

*Training on Financial
Management for Fiscal
and Asset Managers*

Technical Assistance for
Community Services and
Housing Development Center
April 2, 2008

Agenda

- Role Play – Analyzing a project's year-end variance report
- Testimonies and challenges
- What are our financial management goals?
- What role do we play in financial management?
- Why are financial reports important to us?

*Role Play:
Analyzing a project's year-
end variance report*

CFO and Asset Manager

**Income and Expense Variance Report
December 31, 2007**

	Annual Budget	Year to Date Actual	Variance
INCOME			
Gross Potential Rent Income	423,000	398,430	(24,570)
Vacancy & Collection Loss	(20,082)	(18,072)	2,011
Effective Rental Income	402,918	380,359	(22,560)
Other Income	3,156	3,156	0
Effective Gross Income	\$ 406,074	\$ 383,515	(22,560)
EXPENSES			
Management Fee	40,998	41,725	727
Maintenance	4,998	5,130	132
Supplies	4,998	4,700	(298)
Bad Debt Expense	500	1,500	1,000
Trash Removal	2,550	2,625	75
Electricity	12,498	12,350	(148)
Gas	17,502	18,813	1,311
Water and Sewer	15,000	16,650	1,650
Legal and Accounting	4,752	4,725	(27)
Depreciation	40,000	50,000	10,000
Interest Expense	15,000	15,000	0
Miscellaneous	3,996	3,680	(316)
Administrative	1,998	1,990	(8)
Insurance	5,502	5,245	(257)
Real Estate Taxes	60,000	60,000	0
Reserves	7,500	7,650	150
Total Expenses	\$ 237,792	\$ 251,783	13,991
Net Operating Income (NOI)	\$ 168,282	\$ 131,732	(36,550)
Debt Services	\$ 159,696	\$ 159,696	0
Cash Flow	\$ 8,586	\$ (27,964)	(36,550)

Baseline Property Level Financial Goals

- Achieve target rental income that covers operating expenses
- Keep project out of default
 - Make required debt payments to lenders, primary and subordinate
 - Make required reserve contributions
 - Meet minimum debt coverage requirements of lender

Additional Project Financial Goals

- Deposit additional funds in replacement reserves for long term capital needs
- Fund asset management costs
- Cover resident services costs
- Fund or maintain operating reserves
- Support for your organization
 - subsidize other projects
 - subsidize other lines of business
 - fund a portion of general operating costs

Who is accountable for meeting these goals?



The Fiscal Manager?




The Asset Manager?

The Asset Manager, but needs support from the Fiscal Manager

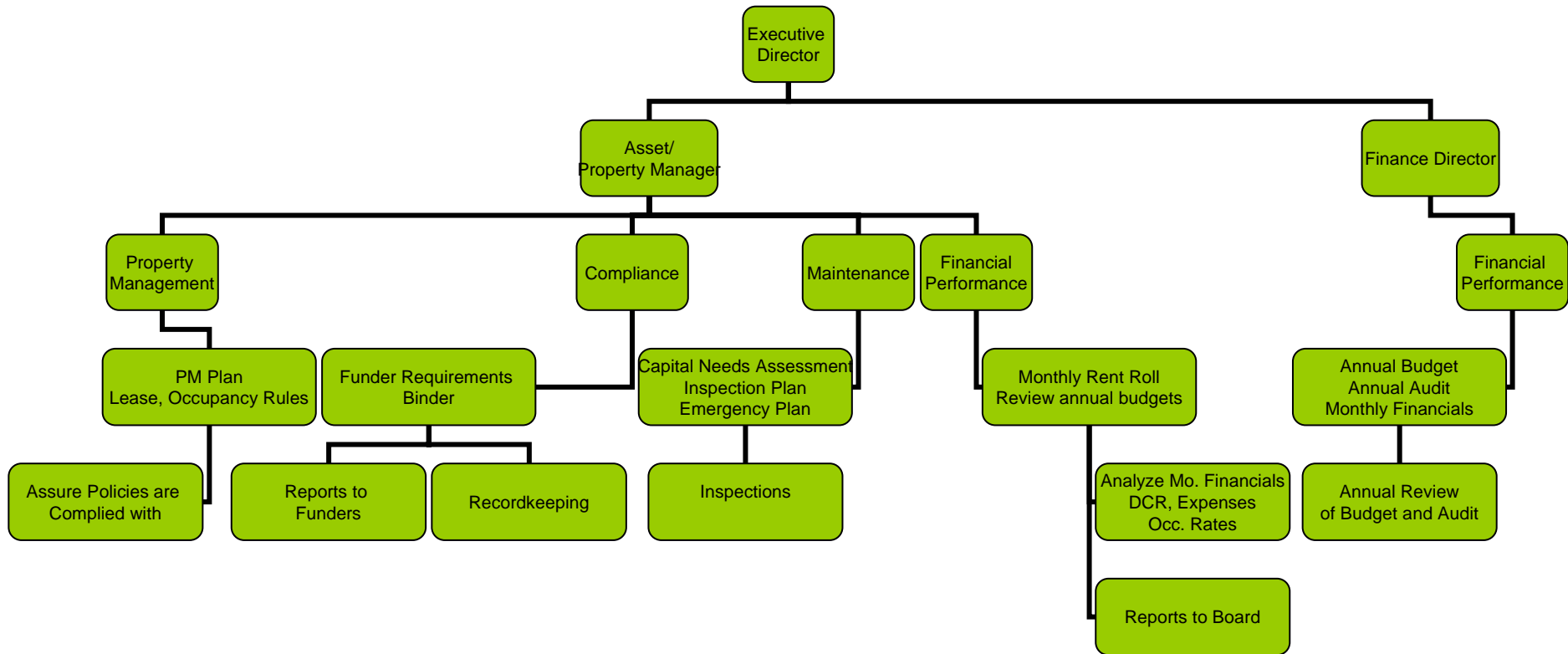


- Activities:
 - Establish rent schedule by reviewing rent roll, market comparables – AM
 - Propose annual budget/ objectives by property for fees to organization – CFO and AM
 - Monitor projections to year-end from financial performance report – AM with support from CFO

Different Roles in Financial Management

- CFO – Accurately reflects organization's and property's financial position in GAAP:
 - Account of records
 - Audit
 - Organizational budget
 - Timely information to Board and Staff
 - Financial information for external reporting
 - Asset Manager – Responsible for the financial performance of the properties:
 - Monitoring revenues, expenses
 - Capital planning
 - Communication with funders and partners
 - Oversee property managers
- Review and Approve Property-level Budgets
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Financial Management Org. Chart Template



Review of Basic Documents

- Organization's Financial Statements
- Property-level Budgets
- Income and Expense Report
- Balance Sheet

Organization's Financial Statements

- Need to ensure that organization's statements accurately incorporate project statements (GAAP)
- Issues:
 - cash v. accrual basis
 - allocation of costs between project and organization
 - when does project cash flow appear on organization's statements

Property-level Budget

- Prepare with property manager; Board should review and approve
- Basis for determining whether actual expenses for upcoming year are reasonable
- Sources of data for budget
- Annually update
- Rent increases - Allowable maximum rents; utility allowance updates; need; market
- Replacement reserve & operating reserve needs

Budget (cont'd)

- Identify Trends:
 - Calculate industry standards
 - Expenses that are consistently higher/lower than budget or other projects
 - Annual rent collection as percent of rents, how much past due, written off debt
 - Vacancies - specific units or unit types
 - Capital needs assessment - inspection findings

Income and Expense Report

- Primary tool to determine project health
- Must be detailed and include current period, year to date, comparison to budget
- Review monthly
- Usually prepared on cash basis; need statement of accrued but unpaid expenses

What does the Income and Expense Report tell me?

- **The Fiscal Manager:**
 - GAAP basis net income
 - Contribution/burden on overall financial health
 - Actual/budget comparison
 - Depreciation expense
 - Interest expense
- **The Asset Manager:**
 - Gross potential rents
 - Vacancy loss
 - Collection losses
 - Bad debt expense
 - Expenses compared to budget
 - Net Cashflow

Role Clarification for the Income and Expense Report

- CFO/Accountant follows GAAP:

- Accrual method required
 - Records depreciation expense
 - Records interest expense
 - Principal payments are reductions in liabilities, not expenses
 - Replacement reserve not included in expenses
 - Records uncollected rent as receivable
 - Cash flow is the accurate financial position from a tax point of view

- Asset Manager/Developer tracks:

- Proforma – cash flow based
 - Depreciation is not expensed
 - Interest part of debt service
 - Show reserve contributions as operating expense
 - Show change in tenant receivables in revenues
 - Principal part of debt service
 - Cash flow is the performance of the property used as a management tool

Balance Sheet

- The project balance sheet describes the relative financial position of the project at a given point in time
- It consists of assets, liabilities, and owner's equity
- $\text{Assets} = \text{Liabilities} + \text{Equity}$
- Profits or losses from the income and expense report cause changes in the owner's equity on the balance sheet

What does the Balance Sheet tell me?

- **The Fiscal Manager:**
 - Overall financial health
 - Cash
 - Receivables
 - Book value of fixed assets
 - Current liabilities
 - Long term liabilities
 - Equity
- **The Asset Manager:**
 - Tenant receivables
 - Cash reserve balances and change from one period to next
 - Change in outstanding principal on loans for debt service calculation
 - GP Payables

Calculating Net Cash Flow: Step 1

1. DETERMINE EFFECTIVE GROSS INCOME:

Gross Rental Income (GRI): Rental Income to project if all units were rented and all rents were collected.

- (Vacancy loss + *uncollected rents*)

= **Net Rental Income (NRI)** = Actual rental income collected during period

+ Other Income (e.g. laundry, interest, etc.)

= **Effective Gross Income (EGI)**

Calculating Net Cash Flow: Step 2

2. DETERMINE TOTAL OPERATING EXPENSES (ADJUSTMENTS TO GAAP):

- + Add in replacement reserve contributions
- Take out depreciation
- Take out interest expense
- Take out capital improvements

= Total Operating Expenses (Adjusted)

Calculating Net Cash Flow: Step 3

3. DETERMINE NET OPERATING INCOME:

Effective Gross Income

- Total (adjusted) Operating Expenses

= Net Operating Income (NOI)

Calculating Net Cash Flow: Step 4

4. DETERMINE NET CASH FLOW:

Net Operating Income

- Debt Service Payments (Principal & interest of first mortgage & subordinate debt):

- Capital Expenditures OR

= Net Cash Flow

- Capital Expenditures



Calculating Net Cash Flow: Overview

Gross Potential Rent

- Vacancies
- Adjustments for uncollected rents*
- + Other Income

= **Effective Gross Income (EGI)**

- Total Operating Expenses (adjusted)

= NOI (Net Operating Income)

- Debt Service
- Capital Expenses

= **Net Cash Flow**

Thank you!

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