# Notes on the Operating Budget

***Note:*** *This handout was created for cohousing financing workshops presented by Design Coalition in 1992*

## PART II ~~ IDENTIFYING OPERATING EXPENSES

### MANAGEMENT

*Line 1*
The management fee is an annual payment to a contracted management firm or agent for whatever scope of services is negotiated between the sponsor and that agent. Of course, you may also choose to manage your project yourself. Typically, the fee is set as a percentage of gross rents. It can also be established on a per unit basis.

*Line 2*
Personnel costs for employees of the project who help manage the project but do not work for a contracted management agency are shown here. If the same person spends time on both management and maintenance jobs, payroll and benefit costs should be prorated between those areas of expense.

*Line 3*
Legal costs may be incurred in negotiating contracts with service providers or establishing contracts internally in a self-managed project. A reasonable estimate of the services expected should allow you to estimate the budget for operations.

*Line 4*
An annual audit for some projects (especially rental) should be planned and the expense budgeted. A review of similar projects will help you to become informed about the scope of such audits, and the fees associated with them,

*Line 5*
An amount should be budgeted for the expenses associated with advertising and marketing units. Remember that this line item is for ongoing operations, not the initial marketing at the time the project is filling up. Accordingly, this expense should be relatively small.

*Lines 6-8*
The project overhead costs to operate a management office, or to perform that function, should be estimated here. These costs are separate from any similar expense which may be included in a management fee.

### MAINTENANCE

*Line 9*
Personnel costs for maintenance employees should be entered her. Costs will include wages, fringe benefits, and withholding or other taxes.

*Lines 10-18*
Building maintenance costs are those costs associated with the upkeep of the building(s) and grounds. Estimates should be made for each of the line items listed here, based on operating expenses for other similar projects and your own vision of how you expect to maintain your project,

### UTILITIES

*Lines 19-21*
Utility costs can be estimated by doing a utility comparison analysis with other buildings in the area of similar scope and design, or based on previous use levels if you are rehabilitating an existing building. Utility companies can also be helpful in doing estimates for energy use.

Sewer and water costs can be estimated by contacting the utility or public service provider, as well as by doing comparisons with previous use.

**TAXES / INSURANCE / RESERVES**

*Line 22*

The estimated annual premium for hazard and liability insurance carried by the project owner(s) should be entered here. Estimates for coverage and rates can be gotten from a local insurance company or agent. Shop around for quality and price.

*Line 23*

Annual real estate taxes are relatively easy to project once you have a clear idea of the assessed value of your property. Talk to representatives of your local taxing authority and ask them to give you an estimate of your tax bill once construction is completed. Since this item is a very large operating expense, be sure to be as accurate as possible in your estimates.

*Line 24*

Replacement reserves are an important part of a budget, and should be taken seriously. This line item should ideally budget to allow you to replace old, worn, or inefficient equipment and building parts. The amount budgeted will depend on the age of the building(s) and the quality of construction and equipment. Roofs, furnaces, laundry and cooking facilities all fall in this category.

## PART III ~~ IDENTIFYING INCOME AVAILABLE FOR DEBT SERVICE

*Line 26-29*

Once you have estimated the project Income and the costs of operating the project, it is possible to estimate the amount of income that will be available to cover debt service, The last portion of the budget provides a space in which to calculate those figures, so that you can compare them to the mortgage amount in your development budget. Is your income adequate to cover mortgage payments? If not you will have to find a way to reduce development costs, operating costs, or increase income to the project from some outside source. You are now in a position to modify the scope of the project, sources of funding, or operating costs to make the budget balance.

Some lenders require a debt service coverage ratio to be applied to your operating budget, This ratio effectively reduces the amount of income a lender will allow you to use in projecting ability to carry debt. In effect, a lender will lower their risk by depending on only a *portion* of the income you claim you'll have for the project. This covers their risk in the event that there are shortfalls in that income or unexpected increases in operating expenses.