



Real Estate
Business Analytics

The Multifamily Guide to Budgeting



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Tips to Better Multifamily Budgeting

Three tips for a less painful budget season.

Chapter 1

Why is Multifamily Budgeting Painful?



Is there any time of the year more frustrating than budget season? So much depends on it—promises to ownership, commitments to management and benchmarks for future bonus payouts—it's a wonder that organizations don't buckle under the weight of all that pressure.

And the worst part of it is that, with all the time spent on budgets, operators end up putting their head facing the CFO and COO and their rear end facing the customer—often in 3rd and even 4th quarter which can be some of the more challenging times.

Everyone muddles through but often at the expense of a) taking too much time away from customers and b) setting up goals and objectives that only cause more challenges in the future.

While not all of these are applicable to everyone, we have found five key drivers that make rental housing budgeting painful.

1. Generic budgeting tools ill-equipped for multifamily

There are many generic budgeting tools out there. The challenge with these tools is that they were not built for rental housing and the many unique aspects of multifamily budgeting (e.g. the concept of renewals being based on both expiring and new rents or costs being triggered by the number of move-ins or move-outs).

2. Excel is not an enterprise application

First, it can be very complex with all the manual processes to copy and paste data into the spreadsheets and then create the appropriate output. Next, this complexity introduces another challenge—multiple opportunities for mistakes. Lastly, Excel doesn't provide any underlying database storage.

3. Arbitrary user entries make analysis difficult

Many models attempt to simplify the process by having users enter “key assumptions” that seem appropriate but actually make it difficult to analyze why budgets were missed (or exceeded). These happen on both the revenue and the expense side.

4. Energy for v2 rarely matches v1

A company is frustrated with its current budget and forecasting model/system. They decide they're going to fix this by building a new budget model. Inevitably, time crunches and other resource trade-offs lead to some functionality being deferred as “we'll get to that in version 2.” Yet, the energy, excitement and commitment for version 2 simply never match that of v1.

5. Keyperson risk

In most situations where a multifamily company has built its own model, there are only one (or at most two) people who “own” the model and really understand it. If/when that person leaves, most of the knowledge leaves with them. Executives are at constant risk that just one inopportune resignation will substantially upset the next budget/forecast cycle.

Chapter 2

Common Budget Model Mistakes

1

BUDGETING AT THE COMMUNITY LEVEL INSTEAD OF THE UNIT-TYPE LEVEL

This mismodeling is often driven by the need to simplify models in Excel. Not that you can't budget at the unit type level in Excel...it's just a LOT more complex and thus harder. We've thus seen some of the larger operators in our industry simplify their Excel-based models to budget at the community level leading to key challenges (rent-constrained unit types, expiration mix, etc.).

2

OCCUPANCY AS AN INPUT INSTEAD OF AN OUTPUT

When you enter Occupancy as an assumption, you lose the ability to examine the true drivers when looking at variances to budget. The question of "Why is my occupancy different from budget?" can be answered by examining true drivers such as the Retention Rate and Vacancy Days. When these metrics exist in Budget and in Actuals, you can examine them and understand what caused the variance in Occupancy.

3

NOT MODELING SEASONALITY CORRECTLY (OR AT ALL)

We've seen models that don't take into account demand (occupancy) seasonality, rent seasonality or both. This will obviously cause variances, especially in highly seasonal markets. Another classic mistake is to have seasonality but be unrealistic about it. If your budgets show occupancy and rent both growing in the fourth quarter, then you are almost certainly making this mistake.

4

MISSING THE RENEWAL STRATEGY

For those of you using revenue management systems or strategies that involve "capture rates" (the percent of the gap between new and expiring rent to "capture" in the renewal offer and/or minimum increases), a common mistake is to use exactly those parameters in the budget model. This inadvertently implies that there will be absolutely no negotiation on renewals. We've typically found that, even in companies with policies against negotiation, it's still unwise to assume for budget purposes that renewal offers will never be adjusted downward.



Chapter 3

Changing the Budget Narrative

Almost everyone in the industry hates budget season. At best, it's a "necessary evil" and at worst, budget is a "four-letter word"! But just because it's always been that way doesn't mean it should stay that way.

We're on a mission to change this budget narrative, and we think you should be, too! So how can we change this narrative?

Here are four important ways to do so.

01

Centralize to reduce man-hours

Why do we require so many man-hours from the field? It's much more efficient to have subject matter experts in more centralized locations who can create the assumptions, load them in bulk across multiple properties and then allow operators to review and comment on results. This saves hours and reduces mistakes.

02

Structured data should sit on a database

If all the budget data is sitting in a database — calculations in code, not in Excel cells — then data entries cannot mistakenly replace equations; and if proper versioning and data backups are employed, users cannot accidentally completely wipe out their work! It's now easy to do rollups at any level of the portfolio.

03

Use driver-based rent & expense algorithms

Expenses are sometimes driven by meta-data, e.g. make-ready expenses based on the number of move-outs & gift baskets based on the number of move-ins. Use or create a driver-based model, and you can create much more useful variance analyses that help operators run their business better.

04

Make budgeting/forecasting ongoing

The line between “budgets” and “forecasts” blurs with the former simply being the quarter (or month) that is declared to be the budget. “Budgeting” is no longer an annual Herculean task; instead, it's just one milestone in a series of smaller reforecasting tasks.

Chapter 4

Defining a Good Budget Application

We polled our audience at a large multifamily conference and found that 70% of them were still using Excel.
But Excel isn't an enterprise solution!

A good budget application should do the following:

01	Sit on Top of a Database Data is never lost & it's easier to do portfolio reporting
02	Control the Workflow Through a Formal User Interface Interface should control the workflow & do entry validation logic
03	Allow Multiple Entries Against Same Ledger Account Input different line items for each GL account
04	Have a Note Taking Feature Reduce the amount of budget and expense explaining
05	Offer Special Case Handling Allow for unique multifamily cases (lease ups, CapEx, renovations)
06	Take a Payroll Input from HRIS Import payroll data to minimize keystrokes
07	Provide Security Roles & Access Have the security to protect access to certain info & functionality

Chapter 5

Building Intelligence Into the Budgeting System



We believe in having your budget software do most of the heavy lifting, leaving operators to contribute the unique inputs specific to their portfolio

Standard Costs

Leaning on the budgeting software to do the heavy lifting is a big part of solving multifamily budgeting hassles.

This means having a standard cost sheet that preloads known costs into the application and gives operators a way to select costs that apply to them or allows the model to reflect changes.

For example:

- Preloaded ILS costs because you know which properties are participating in which listing services.
- Preloaded costs per unit/item but the Community Manager has to input the number of items they have on-site (ex. Ipads).
- Scenarios where costs are based on metrics (ex. revenue management system priced per unit per month, or gift baskets priced per number of move-ins) so when revenue assumptions change and the model comes out with different move-in and move-out counts, the expenses automatically update.

Rents Made Easy

Getting rent forecasts right is a notoriously difficult challenge, so putting the rent forecast intelligence into the model to take inputs like seasonality, expected annual rent growth, renewal strategy, and others make for a great solution that helps take the "season" out of budget season. Here are some key rent drivers:

- **Rent seasonality:** There are clear high, low and shoulder seasons that must be modeled to create good forecasts.
- **Peak-to-peak rent growth:** No budget or forecast can be done without an input defining how much rents are expected to grow over the period.
- **Renewal retention rates:** The percentage of expirations that are renewed. This drives the way the expected value (EV) model* assesses how much to apply new rents and vacancy loss vs how much to apply the expected renewal rents with no vacancy loss.
- **Renewal parameter setting:** This will set the renewal rent for each unit. You can set it to close the gap between market rent and the existing rent, and/or apply a minimum or maximum increase over existing.
- **Vacant days to release:** The number of days you expect each unit to be vacant. The Rent Engine uses this to calculate Occupancy and Vacancy Loss.
- **Average lease term:** Average LT is needed so that the Rent Engine can build future expirations on forecasted leasing events.
- **Concession strategy:** Needed to appropriately calculate gross vs net rents.
- **Bad debt %:** Usually this is based on an analysis of history with possible tweaks up or down depending on expected future improvement or degradation in residents' financial solvency.
- **Early termination expectations:** Based on an analysis of history with possible tweaks up or down depending on future changes in market conditions.

**EV Model calculates unit-level results for Rental Income. The probability of a renewal is multiplied by the cashflow for a renewal & the probability of a moveout is multiplied by the cashflow for a moveout. These 2 amounts are added together to create the rent result, as well as the metric data such as move-ins, move-outs and occupied units.*

Great budget and forecasting tools then make it as simple as possible to assign these inputs at the community-unit type level along with the flexibility to assign different assumptions to different business situations (ex. 3-bedroom homes have different seasonality than 1- and 2-bedroom homes).

Entering each assumption individually to each community/unit type would be very time-consuming, not to mention painfully tedious. A better, and much more efficient, way to do this is to assign values for drivers to profiles (ex. aggressive rent, constrained rent, etc.).

These profiles can, in turn, be combined into packages that are assigned to multiple community/unit type combinations, (ex. Boston high-rise, Atlanta garden, Nashville 3BRs).

This saves many keystrokes and makes it easy to talk about budget/forecasting assumptions!



Sally Matheu

SVP OF OPERATIONS, BROOKFIELD PROPERTIES

"Over and over, I am hearing that this is the easiest way to budget expenses from coworkers who have been budgeting for many years and for a variety of companies. This says a lot!"

Tips to Get Started

01

Start With Real & Up-to-Date Data

Connecting with the property management system, this includes in-place rents, known move-ins and move-outs and upcoming expirations. This serves as the starting point for all budget/forecast calculations

02

Base Budget Calculations on Drivers

Ensure those budget calculations are based on meaningful drivers for both revenue and expenses, with a special eye toward forecasting occupancy and rents, expense line items, payroll and capital expenditures.

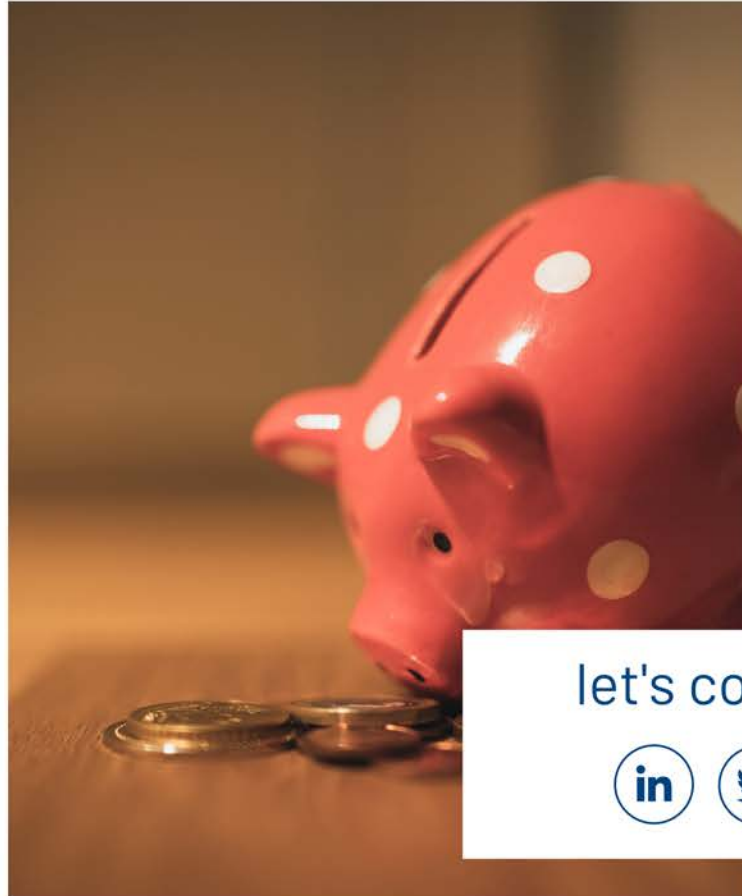
03

Create an Expected Value for Each Home

We strongly advocate a model that takes the known state of each unit from Tip 1 and applies the drivers from Tip 2 to create an expected value for each home. Those are then rolled up to create the overall revenue forecast.

Look for an application that was purpose-built by multifamily people for multifamily people. These solutions will save massive numbers of hours while providing more accurate results and datasets.

Thank You!



let's connect



Want to learn more?

We've put more than 25 years of industry budgeting experience into our REBA Budget application. We're here to help take the pain out of multifamily budgeting once and for all.

CUT YOUR BUDGET
TIME IN HALF

Not ready for a demo?

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