



How to Read Financial Statements

This is a summary information sheet to help property managers navigate the world of understanding the financial statements that we deal with on a day to day basis. It is intended to simplify some industry formulas and to illustrate the typical flow of most management statements.

The Management Statement

The most valuable and commonly used financial statement in multifamily housing is the management statement. The management statement is referred to by many other names such as: Profit and Loss (P&L), Budget Comparison Statement, Cash Flow Statement, Income or Operating Statement, etc. These reports can all vary slightly but there are commonalities to all of them. All of these statements flow the same way, the information that they represent is simply presented differently. These statements represent the financial activities for a *span of time or period*. Typically, the management statements are prepared for a month, a quarter, or an entire year. Learning to spot the anomalies and the trends that are represented will help you to understand and read the story of how the asset, the people managing the asset and the economic climate is affecting the investments performance. Mastery when reading statements will separate the exceptional manager from the average manager.

On the following page you will see the typical structure of a management statement and will see how each line interacts with the other lines on the page. Having a fundamental understanding of the income statement will give a property manager the ability to move from simple property management to investment management.

Budget vs. Same Store Comparisons

Property managers are expected to review financials monthly. To determine if a property is performing as anticipated we often utilize a Budget Comparison Statement. This compares actual results to the budget that was anticipated. Another strategy is to compare actual results for a period to the same period in the prior year; this is referred to as a "same store comparison". With either comparison it is important to prepare thoughtful explanations for any significant variance. To do this it is important to understand how to read the numbers on the generated comparison report. Negative numbers are represented differently by different types of accounting software they are represented in three common ways with a minus symbol, in parentheses, or printed in the color red. It is also important to note that a negative number could represent a positive variance. The best way to truly understand if the variance is favorable or unfavorable is to look at the impact that it has on NOI or Cash Flow, if it is positive to NOI it is a positive variance.

In addition, when reading statements, it is critical that we understand if the general ledger accounting code is accrued or if it is represented on a cash basis. To understand the difference you must understand accrual accounting vs. cash accounting:

- **Cash Accounting:** All income and receipts directly impact the GL period in which they are received or paid.
- **Accrual Accounting:** Income and Expenses are accounted for when they are incurred.
- **Modified Cash/Accrual Accounting:** This is a blended form of accounting is the most commonly used in multifamily housing.

Important Industry Formulas:

Physical Occupancy | Occupied Units/Total Units

Economic Occupancy | Total Rental Revenue (TRR)/Gross Potential Rent (GPR)

Turnover Ratio | Total Number of Move-Outs/Total Number of Units

Net Operating Income (NOI) | Effective Gross Income (EGI) – Total Operating Expense (OE)

Cash Flow (CF) | Net Operating Income (NOI) - Capital Expenses (CE) - Debt Service (DS) - Reserve for Replacement (RR)

Operating Expense Ratio | Operating Expense (OE)/Effective Gross Income (EGI)

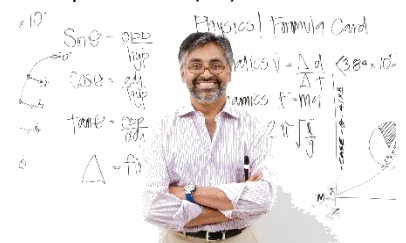
Return on Investment (ROI) | Annual Return (NOI)/Initial Investment

Cash-on-Cash Return | Cash Flow (CF)/Total Initial (Cash) Investment (Down Payment)

Loan to Value (LTV) | Loan Amount/Property Value

Debt Coverage Ratio (DCR) | Annual Net Operating Income(NOI)/Annual Debt Service

Property Value | Net Operating Income/Capitalization Rate



Typical Structure of a Management Statement

Income	Gross Potential Rent	All units at market rent for the period
	<i>(minus)</i> Loss/Gain to Lease	Rental revenue lost or gained due to lease commitments because of market rent changes
	<i>(equals)</i> Gross Potential Income	All occupied units at lease face rent plus all vacant units at current market rent.
	<i>(minus)</i> Vacancy	Lost rent on all units not occupied for the period
	<i>(minus)</i> Concessions	All new and old concessions given for the period
	<i>(minus)</i> Collections	All monies that were billed but not collected for the period (Note: Some companies show this number as the change from prior period)
	<i>(equals)</i> Total Rental Revenue	Total revenue received from rent related items
	<i>(plus)</i> Other Income	All other sources of income such as: Parking, Fees, Interest, Vending, Utilities, Etc.
	<i>(equals)</i> Effective Gross Income	Total Income from the asset for this period inclusive of rent related income and other income sources (aka Total Income)
Operating Expenses	<i>(minus)</i> Salaries & Personnel	Salaries, benefits, FUTA, SUTA, FICA and Other Employment Costs
	<i>(minus)</i> Insurance	Property Related Insurance: General Liability, Hazard, Business Loss, Etc.
	<i>(minus)</i> Taxes	Municipal, County, and State Property Taxes
	<i>(minus)</i> Utilities	Water & Sewer, Electric, and Gas Utilities for all non-resident responsible meters.
	<i>(minus)</i> Management Fees	Management and Asset Management Fees
	<i>(minus)</i> Administrative	Office and Operational Costs including: Professional Fees, Legal Fees, Office Supplies, etc.
	<i>(minus)</i> Marketing Expenses	All Marketing Costs including: Marketing, Advertising, Promotional Expenses, Referral Fees, and Pay for Performance Agreements
	<i>(minus)</i> Contract Services	All Contracted Services including: Waste Removal, Landscaping, Service Contracts, Cleaning Contracts, etc.
	<i>(minus)</i> Repair and Maintenance	Building and Maintenance Supplies including: Plumbing, Electrical, HVAC, Construction Materials, Etc.
The Line	<i>(equals)</i> Net Operating Income	Total Income minus Total Operating Expenses aka NOI
Asset Expenses	<i>(minus)</i> Capital Expenses	Unique expenses that are depreciable and have a life expectancy as governed by the IRS (2 types -Asset Improvement and Asset Preservation)
	<i>(minus)</i> Debt Service	Payments of all asset related loans i.e. the Mortgage inclusive of Principal and Interest
	<i>(minus)</i> Reserve for Replacement	Funding for required capital reserves (typically part of and mandated by the mortgage(s) on the asset)
Distributable Cash	<i>(equals)</i> Cash Flow	Distributable cash flow to the owner or money available for additional investments (aka Before Tax Cash Flow or the dividend a property produces)



Rich George, is the owner and managing director of NOI Coach, a business coaching, consulting and training firm based in Michigan. A successful businessperson with over 30 years of business experience, Rich brings a no-nonsense approach to strategic planning and a passion for employee development and culture building. Rich's background includes the management of over four billion dollars of real-estate assets, and over 750 million dollars of capital re-investment strategies. Rich has been involved with successful acquisitions, dispositions, merger facilitation, and repositions. Key to his portfolio is the management of highly distressed properties, including those in court receivership. Known for his team building, culture changing, and change management skills, Rich leads the market in promotion and preservation.