

Customer & Market Due Diligence Of Property Management Company: Establishing Differentiated Positioning And Geographic Expansion Opportunity

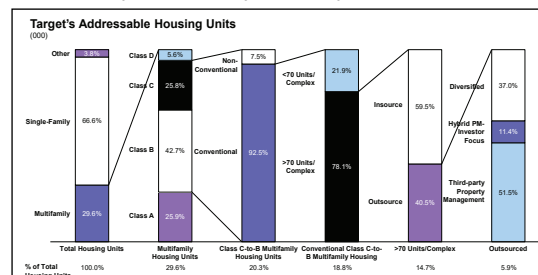
The Challenge: One of our PE clients was pursuing an investment in a leading multifamily property management company serving the workforce housing market. The target was growing rapidly, with units under management more than doubling in the past couple of years due to growing demand for workforce housing in the target's core market. Attracted by the target's impressive revenue growth and EBITDA margin expansion, our client had entered exclusive negotiations to acquire the company, with the investment thesis based on target's differentiated market positioning, its leading presence in a growing market, and the opportunity for geographic expansion. The client asked Gotham to conduct a 3-week customer & market due diligence with the following 3 objectives: (1) establish target's addressable market and competitive positioning/reputation within its market; (2) assess market trends in target's core and expansion markets; and (3) analyze potential impact of recession on target's business.

Bottom-up Market and Competitive Dynamics Assessment: Given a highly fragmented market (service providers and customer set), Gotham undertook a multi-pronged granular effort:

- Conducted 75+ anonymous and "warm introduction" interviews with various types of property owners (e.g., individual investors, institutional investors, syndicators, developers) and other property managers to understand customers' selection criteria, competitive landscape, target's competitive positioning, and investment/growth outlook in the target's core markets. From "warm introduction" interviews, we also gained customer feedback on overall satisfaction with the target, target's performance against 16 performance criteria and its NPS rating, and areas of improvement
- Built competitive landscape by identifying/analyzing virtually all property managers in target's core markets; conducted further research to profile and segment key competitors, determine their property class focus, establish their presence across target's core and expansion markets, and determine their units under management by class in target's core markets
- Profiled demographic, economic, and housing trends across 10 core and expansion geographies (e.g., local job market, rental demand, renting activity, property transaction activity)
- Established market size by type, class, and competitor units under management
- Established 2008 recession impact (occupancy rate, average rent, and maintenance and upgrade spend) on multifamily property market by property class; modeled this impact under various recession scenarios, and built a solid understanding of target's cost and general ledger level model to establish target's proforma financial performance during a recession.

Complex Outsourcing Dynamics In Growing Workforce Housing Focused Property Management Market

Gotham quickly established that the target's market was experiencing robust economic growth due to strong job market and expanding household formation from population growth. Despite new construction activity, multifamily vacancy rates remained low especially in workforce housing property class. Attractive market dynamics led to significant investment activity in the workforce housing market from investment syndicates and out-of-town investors. Such non-traditional investors typically outsourced property management, with the outsourcing decision a function of portfolio size and owners' preference for control vs. convenience. Small local investors with <100 units typically manage their own properties but once portfolios grow to >100 units, they tend to outsource property management. Some who prefer control choose to build their own property management arm as portfolios gained scale (economies of scale for in-house management typically 3,000+ units).



Target Is Leading Outsourced Property Manager Serving Value-add Workforce Housing Investors

Gotham established that the property management market segmented into: Class A-to-B+ property managers who focus on providing high-end tenant experience; and workforce housing (Class C-to-B) property managers who focus on upgrading the property, increasing occupancy, and repositioning the tenant base to drive up Net Operating Income (NOI). Competitive picture was further complicated by in-sourcing dynamics – some property investors build their own property management arms to capture additional revenue, by offering services to other property owners as well. On the other hand, some pureplay third-party property managers also provide investment-related services. After unpacking this complex competitive picture, Gotham established that the market comprised 35-40 pureplay third-party property managers focused on workforce housing, 20-25 hybrid investor-focused players, 20-25 property management focused players, and 25-30 diversified property managers in the target's largest market. Of 35-40 direct competitors, 3-5 were sizable and the target was the largest and the best in the industry for maintaining low costs. Among its customer base, the target was the preferred property manager as it was perceived as a low-cost service provider, capable of delivering NOI targets by increasing rent and improving occupancy rates to help investors achieve their return thresholds.

Opportunity to Professionalize Entrepreneurial Business to Support Next Phase of Growth

From our extensive conversations with the target's current/prior customers, we found that despite the target experiencing rapid growth, there had been no major slippages in service levels. Our interviews indicated that while target was responsive to customer requests, there was an opportunity to improve proactive communication. We also identified an opportunity to upgrade the ERP system, invest in a cloud-based information sharing platform, and improve accounting and reporting processes. Customer experience also varied by the particular regional manager, indicating an opportunity to improve internal processes/training

The Outcome: Gotham unpacked complex market and competitive dynamics and articulated the target's niche positioning and improvement opportunity. Once informed about the opportunity our client was comfortable with the cyclicity exposure/recession risk and closed the transaction, and then worked to put our recommendations into action/professionalize the business.