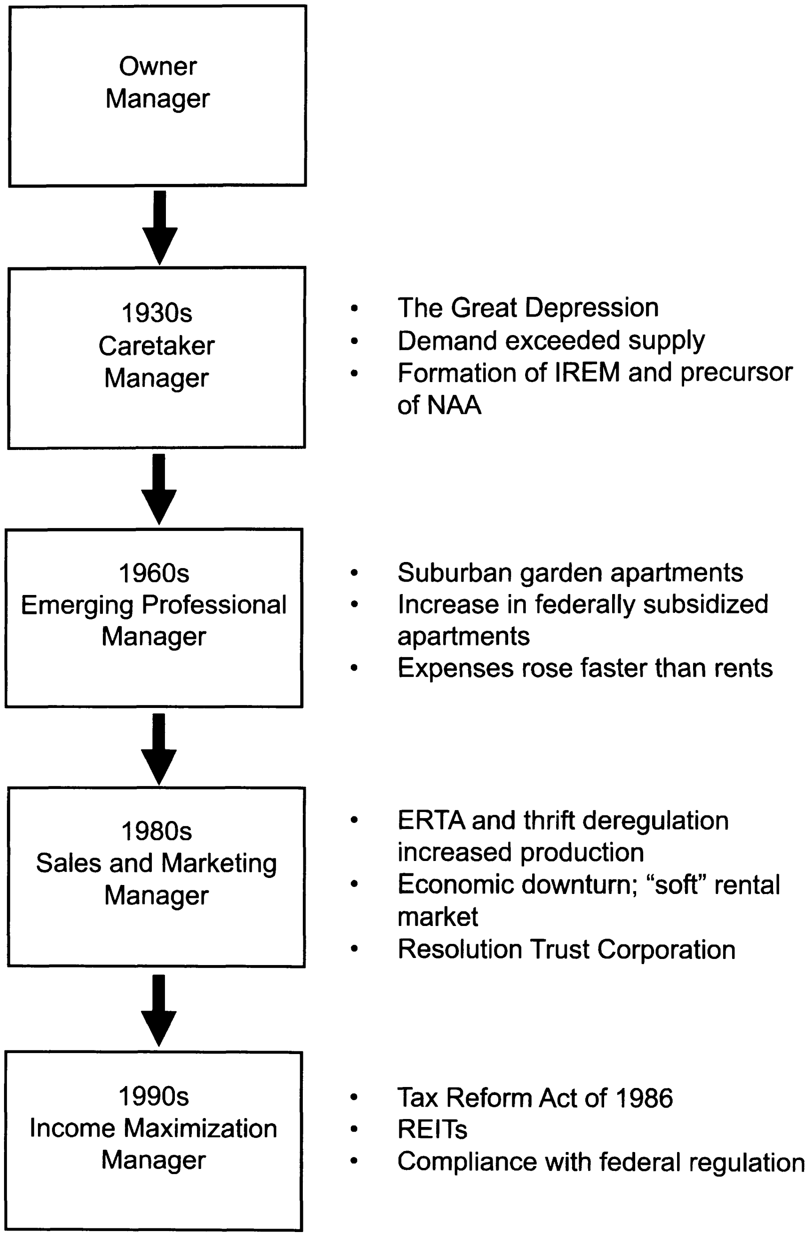
As a result of the changes in apartment structures, location, residents, and demand in the 1960s and 1970s, the role of the apartment manager evolved from the "caretaker" of the 1950s where demand was so strong and turnover so low that mangers were required to do very little leasing, let alone marketing, to an early stage of professional manager or "emerging professional manager " who now had responsibilities that included leasing the new apartments that were being constructed while managing the operational expenses in a rental market where income did not keep up with expenses. Unfortunately, the manager's role was often not viewed as that of a professional, and his or her employment was an afterthought in the development process.

The 1980s—A Decade of Booms and Busts

The role of the manager took on increased importance in the 1980s as apartment construction and demand went through a series of ups and downs. Record high interest rates in the late 1970s and early 1980s added to the construction downturn for apartments. In order to stimulate a recessionary economy, Congress passed the Economic Recovery Tax Act (ERTA) in 1981. According to Colton (2003), ERTA not only accelerated depreciation rates, but provided lenient initial expense write-offs, as well as construction and passive loss write-offs.

Additionally, Congress deregulated the savings associations—savings and loans and mutual savings banks, commonly known as thrifts. The deregulation of the thrifts allowed investment in most types of income-producing properties, and some thrift institutions expanded heavily into apartment financing. By the mid-1980s many thrift institutions were aggressively marketing loans. The passage of ERTA and the deregulation of the thrifts resulted in a dramatic increase in apartment production. This increased production, coupled with the downturn in the economy of the oil producing regions of the country as a result of the softening of the domestic energy market in 1986, caused a significant number of thrifts to go into bankruptcy (Colton, 2003). As a result, Congress imposed strict regulations on thrifts, limiting their investments in real estate and creating the Resolution Trust Corporation (RTC) to take over their holdings. Just as when lenders had to manage the real estate they had foreclosed upon during the Depression, the RTC hired management firms to manage the foreclosed properties that had been a part of the closed thrifts' portfolios. It was at this time that the role of the manager evolved from that of the "emerging professional manager" to that of one who was forced to know more about the general economic environment and to put that information together to market apartments in an extremely "soft" market. The manager that emerged was what the authors have called a "sales and marketing manager" (see Figure 2).

Figure 2. Evolution Typology of the Property Manager



Note: Each property management type continues to exist today. Dates indicate the decade each type of manager first appeared in substantial numbers. Bullets suggest trends or events that significantly influenced the evolution of each property management type.

The Emergence of the Income Maximization Manager

The Tax Reform Act (TRA) of 1986 had a significant impact on the evolution of property managers because the "sales and marketing manager" was forced to evolve into one who was more focused on asset preservation and maximization. The TRA dramatically reduced the tax-favored status of rental housing (Gilderbloom & Appelbaum, 1988) by eliminating accelerated depreciation and prohibiting passive investors from offsetting active income with losses from real estate investments. As a result, apartment starts plummeted from a high of almost 600,000 in 1985 to less than 200,000 per year from 1991-1993 (Colton, 2003). Tax write-offs from real estate were no longer available to these apartment investors; thus, the investment now had to produce actual income and owners now looked to managers for asset preservation and income maximization. Reducing vacancies was still important to operations, but now a manager also became more involved in increasing the net operating income (NOI) by finding innovative ways to reduce expenses or increase revenues. The expectations for this "income maximizing manager," a term coined by the authors, now included a detailed understanding of the property's budget, the owner's goals, and the total real estate market where the property was located. The successful income maximizing manager considered ways to decrease expenses such as water metering each individual unit and charging it back to the residents or increasing incomes through the addition of ancillary services such as cable TV, charging redecoration fees, or allowing pets with one time non-refundable fees in addition to monthly fees.

Another trend that influenced the role of the manager was the emergence of real estate investment trusts (REITs) in the mid-1990s as a major player in the multifamily rental market partially as a result of changes to the Tax Reform Act that made private real estate ownership, especially limited partnerships, less financially advantageous. Again, the role of the property manager was elevated in importance because as public entities, REITs had to make public their financial information, and REIT stockholders expected a return on their investments. All of this required good management.

An additional impact of the Tax Reform Act of 1986 was a provision referred to as Section 42 (or the Low Income Housing Tax Credit) which allows developers to receive an allocation of federal tax credits to sell to private investors to generate capital for the construction of affordable housing. In return, the developer must allocate at least a portion of the development's apartments for rent at affordable rates to those making less than 50-60% of an area's median income. The Low Income Housing Tax Credit (LIHTC) program has produced almost 1.5 million units and annually adds approximately 90,000 units to the country's assisted housing stock (Joint Center for Housing Studies, 2006). Unlike the federally assisted programs of previous decades, owners must answer to the Internal Revenue

Service if the program's strict guidelines on resident eligibility are not followed. Again, the need to adhere to Section 42 guidelines reinforces the requirement for competent professional managers. Moreover, many LIHTC properties have rents similar to older conventional housing. Thus, residents will leave LIHTC communities for conventional housing if they are poorly maintained and managed (Khadduri & Wilkins, 2007). Changes to the tax laws that eliminated passive losses, the emergence of REITs as major players in the multifamily real estate market, and government regulations such as those imposed by Section 42, as well as increased regulations related to fair housing and environmental issues, have combined to require a more sophisticated manager that is focused on income maximization.

The Residential Property Manager of the Twenty-First Century

Brophy and Smith (1997), in a study of mixed-income housing, concluded that it was most successful when it emphasized location, design, financial viability, and excellent management and maintenance. This finding would likely be true for any type of rental housing. The scope and complexity of the rental market has evolved over many years resulting in the need for professional management. In the early days of property management, caretaker managers would never have seen their property budgets. They would have been responsible for collecting the rent, making necessary repairs, paying the bills, and turning over the profits to the owner. Emerging professional managers would have been given a budget from the corporate office and expected to manage the property within the budget. The sales and marketing manager may have had some input into the budget, but would be expected to adhere to the budget while emphasizing resident retention. Today's income maximization managers prepare the budget for their properties in consultation with the corporate office so as to maximize the profit for the owner or stockholders.

The property manager of the 21st Century will be challenged to provide the best product and superior resident service to distinct submarkets: the affordable market which serves low- and moderate-income households, the lifestyle market that serves more affluent adults, and the middle market which serves the largest number of apartment dwellers (Goodman, 1999). If we add to this mix specialized markets for an aging population, student housing, privatized military housing, and other niche markets such as mixed-use neighborhoods that combine retail and residential, it is apparent that the residential property manager of the 21st Century must be a knowledgeable and competent professional with a strong background in finance, marketing, management, and a general understanding of the real estate market. Even with the strong norm for homeownership in the U. S. rental housing remains a vital component of the housing mix. A key factor in its success is the ever evolving professional property manager.

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