Facilitator Guide

Financial Management

June 2017

CAM CERTIFIED APARTMENT MANAGER®

NAA NATIONAL APARTMENT ASSOCIATION Education Institute

Financial Management

Table of Contents

Notes to Facilitator

This guide is designed to help you manage the information for this module and to help increase consistency at all training locations nationwide.

Duration
This is a 6 hour, 30 minute module (excluding breaks and lunch)

Materials Needed
- PowerPoint slides
- Creekwood Case Study
- Financial Management Participant Workbook

Equipment Needed
- Flipchart or whiteboard with stand and markers
- Computer with connection to project PowerPoint slides
- Microphone if necessary – dependent on room size and setup
- Sound system to play videos if necessary

Using Slides
You will notice that some of the slides build, and when that happens, it can be difficult for the Facilitator to know when the slide is at its end. To help with that, there is a red period that indicates the last build. On any slide where you don't see a red period, that means that there is more, and to click again.

Knowledge Checks
There are Knowledge Checks at the end of the PWB. They are used by participants as a self-study after class and are not to be reviewed in class. A copy of the Knowledge Checks, with answers, is at the end of this Facilitator Guide.

Participant Workbook
Participant Workbook pages are noted throughout the facilitator guide. Use them to direct participants to summaries of classroom content. When providing page numbers, explain to participants they can follow along with classroom content, take notes, and/or use the content as a study aid after class. In some cases additional details are listed in the Participant Workbook; this is supplemental "nice-to-know" information.

Remind participants that the space provided in the workbook should be used for notes. Tested concepts and explanations will include the case study, the slides, the reference material and the facilitator's oral explanations.

At the end of each Participant Workbook, you will see Knowledge Checks pertaining to that section. Explain to participants that they can use these for self-study after class. Answers are provided on the pages following the questions.

Module "At-A-Glance"

The timing in this guide is provided as a guideline and is estimated on an average class size of 25; modify or alter as needed.

Topic	Activity	Duration
Introduction	• n/a	10 mins
A CAM's Impact to Financial Performance	• n/a	15 mins
Financial Analysis	• Participants will practice calculations needed to find GOI, NOI, and Cash Flow. • Groups will practice calculations needed to find GOI, NOI, Cash Flow, and Break Even Ratios and determine what that means to the case study property.	75mins
Minimize Financial Loss	• Participants will brainstorm ways they could prevent and solve for bad debt.	40mins
Manage Expenses	• n/a	30 mins
Develop and Manage Budgets	• Groups will gather information they will need to develop a budget and assign values to each budget category. • Groups will extrapolate and annualize numbers, analyze and explain variances, identify a need, and recommend an action to solve the need.	120mins
Performance Measurements	• Participants will practice calculations needed to effectively measure the performance of a property.	30 mins
Property Valuations	• Groups will determine the value of the sample property and share their results.	60 mins
Wrap Up	• n/a	10 mins
		390 mins

Introduction

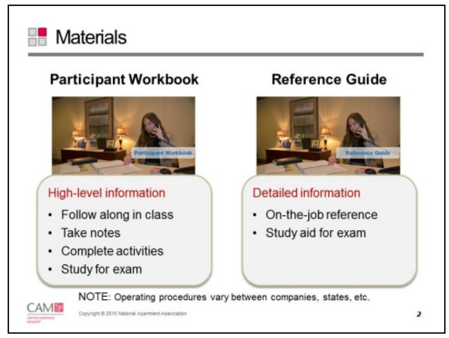
Welcome

Slide 1

Welcome participants and introduce the module.

Slide 2

Provide the following materials and explain their purposes.



Click and Explain the Participant guide:

- Used in class to follow along with information, take notes, and complete activities
- Used as a study aid for the exam
- Contains high-level information covered in class, worksheets, activity information, etc.

Remind participants that the space provided in the workbook should be used for notes. Tested concepts and explanations will include the case study, the slides, the reference material and the facilitator's oral explanations.

Click and Explain the Reference Guide:

- Used after class as an on-the-job reference
- Contains detailed information about topics covered in class

Slide 3

Play Financial Management video.

Click to Play video.

Ask for feedback regarding the financial role of the apartment manager. Has this been your experience?

How a CAM Impacts Financial Performance

A CAM's Role

Slide 4

Display the section title slide and introduce the topic.

Facilitate a discussion about how a CAM can increase the value of a property.

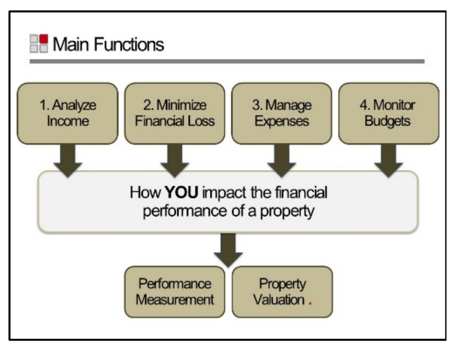
Prompt the discussion towards the following :

- Analyzing income
- Minimizing economic loss
- Managing expenses
- Budgeting

Slide 5

Display slide and **Remind** participants that they are an investor advocate.

Slide 6



Use this slide as an agenda.

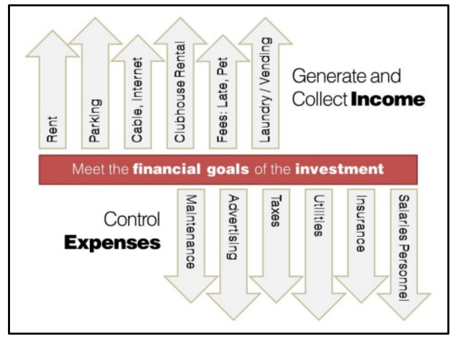
Click and Explain that each task is *directly* related to how a CAM adds value.

Click and Explain that the final topics are measuring performance and identifying the value of a property.

Financial Goals

Slide 7

Display Financial Goals slide.



Explain that a CAM's primary goals are to meet the financial goals of an investment and add value. This can be simplified into two main tasks:

Click and **explain** that one main task is to generate and collect as much income as possible.

Ask the class: "In addition to rent, what income collection and generation are CAMs responsible for?"

Click to reveal Income examples.

Click and **explain** that the other main task is to control expenses?

Ask the class: "What are some expenses that CAMs might have some responsibility for"

Click to reveal Expense examples.

Financial Analysis

Slide 8

Display the section title slide and introduce the Financial Analysis topic.

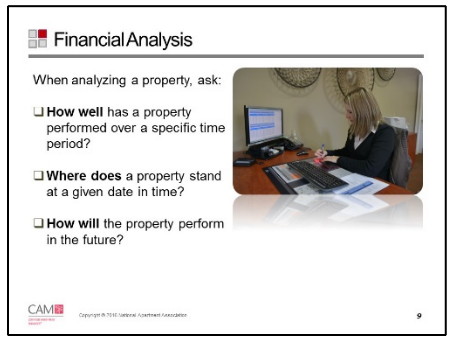
Financial Analysis

Slide 9

Display and Review Financial Analysis slide.

Explain that these questions help identify the past and current state of a property's financial performance.

Explain that we will start our financial journey by exploring the key component of financial analysis, income.



Slide 10

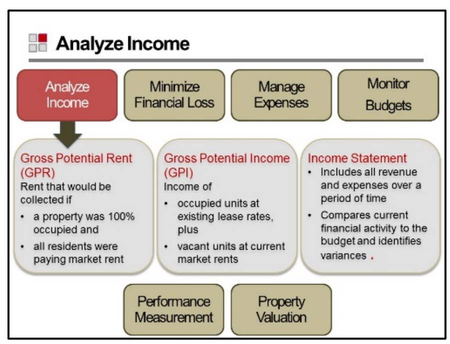
Explain that to complete a financial analysis, a CAM must know the Gross Potential Rent (GPR).

Define GPR using slide content.

Define GPI using slide content.

Click and Explain that a CAM will also need an Income Statement.

Describe an Income Statement using slide content.

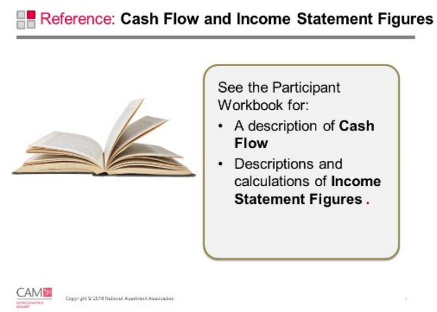


Slide 11

Refer participants to the Participant Workbook for a description of **Cash Flow** and for descriptions and calculations for **Income Statement Figures**.

Review content from Participant Workbook.

Remind participants that the **CAM Reference Guide** found online provides a complete list of formulas with examples.



Cash Flow

Cash flow, also referred to as the operating statement, is the amount of money remaining after all income is collected and expenses are paid. It is used to summarize financial activities and to assess property performance.

- Positive cash flow refers to a positive amount of money remaining.
- Negative cash flow means expenses exceed income and the owner must put money into the operation of the property.

Because apartment managers generally have limited ability to control capital expenses and debt service, they are more concerned with Net Operating Income (NOI) than Cash Flow.

Income Statement Figures

Figure	Description	Formula
Gross Potential Rent (GPR)	The amount of rent that would be collected if a property was 100% occupied & all residents were paying market rent.	Total # of units x avg. market rent
Gross Potential Income (GPI)	The income of occupied units at existing lease rates and vacant units at current market rents.	# of occupied units x avg. mo. rent + # of vacant units x avg. market rent
Vacancy, Concession & Collection Loss (VAC)	Total value of rent loss from vacant units, concessions, collection losses, and non-revenue units.	
Total Rent Revenue	The amount of GPR less vacancy, concessions, collection loss and nonrevenue units. Also called Net Rental Income (NRI).	GPR-VAC=TRR
Other Income (OI)	Income from items other than rent e.g. laundry, vending, parking, late fees, pet fees, etc.; can be up to 10% of total property income.	
Effective Gross Income (EGI)	The amount of GPR less vacancy, concession, collections loss and nonrevenue units plus Other Income. Total property revenue from all sources.	GPR - VAC + OI = EGI
Operating Expenses (OE)	Includes all expenses, fixed and variable, incurred in the course of managing the property. Capital Expenses are not typically included.	
Net Operating Income (NOI)	The total net revenue that remains after all operating expenses are deducted from total income.	EGI - OE = NOI
Operating Expense Ratio	An expense to income ratio showing the percentage of Effective Gross Income (EGI) needed for Operating Expenses. It is used to measure property performance and expense control.	OE ÷ EGI = OE Ratio
Capital Expenses (CE)	Non-recurring capital expenditures such as appliance replacement, renovations, roofing, etc. intended to add to the life of a property.	
Replacement Reserve (RR)	Replacement Reserve (RR) is an account used to set aside money for anticipated future expenses/large projects.	
Debt Service (DS)	A mortgage or loan payment (principal and interest). Oftentimes the RR payment as well as real estate taxes and insurance premiums are paid as part of the Debt Service.	
Cash Flow	The money remaining after all sources of income are collected and all property expenses (including CE, RR & DS) are paid. **Full calculation:** GPR - VAC +OI = EGI EGI - OE = NOI NOI - CE - DS - RR = CF	NOI - DS - CE - RR = CF
Break Even Occupancy Ratio	Calculates the occupancy level needed to earn enough to pay the operating expenses and debt service.	(OE + DS + RR) ÷ EGI
Break Even Rent Per Square Foot	Calculates the rent per square foot needed to pay the operating expenses and debt service. Helps identify necessary rents needed to cover all property expenses (including Debt Service).	(OE + DS + RR) ÷ Total Sq. Ft.

Gross Potential Rent (GPR)

Slide 12

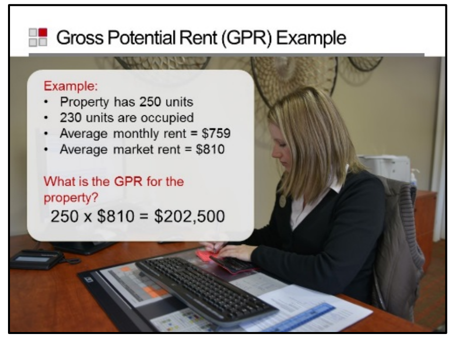
Explain how to find Gross Potential Rent (GPR).

Calculation

total units x avg. market rent = GPR

Walk through the following example:

- Property has 250 units
- 230 units are occupied
- Average monthly rent = $759
- Average market rent = $810

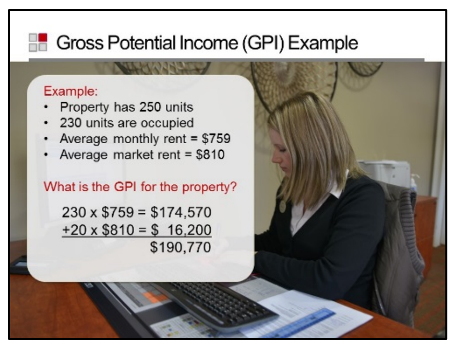


Ask "What is the Gross Potential Rent for the property?"
Answer: 250 x $810 = $202,500

Gross Potential Income (GPI)

Slide 13

Ask "What is the Gross Potential Income for the property?"
Answer: 230 X $759 = $174,570
20 X $810 = $16,200
GPI = $190,770

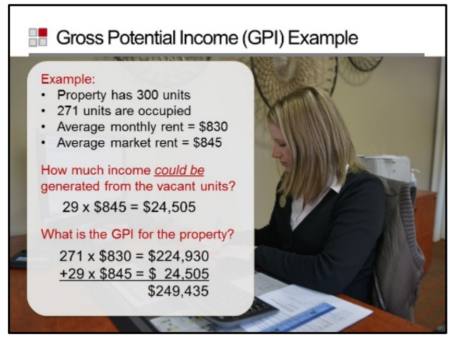


Remind participants that the difference between market rent or (GPR) and potential rent (GPI) is the loss or gain to lease. Leases already in force have a lease rate that will be either more or less than the current market rate. There is always a difference between market and potential.

Slide 14

Walk through the following example:

- Property has 300 units
- 271 units are occupied
- Average monthly rent = $830
- Average market rent = $845



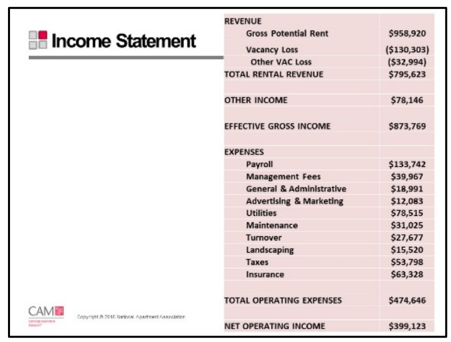
Ask "How much income *could be* generated from the vacant units?"
Answer: 29 X $845 = $24,505

Ask "What is the Gross Potential Income?"
Answer: 271 X $830 = $224,930
29 X $845 = $24,505
GPI = $249,435

Income Statement

Slide 15

Display and Review Income Statement slide.



Click and Explain there are many figures on the statement, but it helps to think in terms of income and expenses. These figures come from the Creekwood T-12 2015 Income Statement in the case study.

Introduce the three primary types of income participants will locate and use in the module's activities:

- Effective Gross Income (EGI)
- Net Operating Income (NOI)
- Cash Flow

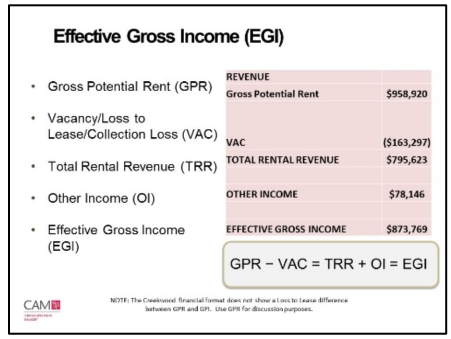
Case Study

Refer participants to the Case Study **Income Statement** for the following calculations.

Effective Gross Income (EGI)

Slide 16

Display Effective Gross Income (EGI)slide



Define each of the figures needed as you walk through the calculation:
GPR – VAC = TRR + OI = EGI

Show the location of each figure on the statement and **Explain** how they are related.

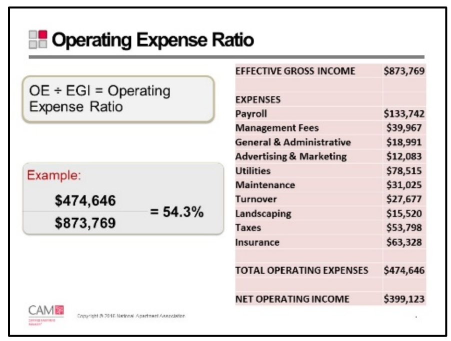
Instruct participants to perform the calculation on their own. **Point out and Explain** the note at the bottom of the slide. In future calculations, only GRP will be used.

Click to show answer.

Operating Expense Ratio

Slide 17

Display Operating Expense Ratio slide.



Define Operating Expense Ratio:

- An expense to income ratio showing the percentage of Effective Gross Income (EGI) used on Operating Expenses. It is used to measure property performance and expense control.

Instruct participants to perform calculation on their own.

Click to show answer.

Net Operating Income (NOI)

Slide 18

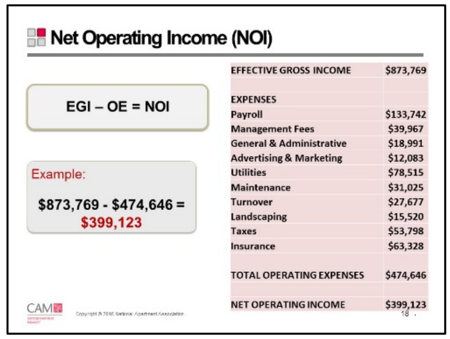
Display Net Operating Income (NOI) slide.

Define each of the figures needed as you walk through the calculation:
EGI - OE = NOI

Show the location of each figure on the statement and **explain** how they are related.

Instruct participants to perform calculation on their own.

Click to show answer.



Financial Analysis: Follow the Money

Say, "You start a financial analysis by analyzing the Income Statement.

- Transactions are recorded on the General Ledger and are organized using groups called accounts.
- A list of these accounts is called the Chart of Accounts.
- The Income Statement is generated from the General Ledger. "

Slide 19

Transition "Now that you've practiced reviewing an income statement, let's see *how* a rental payment or expense gets there."

General Ledger

Slide 20

Display and Read General Ledger slide.

Explain the General Ledger.

- The General Ledger is a group of accounts that support the major financial statements
- It is the formal record for all financial transactions for the property

Click and Explain that transactions are recorded on the General Ledger.

Click and List what is included on the General Ledger.

Click to Remove supporting text.

Click and Show where a rent payment would appear the General Ledger.

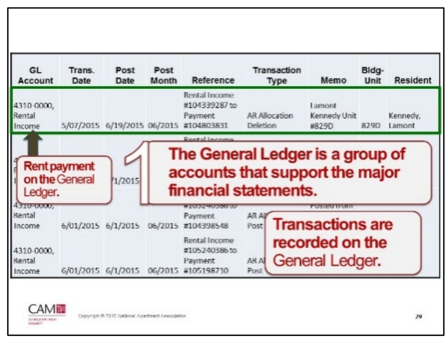


Chart of Accounts

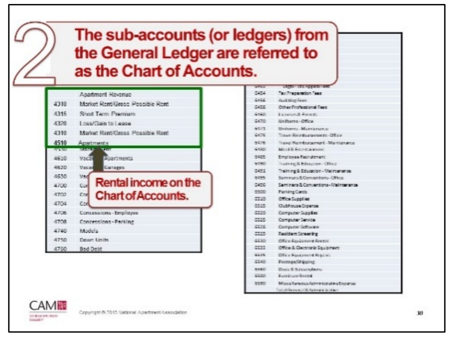
Slide 21

Display and Read Chart of Accounts slide.

Explain the Chart of Accounts.

- The sub-accounts (or ledgers) are assigned names or numbers and provide details of financial activities that occurred.
- These sub-accounts are often called the Chart of Accounts.

Click and Show where a rent payment would appear on the Chart of Accounts.



Income Statement

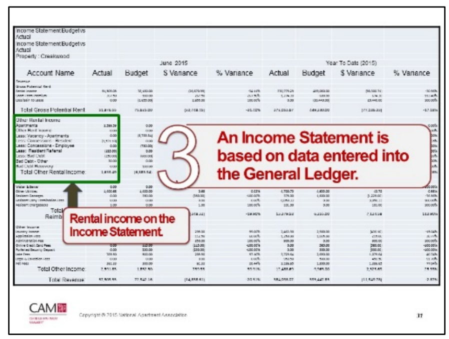
Slide 22

Display Income Statement slide.

Describe the Income Statement

- The Income Statement is based on data entered into the General Ledger.
- It compares the accounting month activity to the budget.
- It reports a variance between the budget and actual.
- It helps CAMs make comparisons, set goals and exercise better control.

Click to Show where a rent payment would appear on an Income Statement.



Slide 23

Refer participants to Participant Workbook for an overview of the **General Ledger, Chart of Accounts, and Income Statement**.

Review content from Participant Workbook.

Reference: General Ledger, Chart of Accounts, and Income Statement

See the Participant Workbook for an overview of the **General Ledger, Chart of Accounts, and Income Statement.** .

General Ledger	Chart of Accounts	Income Statement

• The General Ledger is a group of accounts that support the major financial statements
• It is the formal record for all financial transactions for the property
• It transfers journal data from the book or page where accounting entries are posted
• Debits and credits are the double-entry values used
  o For every debit or credit there is an offsetting debit or credit
  o Debits INCREASE assets and DECREASE liabilities and equity; credits do the opposite
• Much like a check register of expenses
	• The sub-accounts (or ledgers) are assigned names or numbers and provide details of financial activities that occurred.
	• These sub-accounts are often called the Chart of Accounts
	• It establishes account codes for each income and expense item
		• The Income Statement (and Balance Sheet)is based on data entered into the General Ledger
		• Measures performance for a span of time
		• Compares the accounting month activity to the budget
		• Reports a variance between budget and actual
		• Helps managers and owners make comparisons, set goals and exercise better control

Minimize Financial Loss

Slide 24

Display the section title slide and **introduce** the topic.

Slide 25

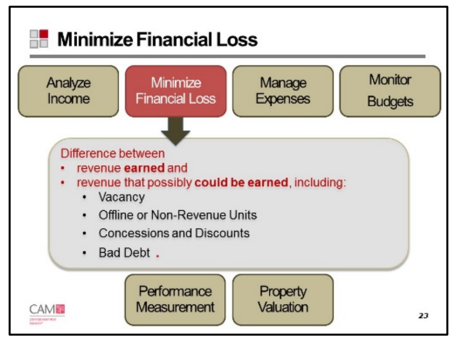
Display and Review Minimize Financial Loss slide.

Remind participants that this is the second of the four main functions that impact a property's financial performance.

Define Financial Loss

- The difference between actual revenue earned and the possible amount of revenue that could be earned

Remind participants that a line item on an income statement is VAC: the total value of rent loss from vacant units, concessions given, bad debt collection losses, and non-revenue units. These are the types of economic loss a CAM should work to prevent.



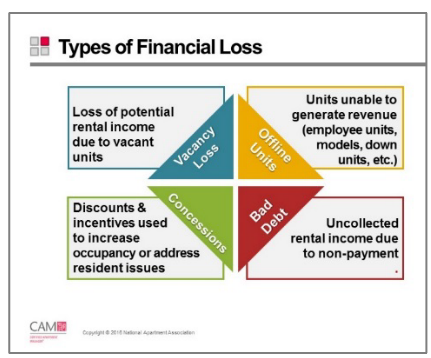
Types of Financial Loss

Slide 26

Display Types of Financial Loss slide.

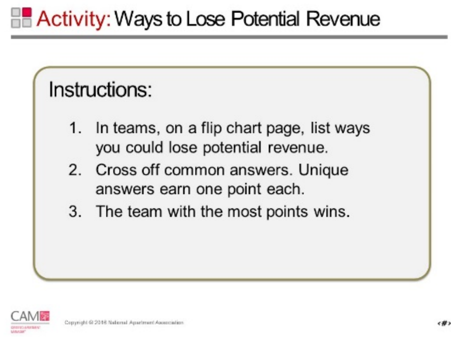
Click to show the types of Financial Loss and **Read** the definition of each.

- Vacancy
- Offline Units
- Concessions and Discounts
- Bad Debt



Slide 27

Display Activity: Ways to Lose Potential Revenue slide.



Divide the class into groups of three to five participants.

Give each group a flip chart page.

Explain the instructions:

- Groups will have five minutes to list as many ways that you could potentially lose income on a property that they can think of.
- After five minutes, each group will share their answers.
- Teams should cross off all common answers.
- Unique answers earn one point.
- The team with the most points wins!

Potential Answers May Include:

- Concessions
- Discounts
- Unnecessary non-revenue units
- Slow make-readies
- Inconvenience concessions
- Early-bird discounts
- Underachieving rental rates

Slide 28

Display Minimize Financial Loss: Collect Rent slide.

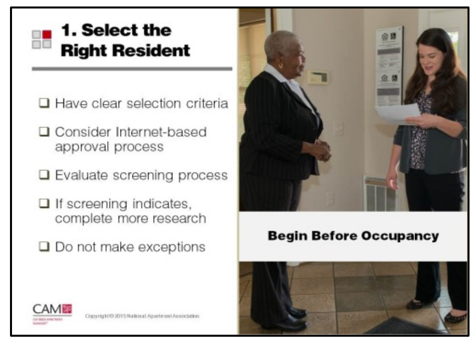
Explain that paying attention to these areas aids the rent collection process:

- (**Click**) Begin Before Occupancy
  - o Screening process and policies
- (**Click**) Communicate with Residents
  - o Facilitating the rent collection process
- (**Click**) Implement Strong Policies
  - o Actions to prevent late payments or no payments
  - o Ways to collect funds

Begin Before Occupancy

Slide 29

Display Select the Right Resident slide.
Click to show each bullet.



Click and Explain that clear, detailed selection criteria are set *by property*. CAMs should evaluate and adjust criteria as needed, but should NOT change or manually adjust scores.

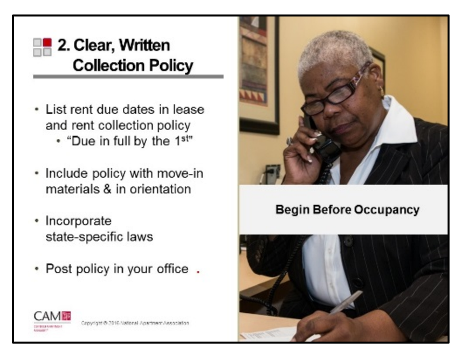
Click and Explain Internet-based approval processes.

Click and Explain that if screening indicates, CAMs should complete more research. E.g. calling references.

Click and Explain that CAMs should not make exceptions.

Slide 30

Display Clear, Written Collection Policy slide.



Emphasize that most rent collection problems are not because of the policy, but because the policy is not followed.

Click and List some things a CAM should explain during orientation:

- How much is due and when it is due

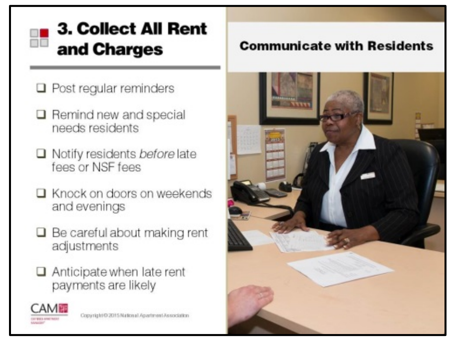
- Time period the payment covers
- Payment methods and details for each
- Where/how payment is collected
- What to do if the payment can't be made
- Returned payment information
- Penalties

Click and Review final points on slide.

Communicate with Residents

Slide 31

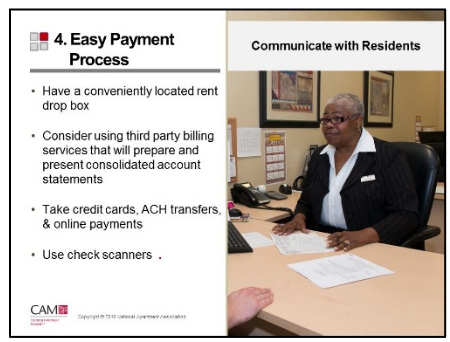
Display Collect All Rent and Charges slide.



Explain that CAMs should make paying rent a habit with residents. **Click to show** each technique and **discuss** as needed.

Slide 32

Display Easy Payment Process slide.



Explain that an easy payment process encourages on-time payment.
Click to show each point and **Review** ways to make paying the rent easy for residents.

Ask participants for additional ideas and **develop** a collective list (using a flipchart).

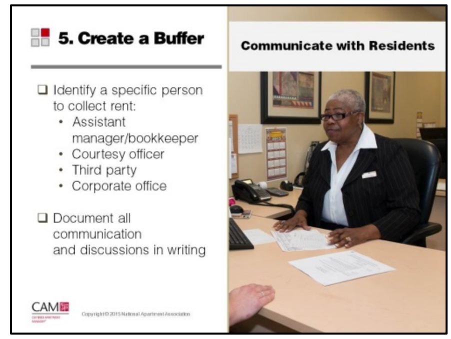
Slide 33

Display and Review Create a Buffer slide.

Discuss types of buffers and techniques.
Click to show a list of buffer examples.

Explain that a buffer helps a CAM maintain "good terms" with tenants and helps ensure timely and complete payments.

Click and Explain that CAMs should document all communication and discussions about rent collection in writing.



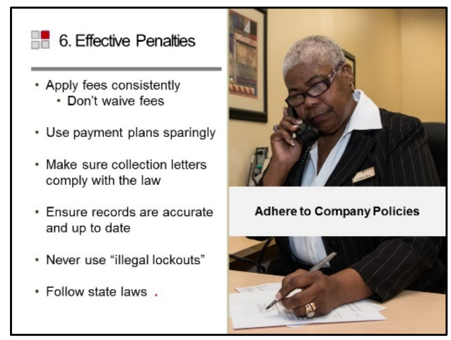
Adhere to Company Policies

Slide 34

Display and Review Effective Penalties slide.

Click to show each point and **Explain** that the type of late fee or penalty is *based on* the resident profile, e.g. a daily penalty amount for each day a resident is late.

Explain that CAMs must also follow any state-specific laws about late payment penalties and incorporate them into collection policies.

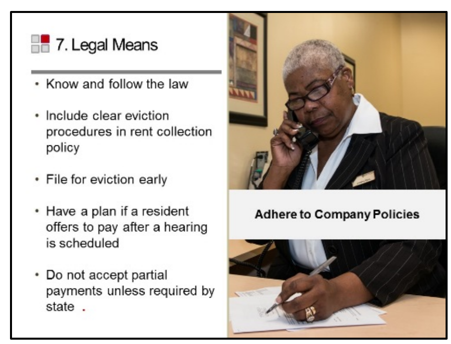


Slide 35

Display and Review Legal Means slides (2).

Click to show each point and **Explain** the actions a CAM should take.

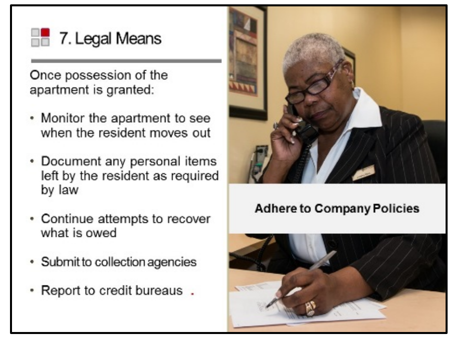
Note that some states allow partial payments without disrupting court proceedings.



Slide 36

Click to show each point and Explain information about CAM actions once possession of the apartment is granted.

Note that timely, electronic submissions will increase collection changes after the resident has moved out.



Slide 37

Display Reference: Financial Loss and Rent Collection Rules slide.

Refer participants to Participant Workbook for an overview of **Minimizing Financial Loss, Rent Collection Rules, and Implementing Strong Policies**.

Review content from Participant Workbook.

Transition – This is the end of the Income section. Now let's transition to Expenses.

Reference: Financial Loss and Rent Collection Rules

See the Participant Workbook for an overview of **Minimizing Financial Loss, Rent Collection Rules, and Implementing Strong Policies.**.

Minimizing Financial Loss

Financial Loss is the difference between actual revenue earned and the amount of revenue that *could be* earned.

Financial Loss	Description	Impact	Solution
Vacancy	Loss of potential rental income due to vacant units	• Property does not produce income • Continues to cost money; e.g. utilities	• Fill units with effective marketing • A timely make ready process • Maintain a high level of resident satisfaction
Offline Units	Units unable to generate revenue • Model units • Employee units • Maintenance or renovation • Other uses	• Property does not produce income	• Only maintain the *necessary* number of model units • Provide employee units judiciously • Complete maintenance renovation quickly • Use space wisely (e.g. if storage is needed, look for cheaper alternatives)
Bad Debt	Uncollected rental income due to non-payment	• Reduces income to the property due to uncollected rent and other charges	• Create, follow, and communicate a clear rent collection policy
Concessions and Discounts	Discounts & incentives used to increase occupancy or address resident issues	• Reduces rental income • Property collects less than current market rent	• Do not offer concessions/discounts if market conditions do not call for them • Consider impacts of concessions and discounts

Rent Collection Rules

Begin Before Occupancy	

1. Select the right resident	• Establish clear, detailed, unambiguous selection criteria ***by property*** based on your resident profile and adjust as needed.
	• Consider an Internet-based approval process using appropriate selection criteria.
	• Don't rely solely on the automatic screening if more in-depth research is indicated.
	    o e.g., Verify landlord references and rent payment history
	• Evaluate current criteria for screening residents and approving applications.
	• Consider adjusting property criteria to maximize revenue.
	    o Do NOT change or adjust scores.
	• Do not make exceptions.

2. Establish a clear rent collection policy *in writing*	• Make it clear when rent is due. No ambiguity: Each resident is obligated to pay rent on or before the first of the month, in full, and in the form specified by the lease. • Ensure the timeframe is clearly indicated in the lease. o e.g.: "Rent is due on the 1st of the month & considered late on the 2nd." • Include a copy of the policy with resident move-in materials & post it in the office. • Begin the orientation process when a prospect applies. • Reorient residents when they renew their lease.
Communicate with Residents	
3. Collect all rent & other charges that are due	• Make rent payment a habit. • Post regular reminders on community bulletin boards. • Remind new and special needs residents when rent is due. • Notify residents ***before*** late fees or NSF fees • Knock on doors on weekends and in the evenings. • Be careful about making rent adjustments. • Collect ONE check per apartment. • Anticipate when late payments are likely.
4. Make rent payment as easy and convenient as possible	• An easy payment process encourages on-time payment. • Use a conveniently located rent drop box and/or pre-printed envelopes. • Consider sending monthly invoices for rent. • Accept credit cards, ACH transfers, and online payments. • Use check scanners (frequently provided free by the bank).
5. Create a buffer between you and your residents	• Appoint a specific person to collect rent politely but firmly. • Use a courtesy officer (if available) or a third party to collect. • Ask your corporate office to call residents who have not paid. • Keep all communication in writing and document discussions.

Implement Strong Policies	
6. Make penalties effective	• Determine most effective late fee or penalty for your resident profile. o Could include a late fee plus a daily penalty. • Apply late fees consistently and do not waive them. • Use "payment plans" sparingly. They must be realistic and in writing. • Letters attempting to collect rent must comply with the Fair Credit Reporting Act. • Ensure records are accurate and up to date. • Never utilize "illegal lockouts."
7. Use legal means if necessary	• Know the law and follow it. • Include clear eviction conditions in rent collection policy. • File for eviction to get on the court docket early in the month. o Some jurisdictions do not grant evictions during certain times of the year. • Once eviction proceedings have started have a plan if a resident offers to pay. • Don't accept partial payments unless required by the state. • Determine how many times you will allow a resident to "pay and stay." • Understand what you can do legally once possession of the apartment is granted. o Monitor the apartment for when the resident moves out. o Document personal belongings left behind and abide by applicable laws. o Continue all attempts to recover what is owed. o Submit accounts to third-party collection agencies. o Report outstanding debt to various credit bureaus.

Manage Expenses

Slide 38

Display the section title slide and introduce the topic.

Say "Now let's begin our discussion of expense control."

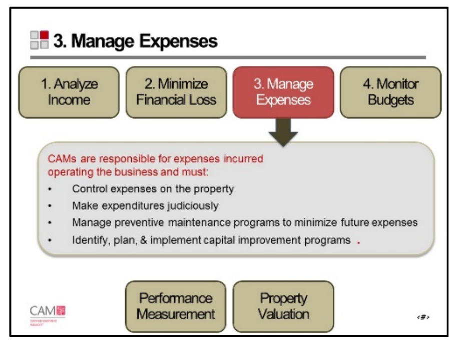
Slide 39

Display Manage Expenses slide.

Remind participants that this is the third of the four main functions that impact a property's financial performance.

Explain that a CAM is responsible for expenses incurred in operating the business. They must :

- Control expenses on the property
- Make expenditures judiciously
- Manage preventive maintenance programs to minimize future expenses
- Identify, plan, and implement capital improvement programs
- Recommend expenditures that could improve operations, decrease future costs or increase rents.

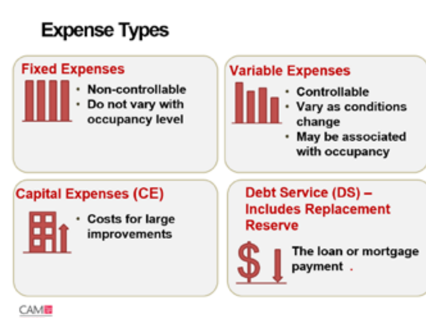


Expense Types

Slide 40

Transition "First, we'll talk about the types of expenses you'll encounter. Then we'll talk about how to manage them."

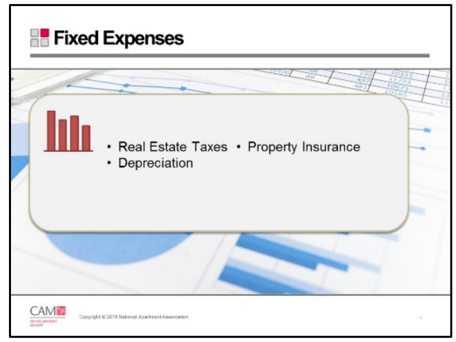
Click and Review each expense type using key points on the slide.



Fixed Expenses

Slide 41

Display Fixed Expenses slide.



List characteristics of Fixed Expenses:

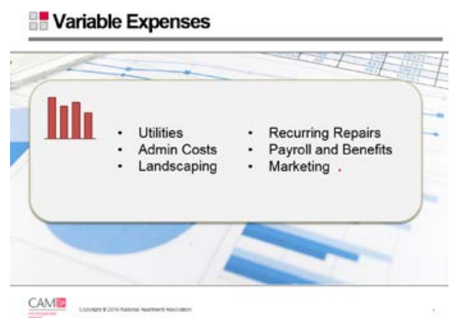
- Do not vary with occupancy
- Not affected by daily operations

Explain that depreciation is a non-operating expense posted to record aging of the property equipment and building. It is an expense that can reduce the owner's cash flow and thereby save tax dollars on property proceeds.

Variable Expenses

Slide 42

Display Variable Expenses slide.



List characteristics of Variable Expenses:

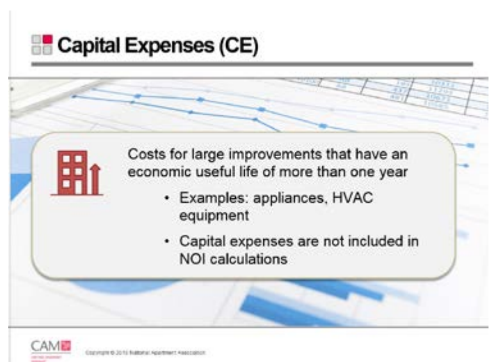
- Considered controllable
- Vary with occupancy and season

Explain that Variable Expenses are sometimes calculated per square foot, per unit and/or as a percentage of total expenses.

Capital Expenses (CE)

Slide 43

Display Capital Expenses (CE) slide.



Define Capital Expenses:

- Costs for large improvements that have an economic useful life of several years

List examples:

- Appliances
- HVAC equipment
- Carpet
- Vinyl
- Roofing
- Exterior painting

Note that Capital Expenses are subject to depreciation, so they are not included when calculating NOI.

Replacement Reserves (RR)

Slide 44

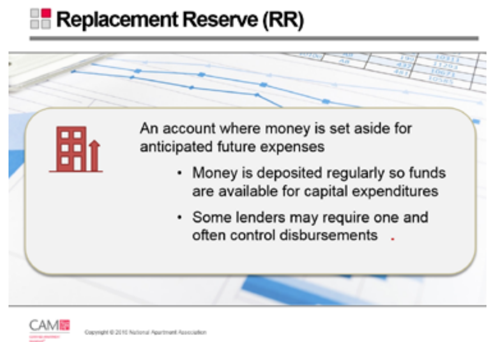
Define Replacement Reserves (RR) :

- An account where money is set aside for anticipated future expenses.

Review the following key points:

- Money is deposited regularly so funds are available for capital expenditures
- Some lenders may require one and often control disbursements from the Replacement Reserve account

Ask what is Creekwood's monthly Replacement Reserve Amount in the 2016 budget? Lead students to the report and discover an annual total of $34,800.



Debt Service

Slide 45

Display Debt Service slide.

Define Debt Service:

- The loan or mortgage payment

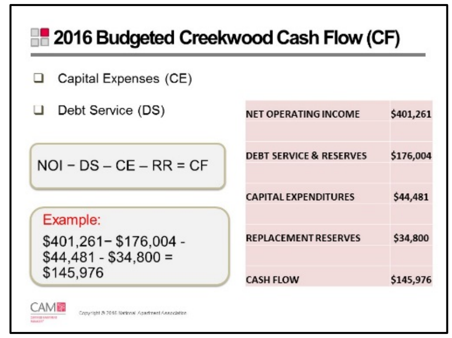
Explain that often times the RR payment as well as real estate taxes and insurance premiums are paid as part of the Debt Service.

Note that Debt Service is not considered an operating expense and is not included when calculating NOI.

Cash Flow

Slide 46

Display Cash Flow slide.



Define Cash Flow. Cash flow is the amount of money left after all sources of income are collected, and operating expenses, capital expenses and debt services have been paid.

Say "Let's look at the Creekwood's 2016 budget and see what the owner has planned for cash flow this year."

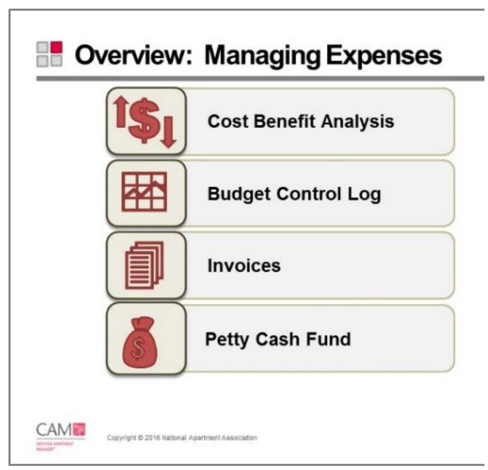
Review the numbers from the budget.

Explain now that we understand the formula, transition the class to managing expenses.

Managing Expenses

Slide 47

Display Managing Expenses slide.



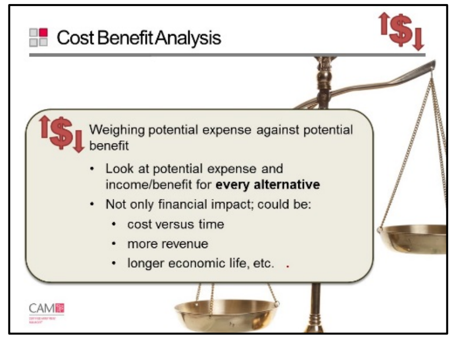
List the tasks included in managing expenses:

- Cost Benefit Analysis
- Budget Control Log
- Invoices
- Check request payment voucher
- Petty Cash Fund

Cost Benefit Analysis

Slide 48

Display Cost Benefit Analysis slide.



Define a Cost Benefit Analysis:

- The act of weighing a potential expense against a potential benefit in order to help you spend wisely

Explain how to perform a cost benefit analysis:

- Look at both the potential expense and the potential income/benefit for every alternative.

Explain that a cost-benefit analysis could be cost versus time, more revenue, better people, etc.

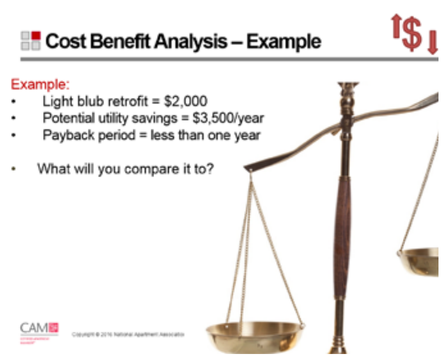
List some examples:

- In-house staff versus contractors
- Cost of training versus improved employee performance

Note that the most difficult part of the analysis is estimating the potential income to be generated or the expenses/costs that will be saved.

Slide 49

Display Cost Benefit Analysis – Example slide.



Click and Ask the following questions:

Q: In this situation, what would you track?
A: The utility expense

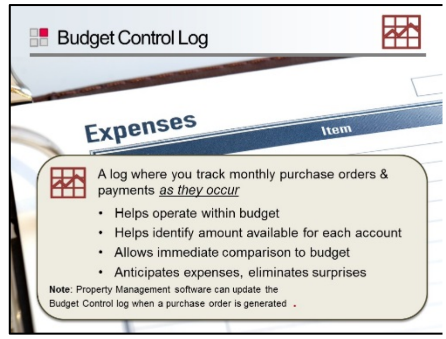
Q: What would you compare it to?
A: The cost of the retrofit

Ask "What would it mean if the utility reduction exceeded the cost of the retrofit?"
Answer: You should do the retrofit.

Budget Control Log

Slide 50

Display Budget Control Log slide.



Define a Budget Control Log:

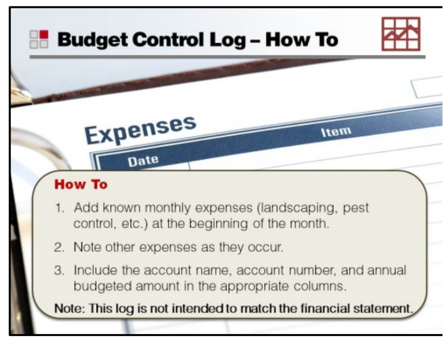
- A log where you track monthly purchase orders and payments *as they occur*

Click and Explain its purpose using slide content.

Note that most property management software has an automated Budget Control Log that updates each time a purchase order is generated.

Slide 51

Display Budget Control Log - How To slide.



Click to show each step.
Review the steps on the slide.

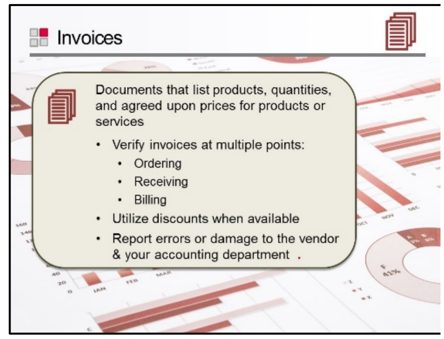
Mention that CAMs should record expenses for each account complying with their company's accounting practices. We will explore the two major accounting methods later in this chapter.

Click and Note that this log will not match the financial statement on a monthly basis, nor is it intended to.

Invoices

Slide 52

Display Invoices slide.



Define an invoice as document that lists products, quantities, and agreed upon prices for products or services.

Click and Explain that a CAM needs to verify invoices at multiple points of the ordering process.

- Ordering: verify quantities ordered, prices, receipt of all items and correct charges
- Receiving: verify packing slip and purchase order number before approving payment
- Billing: confirm that service was actually rendered

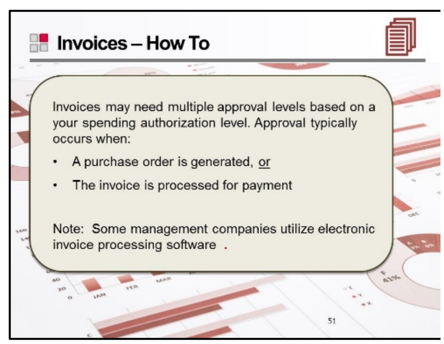
Click to show each of the following key points.

Review each:

- If discounts are offered for prompt payment, pay within the discount period to maximize funds.
- If there is an error or damaged merchandise, contact the vendor and notify your accounting department.

Slide 53

Display Invoices– How To slide.



Explain that invoices usually need multiple levels of approval based on a CAM's spending authorization level.

Click and Explain that approval typically occurs when:

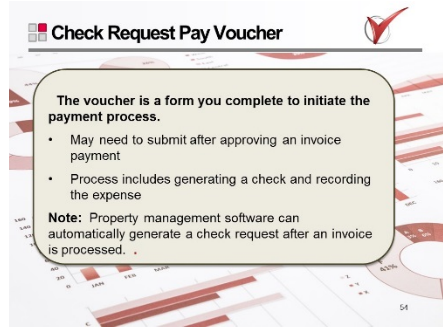
- A purchase order is generated
- The invoice is processed for payment

Note that the approval process frequently happens online if an automated system is in place.

Check Request

Slide 54

Display Check Request slide.



Define a Check Request:
This is the method by which a check is generated for an expense in advance of the actual expense.

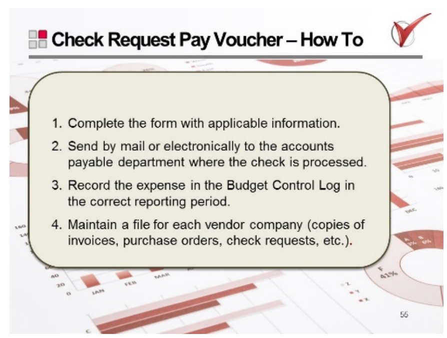
Click to show each of the following key points.

Review each:
After determining the total cost of the expenditure, the check request is generated when goods or services need to be purchased and paid for in advance of actual receipt. After the expense has occurred, a receipt is required to support the requested funds.

Provide example: Paying for a DJ for a resident event prior to the event.

Slide 55

Display Check Request – How To slide.

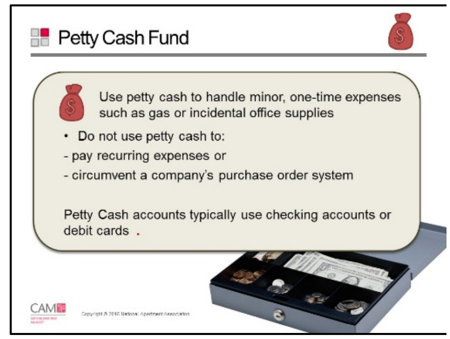


Click to show each step.
Review the steps on the slide:
1. Complete the advance request with the applicable information.
2. The request is approved and transmitted to the accounts payable department where the check is processed
3. The check is delivered and then delivered to the vendor
4. The receipt is received, coded, and sent back to accounting to close out the request

Petty Cash Fund

Slide 56

Display Petty Cash Fund slide.



Define a Petty Cash Fund:
A fund of available cash to handle minor, one-time expenses such as purchasing gas or incidental office supplies.

Click and Explain that petty cash should NOT be used to:

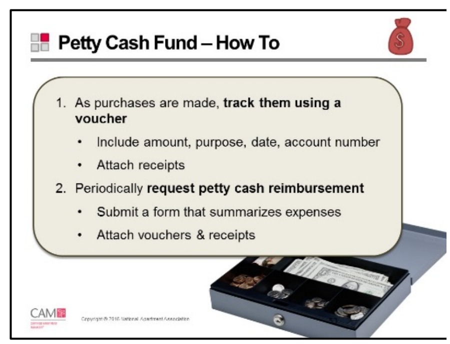
- Pay recurring expenses
- Circumvent a company's purchase order system

Click and Explain that most companies have strict rules for the use of petty cash accounts.

Click and Explain petty cash accounts typically use checking accounts or debit cards.

Slide 57

Display Petty Cash Fund – How To slide.



Click to show each step.

Review the steps on the slide.

1. Use a voucher to maintain records of expenses as purchases are made.
   - o Include amount, purpose, date, and account number
   - o Attach receipts when possible
2. Periodically process petty cash reimbursement requests
   - o Submit a form that summarizes expenses
   - o Attach vouchers/receipts and submit

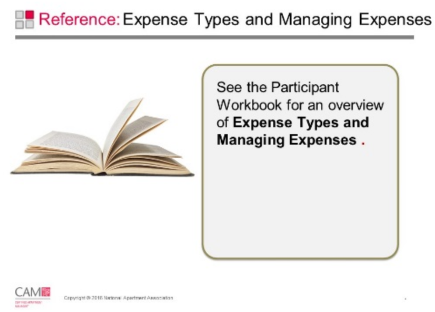
Note that the amount of the fund varies based on property size and company policy.

Slide 58

Display Reference: Expense Types and Managing Expenses slide.

Refer participants to Participant Workbook for an overview of **Expense Types** and **Managing Expenses**.

Review content from Participant Workbook.



Expense Types

<table>
<tr><th>Expense Type</th><th>Description</th></tr>
<tr><td>Fixed Expenses</td><td>Always the same amount; they do not vary with occupancy level. Includes property taxes and insurance premiums.

Property Taxes are based on the assessed value of the property which only changes if reassessments are done.

Based on assessments established by local municipalities
All charges should be understood by the CAM and owner
Real estate is not taxed the same as income

Insurance Premiums include liability, casualty, auto, and workers' comp.

Loss history usually affects the premiums.

</td></tr>
<tr><td>Variable Expenses</td><td>Controllable expenses that vary as conditions change including utilities, maintenance, landscaping, marketing, payroll, etc. Many are associated with occupancy.
Variable Expenses are often computed per square foot, per unit and/or as a percentage of total expenses.</td></tr>
<tr><td>Capital Expenses (CE)</td><td>Costs for large improvements like appliances, HVAC equipment, roofing, etc.
Note: Subject to depreciation, therefore not included in NOI</td></tr>
<tr><td>Replacement Reserve (RR)</td><td>Replacement Reserve (RR) is included in CE. It is an account used to set aside money for anticipated future expenses/large projects.

Money is deposited regularly so funds are available for projects
Some lenders may require one and often control disbursements from the account
</td></tr>
<tr><td>Debt Service</td><td>
The loan or mortgage payment
Oftentimes the RR payment as well as real estate taxes and insurance premiums are paid as part of the Debt Service.
Includes Replacement Reserve (RR), which an account used to set aside money for anticipated future expenses/large projects.

Note: Not considered an operating expense, therefore not included in NOI</td></tr>
</table>

Managing Expenses

Task	Description	Additional information
Cost Benefit Analysis	An analysis weighing the cost against the possible resulting benefits	• Look at both the potential expense and the potential income for every alternative • Not only financial impact; could be cost versus time, more revenue, longer economic life, etc.
Budget Control Log	A log where you track monthly purchase orders and payments <u>*as they occur*</u>	• Helps operate within the budget • Helps identify amount available for each account • Allows immediate comparison to budget • Anticipates expenses, eliminates surprises • <u>*Not*</u> intended to match the financial statement • Add known monthly expenses (e.g. landscaping), then continue adding expenses <u>*as they occur*</u> • Most property management software has an automated updates the Budget Control Log that each time a purchase order is generated

Invoice	Document that lists products, quantities, and agreed upon prices for products or services	• Verify invoices at multiple points of the ordering process:
		  o Ordering: Verify quantities ordered, prices, charges, and receipt of all items
		  o Receiving: Verify packing slip and purchase order number before approving payment
		  o Billing: Confirm service was actually rendered
		• If prompt payment discounts are offered, pay within the discount period to maximize funds
		• If there is an error or damaged merchandise, contact the vendor and notify your accounting department
		• Invoices usually need multiple levels of approval based on a CAM's spending authorization level. This typically occurs when a purchase order is generated and when the invoice is processed for payment.
		  o The approval process frequently happens online if an automated system is in place.

Budgets: Developing Budgets

Slide 59

Display the section title slide and introduce the topic.

Explain that CAMs may be responsible for creating a budget.

Slide 60

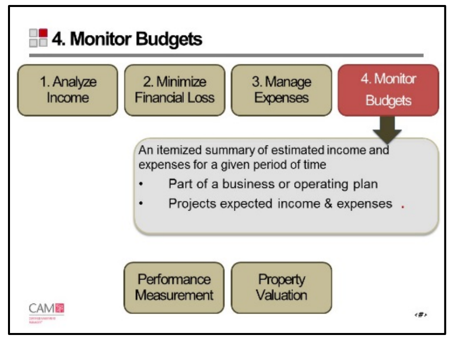
Remind participants that this is the fourth of the four main functions that impact a property's financial performance.

Define a budget:

- An itemized summary of estimated income and expenses for a given period of time.

Explain that a budget:

- Is part of a business or operating plan
- Estimates expected income and expenses for a specific period of time – usually 1 year

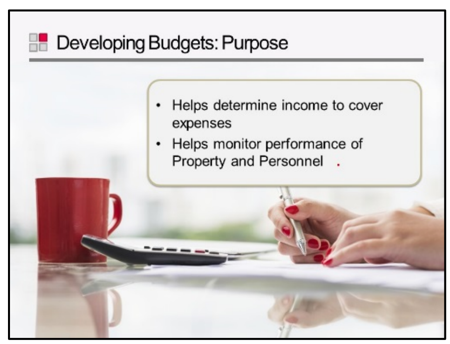


Slide 61

Display Developing Budgets: Purpose slide.

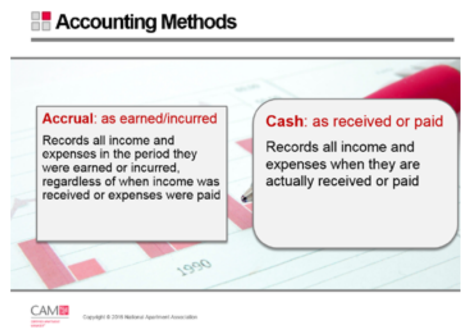
Explain that a budget:

- Helps determines occupancy level needed to cover expenses and make ROI.
- Monitors a property's performance.
- Helps evaluate performance of personnel.



Accounting Methods

Slide 62
Display Accounting Methods slide.



Discuss the importance of knowing how income and expenses are recorded before you budget.

Explain that there are two main types of accounting methods their property may use.

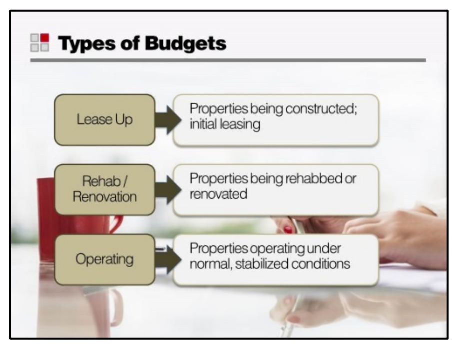
Describe the accrual method using key points on the slide.

Click and Describe the cash method using key points on the slide.

Provide example: In a cash statement a monthly landscape charge would be posted when the check was cut. Using the accrual method, the charge is recorded at the first of the month, even if the check hasn't been cut.

Types of Budgets

Slide 63
Display Types of Budgets slide.



Click to show each budget type and **Review** its description.

Refer participants to Participant Workbook for an overview of **Types of Budgets.**

Review content from Participant Workbook.

Ask participants to contribute their experiences with any of the three budget types shown.

Types of Budgets

Every type of budget must be based on the owner's property performance and investment goals.

Lease Type	Description	Details
Lease-up Budget	When a property is constructed, a budget is created to guide activities during lease up	• Without history to reference, projections are less precise than those for a stabilized property. • Information for projections depends on staff experience and local, regional or industry standards. • Pay special attention to: o Activities & costs to attract residents, sign leases, and generate income o Absorption & timing of move-ins & timing of expenses • As you learn about actual income and expenses, you may need to adjust forecasts and re-forecasts, but do *not* adjust budgets. • Note circumstances and events that affect the budget so you can explain variances and recommend action.
Rehab / Renovation Budget	Properties being rehabbed or undergoing renovation/modernization require specialized budgets	• Reflects larger allocations for capital expenses and labor than for a stabilized property. • May be more flexible if work depends on subcontractors' schedules &supplies. • During renovations, part or all of a building may have periods of no rental income. • May be prepared separately from the operating budget. • Durations vary from a few months to over a year. • Resident move-ins, move-outs, and renewals may be impacted.
Operating Budget	Once a property is fully leased and operating under stabilized conditions, budgeting is more routine	• Reflects varying expenses from month to month. o Utility expenses for heating and cooling would vary depending on the season. o Snow removal expenses would only be budgeted for winter months, etc. • Your supervisor will typically establish detailed goals based on the owner's investment goals and objectives as well as a deadline. o Deadlines are usually dictated by a property's management agreement.

Slide 64

Display slide and **Emphasize** that every type of budget must be based on the property's performance, the owner's investment goals, and ownership objectives.

Transition a review of each budget type.

Lease Up Budget

Slide 65

Display Lease Up Budget slide.

Click and Explain :

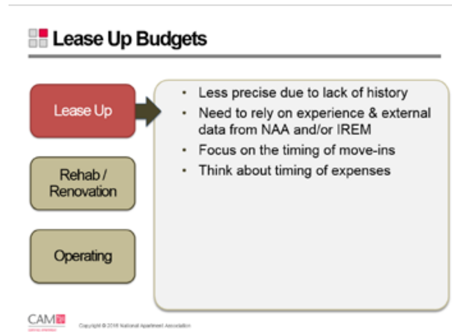
- Without history to reference, projections are less precise.

Click and Explain :

- Information for projections depends on staff experience &available industry data.

Click to show each point and **Explain** that for Lease Up Budgets, CAMs should:

- Pay special attention to:
  - o Activities to attract residents
  - o Costs to attract residents
  - o Balancing ready units with timing of move-ins
  - o Timing of expenses
- Never adjust budgets
  - o Can adjust forecasts and re-forecast as needed
- Note what affects the budget so they can explain variances and recommend action

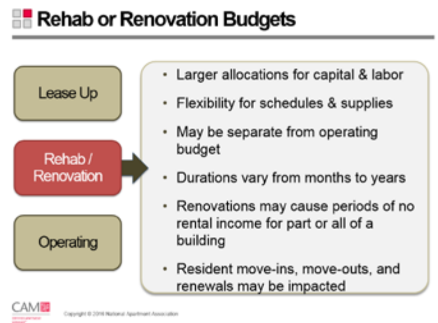


Rehab or Renovation Budget

Slide 66

Display Rehab or Renovation Budgets slide.

Click to show each point and **Explain** information about Rehab or Renovation Budgets.



Operating Budget

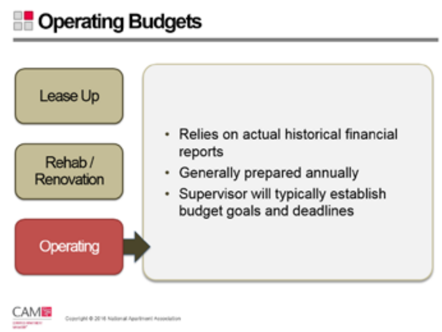
Slide 67

Display Operating Budget slide.

Explain that expenses on the Operating Budget may vary from month to month.

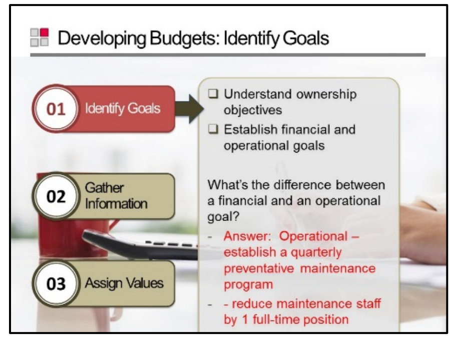
Click and Explain that the CAM's supervisor will typically establish:

- Detailed goals for the budget based on identifying the owner's investment goals and objectives
- A deadline for completing the budget
  - Deadlines are usually dictated by a property's management agreement



Developing Budgets

Slide 68
Display Developing Budgets -Identify Goals slide.



Ask for a show of hands for how many people have some involvement in the development of budgets?

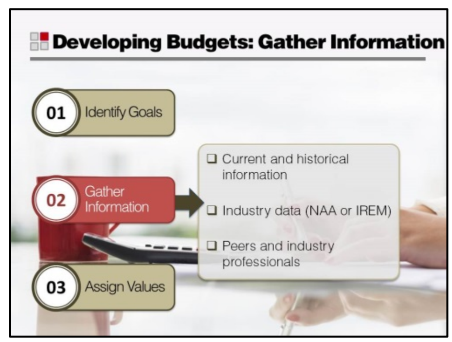
Ask for those of you who do, what are the goals for the property?

Walkthrough the steps of developing a budget.
Start with step one.

Explain that a CAM must understand the owner's property objectives and investment goals, and then determine the long and short-term actions necessary for the desired result.

Ask the participants the question then reveal the examples.

Slide 69
Display Developing Budgets: Gather Information slide.

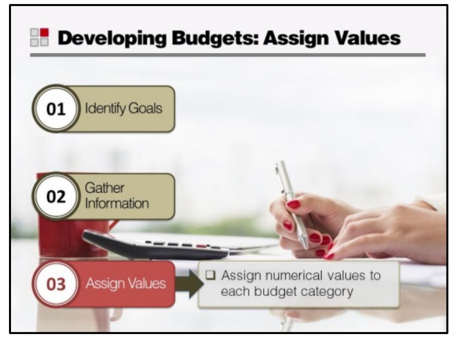


Ask "When developing a budget, what are some sources for information?"
Answers may include:

- Current and historical information
  - Operating history for the property
  - Previous budget including notes
  - Similar properties in the portfolio
  - Current service contracts
- Association and institution historical data
  - National Apartment Association Income and Expense Survey
  - Institute of Real Estate Management Survey of Income & Expenses
- Peers and industry professionals
  - Vendors and contractors
  - Other owners, supervisors
  - Insurance agents
  - Taxing authority office

Slide 70

Display Developing Budgets -Assign Values slide.



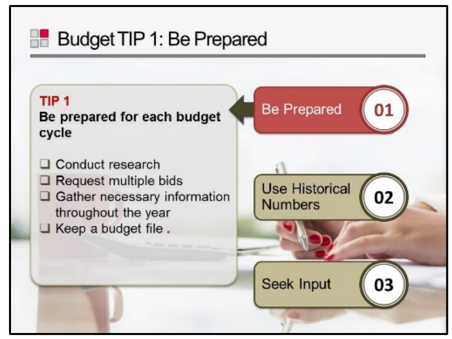
Mention that budgeting software allows a CAM to "pre-populate" fields that lock in recurring expenses.

Explain that a CAM must always include a narrative that supports assumptions including the why and when of projections.

Developing Budgets Tips

Slide 71

Display Budget Tip 1: Be Prepared



Click and Explain the following key points:

- Conduct research
- Request multiple bids
- Gather necessary information throughout the year
- Keep a budget a file
- Consult with contractors and vendors

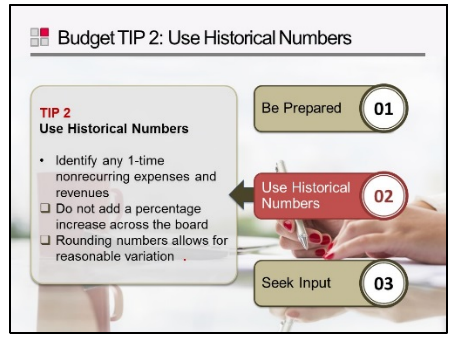
Explain that when budgeting a major repair, CAMs should allow time to:

- Request multiple bids
- Weigh the expense against expected revenue

Explain that you should use a budget file when gathering information throughout the year to:

- Store things as they come up
- Maintain a resource for covering all expenses
- Stay on track

Slide 72
Display Budget Tip 2: Use Historical Numbers slide.

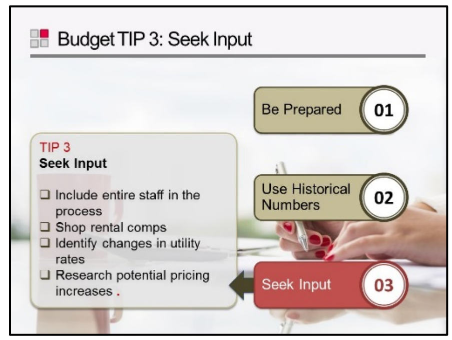


Explain that historical numbers help a CAM determine:

- Expenses not needed (completed in prior year)
- Future expenses
- Anticipated occupancy income
- Pricing strategies

Click to show each remaining point and **Review** information about using historical numbers.

Slide 73
Display Budget Tip 3: Seek Input slide.



Explain that staff is a great resource and can help:

- Develop realistic projections
- Provide details
- Document financial assumptions
- Create realistic projections

Explain that CAMS should provide staff with:

- Previous financial reports
- Major contracts
- Anticipated major expenses

Click and Explain that CAMs should:

- Shop rental comps
- Identify changes in utility rates

Mention that CAMs should organize the information as a tool for the entire staff.

Slide 74

Display Activity: Develop an Operating Budget

Objective: Practice identifying and collecting applicable information needed to improve budget development skills

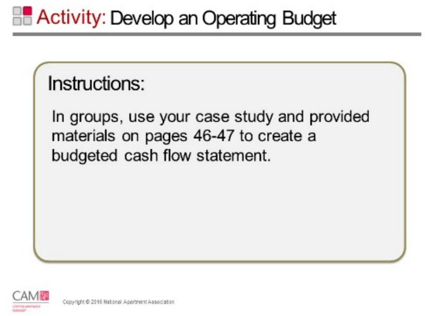
Duration: 30-40 minutes

Instructions:

- Divide the room into groups of four or five people
- **Instruct** groups to create a budgeted cash flow statement using the provided materials on pages 46-47 of the case study

Debrief:

- Answers to the budget activity can be found on the Instructor Resources page of the NAA website.
- **Lead a discussion** about one or more of the following:
    - Similarities and differences in what groups found.
    - How a budget similar to this one would help them on the job.
    - How using the owner's goals impacted the decisions they made.

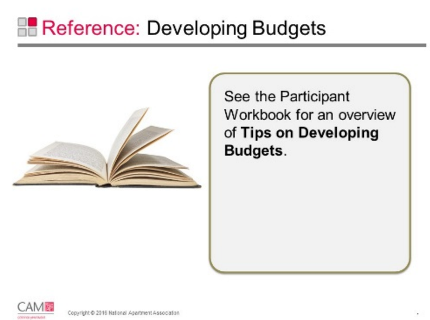


Slide 75

Display Reference: Developing Budgets

Refer participants to Participant Workbook for an overview of Tips **on Developing Budgets.**

Review content from Participant Workbook.



Tips on Developing Budgets

Tip	Description
Be Prepared	Preparing budget projections several months before they are due allows time to: • Think about the business • Conduct research • Consult with contractors and vendors When budgeting a major repair, allow time to: • Request multiple bids • Weigh the expense against expected revenue When gathering information throughout the year, consider using a budget file to: • Store things as they come up • Maintain a resource for covering all expenses • Help you stay on track
Use Historical Numbers	Review the operating history and prior year's budget, but consider current economic trends and the age of the property to forecast expenses. Using historical numbers helps you determine: • Expenses not needed because they were completed in a prior year • Future expenses not part of previous budgets • Anticipated occupancy income • Pricing strategies Do not add a percentage increase across the board. It's easier and more accurate to change a few specific projections. You must be able to justify every number. In addition, rounding numbers allows for reasonable variation.
Seek Input	Your staff is a great source of information and can help: • Develop realistic projections • Provide details • Document financial assumptions • Create realistic projections • Shop rental comps • Identify changes in utility rates The Service Manager or Maintenance Supervisor will be especially helpful. Provide staff with: • Previous financial reports • A detailed list of major contracts • Anticipated major expenses Organize the information as a tool that is readily available for the entire staff to use. When the new budget is approved, add it to the tool and update each month.

Budgets: Managing Budgets

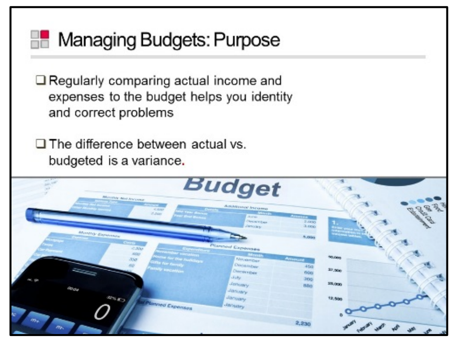
Slide 76

Display the section title slide and **introduce** the Managing Budgets topic.

Transition "In addition to developing budgets, you must continually *manage* them as well."

Slide 77

Display Managing Budgets slides.



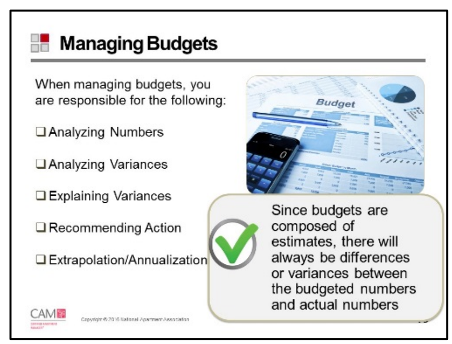
Review the purpose and benefits of managing budgets:

- Insight into variances helps a CAM manage and add value to a property.
- Regularly comparing actual income and expenses to the budget can help identify and correct problems.

Slide 78

Explain that managing budgets includes:

- Analyzing Numbers
- Analyzing and Explaining Variances
- Recommending Action
- Annualization / Extrapolation



CAMs are responsible for comparing the budget with actual numbers, identifying and explaining variances, and ultimately recommending action.

Click and Explain that budgets are composed of estimates; there will always be variances.

Slide 79

Display and Review Budget Management Tools slide.

Click and Review the three tools we've already discussed and their role in keeping you on track:

- Budget Control Log – records income and expenses during the current month
- General Ledger – reflects income and expenses from previous months
- Operating Statements – the official record of income and expenses for an operating period

Analyzing Numbers

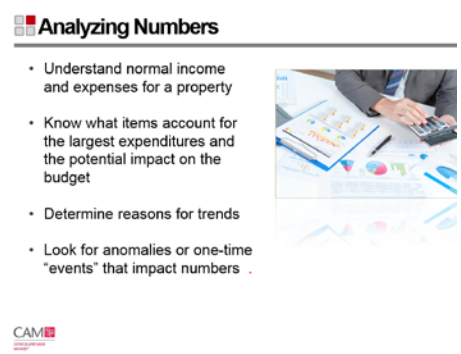
Slide 80

Display Analyzing Numbers slide.

Click to show each point and **Review information** about analyzing numbers.

Explain that when analyzing numbers, a CAM must:

- Note any steady increases or decreases and determine the reasons for the trend.
- Trends can be due to unresolved problems or a result of sound management decisions.



Variances

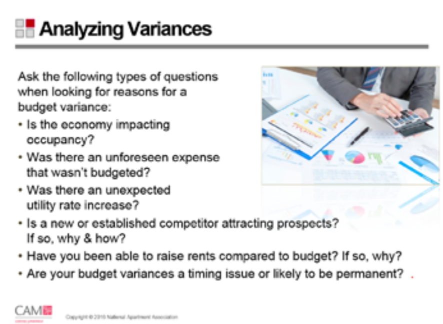
Slide 81

Display Analyzing Variances slide.

Review the following key points:

- To identify and explain variances, CAMs compare the budget to actual numbers.
- This is typically done in monthly reports to the regional or corporate office or directly through the owner's reports.

Review questions on the slide used to help identify variances.

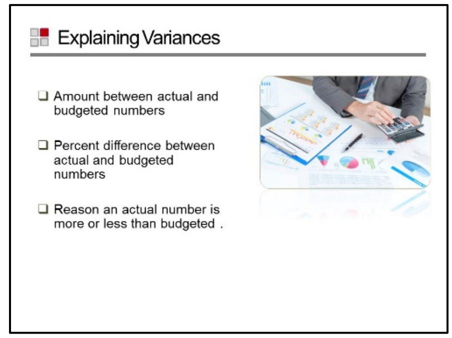


Slide 82

Display Explaining Variances slide.

Explain that in reports, CAMs need to explain:

- The *amount* of the change between the actual and budgeted number
- The *percent* of change
- *Why* an actual figure is more or less than projected in the budget

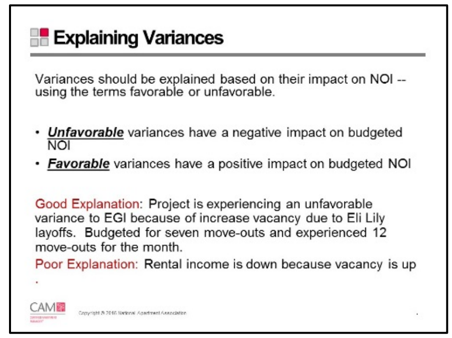


Slide 83

Click and Review the examples on the slide.

Explain that variances are explained using the terms *favorable* or *unfavorable* because they are always compared to its impact on NOI.

Read the examples.

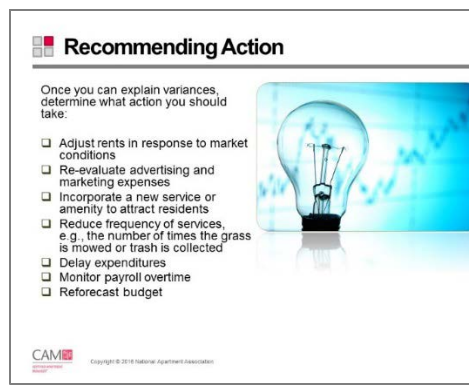


Slide 84

Display Recommending Action slide.

Explain that once a CAM can explain variances, they must determine what, if any, action to take.

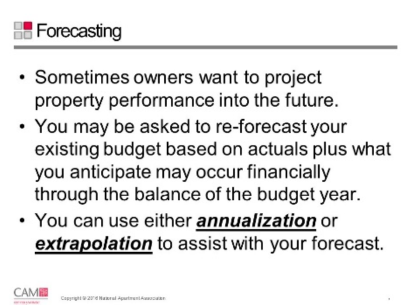
Click and Review examples listed on slide.



Slide 85

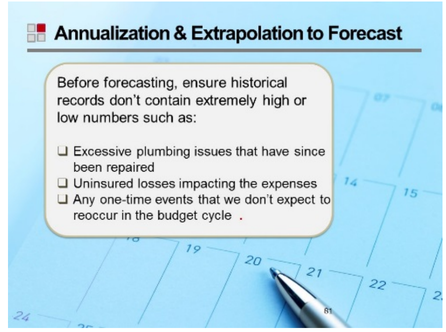
Display Forecasting slide.

Explain that forecasting is generally built from year-to-date actual financial performance combined with remaining year actual budget. This allows the owner to look forward to how the year might end.



Annualization and Extrapolation

Slide 86



Click and Explain that CAMs may need to re-forecast an existing budget. To do so, they will need to annualize and extrapolate numbers.

Define Annualization:

- The act of using known data to estimate a full year of data

Click and Define Extrapolation:

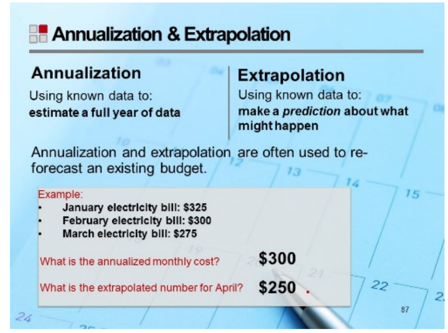
- The act of using known data to make a prediction about what might happen

Explain that before forecasting, ensure historical records don't contain extremely high or low numbers due to extenuating circumstances such as:

- Excessive plumbing issues that have since been repaired.
- Uninsured losses impacting the expenses.
- Any one time events that we don't expect to reoccur in the budget cycle.

Slide 87

Display and Review Annualization & Extrapolation to Forecast slide.



Click to show example.

Click to show first question.

Ask: What is the annualized number for this example?

Click to show answer.

Ask: What is the extrapolated number for April in this example

Click to show answer.

Demonstrate the following example on a flipchart:

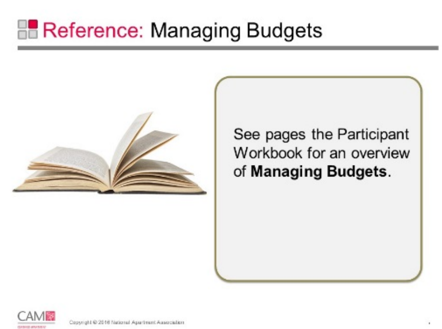
Write the following example on a flipchart and **demonstrate** the calculation to reach the annualized number.

- **52** service requests recorded in January
- **36** service requests recorded in February
- **47** service requests recorded in March

$$52 + 36 + 47 = 135$$
$$(135 \div 3) \times 12 = 540$$

Slide 88

Display Managing Budgets slide.



Refer participants to Participant Workbook for an overview of **Managing Budgets.**

Review content from Participant Workbook.

Managing Budgets

Once your budget is developed, you will use a Budget Control Log and operating reports to ensure that meeting the budget is attainable. Since budgets are composed of estimates, there will always be differences or variances between the budget and actual numbers.

CAM Responsibility	Description
Annualization & Extrapolation	To annualize and extrapolate a number is the act of using data that is known for a few months to estimate data that is likely to occur in future months. **Annualization**: Using known data to *estimate* a full year of data • *(Number ÷ time period in months) x 12 = Annualized Number* **Extrapolation**: Using known data to *predict* about what might happen • *(Number reduced by non-repeating expense or increased by unspent but necessary expenses ÷ time period in months) x 12 = Extrapolated Number* The budgeting process often uses annualization and extrapolation to forecast figures. Before forecasting, ensure historical records don't contain extremely high or low numbers due to extenuating circumstances such as: • Excessive plumbing issues that have since been repaired • Uninsured losses that impacted the expenses • One-time events that not expected to reoccur in the budget cycle
Analyzing Numbers	When analyzing numbers, a you must: • Understand normal income and expenses for the property. • Know what items account for the largest expenditures and the potential impact on the budget • Note any steady increases or decreases and determine the reasons for the trend. • Look for anomalies or one time "events" that impact numbers Trends can be a clue to an unresolved problem or a result of sound management decisions.

CAM Responsibility	Description
Analyzing Variances	You must compare the budget to actual numbers so you can identify and explain variances. • *(Actual number – budgeted number) ÷ budgeted number = variance percentage* The variance percentage is the percentage over or under budgeted figures. Analyzing variances is typically done for monthly reports to the regional or corporate office or directly through the owner's reports. When looking for variance reasons, look at events in your local market or region. Ask questions such as: • Is the economy impacting occupancy? • Was there an unforeseen expense that wasn't budgeted? • Was there an unexpected utility rate increase? • Have there been job layoffs? • Is a competitor attracting people? If so, why/how? • Have you been able to raise rents compared to budget? If so, why? • Are your budget variances a timing issue or permanent? Note: If an unexpected expense affects the budget, you need to reduce future expenses, perhaps in other categories, to make up for the loss.
Explaining Variances	In reports, you should be able to explain *why* an actual figure is more or less than projected in the budget. • **Good example**: Vacancy is up because area layoffs have caused move-outs. • **Poor example**: Rental income is down because vacancy is up. Explain variances using the terms 'favorable' or 'unfavorable.' • Unfavorable variances have a negative impact on budgeted NOI • Favorable variances have a positive impact on budgeted NOI Be prepared to explain: • Both positive and negative variances • *Why* actual numbers vary from the budget • The *amount* of the change • The *percent* of change
Recommending Action	Determine what, if any, action to take and when to implement the plan. Examples include: • Adjust rents in response to market conditions • Re-evaluate advertising and marketing expenses • Incorporate a new service or amenity to attract residents • Reduce the number of times the grass is mowed • Delay expenditures • Monitor payroll overtime

Performance Measurements

Slide 89

Display the section title slide and introduce the topic.

Transition "Successful investors know their financial objectives *and* know how to measure the performance of their investments."

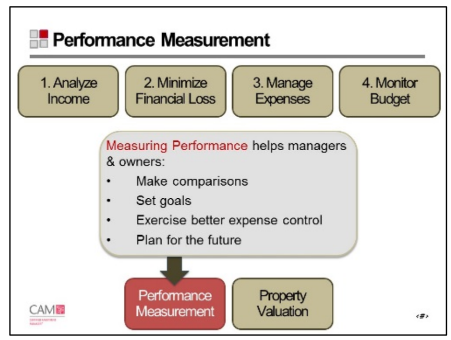
Slide 90

Display and Review Performance Measurement slide.

Remind participants that this section will discuss the results of performing the four main functions.

Explain the purpose of measuring performance is to help managers & owners:

- Make comparisons
- Set goals
- Exercise better control
- Plan for the future



Performance Measurement

Slide 91

Display slide.

Define Performance Measurement:

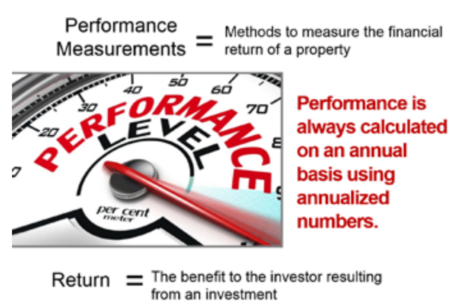
- Methods to measure the financial return of a property

Click and Define Return:

- The benefit resulting from an investment

Click and Read key point on slide.

Note that return can refer to many things. This discussion is about the *financial* return of a property.



Slide 92

Mention that the term "yield" is used interchangeably with the term "return."

Click to show each point and **Explain** that performance measurements:

- Show if goals are met
- Drive investment decisions about buying, selling, increasing, or decreasing an equity (ownership) position, etc.
- Can evaluate time, efficiency, productivity, etc.

Emphasize that knowing an owner's goals helps you identify the best way to measure performance.

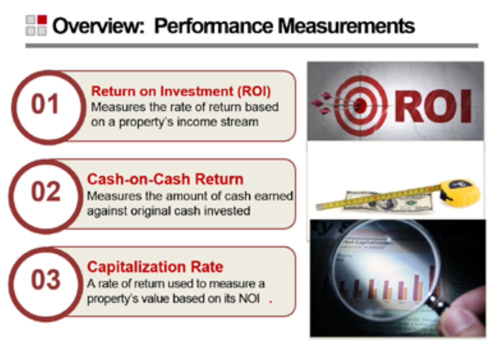
Types of Performance Measurement

Slide 93

Display Types of Performance Measurements slide.
Click to show and **Define** each performance type:

- Return on Investment
- Cash-on-Cash Return
- Capitalization Rate

Say: Let's look at each one of these in more detail.



Return on Investment (ROI)

Slide 94

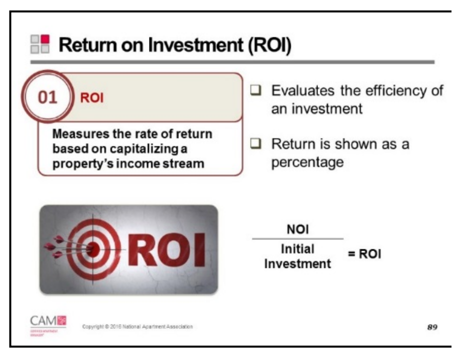
Display Return on Investment (ROI) slide.

Define Return on Investment. For our purposes, it is:

- Percent of return on each dollar invested
- Measures the efficiency of an investment

Click and Explain that the rate or ROI evaluates the efficiency of an investment

Click and Explain that returns can be cash, cost, growth, etc.

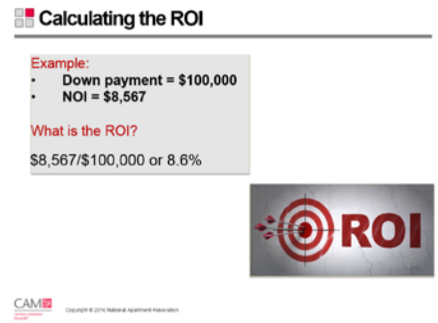


Slide 95

Click to show the calculation for ROI. **Walk through** the example on the slide.

Ask "What is the ROI?"
Click to show answer: $8,567/$100,000 or 8.6%.

Remind students this is a calculation using NOI.



> **Calculation**
> (Gain – Cost)/Cost= ROI

Cash-on-Cash Return

Slide 96

Display Cash-on-Cash Return slide.

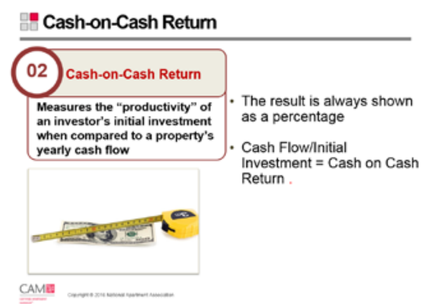
Define Cash-on-cash return:

- Measures the "productivity" of an investor's initial investment when compared to a property's yearly cash flow

Click and Explain that cash-on-cash return can be further separated into before and after tax returns

Click to show each point and **Review the** remaining key points on the slide.

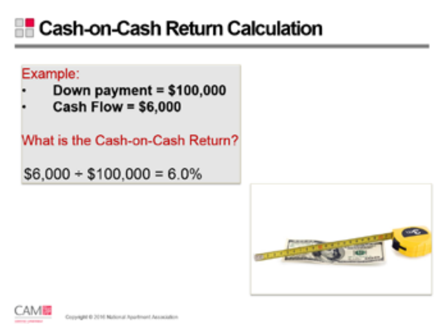
Remind students that this is a calculation using Cash Flow rather than NOI.



Slide 97

Walk through the example on the slide.

Ask "What is the Cash-on-cash return?"
Click to show answer.



Capitalization Rate

Slide 98

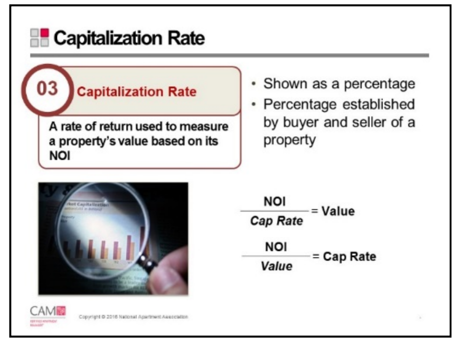
Display Capitalization Rate slide.

Define Capitalization rate:

- A rate of return used to measure a property's value based on its NOI
- Determined by dividing NOI by the purchase price or value.
- Expressed as a decimal or percent.

Click and Review the Value Calculation:
NOI/Cap Rate = Value

Click and Review the Cap Rate calculation:
NOI/Value =Cap Rate

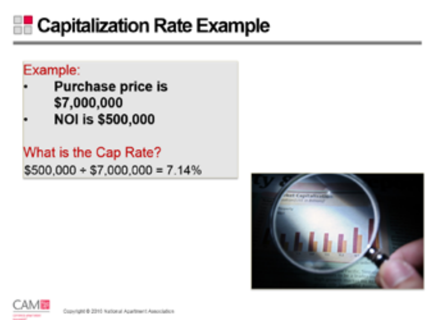


Slide 99

Walk through the example on the slide.

Ask "What is the Cap Rate?"

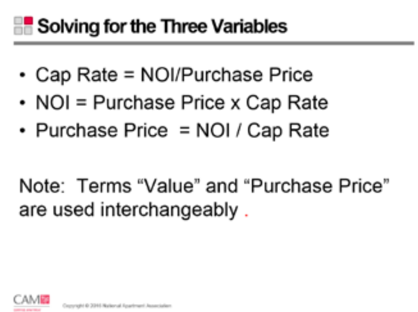
Click to show answer



Slide 100

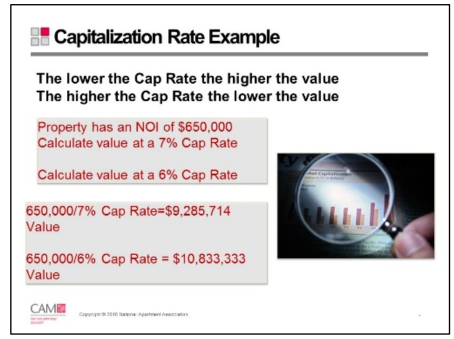
Display Solving for the 3 Variables Slide.

Explain that if you have any two components, you can solve for the third.



Slide 101

Display Capitalization Rate Example slide.



Click and Explain :

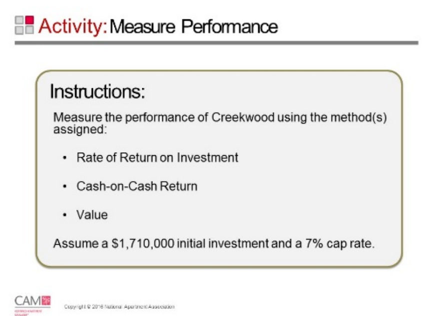
- A lower cap rate typically indicates a higher value
- A higher cap rate typically indicates a lower value

Explain that we will now apply the Cap Rate to NOI. So lastly, let's show what a Cap Rate does to the NOI.

Click to reveal Value.

Slide 102

Display Activity: Measure Performance slide



Objective: Practice calculations needed to effectively measure the performance of a property

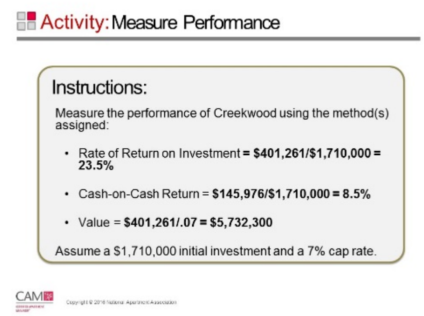
Duration: 10-15 minutes

Instructions:

- Using an example **demonstrate** how to find the following measurements of performance:
    - Rate of Return on Investment
    - Cash-on-Cash Return
    - Value
- **Assign** one or more methods of performance measurement to individuals or groups.
- **Direct** participants to the Participant Workbook Slide 46 for estimated 2016 numbers needed to perform the calculations.
- **Provide** time for participants to perform calculations.

Slide 103

Display the answers.



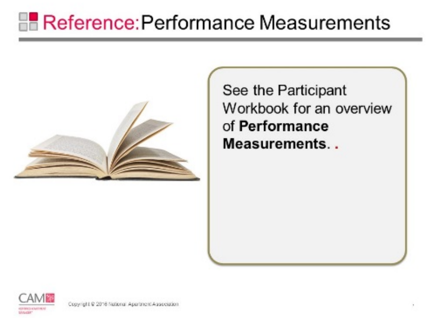
Debrief:

- **Reinforce** the purpose and benefits of performance measurements.
- **Review** the correct answers and ask questions to reinforce content.

Clarify calculations as needed.

Slide 104

Display Reference: Performance Measurements slide.



Refer participants to Participant Workbook for an overview of **Performance Measurements.**

Review content from Participant Workbook.

Performance Measurements

Performance measurements are methods to show if goals are met and measure the return of a property.

- Return is the benefit to the investor resulting from an investment.
- The term "yield" is used interchangeably with the term "return."
- Financial rates of return are always calculated on an annual basis using annualized numbers.
- Measurements are not always financial; they can measure time, effectiveness, efficiency, productivity, etc.

Measurement	What it Measures	Calculation	When Used
Return on Investment (ROI)	Measures the rate of return based on a property's income stream	$\frac{(\text{Gain} - \text{Cost})}{\text{Cost}} = \text{ROI}$	Used to identify the efficiency of an investment
Cash-on-Cash Return	Measures the amount of cash earned against original cash invested Note: The investment is always the same, however, the cash flow or amount of the principal paid to date may change.	$\frac{\text{Annual Cash Income}}{\text{Total Cash Invested}} = \text{Cash-on-Cash Return}$	Used to identify the amount of the principal paid off to date in monthly payments Can be separated into before-tax and after-tax returns
Capitalization Rate	A rate of return used to measure a property's value based on its NOI Lower cap rate = higher value Higher cap rate = lower value	$\frac{\text{NOI}}{\text{Purchase Price}} = \text{Cap Rate}$ $\frac{\text{NOI}}{\text{Cap Rate}} = \text{Value}$	Used to reflects the investor's desired ROI Used to roughly value a property based on its Net Operating Income

Knowing an owner's goals helps you identify the best way to measure performance.

Perform a Property Valuation

Slide 105

Display the section title slide and introduce the Property Valuation topic.

Slide 106

Display Property Valuation slide.

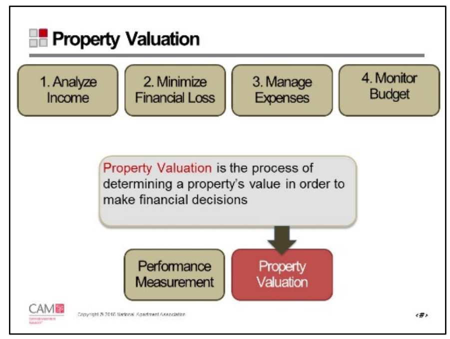
Remind participants that this is the second result of performing the four main functions.

Define Property Valuation:

- The process of determining the value of a property.

Explain that knowing the value of a property helps:

- Management decisions.
- Analysis and interpretation of financial data.



Property Valuation - Purpose

Slide 107

List some examples showing why an owner may need to know the value of a property:

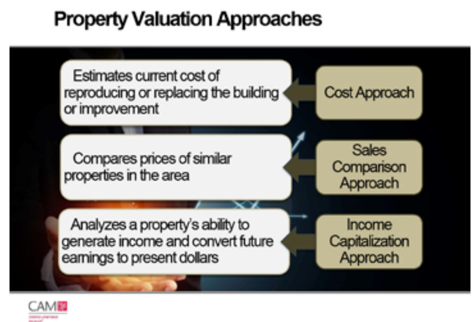
- Estimate property's price for buying/selling
- Reorganize/merge ownership of multiple properties
- Establish basis for real estate property exchanges
- Estimate value for obtaining mortgage loan
- Establish market value for condemnation
- Estimate market value for tax purposes
- Decide feasibility of construction or renovation

Property Valuation Approaches

Slide 108

Display Property Valuation Approaches slide.

Click to show each valuation approach and **Review** its description.

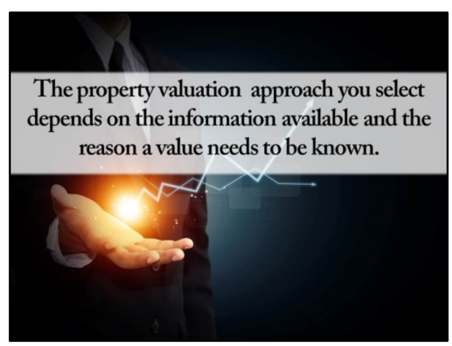


Instructor Note

Limit time spent on Cost and Sales Comparison Approaches.

Slide 109

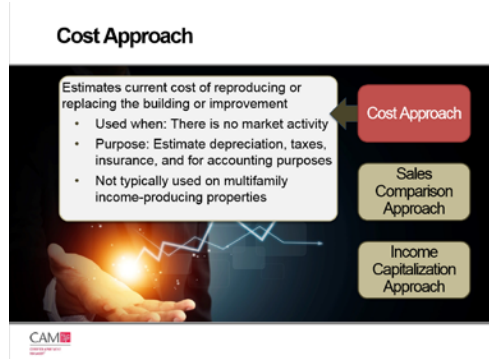
Display slide and **Emphasize** that the approach selected depends on the information available and the reason a value needs to be known.



Cost Approach

Slide 110

Display Cost Approach slide & **Review** its description.



Add the following key points to the description:

- Includes The cost of construction minus depreciation, plus land
- Land and improvements valued separately

Click and Review when it is used:

- When there is no market activity and a sales approach cannot be used

Click and Explain the purpose of this approach:

- To estimate depreciation income taxes, insurance, and accounting purposes

Click and Review the remaining key point:

- Not typically used on multifamily income-producing properties because it does not account for future costs and earnings

Example: Typically used for special use properties (e.g., public assembly, schools, hospitals)

Sales Comparison Approach

Slide 111

Display Sales Comparison Approach slide and **Review** its description.

Click and Review when it is used:

- When there are several similar properties in the local market that have been recently sold or are currently for sale

Click and Explain the purpose of the approach:

- To identify the market value of a property directly related to the prices of comparable, competitive properties

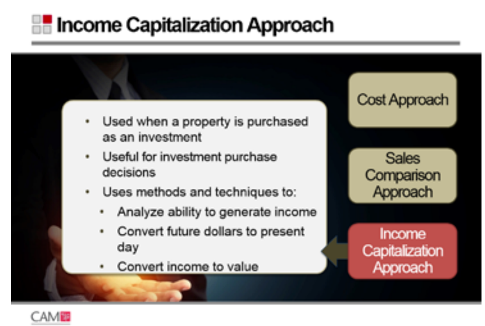
Click and Review the remaining key point:

- Not typically used because it does not account for future costs and earning; typically used when buying a single family home.

Income Capitalization Approach

Slide 112

Display Income Capitalization Approach slide and **Review** its description.



Click and Review when it is used:

- When a property is purchased as an investment
- Typically, investors believe that higher earnings translate into higher value

Click and Explain the purpose of the approach:

- To help investors identify the value of a property and make purchasing decisions
- To reflect the investor's desired ROI

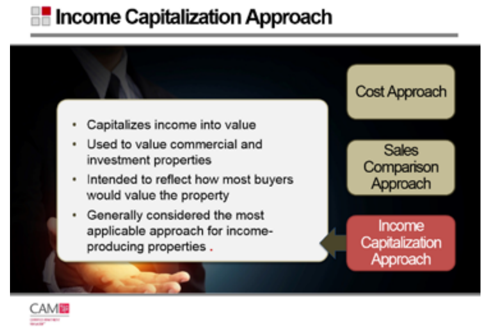
Click and Review *what* the approach uncovers:

- Property's ability to generate income
- Future earnings to present day dollars
- Income converted to value

Slide 113

Click to Review each additional key point:

- Capitalizes income into value
- Used to value commercial and investment properties
- Intended to reflect how most buyers would value the property
- Generally considered the most applicable approach for income-producing properties



NOTE TO FACILITATOR: It is recommended you research and bring to class a local current cap rate to make the learning more meaningful.

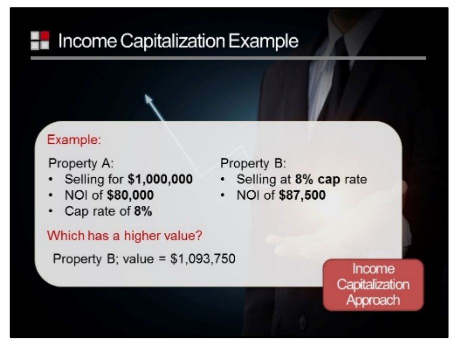
Slide 114

Review the following example:

Property A:

- Selling for $1,000,000
- NOI of $80,000,
- Cap rate of 8%

Investor recovers 8% of the investment each year.



Property B:

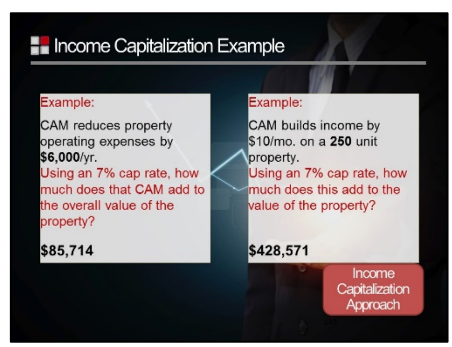
- Selling at an 8% cap rate
- NOI of $87,500,

Value would be $1,093,750 (more value!)

Emphasize that a higher NOI raises the property's value.

Slide 115

Walk through the example on the slide.



Ask "Using a 7% cap rate, how much does the CAM add to the overall value of the property?"

Click to show answer.

Click and Walk through the example on the slide.
Ask "How much does this add to the value of the property?"
Click to show answer.

Capitalization

Slide 116

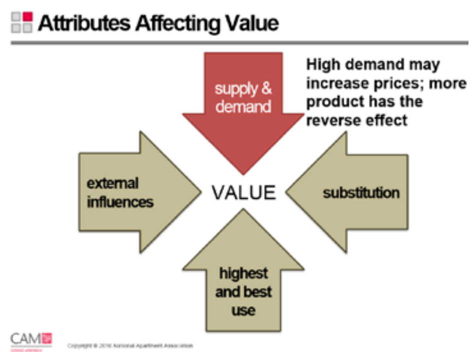
Display Capitalization and Other Attributes that Affect Value slide.

Explain that capitalization is not calculated in a vacuum. There are other attributes affecting value. Let's look at some of the other components that could add or deduct value.

Explain that while the property value is based on has a there are additional attributes that can affect perceived and actual value.

Slide 117

Display slide and **Review** Supply and Demand:

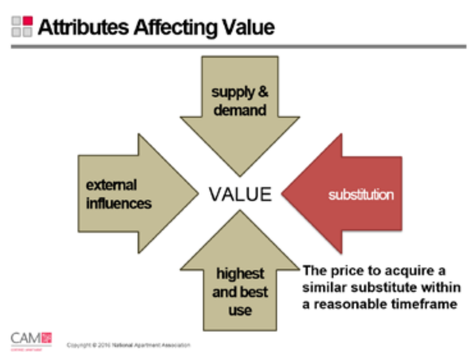


Explain:

- High demand may increase prices
- More new units may *decrease* demand
- Includes supply in terms of unsold, vacant, under construction, converted, or planned properties

Slide 118

Display slide and **Define** Substitution:

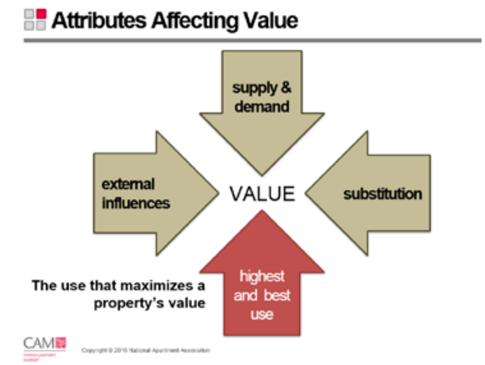


Explain:

- The price that would be paid to acquire a similar substitute within a reasonable amount of time

Slide 119

Display slide and **Review** Highest and Best Use:

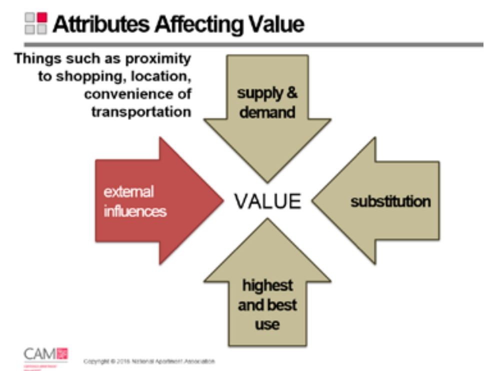


Explain:

- Refers to the use that maximizes an investment property's value
- The use must be legal, physically possible, and financially feasible
- Older property on a valuable piece of land may be more valuable torn down and rezoned for retail

Slide 120

Display slide and **Review** External Influences:

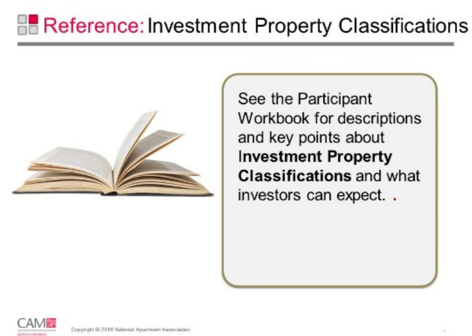


Explain:

- Refers to things such as location, convenience of transportation, proximity to shopping, etc.
- Can impact the value of a property positively or negatively

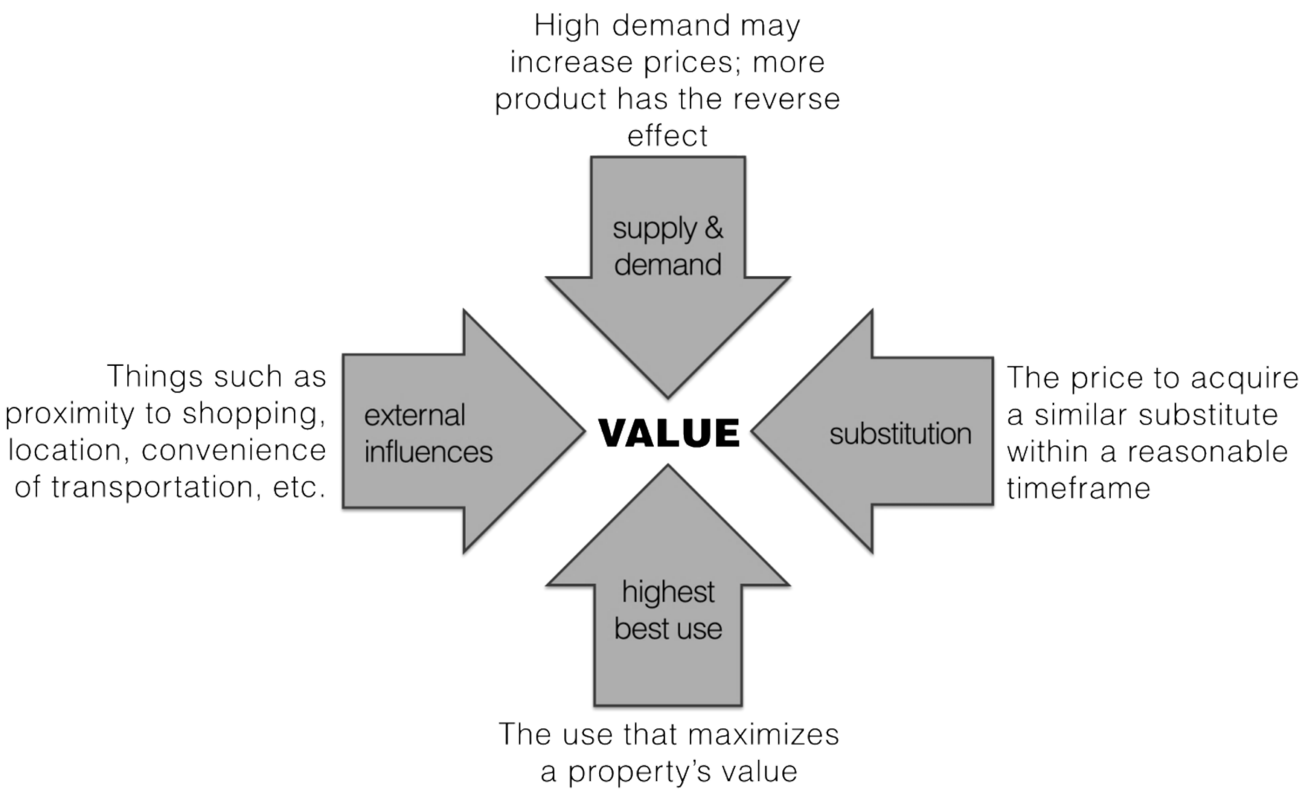
Slide 121

Display Reference: Investment Property Classifications slide.



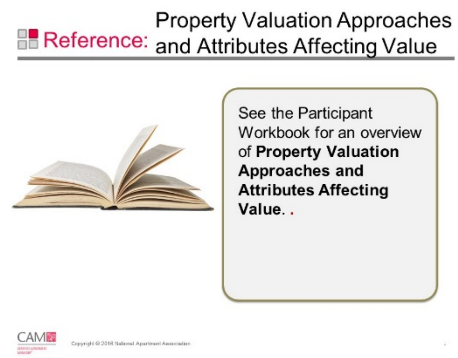
Refer participants to Participant Workbook for descriptions key points about **Investment Property Classifications** and what investors can expect.

Review content from Participant Workbook.


High demand may increase prices; more product has the reverse effect
supply & demand
Things such as proximity to shopping, location, convenience of transportation, etc.
external influences
VALUE
substitution
The price to acquire a similar substitute within a reasonable timeframe
highest best use
The use that maximizes a property's value

Slide 122

Display Reference: Property Valuation Approaches and Attributes Affecting Value slide.



Refer participants to Participant Workbook for an overview of **Property Valuation Approaches and Attributes Affecting Value**.

Review content from Participant Workbook.

Property Valuation Approaches

The approach selected to value a property depends on the information available to estimate a value and the reason why a value needs to be known.

Approach	What it does	Why Useful	When Used
Cost Approach	Estimates the current cost of reproducing or replacing the building, minus depreciation, plus land value	Because improvements and land are valued separately, it is useful for insurance and accounting purposes when depreciation must be estimated for income taxes	Used when there is no market activity, and a sales approach cannot be used. Note: Not typically used on multifamily income-producing properties
Sales Comparison Approach	Compares sale prices of similar properties in the area Identifies market value of a property directly related to the prices of comparable, competitive properties	Useful when there are several similar properties in the local market recently sold or are currently for sale	Used when several similar properties in local market recently sold or are for sale
Income Capitalization Approach	Uses methods, techniques and mathematical procedures to analyze a property's ability to generate income and convert future earnings to present day dollars	Useful for making purchasing decisions	Used when a property is purchased as an investment Typically, investors believe higher earnings translate into higher value

Capitalization

Capitalization is the process of estimating the market value of a property by applying a proper investment rate of return to the annual Net Operating Income expected to be produced by the property.

- Annual Net Operating Income ÷ Capitalization Rate = Value

The cap rate is variable like an interest rate. However, it does not distinguish between the return on and the return of capital. Capitalization rates are determined by the market and quality of the property; it can be as low as 5% and as high as 12%.

Attributes Affecting Value

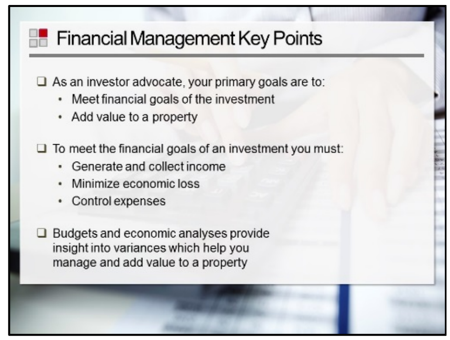
Attribute	Description
Supply And Demand	If demand for a particular property type is high, prices tend to increase. This takes into consideration existing properties that are unsold or vacant and properties being constructed, converted, or planned. More new units may *decrease* demand.
Substitution	Value is set by the price that would be paid to acquire a similar substitute within a reasonable amount of time.
Highest and Best Use	Highest and best use refers to the use that maximizes an investment property's value. This use must be legally permissible, physically possible, financially feasible and produce maximum returns.
External Influences	Location, convenience of transportation, police protection, municipal regulations, the conditions of street lighting, and the proximity to shopping and restaurants can have positive and negative effects on value.

Wrap Up

Slide123
Display the section title slide and transition into the wrap up.

Key Points

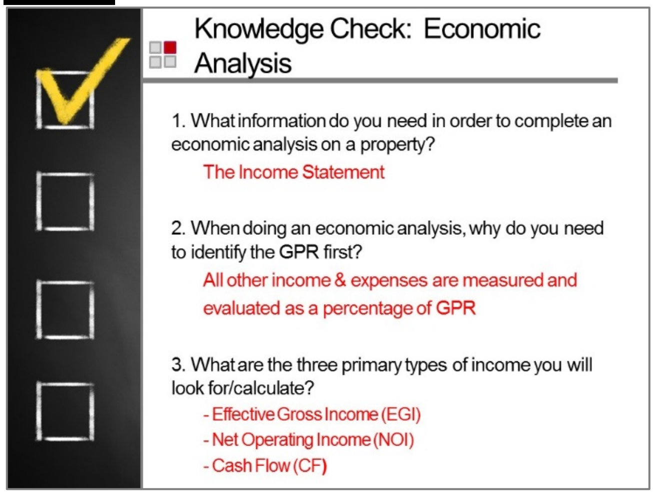
Slide 124
Click to show and **Review** Key Points.



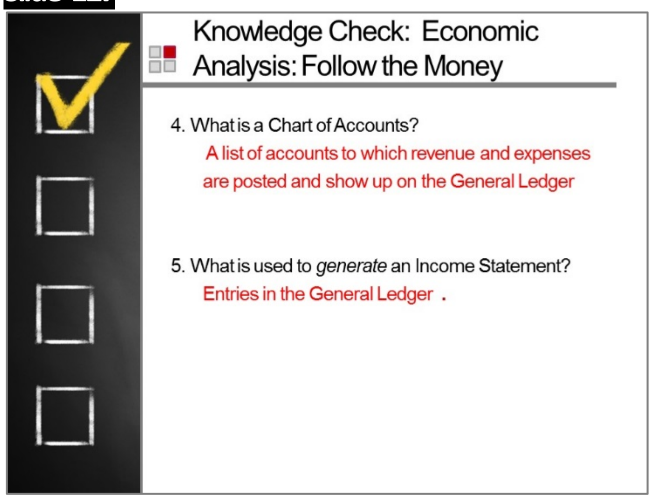
Slide 125
Thank participants.

Knowledge Check Answers

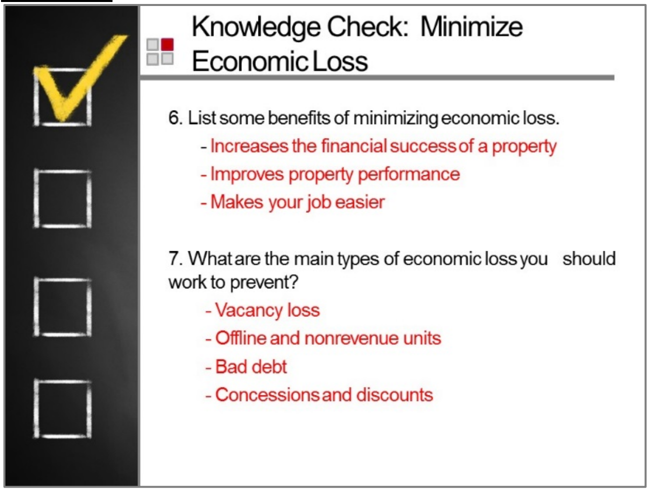
Slide 126



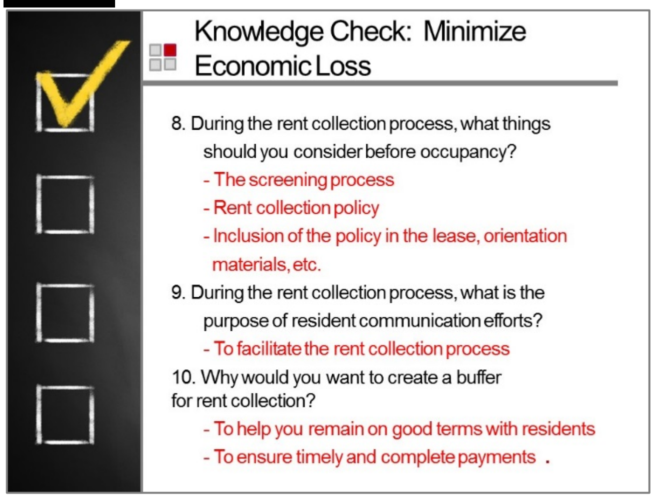
Slide 127



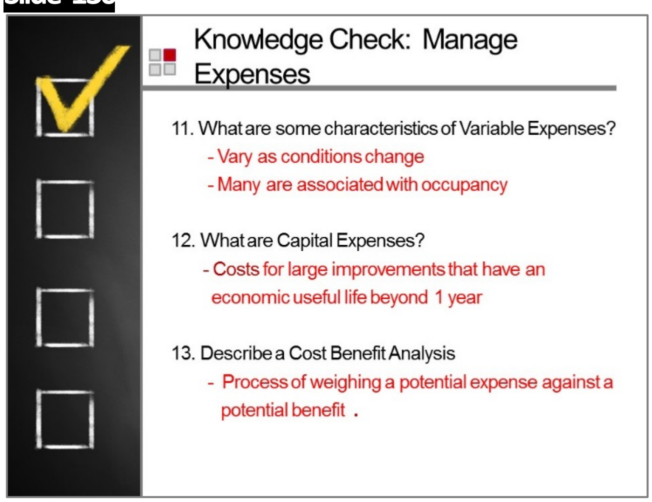
Slide 128



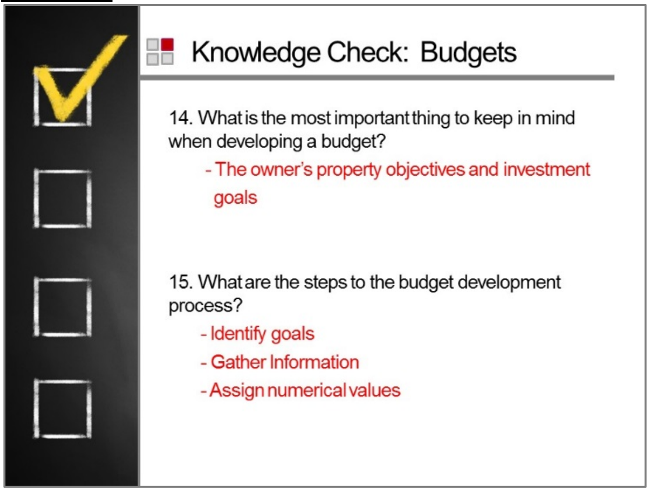
Slide 129



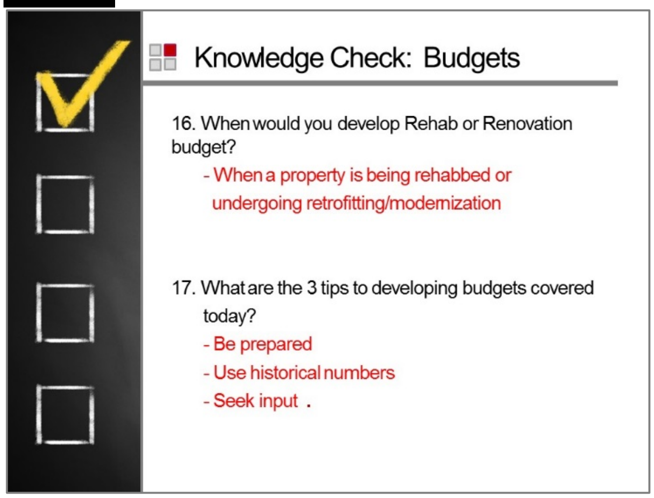
Slide 130



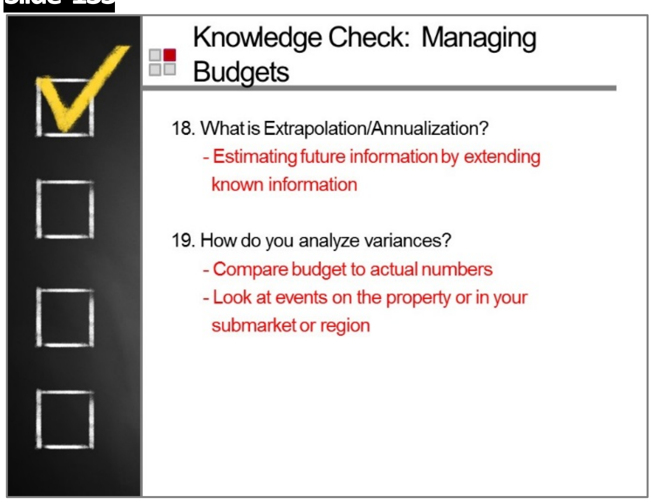
Slide 131



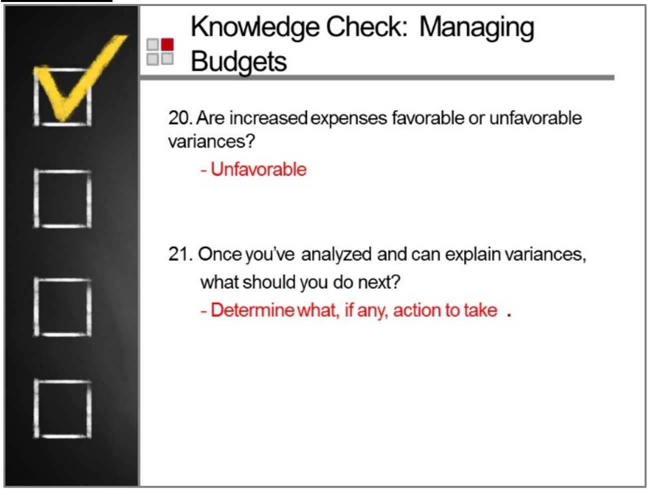
Slide 132



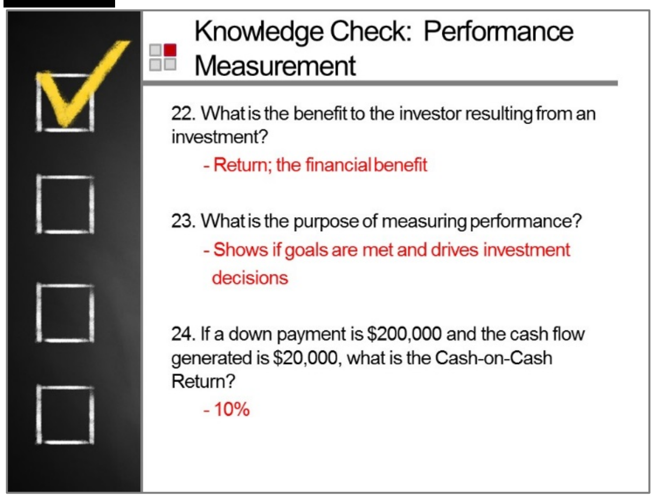
Slide 133



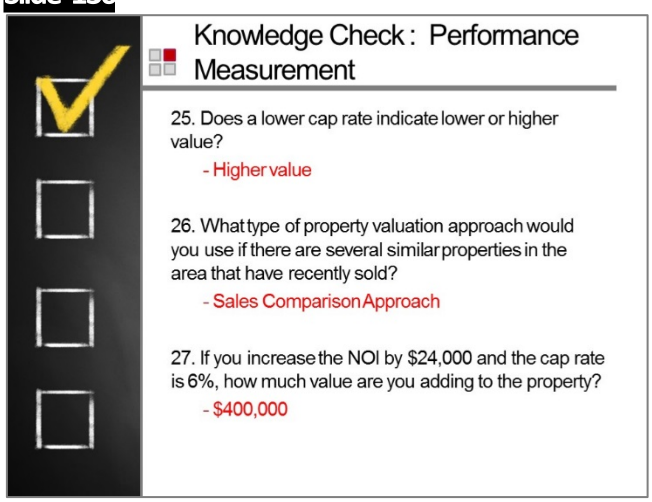
Slide 134



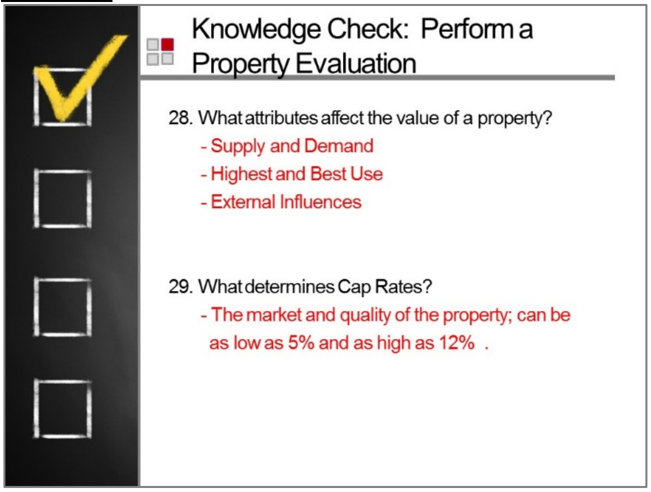
Slide 135



Slide 136



Slide 137


Knowledge Check: Perform a Property Evaluation
28. What attributes affect the value of a property?
- Supply and Demand
- Highest and Best Use
- External Influences
29. What determines Cap Rates?
- The market and quality of the property; can be as low as 5% and as high as 12% .