The Definitive Guide To Apartment Budgeting:

How to Calculate Effective Rent

By Mike Brewer

In this eBook we are going to define each and every line item that drives Effective Rent, a term we will define in detail later on in the book. The goal is to help you develop a deeper and more thoughtful understanding of the Effective Rent line items. With that in mind you can expect to learn more about account definitions, how different line items relate to each other and conditions that impact different accounts. And, you will learn tips and strategies to move income and expenses in the right directions.

Creating A Financial Plan For Your Properties

It's a good time to be in the multifamily industry - things seem to be shoring up and gaining traction in the multifamily space. The perfect storm is almost complete; new construction starts are at historical low and the largest population base to hit the market since the baby boomer generation is of age and they like the ease of renting over home ownership. The only thing missing is the job growth. All that in mind and despite market conditions, time marches on and so does the need to create a financial plan for your property.

The Numbers

It all comes down to the numbers. Be it an operational spend or a big capital spend, it all comes back to a math problem to be considered and or solved. In the absence of a financial plan you are sure to experience chaos and discord as you try to operate your multifamily asset. The math and thus a good solid budget matters. It is your road map.

Speaking Greek

Full admission – numbers have not been my favorite part of the multifamily business. I can do it. I understand the relationships. And, I know how to move them in the right directions. But, as much as I try, I am just not the analytical left brain thinker. I am as far from pragmatic and methodical as you can get. I am a right brain thinker, creative in nature and never like to do the same thing the same way twice. Numbers are the work side for me. And, it has been very much a necessary learned behavior and exercise.

I say all that to say this, if you hate numbers or just can't wrap your head around math and the concepts that math problems capture and demonstrate, you are not alone and better yet you are not stuck. I hesitate to go cliche on you but it fits; if I can do this you can do this. Let's dive in, learn and discover the wonderful world of apartment budgeting.

Road Map: Outline Of Accounts

In an effort to lay out what I will be describing in detail throughout this eBook, I am going to provide an outline of accounts (by way of name only): Rental Income, Gross Potential Rent, Loss To Lease, Loss To Lease (Move-Ins), Loss To Lease (Renewals), Total Loss To Lease, Total Effective Rent.

Gross Potential Rent (GPR)

This is the top line. This is where it all starts. Some call it market rent while others call it the pixie-dust-pie-in-the-sky line as it is really meaningless.

Item of note: I am working from a non-revenue management model.

Gross Potential Rent can be defined as charging and receiving payment for 100% of maximum rents at 100% occupancy. It's the number you would collect if every single unit were physically occupied and everyone paid their rent at the full market rate value of the lease. And, most importantly - on time.

Where do you derive the Gross Potential Rent number?

In essence, it is a made up number. In all fairness it is calculated on a per unit type or per square foot basis and is relative to your competition in the market place. You should think of your competition as the three to five communities that you lose the most leases to. And, the very best way to determine that is to review your last 100 move out files and pin their forwarding address on a large wall map. In doing this exercise, you will learn quickly and accurately who your real comps are.

When does it change?

It is predicated on a good number of factors to include broader things like the economy, jobs and household formations. Or more minutely on your competitors and classic supply and demand factors set inside of seasonality. And, it demands to be studied right down to a unit type basis. That is to suggest that if you are very highly occupied in a specific unit type then you should raise the rent on that unit type. If you have tons of inventory with little to no demand – you keep the rents neutral or consider lowering them. That last sentence needs to be heavily considered and never acted out unless every constituent is in agreement. Some management companies/owners believe it to be the right thing to do while others would never consider a downward movement in rents.

> What is the fastest way to move this line item up, up, up? By being remarkable.

Loss To Lease (LTL)

Now unless you have a brand new community in lease up, you will have in place leases that are very likely below the Gross Potential Rent (GPR) numbers. The primary reason being - increases in rent rates. Any time you increase the rents (GPR) you create a margin between the in place leases and the new increased Gross Potential Rent.

> **Put The Math To It**
> You have a unit that rents for $500 and you have an in place lease for that rent rate.
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> You do some market research (as suggested above) and you think you can boost the rent (GPR) by $20.
>
> This makes the new rent (GPR) $520.
>
> Remember you have an in place lease booked at $500 and that $20 margin must be captured somewhere - in the Loss to Lease (LTL) line item.
>
> So the LTL line item will show up as a negative -$20
>
> *Note: This can occur in reverse and the impact to loss to lease can be negative in a positive sort of way. In other words, using the example above, if rents (GPR) were decreased by $20 making the new rent (GPR) $480 then the in place lease would be $20 over the new rent (GPR). It would show up as a positive $20.*

Loss To Lease: New Move In

To put this simply; if you lease an apartment below the Gross Potential Rent (GPR), the discount is captured in a Loss to Lease – New Move In line item.
Note: The difference between this line item and the one we described above is that this line is not affected by rent (GPR) increases.

> If your apartment rent (GPR) is $500 and you lease it for $450, the $50 reduction in rent (GPR) is captured in the Loss to Lease – New Move In line item as a -$50 charge. And, it will exist for the life of the lease.

Loss To Lease: Renewals

When an in place lease comes up for renewal and the actual rent rate is below the Gross Potential Rent number – the margin is by default in the current Loss to Lease - New Move In line item. When the lease renews, if the new rent rate is still below the current Gross Potential Rent that new number gets captured in the Loss to Lease – Renewals line item.

> Suppose your apartment rent GPR is $500 and the current in place lease is $450 and you renew it at $475. The $25 margin is captured in Loss to Lease – Renewals.

You are now at a point in your budget that you can total your Loss to Lease and deduct or in rare cases add back to get to your Total Effective Rent number.

Total Effective Rent

Once you have accounted for all of your losses related to in place, new and renewed leases under/over the current Gross Potential Rent, you come up with the Total Effective Rent. That is simply 100% of your in place leases paying 100% of the payable rent(s) recorded on the actual lease contracts.

Summing It Up: Do Your Homework First

Budgeting for rents is a bit of science in the way of setting the top line. It is wise to do your homework as it relates to identifying your real comps. That is other apartment communities, single family home rentals, condos or otherwise. I can't stress this enough - really do this. I can't tell you how many times I have walked on to a property and asked for a comp survey only to get back outdated and downright thoughtless information. If you don't know who are losing leases to, you can't really begin to understand what that top line should be. So, do the research. Solid Total Effective Rent is one of a few linchpins to an accurate budget. Remember this is your road map.

About the Author
Mike Brewer has spent fifteen years participating in the multifamily space. He has also worked in both the public and private sector and is presently employed as a Regional Manager for Mills Properties in St. Louis, MO. Mike has spent the last six years immersed in social media as it relates to marketing apartments. He entered the blogging world in early 2005 and has authored well over one thousand posts on topics ranging from maintenance to marketing. He is the proud Father of Ryan, Justus and Kate. Connect with Mike on his blog M Brewer Group, Facebook, Twitter or LinkedIn.