Case: Retirement Apartment Complexes

BCG, Round 1

Problem statement narrative

The client owns and operates 25 retirement apartment complexes for the 55-75 year old demographic in the south-east and south-west states of FL, CA, NM and AZ. By and large the apartment complexes have a similar design and amenities. Should the client company's CEO consider expanding to other Northern cities or continue to focus on the South?

Overview for interviewer

Even though this case starts out with a market entry problem question, the candidate should eventually realize (with or without guidance) that the case is about profitability, specifically costs as there is clearly an unmet market in the North and hence revenues wouldn't be an issue.

Ultimately, the candidate should use some math to determine that the financial justification for expanding in the North vs. South is roughly equivalent, so strategic benefits and risks should guide the client's focus.

Case Type: Profitability/ Market Entry

Information to be provided upon request

candidate should probe deeper to understand the market in the North and why the client wants to consider expanding.

- Any specific financial goals? – maximizing profitability through new apartment existing properties.
- What makes the client think that there is demand in the North? – Survey conducted 2-3 years ago in states such as NY, NJ, MA and IL revealed that the pre-retirees /retirees want similar facilities in those underserved (hence no competition exits) markets so that they can stay closer to their families and friends.
- A pilot apartment complex was erected in downtown Chicago 2 years ago with more amenities than its sister properties in the south.

Potential Categories of Candidate's Framework

Notable comments / potential discussion points

Most candidates will tend to examine revenues and costs once they realize this case is about maximizing profitability. While this is the eventual course of action it is important for the candidate to understand the current markets that the client operates in and glean key learnings. Remember – if the candidate had asked the financial goal question, the client wants to maximize profitability through new or <u>EXISTING</u> properties.

Potential points include, but are not limited to:

Industry analysis

- firm position / market share
- trends
- competition

Profit drivers

- revenue
- costs

Potential Issue Tree & Approach to Solving the Case

Key elements of analysis to solve the case

Market Size	Revenue	Cost
When dealing with apartment complexes, examine the following: • Number of properties • Number of units per property • Occupancy Rates	Identify sources of revenue from apartment complexes: • Rent • Utilities, if managed by building co. • Premium for amenities, if any • Retail revenue, if any • Maintenance or other fees	Identify cost buckets and distinguish fixed from variable components • Maintenance • Amenities • Leasing/Marketing • Utilities • Property Taxes
Possible follow-up and guidance to interviewer	**Possible follow-up and guidance to interviewer**	**Possible follow-up and guidance to interviewer**
If the candidate has not yet asked for the current apartment complexes in the Southern states, give her/him details: • Competition is strong in the south; easy to build new apartments. • Occupancy rates typically start out at 90%+ but eventually settle at 80% as new complexes are built. • 3-5% growth every year fed by new people who migrate to the south		Recall that the Chicago property pilot provides residents with additional amenities compared to properties in the south. The candidate should examine this aspect to accurately compare costs.

Question 1 – Math

Math Question: Which is more profitable – north or south?

1. First compute occupancy levels and revenue. For this discussion all apartments in a given region can be considered equivalent.

South: 800 units/bldg * 0.8 occupancy rate * $500 rent/mo = $320,000 per mo (let candidate know that rent includes maintenance, amenities, utilities; each property generates identical revenue so leave calculations on an individual property basis)

North: 400 units * 0.9 occupancy rate * $1,000 rent/mo = $360,000 per mo
Rent includes amenities charges for a 24 hr. on-site medical facility that residents benefit from in a huge way

2. Next compare costs (per month)

Cost Item	North	South
Maintenance	400 units * $200 = $80,000	800 units * $125 = $100,000
Amenities	$54,000	$48,000
Utilities	$45,000	$38,000
SG&A	$60,000	$80,000
Medical Facility	$60,000	$0

Total Cost per mo	$299,000	$266,000
Total Revenue per mo	$360,000	$320,000
Profit per mo per bldg	**$61,000**	**$54,000**

Question 1 – Math, cont'd

Math Question cont'd…

3. Next calculate profitability for both locations by using the formula

    Profit per mo per building

    ÷

    Total Revenue per mo

4. Turns out that the south and north are equally profitable at 16.8% approx.

Overall approach, good shortcuts & solution

The key to this question is not to stop at calculating profit and jump to a conclusion then. A good candidate will take the next step to calculate profitability and realize that the South and the North are **equally profitable relative to revenue generated**.

Now the candidate should consider the **profitability relative to the cost** to implement various initiatives. Is it more expensive to open in the North or South? What is the incremental cost of constructing medical facilities in the south (relative to increased earnings)? What is the cost of enhancing some amenities in the South to generate higher rent? Higher NPV is the goal.

We will not explore the capital cost in this case, but a return on cost analysis should be part of next steps.

Information to provide up front

N/A

Provide information if asked

At this point the candidate may ask about the market size in the North or the cost to open new facilities in the North (or the cost to renovate / alter facilities in the South). There is no additional data available, but for the purposes of this discussion we can assume that the return relative to cost is also comparable in North vs. South.

Sample Recommendation

Recommendation	To improve shareholder return and maximize profitability, the CEO of the Retirement Homes should consider expanding in the north to capture unmet demand and be the first mover in this area. To increase profitability in the South the following could be considered: 1. Increase revenues by opening medical centers in all apartment complexes and increase the rent. We have seen that people will pay for the convenience of such an amenity. 2. Decrease costs using best practices with the Chicago site, re-negotiate contracts, etc. The key here is that the candidate should make a strategic argument for the recommendations he makes. Given that the financial measures are roughly equivalent here (profit margin per region, profit relative to capital investment (NPV) per region, strategic intuition will drive the client's decision.
Risks	candidate should mention risks such as cost of expansion in the North, the commercial real estate issues facing the industry however, pulling this business insight from the information provided during the case interview will distinguish a good response from an insightful one - 90% occupancy is not sustainable in the long run given what happens in the South.
Next Steps	Evaluate cost to open new buildings in the North and cost to renovate in the South. Size demand in major Northern cities and, cost of expansion notwithstanding, consider expanding rapidly to secure demand. Examine how best practices can be applied to existing properties North to South and vice versa.