Budget Best Practices:

A Guide for Property Managers

The most important success factor of any property management business is how the numbers add up at the end of the day. Simply put, are you making money or losing money? Are you in the best position to make money in the future? Set your business up for success and ensure you're always in the green by managing your budget using real-time data.

So, what is the secret to having an accurate budget?

- Knowing Your Competition
- A Solid Total Effective Rent
- Reliable Accounting Tools

If you're saying to yourself, "I want all those things but don't know where to start," read on. The success of your property management business relies on a strong financial foundation.

SECTION 1: SCOPE OUT THE COMPETITION

In Section 2 of this guide, we'll outline and define the major pieces of data that go into budgeting for your success. But before we get into the numbers, you should first perform a market analysis.

A market analysis, while seemingly daunting, allows you to know more about what trends are happening in your area and answer questions like:

- Am I charging too much? Too little?
- How much new construction is planned or in the works and how will it affect me?
- What do I need to do to make money on my properties?

All of these questions are important to answer when preparing your business for future success; but the last will be especially important to complete Section 2 of this guide.

Continue to the next page for a few tips on how to do your own market analysis.

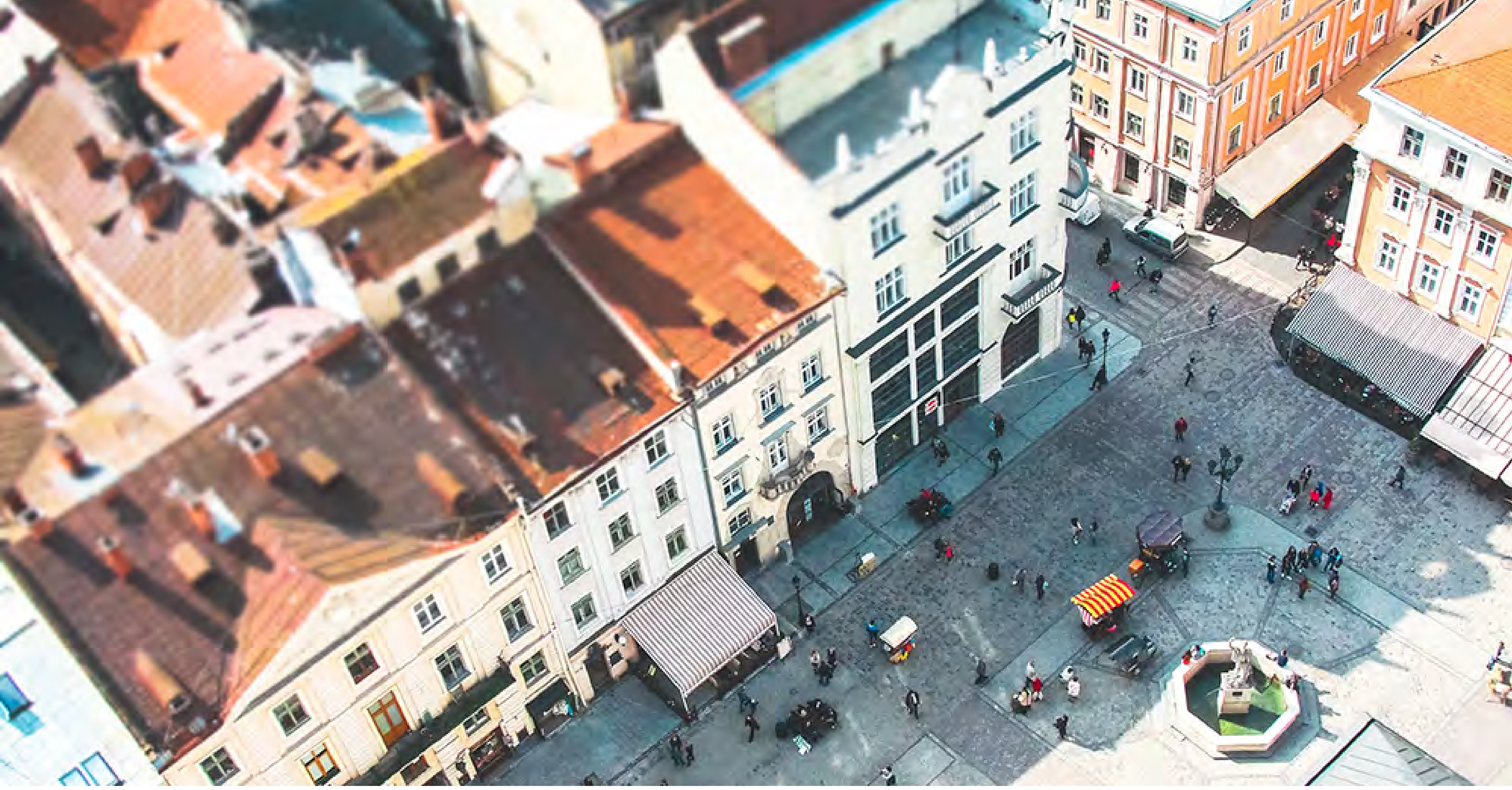
CHOOSE AN APPROACH

An analysis can be tricky, as there is a lot of data to sift through. Before you start, know your goals and choose the right approach. There are two distinct, but complementary, strategies for conducting an analysis.

The first, **demand-based analysis**, explores and identifies competition that offers similar housing features consumers expect—amenities, location, access to public transportation, and price.

The second, **supply-based analysis**, identifies rental properties that market options similar to your apartments or single-family homes.

Looking at your competition from both angles will help you determine where you need to invest your resources and dollars to stay competitive. You might not be able to easily address some of these issues, like location and distance to public transportation, but you can make adjustments or plan upgrades to still make your property desirable.



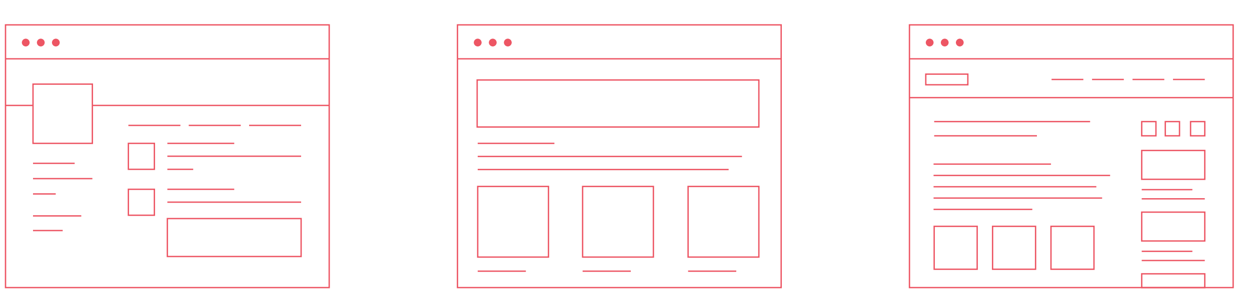
GATHER ALL THE INFORMATION

It's going to take some time and effort on your part to conduct a comprehensive review. You should start by researching the following information about properties in your area:

- Average vacancy rate
- Number of days on the market, per unit
- Tenant profile: age, occupation, length of tenancy, families or singles
- Proximity to your property
- Established vs. new construction
- Rent in the area *(more on this topic later)*

USE THE INTERNET WISELY

The internet makes conducting an analysis less time-consuming and exponentially easier than ever before. Social media sites, business directory reviews, and competitor websites all provide you with valuable information about how your competition interacts with consumers, and what consumers think about those other property management teams and their properties.



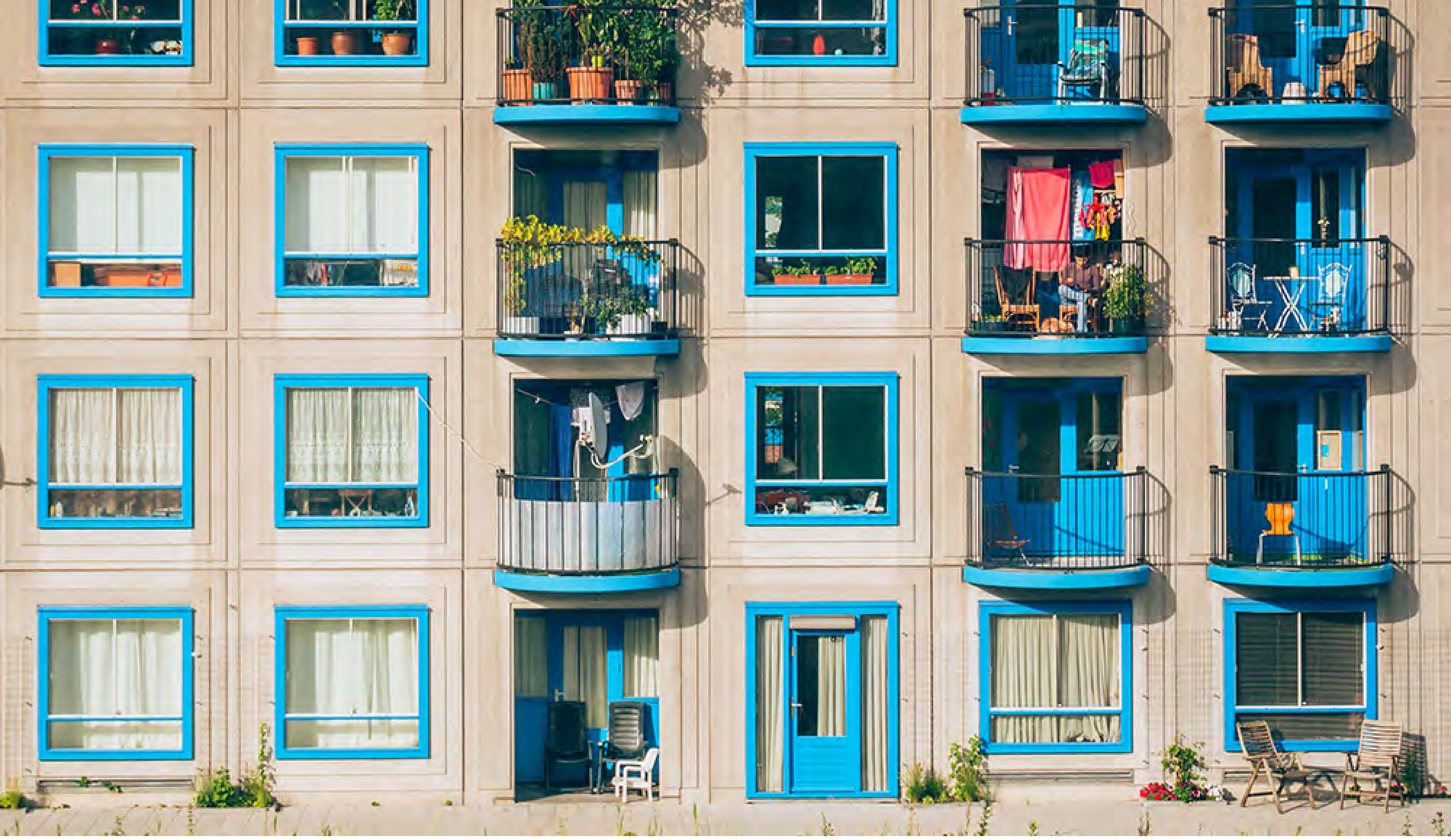
DO A RENT COMPARISON

The most important part of your market analysis, and what you will need ready for Section 2 of this guide, is figuring out accurate rents for your area.

There are property management software solutions that offer rent comparisons for free as part of their service. Running rent comparisons are extremely important to your profitability, but they can be time-consuming and resource-intensive. You might have to call multiple properties in your area to find out this information, or spend a lot of time researching online.

You also need to refresh your numbers often to stay up-to-date. In order to save valuable time, consider a simple tool that can collect and analyze this data in real time.

Once you've accumulated all the pertinent data, you can put together your plan of action.



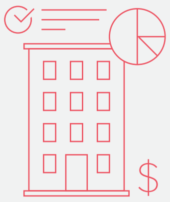
SECTION 2: TOTAL EFFECTIVE RENT: WHAT IS IT AND WHY SHOULD I CARE?

It's important that you develop a deep understanding of the line items that relate to and directly affect your Total Effective Rent, which we will define in a moment. In order to calculate your Total Effective Rent, you need:

- Gross Potential Rent
- Loss To Lease
- Loss To Lease (Move-Ins)
- Loss To Lease (Renewals)
- Total Loss To Lease

GROSS POTENTIAL RENT (GPR)

Some call Gross Potential Rent the market rent (also referred to as Gross Potential Income); others call it made up. Either way, this is where it all begins.



Gross Potential Rent

GPR is the amount you would collect if every single unit were physically occupied and everyone paid their rent at the full market rate value of the lease, i.e., charging and receiving payment for 100% of maximum rents at 100% occupancy.

GPR is calculated on a per unit type or per square foot basis and is relative to your competition in the marketplace. (See? All that competitive analysis wasn't for nothing!) Many factors affect this number, from the economy and employment rate to your competitors and seasonal supply and demand. It can go either up or down—but be sure to consider all your options before decreasing rent.

If you have a rent comparison solution, you can easily look up current rents in your specific area to get an accurate rent price on which to base your GPR calculations.

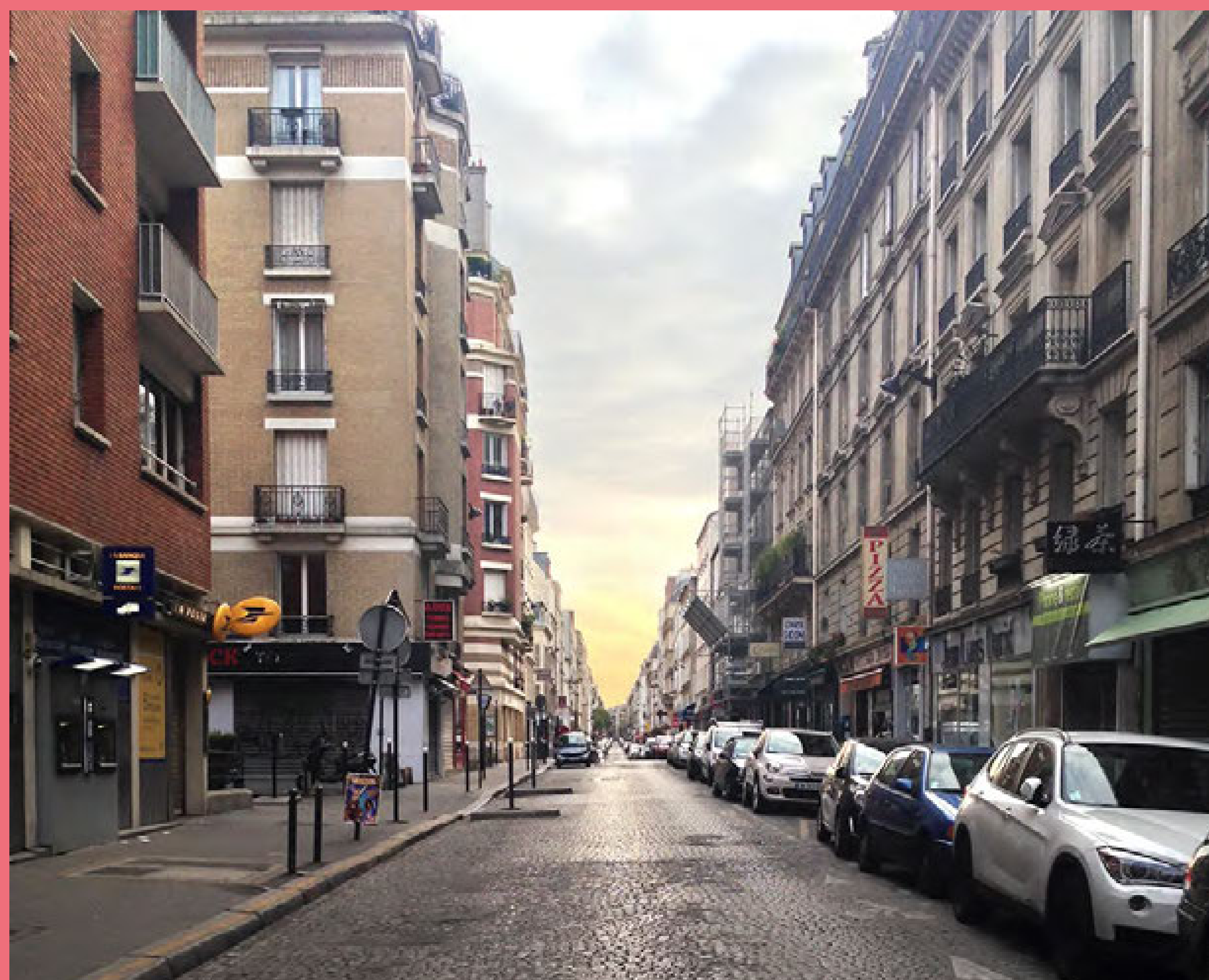
LOSS TO LEASE (LTL)

Unless you have a brand-new community, you probably have leases in place that are below the current Gross Potential Rent (GPR) numbers due to yearly rent increases. Any time you increase the rent, you create a margin between the in-place leases and the new increased Gross Potential Rent.

You have a unit that rents for $1,000 and you have a lease in place at that rate. Based on your market research you decide you will boost the rent (GPR) by $50. This makes the new rent (GPR) $1,050. Remember, you have a current lease booked at $1,000 and that $50 margin must be captured somewhere—in the Loss to Lease (LTL) line item.

So the LTL line item will show up as a negative $50.

Note: This can occur in reverse and the impact to loss to lease can be negative (in a positive way). In other words, using the example above, if rents (GPR) were decreased by $50 making the new rent (GPR) $950 then the in-place lease would be $50 over the new rent (GPR). It would show up as a positive $50.



LOSS TO LEASE: NEW MOVE IN

To put this simply, if you lease an apartment below the Gross Potential Rent, 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 is $1,000 and you lease it for $950, 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

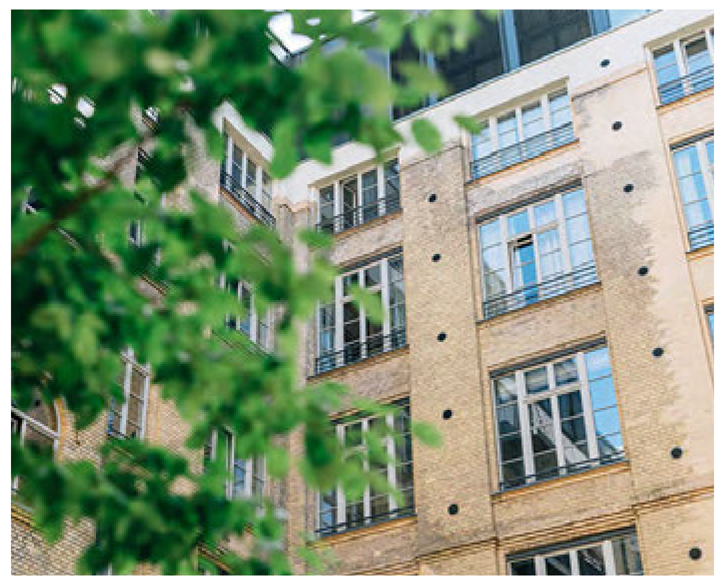
When a lease comes up for renewal and the actual rent rate is below the Gross Potential Rent number, the margin is by default in the current Loss to Lease – New Move In line item. When the lease renews, if the new rent rate is still below the current Gross Potential Rent that new number gets captured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

Suppose your apartment rent is $1,000 and the current in-place lease is $950 and you renew it at $975. 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 it, or in rare cases add it back in, 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.



Doing this type of budget planning can give you insight into any gaps you have between what you are currently charging, what you could be charging, and where the potential and opportunity lies.

ACCURATE ACCOUNTING SOFTWARE IS A KEY INGREDIENT TO A SUCCESSFUL BUSINESS

Between conducting research, managing Excel spreadsheets, and performing numerous calculations, budgeting alone can eat up a huge chunk of your time. Rather than analyzing the data and figuring out a strategy for success, you're focused on Googling, making phone calls, and hand-entering hundreds of numbers. The risk for errors is great. The potential for success is greater when you add software to the mix.

The numbers don't lie. Accurate, reliable accounting software is a game-changer for your business. You can easily run and share financial reports, access real-time business data, reconcile quickly, enter bills, make payments, create budgets, and more. Manual accounting is a thing of the past and can hold you and your business back.

Learn how AppFolio Property Manager can help streamline your accounting processes at **www.appfolio.com.**

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