



How to Prepare a Supportive Housing Operating Pro Forma

The Operating Pro Forma is the tool used to estimate the expenses of a project during operations. It provides a summary of anticipated ongoing project expenses. The Operating Pro Forma is critical to establishing the feasibility of a project. If revenue is not sufficient to cover operating costs, real estate taxes and debt service *over time*, the project's acquisition or development cannot be deemed feasible.

The components of the Operating Pro Forma are fairly consistent around the country, but the terminology used to describe them sometimes varies. Even within the same locality, different lenders, investors and government funders may use different terms.

Following are issues that need to be considered in preparing an Operating Pro Forma:

- Costs can vary significantly
- Cost projections should be based on actuals from other projects
- Funders may require certain underwriting standards
- Operating and replacement reserves might be capitalized in the development budget or funded through the operating budget
- Vacancy factors should closely track the target population and local market conditions. Low-income housing projects can suffer effects of market changes

The three most critical aspects of evaluating the Operating Pro Forma are:

1. Is it complete?

Does the Pro Forma include all of the costs that the owner/property manager will incur to properly maintain and manage a successful project? Recognizing that labels and categories vary, you will need to understand the project and ask questions about the construction and management to clarify the extent to which the budget is complete.

2. Is it accurate?

Evaluating the Operating Pro Forma early in the development process can be difficult. As you near construction, you gain more detailed knowledge about the project and can refine operating cost projections and budgets. The basic question is: What are the underlying assumptions in establishing operating costs, and are they reasonable?

The actual costs of comparable projects are the best assumptions to use. In addition, try to use locally accepted underwriting standards for operating expenses. Other questions to consider in evaluating the accuracy of an operating budget are: What is the target population? What are the local market conditions? What is the local environment in terms of climate and utility costs? How will the type of construction affect operating costs? What role will the owner play in operations? Is there a property management plan? And has the proposed property manager been involved in developing the operating projections?



3. Is it realistic over time?

Unlike the development budget, which deals with the one-time costs of building the project, the operating budget deals with the continuing costs of operating the project over time. Therefore, multi-year projections should be carefully scrutinized to ensure that escalation factors are prudent, given the nature of the project and expected economic conditions. For example, the impact of real estate abatements or exemptions that may decrease or expire over time also should be considered. The multi-year analysis also should make realistic assumptions about rental assistance, especially regarding the impact of renewals (or lack thereof) and tenant mobility. The expense assumptions should cover the expected increases over the years of operation. Most projections assume that operating expenses will increase at between 2% and 5% per year.

The following section describes the typical items found in a supportive housing operating budget and provides guidance to determine the underlying assumptions and results. (Unless otherwise noted, all costs are quoted on an annual basis.) The order and grouping of these costs reflects a typical maintenance and operating budget for supportive housing.

Operating Expenses and Cost Evaluation Approaches

GENERAL & ADMINISTRATIVE

Note that the costs described below are solely for the real estate operating costs, and do not include services and program costs are typically found in supportive housing.

Management Fee

This fee is intended to cover the cost of property management services, whether provided in-house or by a private firm. The allowable fee is usually set by the lenders' underwriting standards, and typically ranges from 6% to 8% of net rental income. In some locales, the fee is established based on a flat, per-unit, per-month rate. Note that the fee will not necessarily cover the real cost of in-house management, especially if your organization has a small portfolio and/or particularly complex management responsibilities (e.g., administering Section 8 or Low Income Housing Tax Credit compliance).

If this is the case, check whether your management fee matches your cost. If it's tight, make sure that you have adequate agency operating support to cover the full cost of property management. If the property management is being contracted out to a private firm, however, make certain that they have relevant experience with low-income and supportive housing projects. It is also important to confirm that the Property Manager has been involved in the design of the project and is committed to working closely with service providers to develop integrated management and service delivery protocols.

Tax Credits

When using an outside management firm, send a copy of the equity investor's Property Management Agreement and Addendum (if one exists) to the agent before its fee proposal is submitted to your organization. This is because equity investors will sometimes mandate specific

fee agreement and contractual requirements. Ideally the firm should have experience in managing tax credit projects, since the reporting requirements are more complex than most traditional affordable housing projects.

Office Supplies & Expense

The cost of other-than-personnel-services (OTPS), (e.g., office supplies) related to on-site activities is usually part of the supportive services operating budget, and not included in the operating budget. In limited cases, this cost cannot be supported by other sources, and if the lender allows, it can be included here. The staffing plan drives the cost, and it should be prepared as a budget detailing each cost.

Legal & Accounting

Legal expenses largely refer to the cost of carrying-out evictions (“dispossesses”). This cost is difficult to project, since it is not known how many tenants will be evicted each year until operating experience is gained. This could easily become a higher-than-projected cost if eviction rates are higher than anticipated, especially in the first year of operation. In this event, the additional cost would come from savings on other line items or from the operating reserve.

Tax Credits

In the case of tax credit properties, there should be an increased allowance for accounting, since the reporting requirements to the investors and tax filings are more extensive than projects that are not syndicated.

Annual Partnership Management Fee

This fee only applies to projects syndicated under the Low-Income Housing Tax Credit Program. The fee is intended to compensate the general partner (subsidiary of the sponsor) for the additional required reporting to the limited partners (largely financial in nature). Equity investor’s underwriting, as determined by the complexity and scale of the project, sets the fee. This fee may be included as an operating cost, or may be paid to the extent that it can be covered by cash flow, after all other operating expenses are covered. Whether this is a “must-pay” expense or funded from excess cash flow is negotiable with the investors and is sometimes dictated by other funders’ requirements.

PAYROLL & RELATED

Since supportive housing projects have limited rental revenue, they usually cannot support much in the way of program or services staffing costs without additional outside funding.

Administrative Payroll

Some supportive housing projects will include limited administrative payroll costs in the operating budget, while others will fund it out of the supportive services budget. This cost may include such staff as the resident manager, administrative assistant, receptionist and bookkeeper. The payroll cost is a function of the staffing plan, and should be detailed in as budget backup. If this cost is

included, check with lenders to make sure it is allowable, and also compare with services budget to make sure that there are no redundant costs. The amount of the payroll cost is highly variable.

Maintenance Payroll

Maintenance staff costs typically include superintendents, janitors, handypersons and occasionally, housekeepers, and are generally charged directly to the operating budget. The number of maintenance staff is a function of the project's scale and maintenance demands.

Security Payroll Benefits, Payroll Taxes and Insurance

Security costs are sometimes included in supportive housing project operating budgets, though 24/7 coverage is difficult to pay. The security configuration and related costs are quite variable among projects, and are affected by such factors as: building scale, level of vulnerability of tenants, tenant involvement in building security, sponsor's philosophy, daytime staffing pattern, and the rate and nature of crime in the neighborhood. Most projects have at least evening and weekend coverage, and a front desk clerk typically handles security. Full security— 24-hour, 7-day coverage — requires approximately five full-time shifts (including allowances for vacation and sick time). Evening and weekend coverage – about four full-time shifts — may be sufficient for smaller projects or those with a strong staff presence during business hours.

In some localities, a supportive services contract or tenant employment program may fund security costs. As noted earlier, it is generally difficult to support a significant share of the security costs in the operating budget, so other sources should be identified to supplement them.

In most cases, you will want to factor in the cost to provide health and retirement benefits as well as payroll taxes and worker's compensation insurance for your property management staff.

UTILITIES

General

Utility costs can vary widely among projects based on such factors as efficiency of heating systems, energy ratings of insulation and windows, type of construction (new vs. rehabilitation), local climate, local utility rates, conservation practices of tenants and property Managers, and air conditioning and ventilation systems. The best information will be from the actual, recent operating expenses of comparable projects in your area.

Heating

Heating costs for systems that are master-metered and paid out of the project operating budget are generally projected on a per-room or per-square-foot basis, and are typically part of the local lender's underwriting standards.

Master Metering

Some supportive housing projects have master-metered gas and electric (versus individual metering for each unit). Because usage is not metered individually for each tenant, these costs are estimated and then included in the rent. The property manager then pays the actual cost based on usage for the entire project. It is especially important that the costs are estimated accurately; if the cost is underestimated, the owner, not the tenant, will end up paying the difference. These costs are then included in the rent and paid by the owner.

In some cases, electricity as well as gas for heating may be individually metered (each tenant pays for actual usage) while cooking gas is still master-metered (and included in rent). It is important to note that if the tenants will be paying for their own heating costs, these expenses will impact their contribution toward their rent payment.

Individually Metered

Common-area gas and electric is budgeted separately when tenants are responsible for their own utilities. This utility cost covers such areas as public area lighting, on-site offices, elevators, activity rooms, commercial kitchens and laundry rooms.

Common Area Utilities

Energy costs vary considerably across the country, and in areas experiencing energy shortages, rates are likely to climb considerably. The uncertainty surrounding gas and electric rates is a compelling reason to budget operating reserves conservatively. These rates, along with insurance costs, are probably the most unpredictable operating costs.

Water and Sewer

Charges for municipal water and sewer services are based on either a lump-sum “frontage charge” or on actual usage (as measured with individual water meters per building). Frontage charges are based on the width of the building, and are usually a poor indicator of actual usage, but easier to project reliably. If this system is used in your locality, verify the charge with the appropriate agency (often the department of finance or taxation). Be sure that the current rate is being used and that any anticipated increases are included in the projection. If the building will be individually metered, check with other comparable projects for usage and factor by the expected rate. Note that some localities are changing over from frontage systems to individual metering and that historical costs are not reliable. Frontage charges often understate the actual usage, and individual metering can be a significantly higher cost. Family projects generally use significantly more water than projects housing individuals.

Telephone

Telephone costs for general administration and supportive services are generally included as an OTPS cost in the project’s operating contract. However, if the cost is to be included in the operating budget, check comparable projects. Comparable projects should have similar staffing plans, since staff levels largely drive this cost. Tenants are generally responsible for their own telephone costs.

MAINTENANCE & REPAIR

Extermination and Supplies

This cost is for supplies used in routine cleaning and maintenance and the cost of regular extermination services. It is partly a function of apartment turnover, ease of maintenance (e.g., the presence of resilient floor covering vs. carpet), the use of outside vs. in-house extermination services and the amount of common-area space.

Repairs

This includes the non-personnel costs of repairs done by maintenance staff and the cost of repairs performed by outside vendors or under services contracts (other than elevator). These costs are affected by the intensity of use by tenants, the durability of the buildings systems and surfaces, and the level of ongoing maintenance.

Trash Removal

This cost should only be included in budgets in which municipal service is not available, and trash removal is performed privately or by the municipality for a charge. Consult the locality's department of public works to determine the policy. Note that some projects in commercial areas (e.g., downtown SROs) may not have municipal service. Verify private rates with garbage collection firms and/or other non-profit providers.

Snow Removal/Grounds Upkeep (Landscaping)

This cost is usually included in the maintenance staff and supplies budget lines. However, if the project requires snowplowing service or special grounds upkeep beyond the scope of on-site maintenance staff, the cost should be included here. These costs are more likely to be incurred in suburban or rural settings where there are more extensive grounds to maintain. Verify the cost with contractors and/or other non-profit providers.

Unit Turnover

This should cover the cost of painting the apartments and common areas on regular intervals, usually about every three years. Projects that anticipate a higher than average rate of turnover among tenants (in particular, transitional housing) should budget a higher amount, since the apartment units are generally re-painted upon turnover.

Elevator Maintenance

If the project will have an elevator(s), the budget should include an elevator maintenance contract separate from the other maintenance costs. This is a very specialized service and is usually retained through an elevator maintenance firm on a contract basis.

Replacement Reserve

This reserve is used to fund the cost of replacing furniture, appliances, carpeting and other building fixtures that have a limited useful life. All projects must include a budgeted replacement reserve. These costs cannot realistically be funded from cash flow. Lenders will likely have their own underwriting standards for calculating the reserve, and tax credit investors may have standards for these reserves as well.

MARKETING & LEASING

Advertising/Credit Investigations/Leasing Fees

The cost of marketing and leasing is usually not applicable to supportive housing since referrals are typically made through social services agencies or through outreach/intake staff (funded through operating contracts). Advertising costs are generally not incurred. The cost of leasing the unit should be included in the scope-of-services of the Property Manager. These costs are more often found in rental or homeownership housing for families.

TAXES & INSURANCE

Real Estate Taxes

Many supportive housing projects will be able to receive real estate tax abatements or exemptions, depending on a locality's policies. Do not assume that the project will be exempt on the basis of non-profit ownership, as the operation of housing in and of itself is not considered to be a non-profit, tax-exempt activity. Similarly, projects developed using tax credits are owned by for-profit entities and may not be eligible for tax programs targeted to nonprofit-owned affordable housing. If there is no abatement or exemption program available, the taxes should be projected on the basis of the assessed value of the completed project, at the tax rate likely to be in effect at the beginning of operation. Check with the local department of finance or taxation to determine the assessment policy (e.g., some localities do not assess at full value, but rather at a percent of value). Recently completed comparable projects are the best source of determining projected taxes. Make sure that you check whether there are other charges on the tax bill for which your project would be responsible. To do so, review the prior year's tax bill.

Other Taxes or Fees

Water and sewer charges (see "Utilities") are sometimes included under the category of "taxes." You also may have to pay for a local business license.

Insurance

The cost of premium payments for a comprehensive fire and liability insurance policy must be included and should be based on a quote from an experienced insurance broker. Since quotes are usually only held for up to six months, they are not a totally reliable source for projections. Better still is an estimate from an experienced broker for the insurance costs likely to be in effect at the time of operation.

Tax Credits

Check with all financing sources, including the equity syndicator, on any specific insurance requirements. Be certain to forward any property insurance requirements to the broker before the quote or estimate is prepared.