

Section VI: Financial Data

Income Analysis

A Cash Flow Statement, which can be found in **Exhibit O**, was completed to calculate PROPERTY's annual cash flow of \$179,245. The statement shows that the property is operating well and creating positive cash flow proceeds for the owner.

Conditions and Rents

PROPERTY offers 3-12 month lease terms. Twelve-month lease terms are based on amount equal to the market rent minus two months prorated over the term of the lease; six-month leases follow the same formula, but with just one month prorated. Leases of 3-5 months are available at market rent. These lease policies have changed over time and as the market dictates. As the market firms, the prorated savings of a twelve or six month lease would decrease.

Security Deposits vary based on the applicant's credit and rental history. They range from \$100 to \$400. Our criteria allow a cosigner or an additional deposit if credit history is poor or there is no credit history to evaluate. Similarly, a first time renter would be required to pay an additional deposit for the initial lease term.

An application fee of \$50 per leaseholder and a redecoration fee of \$100 per apartment are charged; both are nonrefundable. As with the additional deposits, these fees can fluctuate based on the market and competing properties. The application fee was raised to \$50 from \$35 last year. The redecoration fee offsets the basic costs of turning the unit.

There is a nonrefundable pet fee of \$300 for dogs or cats, with up to two pets allowed per apartment. Weight and breed restrictions also apply and no exotic pets are permitted. Typically, the manager meets the pet prior to approval.

Analysis of Defects

In assessing the policies and practices relative to rents and other income, the formula of using a two-month proration for 12-month leases and a one-month proration for 6-month leases is ineffective, because in reality it makes apartments the same price. Building an additional upcharge of \$25 per month into leases shorter than 12 months will keep PROPERTY competitive within the marketplace while generating ancillary income for the property. This practice will also encourage longer lease terms.

As is mentioned in Section V, the popularity of PROPERTY's three-bedroom floorplans allow for the rental rates on those apartments to be increased. Much like the previous recommendation, an increase of \$25 per month will create general income without contributing to a slide against the competition.

Turnover at PROPERTY was 56% last year as mentioned in Section III. This rate is 8% lower than the turnover rate for the CITY metropolitan area as reported by NAA. We feel certain that high service levels and continued upkeep of the PROPERTY has resulted in a lower amount of residents moving out. Also since most of PROPERTY'S floor plans are smaller, we find fewer residents seeking home buying options, so have lost fewer to that reason.

New Income Sources

As previously mentioned, rental increases will effectively create new income. In addition to the across the board increases, management can take a more aggressive and educated approach to pricing. Based on views, access to amenities, and desired location, an upcharge can be applied to more popular apartments. This has been tried with success at some of our competing properties.

The pet fee system can be revamped to charge an additional amount per pet. As mentioned earlier, the flat \$300 fee currently covers up to two dogs or cats. PROPERTY averages one pet fee a month, approximately half of which are paid for two dogs or cats. By charging an additional \$150 for a second pet, PROPERTY will generate an additional \$900 annually. No pet rent is charged so the resident can still enjoy a value.

PROPERTY currently provides free use of paper to residents taking advantage of the business center. The community purchases paper by the case for \$23.50, or \$2.35 per ream. By charging \$1.00 per 20 pages of paper used by residents, PROPERTY can easily recoup the cost of all paper and create a small amount of additional income. Charging a small fee for other business services such as sending faxes and notarizing a document can also generate income.

Lastly, the auto wash and car vacuum could easily be retrofitted with a coin-op function. Residents are quite accustomed to paying for this service elsewhere and the convenience of being able to accomplish this task is significant. I recommend a wash amount of \$1.00 and a vacuum at \$.50.

Budget vs. Actual Analysis

A community budget was prepared and has been used to compare actual income and expense performance to plan. An income and expense statement is also provided, both documents are parts of **Exhibit P**. In comparing PROPERTY's actual income to the budgeted income, Adjusted Gross Potential Income is 97.8% of the budgeted amount. This performance meets acceptable variance allowances. The Budget vs. Actual Analysis Worksheet is **Exhibit Q** and shows this full comparison.

The budget was created slightly low as far as Total Possible Current Rent is concerned. Therefore, while numbers are slightly inflated per unit and square foot, the expenses as a percentage of TPCR are in line with budget. Operating expenses are largely in line with the budget.

Actual salary expenses exceed the PROPERTY budget. This can be attributed to the need for one additional staff member on both the management and maintenance teams due to the age and upkeep of the community. When commissions and incentives are considered, the salary expense exceeds the industry standard, as well.

Actual repairs and maintenance expenses, as well, are in excess of both the budgeted amount and the industry standard. The high figures here are due to a combination of the property's age and construction. Cedar siding does not age well, and there are heavy maintenance efforts to solve existing problems and prevent future problems. The four vacant units that have been down due to structural leaks are not budgeted so would represent an even more significant overage if repaired.

Overall, the property is slightly behind, but still in line with, budget projections as well as industry standards.

NOI Analysis

In comparison to the industry standards, Actual GPI is 98.4% of the amount. The full comparison and worksheet is **Exhibit R**.

Overall, operating expenses are almost in line with the industry standard, while still over budget expectations. For example, while actual salary expenses exceed the PROPERTY budget they are slightly below industry standards. This position will be discussed in the next section but is basically a function of the size of units at the PROPERTY.

Repairs and maintenance expenses are the main reasons for the property to exceed industry standard for operating expense. The property is beginning to require higher than average expenses to maintain the physical asset and to remain competitive in the marketplace. Marketing and administrative expenses are in line with the industry. While in line with budget, expenses are higher than the industry standard in the Metro CITY Market. This variance is due to the age of the property, which makes a major impact on the cost of Maintenance and Repairs, Utilities, and Salaries.

Rent revenue collected at the property exceeds the industry standard of 89.4%. PROPERTY collects 90.8% of rent revenue. This is a notable variance and may be due to the lower than standard turnover and the firm collection policies in place.

Loss to vacancy is 4.6% of GPR, loss of collections is .7% of GPR and loss to concessions is 1.3% of GPR. These losses combine to equal a small 6.6% of GPR. All three conditions point to a strong market, a commitment by management to use true rents rather than concessions and a firm collections policy. This position is also apparent below when examining the economic vacancy.

The operating expense ratio for PROPERTY is a bit higher than industry standard. PROPERTY expenses are 42.3% of GPR and industry standard is 40.8%. As discussed above, repairs and maintenance expenses are the primary reasons for the higher percentage.

The economic vacancy percentage at PROPERTY is 5.3% which is significantly less than the industry standard of 8.4%. With physical vacancy at 4.6%, strong collections keep this number low. The variance of 3.1% or 37% is a large difference. With an average rental rate of \$690, this variance represents over \$77,000 per year in additional income.

Payroll and Job Descriptions

With a total annual salary of \$241,500 before commissions and incentives, PROPERTY's staff salaries are slightly below, but in line with, the industry standard. PROPERTY's annual salary expense is closer in line with the industry standard of annual salary per square foot than in comparison to a "by unit" measure.

The staff of PROPERTY is fortunate to work for My Company, which offers wonderful benefits to its employees. Among these benefits are rent discounts ranging from 10%-100%, education reimbursement up to \$1,700 per year, a 401(k) program with 50% company matching, a wide array of healthcare choices, 16 days of paid time off – including every employee's birthday – as well as 8 paid holidays each year. The company also provides life insurance, long-term disability, and company paid career apparel.

A list of salaries, a payroll schedule, job descriptions, and benefits information are all located in **Exhibit S**. Organizational charts of both the company leadership as well as the property operation make up **Exhibit T**.

Capital and Replacement Reserves

PROPERTY has an annual Capital budget of \$168,550. The budget and actual performance has been reflected in the Capital Expenditures Budget vs. Actual grid in **Exhibit U**. The largest portion of this budget is earmarked for carpet and vinyl repairs. Actual expenditures are in line with what has been budgeting for these floor coverings. In addition, sizeable amounts of money are budgeted for monthly roof repairs. These roof repairs are necessary due to the age of the community and the heavy tree cover, which negatively affects the lifespan of the roofs. Money is also set aside for major projects such as pool resurfacing, deck replacements, and lighting improvements throughout the year. We do a careful job of staying within the budget yet maintaining the property and providing preventive maintenance as needed. As mentioned earlier, capital dollars should be committed to correcting the leaks in four units and bringing them back on line for service. With strong demand, these units could be quickly leased and occupied.

Conclusions and Recommendations

Taking into consideration its age and maintenance concerns, PROPERTY is displaying strong, but average financial performance. As the property continues to age and expenses

inflate, it is important to generate new and additional income to keep the property profitable. This can be achieved through raising rents on the three bedroom apartments, charging additional fees, and commanding renewal increases that keep all apartments in line with market standards. Policies should be continuously reviewed so that we are capturing as much of qualified traffic as possible and adding new residents as needed. If PROPERTY wants to stay at the top of the comparable market and command leading rents, investments in exterior appearance, curb appeal and upgraded interiors have to occur. A full funded capital improvement budget, including returning four units to the line, is essential.

In addition, an aggressive preventative maintenance program must be implemented and followed closely. By finding problems before they occur, PROPERTY will be able to minimize maintenance costs in both man-hours and supplies in lengthy repairs further down the road.

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