

Start Your New Year's Success – Do You Know Your Building's Financials?

by Cliff Hockley

“The biggest mistake many investors make is to ignore the numbers generated by their properties.”

Financial Statements

Let's start with financial statements, or lack of them. Many real estate investors only track the results of their real estate investments at tax time. Instead investors should be reviewing their results by reading their financials on a monthly basis, or at a minimum on a quarterly basis.

I have been working with a client who always files an extension. He really never pays attention to his financial information, because it is always six months late. He just assumes he is making money and the people that are working for him are doing the right thing. He owns over 150 units at three locations. He has no way to make a quick decision. He has no idea if he is losing money or making money. Do you want to be in his shoes?

What are Financial Statements?

Typically, we assume financial statements will include:

- A balance sheet (a summary of a person's or organization's balances. Assets, liabilities and ownership equity are listed as of a specific date, such as the end of its financial year). This document is usually prepared by a CPA or management accountant.
- An income statement (a summary of income and expenses) usually prepared by the investor, a bookkeeper, an investor, or a property manager.
- An income register that includes a rent roll (summary of all collected rents and miscellaneous income).
- Check register (list of all bills paid by check or via wire or electronic transfer)
- A summary of security deposits (a summary of all tenant security deposits)
- Aged payables reports (if you have aged payables, bills that have been incurred but not paid.)

Typically, financial statements are prepared on either an accrual basis or cash basis. In my mind (not being an accountant) I prefer cash basis. It is easier to see how a property is operating from month to month, without the numbers being clouded by budget accruals (O.K., O.K. I know I am not an accountant).

Other Helpful Thoughts

Many people use excel spreadsheets, or QuickBooks to track property income and expenses, or if they own only a rental house, maybe just a checkbook. I recommend that you do not mix your personal expenses with your investment expenses, and that you have a separate check book for every property you own.

What Do You Look For?

I believe you are looking for breaks in the patterns. Accounting is just a way of organizing numbers into helpful patterns.

- Look to make sure all the rents have been paid.
- Make sure all bills have been paid on time
- Compare the bills and rents to the trailing 12 months.
- Are some of the bills out of line? In other words are the water bills higher than you expected?
- Is the insurance bill three times what you thought it was going to be, especially when compared to your other investments?
- Look carefully at your maintenance numbers , are they in line with industry standards
- Cash on cash return
- Compare your income and expenses to budget and use the variances to find inconsistencies.
- How much you owe to the bank and when you have to refinance or pay off your loan?
- Current CAP rate (Sales price divided by Net operating income)
- Percent of expenses to income (this ranges from 20 – 60% depends on the property)
- What is your vacancy rate?
- How many move out notices do you have?
- What are the rent levels for units (are they within the range for the market place?)

If others are preparing the reports for you, you should review monthly account reconciliations to make sure all the numbers balance. Randomly check the check register and income register to see if someone is not siphoning money out of your property accounts. It is very easy for onsite managers to collect rents and not send them to the central office. (This is why we have a policy that most of our rents are mailed or directly delivered to our office).

Conclusion

Many real estate investments stumble from time to time. Tracking the monthly operations is just like a doctor checking your pulse, blood pressure and taking your temperature. You can tell a lot from the basics. You can tell early when you are running into a problem and what you need to do to restructure and improve your operational results. Reviewing and understanding your numbers will help you decide whether to keep, sell, refinance, or improve your property.

There are many standard rules of thumb. Call a local property manager and ask how they gauge the successes of your property type.

Finally, ignoring your numbers will not help you. Preparing an annual budget and reviewing your financial reports on a monthly basis are the first and second steps to insuring the operational success of your investment. Do both today. Your real estate investment success is all in the numbers.

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