

Gaining A Competitive Edge

How to Select Community
Association Management
Company Software



CIRACONNECT

INTRODUCTION

The community association management industry faces significant trends and competitive threats that will likely create dramatic change in the next several years as disruptive software technology is introduced that allows management companies to deliver superior service at lower costs. This should in turn translate into significant market share gains for the most innovative firms.

Identifying the best software solutions(s) can be difficult, as many providers seem to offer similar features and functionality. This white paper explores the industry challenges and explains the differences in various technology platforms. The companion “Software Selection Criteria” paper provides the criteria for how to choose a software ecosystem that results in a formidable competitive edge.

COMMUNITY ASSOCIATION INDUSTRY OVERVIEW

The U.S. community association industry is a massive industry comprised of 342,000 community associations (CAs) that collect \$88 billion in assessments from over 69 million residents that live in 26.3 million housing units.

CAs range from large, highly-amenitized communities with on-site employees to small associations that are managed by resident volunteers to everything in between. These communities range in stage from under development to fully-built out with older homes and the legal structure ranges from homeowners associations to condominium associations to cooperatives.

CAs are governed by developer, builder, or resident board members and managed by an estimated 7,500 management companies (MCs) that employ roughly 52,500 community association managers (CAMs) to provide community management services along with numerous other staff positions such as various accounting and administration (back-office) and leadership functions.



INDUSTRY TRENDS AND CHALLENGES

Industry Growth

The overall CA industry has experienced tremendous growth over the past five decades from only approximately 10,000 CAs in 1970 to the current 342,000 CAs according to the 2016 CAI statistics.

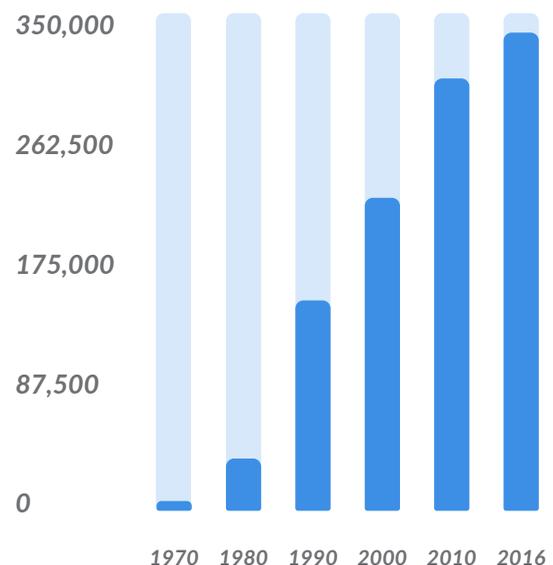
The growth in common-interest communities has been driven primarily by the demand for amenities that are much more affordable when owned in common, and the protection of property appearance and value. In addition, the format is an easier way for developers to finance and develop the necessary infrastructure for new developments when the infrastructure needs out-pace the local government's ability to provide the necessary utilities and other city services.

MCs include full-service management firms with both CAM and back-office services, "management-only" MCs that offer only CAM services and "Accounting-Only" firms that offer only back-office services also known as "Shared Services".

Many other types of professional service providers (such as law firms, audit firms, collection firms and investment management firms) and vendors (such as landscape service firms, pool service firms, a and maintenance firms) also serve the various needs of CAs.

Other providers serving the industry include specialty services, technology, and solutions firms that range from assessment coupon services to collections services to point-solution software to automate specific tasks.

Community Associations by Year



The primary growth driver for new CAs and their residential units is the overall demand for new housing units, which is tied to the population growth and the availability of home mortgages for home-buyers. In recent years, the mortgage crisis and extended recession has had an obvious negative impact on the following: 1) the number of new communities being developed, 2) the number of new buyers that are ready, willing, and able to jump into home ownership, and 3) the increased rate of association assessment receivables and foreclosure rates which has left many CA units in limbo and with stressed budgets. All of the above has exerted downward pressure on management fees.

Management Company Growth

The growth of the number of CAs over the years has also led to the continued growth of the MC industry to manage the CAs. But in recent years, the growth of the number of MCs has dramatically outpaced the growth in CAs due to the relatively low barriers to enter the industry. This in turn has led to an increasingly competitive market.

Increased Competition Among Management Companies

According to the CAI, the number of CAs have grown from 240,000 associations in 2002 to 342,000 in 2016, while the number of estimated MCs grew from 2,000 to roughly 7,500 in the same time-frame. In other words, while the number of CAs rose by 42.5%, the number of MCs competing to serve them has risen 275% in the same amount of time. The fact that the MC industry has grown nearly 8x faster than its customer base (despite a good number of acquisitions of smaller firms by larger firms) means that the average number of CAs per MC has dropped from an average of 78 communities per management firm to 30 CAs per MC (when taking into account the number of self-managed communities).

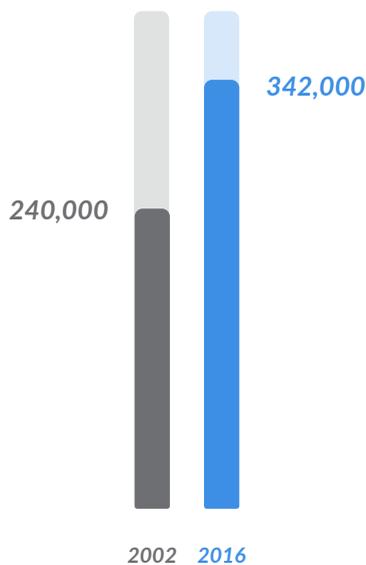
This increased competitive intensity leaves most MCs with very little year over year growth, flat management fees, and razor-thin profits. Only firms with distinctive value propositions that clearly differentiate themselves from the rest of the pack will generate meaningful organic growth.

Larger and more creative firms will find new revenue streams and new ways to monetize the resident and vendor relationships to compensate for the lack of gains in management fees.

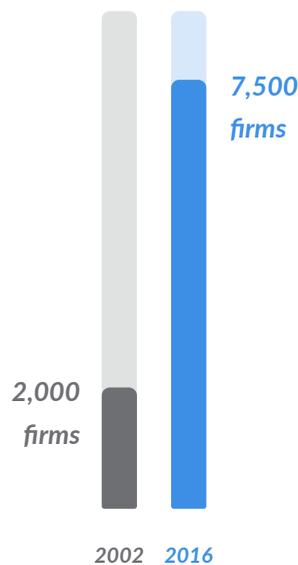
Based upon the MC trends and outlook, the industry will be less inviting for the many small “mom and pop” MCs that currently populate the industry landscape. The new generation of tech-savvy MC owners as well as the larger,

deeper-pocketed firms will mean that the only meaningful growth will come from stealing share from competitors or consolidation. This competitive context will make it even more difficult for a small lifestyle business to survive and is likely to force many MCs out of the industry or to more rapidly be rolled up into the larger firms.

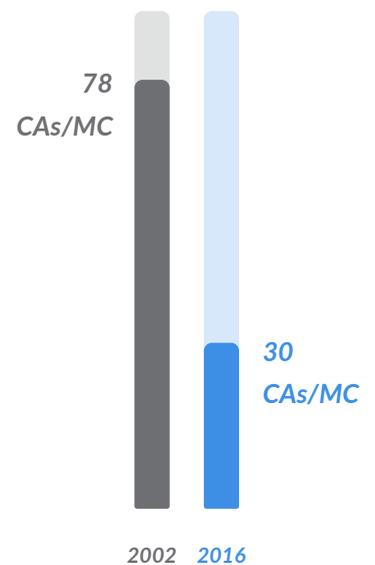
Community Association Growth
42.5% growth



Management Company Growth
275% growth



Communities per MC Decline
39% decline



Industry Consolidation

A move to consolidate the industry began in earnest in the late 1990s with two large MCs (Associa and FirstService) emerging as industry leaders with several other smaller regional companies rounding out the top ten MCs in the U.S.

Most of the consolidation has been via acquisitions of other MCs while some consolidation has occurred via market share gains from competitors through a more distinctive value proposition (such as a leading software program) and a well-honed sales and marketing process.

MCs will most likely follow the typical path to industry maturity of all other older and more mature industries. Market forces, access to capital, implementation of disruptive technology, distinctive value propositions, and M&A activity will likely winnow down the smaller management firms to a mature stage of industry consolidation where only **three to five companies carve up 80% of the market**. There will always be a long tail of smaller companies scrapping over the remaining 20%, but most will be virtually irrelevant except for those with exceptional “niche” service offerings. Although the industry already has consolidation at the top, current size alone is no guarantee of the ultimate winners.

Increased Application of Technology

Most of the larger current MCs - as well as most industry participants of all sizes - have service delivery platforms that lack the **scalability** and **repeatability** that are required for truly exceptional service of a predictable nature. This means there is still plenty of room for the “fast follower” that rises quickly through the industry ranks with a better solution and higher customer satisfaction.

The winners in the next phase of the MC industry are most likely those firms that **invest disproportionately in technology** compared to their peers and reap the rewards.

The CA industry - writ large - lags other sectors in the application of technology by at least one or two generations. While home owners and board members are used to mobile and tablet apps and sophisticated cloud based solutions at work, at the bank, and in other walks of life, their community and the MC that manages it are often stuck in the world of clunky client/server applications with very limited true cloud or mobile capabilities.

A 2012 IBM Global CEO Study surveyed over 400 business and IT executives to examine factors affecting their organizations in today's marketplace and **technology was ranked as the most important external force impacting their organization.**

More than 50% of the CEOs recognized that software was key to achieving a competitive advantage, but only 25% leverage software effectively.

-IBM.com

Increased Specialization Between CAM and Back-Office Operations

While CAM operations are performed by community management experts that perform high-touch, in-person tasks such as managing vendors and meeting with boards of directors, back-office operations such as processing assessment payments, printing and mailing deed restriction letters, and processing accounts payable are scale-intensive operations that lend themselves to large, high-capacity processing centers.

Historically MCs performed all back-office tasks internally, but over time some of those tasks - such as assessment lockbox operations - have already migrated to specialty vendors that can perform those tasks with a much higher degree of process automation at a lower cost when they have a large-scale operation that serves hundreds or even thousands of management firms. **The larger customer base makes it easier for the back-office vendor to invest in the technology, process expertise, and specialized skills that smaller MCs cannot match on their own.**

The MC industry will likely follow the pattern of other sectors such as commercial and multi-family management operations with similar processes that have outsourced much of their back office. RealManage, a relative newcomer to the industry in 2004, launched its operations with a centralized back office and is now among the top ten MCs in the US. Sentry Management is another notable large MC that was an early adopter with mostly centralized back office operations. Associa has also recently followed suit with a shared services center in the Dallas/Fort Worth area.

In fact, back-office operations of all types have made similar strategic moves. Consider mortgage and credit card processing, call centers, and accounts payable processing. These are all examples of general finance and accounting-related processes considered widely as being “non-core” that have migrated to large outsourced processing centers due to the cost efficiencies.

It makes little sense for management firms to try and invest both in local, high-touch CAM operations and centralized, high-scale back-office processing operations. In benchmarked cost studies, MCs typically have a much higher cost of processing similar transactions compared to large outsourced processing centers.

New cloud-based technology platforms have the opportunity to disrupt the current industry standard and bring change over time with the likely result of two types of management operations: local CAM operations and the continued rise of larger back-office operations that take on more and more tasks in centralized Shared Services centers.



STRATEGIC CONSIDERATIONS FOR MANAGEMENT COMPANIES

While many management firms experienced acceptable and even high growth rates in the past by simply growing organically along with new community growth and builder/developer relationships - with little to no investment in any sales and marketing - the current market would indicate that future growth will come at the expense of competitors. This can be a somewhat unwelcome thought in a historically collegian industry that has embraced the notion that there was enough business to go around and the MCs should only respond to inbound requests for proposals.

However, given all of the industry trends and challenges previously discussed and the high probability of an ongoing increase in competitive intensity, the primary strategic consideration for MCs should be the **basis of competition**. Management firms will need to focus on creating the necessary differentiation to outsell the plethora of competitors all vying for the same business.

Basis of Competition

Management firms can create some competitive differentiation in terms of their service model (such as offering maintenance services or other ancillary services) and focus (such as focusing only on on-site communities), but for the most part, MCs compete on four primary dimensions: Price, People, Process, and technology.

PRICE - The community management industry is somewhat unique in that management fees on a unit level have been relatively flat for decades. Because of the intense competition, community association boards rarely allow any type of price premium. Management fees come under scrutiny since no one will raise homeowner assessments just to pay a higher management fee.

Some MCs resort to shifting price from management fees to administrative fees or shifting price from the communities to residents or vendors by raising homeowners fees or charging vendors participation fees. In many cases, legislative caps are put in place to prevent management firms from charging high fees for disclosure-related fees and most vendors push back hard on MC fees by complaining to the CA boards.

Further, many MCs break even or lose money on management fees and are only profitable when taking into consideration closing-related fees and other miscellaneous revenue.

If an MC wants to compete by leading with a low price, the result may be additional business, but at **reduced margins**. And reduced margins mean an inability to increase investment in the other dimensions of People, Process and Technology. This in turn, would likely increase customer churn, negating any market share gains by leading with a low price.

PEOPLE - The MC industry has been built on a low-tech, labor-intensive business model with total compensation costs historically running 60%+ of revenues. And while excellent employees can be a competitive edge, maintaining a stable workforce of highly-capable and talented CAMs and back-office staff is extremely difficult. Not only is the pool of experienced employees aging out of the system with the younger generation seemingly reluctant to replace them, but the best employees will often quickly leave (after being trained) to start their own firm. Or, probably not surprisingly, the best employees may leave the industry altogether for greener pastures due to the long hours, prevalence of night meetings, and difficult customer expectations the industry is known for.

Basis of Competition	Typical Strategy	Typical Outcome
Price	Lowest cost/ highest value	Lower margins Lower profits to invest in People, Process or Technology
People	Best people/ highest compensation	Lower margins or premium price Lower profits to invest in Process or Technology or lower win rates
Process	Better service/most customization	Lower margins or premium price Lower profits to invest in People or Technology or lower win rates
Technology	Superior technology platform	Higher margins or lower price Higher profits to invest in People and Process or higher win rates

An MC that tries to compete with the “best people” can find itself in a difficult position. Attempting to be the employer of choice usually means attracting staff with higher compensation, but since price premiums are rarely a reality in the competitive bidding wars for new contracts, this strategy will only result in **thinner margins than normal**. And, just like the problem with a low-price strategy, lower margins mean less to invest further in People, Process and Technology.

Thus overpaying employees relative to industry peers is not likely to be sustainable.

PROCESS - Most management firms are launched with the vision to provide better and more customized service than the founder’s previous employer. But those same founders often find that even the best processes and operating procedures tend to break down with any meaningful scale. It may be easy for a senior controller to remember the nuances of how all 50 boards want their financial reports presented, but it is another challenge altogether to try to keep track of 100+ clients and their various preferences.

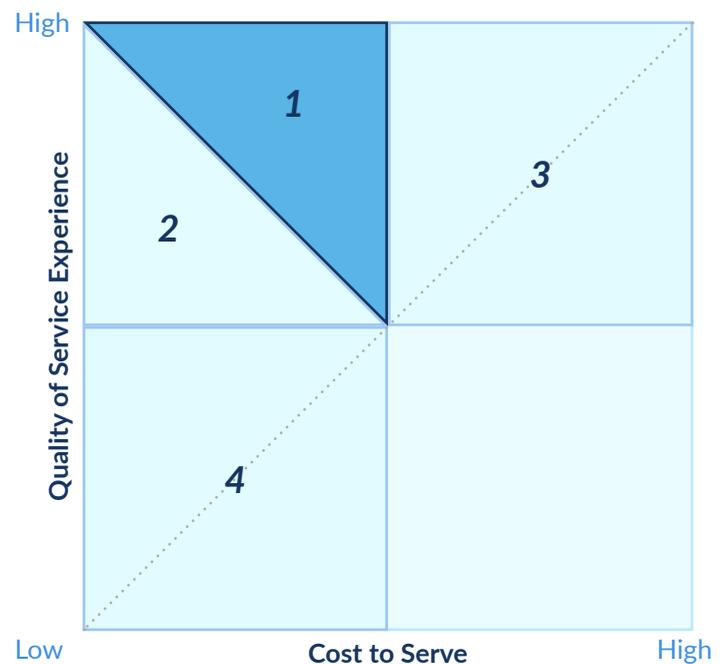
Most measures to document and “perfect” the many processes required in an MC - short of a world-class technology platform - will be expensive and time-consuming, and will again clash with the priority of keeping costs low in order to compete effectively.

This **efficiency vs. service trade-off** can be difficult for an MC to navigate. Per the Harvard Business Review article “*Breaking the Trade-Off Between Efficiency and Service*”, the two winning strategies are to either pick a small **niche market** to serve that have less service variability or deploy more customer **self-service** capabilities to enable customers to absorb the cost of process/service

variability by serving themselves. This type of self-service can only be embraced with the right technology.

EFFICIENCY AND SERVICE TRADE-OFF

- | | |
|--|---|
| <p>1 Low-cost Accommodation
(customer self-service)</p> <p>3 Classic Accommodation
(unsustainable)</p> | <p>2 Uncompromised Reduction
(niche focus)</p> <p>4 Classic Reduction
(reduce cost and quality)</p> |
|--|---|



TECHNOLOGY - Technology is the lone competitive lever in which an investment can truly provide a substantial return. While competing on a lower price, better employees, or more customized processes lead to lower profits, a wise technology investment can deliver all three. 1) An automated technology platform can lower costs, 2) an easy-to-use software ecosystem can lead to higher employee satisfaction and retention, and 3) a process-oriented technology engine can improve process speed and quality.

It is therefore imperative that MC owners view technology as a critical investment rather than an operating expense.

Technology as a Disrupter

Survey after survey of objective measures with quantifiable results show that technology in any industry is the major source of disruptive innovation that causes changes in market share to shift from the Technology Followers and Laggards to the Technology Leaders.

In the mid-1990s the travel agent industry existed primarily to move information from travel providers to travelers using a multitude of antiquated information silos to issue the traveler a ticket in exchange for a 10% commission paid by the travel provider.

The rise of the internet and online ticket processing eventually eliminated about 80% of all travel agents in a massive industry upheaval that agents never saw coming.

- Boston Consulting Group travel industry consultant

Netscape's founder turned tech investor Marc Andreessen summed it up in a Wall Street Journal article as follows:

"More and more major businesses and industries are being run on software and delivered as online services - from movies to agriculture to national defense... Over the next 10 years I expect many more industries to be disrupted by software..."

Not only does technology have a disruptive effect on all industries, it is especially harsh in any information industry with its primary purpose rooted in the exchange of information. The MC industry is one that primarily exists because of the need to move information between the various developers, board members, committee members, residents and vendors. Seamless, standardized and automated information exchanges lead to

a higher quality of service, lower the chances of mistakes or fraud, higher the customer satisfaction, and lower cost of service.

Furthermore, the more real-time transparent and visible the process is for all constituents, the more trust and credibility is built. As most MC owners can attest, the industry has its share of frustrated board and committee members that often question what the management firm is doing and how the money is being managed. The better the technology platform, the higher the process clarity and the higher the standard of accountability. **Everyone wins.**

In addition, a software platform that delivers a better customer experience coupled with a well-established sales and marketing process means it is easier for the Technology Leaders to simply take market share away from the Technology Followers and Laggards rather than acquiring them. This raises a significant exit risk for many MC owners with small lifestyle businesses that are unattractive for larger MC acquirers that have the competitive advantage to simply outsell them. As a result, MCs who have historically under-invested in technology will continue to lose market share to market leaders as the performance gap between them widens.



The challenge for most management firms is this: at the very time they need to invest in technology, their margins and profits are at the lowest point in decades due to the competitive stresses already addressed. This will likely push most MC owners to look for cloud-based hosted, monthly subscription-based solutions - also known as **Software-as-a-Service (SaaS)** - rather than risking the investment in up-front license fees for on-premise hardware and software.

Cloud-Based Technology

Cloud based or SaaS technology has revolutionized the software industry in aggregate because of the **significant value proposition** it brings compared to the traditional client/server method of an on-premise customer installation.

MANAGEMENT COMPANY TECHNOLOGY

Current management company technology has grown and transformed over the years and currently is typically a mix of a somewhat antiquated client/server management software application with some band-aided connectivity to a handful of web-based “point solutions” such as disclosure portals, architectural committee approval portals, etc. This results in a high degree of duplicate effort of data entry, document archival, and potential connection disruptions any time an application hiccups or rolls out a new version.

The industry has lagged behind other more tech-savvy sectors in terms of investing in technology and embracing new technology trends. Tech-leading industries such as banking and financial services have been

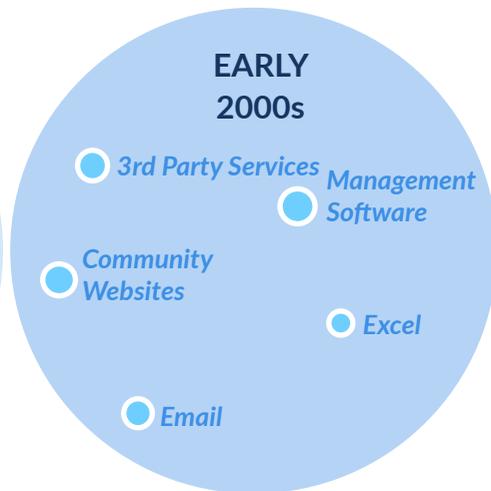
Item	Client/Server Technology	SaaS/Cloud Technology	Benefit of SaaS/Cloud Tech
Software	Upfront purchase of license, middleware, apps	Monthly Subscription fee	Capital savings
Software Maintenance	15%-25% annual maintenance fee	Included	Operational expense savings
Software Upgrades	Periodic software upgrade/version expense	Included	Operational expense savings
Hardware	Upfront purchase of data center, power, cooling, storage, servers, backup system, disaster recovery	Included	Capital savings
User Access	Software installed on every device	Web browser	Operational expense savings
Customization	Usually required and typically not supported by future releases	Configuration is wrapped into the core product	Capital/operational savings
Implementation and time to value	Upfront purchase, staging, configuration, optimization, and testing prior to implementation	Included	Capital/operational savings, faster implementation and ROI
Hardware Replacement Cost	Ongoing customer expense as hardware needs to be replaced and/or upgraded	Included	Operational expense savings, faster issue resolution
Issue Resolution and Support	Desktop support is required, slow issue resolution as provider must try to replicate issues	No desktop support required. Provider support	Operational expense savings
Energy Consumption	Data center/computer room electrical consumption adds significant energy costs	Included	Operational expense savings
Risk	Customer takes all of the risk by purchasing everything	No customer risk	Capital/operational expense savings

spending over 6% of revenue and 13% of operating expenses year over year for the past decade according to a PWC technology spending survey. By comparison, few MCs with \$5 million have been investing \$300,000 per year (6% of revenue) in technology during that same time-frame.

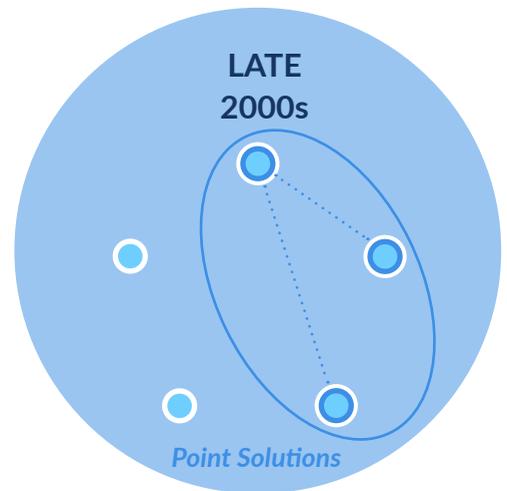
While consumers can easily perform most banking and similar services on their smartphones, few MC “mobile app” offerings are truly fully-functioning, fully-interactive apps that perform end-to-end processes such as approving an invoice, reporting a deed restriction violation, or paying an assessment. Younger, more tech-savvy homeowners will increasingly demand better access and self-service than most MCs can deliver on existing platforms from their current technology providers.



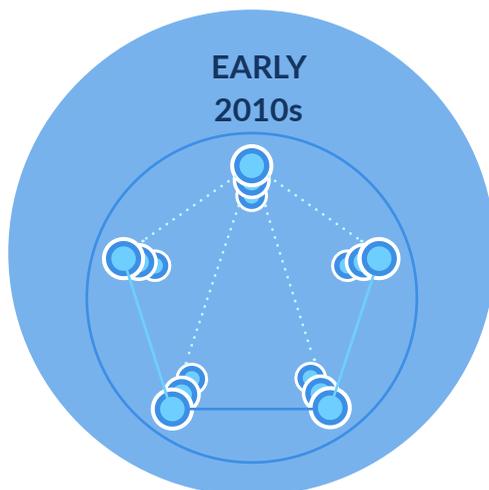
- Few/no solutions
- Introduction of email and management software
- No integration



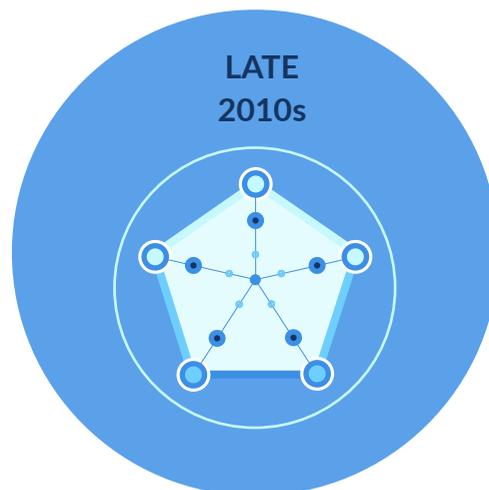
- Rise of client/server software
- Rise of 3rd party services
- Rise of email
- No integration



- Rise of community websites
- Rise of point solutions such as homeowner, disclosure and ACC portals
- Introduction of integration



- Rise of integration
- Introduction of tablet apps
- Introduction of cloud solutions



- Rise of integrated platform solutions
- Rise of specialized management
- Rise of mobile and tablet apps



While the hopes and demand for community association and management company software and services remain high the promise of truly compelling solutions have been slow to develop. Existing technology providers for the most part have not lived up to the market's expectations due to limited development, support, resources, functionality, lack of cloud-based delivery, and lack of mobile apps.

Much can be learned by looking at the typical evolution of technology in more tech-savvy industries as [it is a good predictor of what the MC industry will also experience](#).

As in other market sectors, the value of industry solutions is likely to move from technology to services as the solutions eventually transition into cloud-based software delivery with embedded services. Data entry, error checking, accounting, print fulfillment, collections, and analytics are a few examples. This means the lines between software vendors and third-party service providers typically blur.

Also, web-based solutions should grow at rates higher than that of client/server systems due to the lower cost of delivery and opportunities with mobile devices.

As access to technology becomes more and more universal via tablets and smart phones, the industry solutions will increasingly be [distributed to mobile platforms](#). However, existing industry technology will likely continue to lag the capability newer, more nimble distribution platforms.

A large flaw of existing industry software is the MC process which is still expected to change in order to fit the technology, rather than [wrapping the technology around the proven process](#) that truly leverages the CAM or back-office employee of a management firm. With continued innovation and more flexible technology, industry solutions should eventually reach their full potential with more of a process view of how the work is actually performed.

Additionally, as MCs struggle to prevent financial fraud - a recent CAI survey indicated [33% of MCs have experienced fraud and 28% had no financial controls in place to reduce fraud](#) - the industry will likely embrace much more stringent financial accountability and third-party audits such as Service Organization Controls (SOC) audits. Such audits would be much easier to implement on SaaS/cloud-based software platforms and would only be feasible with software providers that have built-in user audit functionality. In all likelihood state or federal regulators may step in to address the financial fraud issue with requirements that could eliminate or require massive overhaul of many current industry software providers.

Finally, as the industry solutions move to the cloud and become more standardized, more structured, and more database-driven, decision support can be injected into the process to assist management professionals in much more powerful ways.

There are many strategic considerations when selecting software prior to diving into a demo (which always look good on “dummy” data). One critical consideration is that a software change is usually the most painful/disruptive process an MC can experience and is often fraught with problems. Once a commitment is made an MC tends to stick with that platform for several years. **The selection process should be taken very seriously** as one of the most important and strategic decisions an MC CEO/owner can make.

THE CIRACONNECT ADVANTAGE

CiraConnect would welcome the opportunity to discuss its unique Software and Shared Services offering with select management firm owners that desire to be Technology Leaders. CiraConnect was developed from 2004-2014 as the internal software and services platform for one of the largest US management firms (RealManage). While CiraConnect is a separate sister company, this real world development design and testing has refined CiraConnect into the industry’s leading provider of cloud-based and mobile applications.

Our deep experience as both **software entrepreneurs** and as **owners of a large, high-growth and highly-successful management firm** make us a competent and credible partner to help other management companies transform into industry leaders.

Contacting CiraConnect - For more information or a demonstration of our technology, please contact us at 855-255-9541, info@ciraconnect.com, or visit our website at www.ciraconnect.com

SOURCES

Community Association Institute

The Boston Consulting Group

The Boston Consulting Group Survey of 4,000 Small and Medium Size Business Leaders; “Technology Leaders” were defined as embracing cloud-based applications and used smartphones and tablets.