

**Accounting for Apartments and Residential Real Estate**  
**February 12, 2008**

**The Balance Sheet**

- The balance sheet represents a snapshot in time.
- Assets - Liabilities = Equity
- Assets = Liabilities + Equity

**The Income Statement or Profit and Loss or “P & L”**

The income statement presents period of time, such as a year or a month.

**Debits**

A debit is a journal entry that occurs on the left side of the ledger. Debits include:

- An increase in an asset such as a tool or a rent receivable
- A decrease in a liability, for example the principal portion of a loan payment
- Any expense

**Credits**

A credit is a journal entry on the right side, such as:

- A decrease in an asset, for example the sale of a property
- An increase in a liability, such as a loan
- Any revenue
- An increase in equity such as cash injected into the business by the owner

**Applying for a Mortgage: Debt Service Coverage Measured by the Bank**

The biggest factor to the bank is cash flow. They will construct a debt service coverage ratio for your property. Banks usually want to see at least 120% debt service coverage.

$$\text{Debt Service Coverage Ratio} = \frac{\text{NOI after income tax}}{\text{annual principal and interest payments required}}$$

**Valuation: The Income Approach**

$$\text{Property Value} = \text{Net Operating Income} / \text{Cap Rate}$$

**Valuation Using the Gross Rent Multiplier**

$$\text{Gross Rent Multiplier} = \text{purchase price} / \text{annual rents received}$$

(Subtract amounts paid for utilities from annual rents received before constructing the ratio. A higher ratio is better for the seller.)

Another way to look at the same ratio is:

$$\text{Price} = \text{gross rent multiplier} \times \text{annual rents received}$$

	<b>Property 1: One Bedrooms</b>	<b>Property 2: Three Bedrooms</b>	<b>Comments on Property 1</b>
Number of Units	12	6	
Annual Rent per Unit	\$ 7,800	\$ 15,600	
Gross Rent	\$ 93,600	\$ 93,600	
<u>Vacancy and Bad Debt</u>	<u>\$ 9,500</u>	<u>\$ 4,500</u>	higher vacancy
Net Rent	\$ 84,100	\$ 89,100	
<b><u>Expenses:</u></b>			
Advertising	\$ 2,000	\$ 800	more units to rent
Bank Charges	\$ 100	\$ 100	
Insurance	\$ 4,500	\$ 4,500	
Lawn Care/ Landscape	\$ 500	\$ 500	
Management Fees	\$ 9,360	\$ 9,360	
Office Supplies	\$ 1,500	\$ 800	more paperwork/supplies
Property Tax	\$ 15,500	\$ 13,000	higher tax rate
Professional Fees	\$ 1,200	\$ 1,200	
Repair & Maintenance	\$ 7,500	\$ 4,500	more appliances to repair
<u>Utilities</u>	<u>\$ 2,700</u>	<u>\$ 900</u>	rent includes heat, water
Total Expenses	\$ 44,860	\$ 35,660	
<b>Net Operating Income (NOI)</b>	<b>\$ 39,240</b>	<b>\$ 53,440</b>	
<b>NOI divided by 9% Cap Rate</b>	<b>\$ 436,000</b>	<b>\$ 593,778</b>	

**Accounting is a Balancing Act**

- On one hand you want to minimize profits for income tax purposes.
- At the same time, you want to maximize profits for appraising and borrowing purposes.

**Capitalizing and Depreciating Assets**

- Does it add value or life to the property? If yes, then capitalize and depreciate.
- You may accelerate depreciation on equipment, appliances, and furniture.

**Accounting for Mortgages and Principal and Interest Payments**

**Helpful Hints**

- Use “classes” when multiple properties are owned by one entity.
- Backup your data regularly and store the backup offsite or at home.
- Don’t change transactions after finalized your books or file taxes.
- Close your books.