

**AN INVESTIGATION OF THE BUDGETING FUNCTION IN  
THE MANAGEMENT OF COMMERCIAL BUILDINGS  
IN NAIROBI**

**BY**

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UNIVERSITY OF NAIROBI**



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## DECLARATION

I, **NYAGUTHII JACQUELINE**, hereby declare that this project is my original work, and to my knowledge, it has not been presented for the award of a degree in any other University.

Signature:



Date:

MARCH 2005

This project has been submitted for examination with my approval as the University Supervisor.

PROFESSOR PAUL M. SYAGGA

Signed:

SUPERVISOR

Date:



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## **DEDICATION:**

This project is dedicated to the following:

To my children, Wangechi and Gabriel - You have added meaning to my life!

And

To my Parents for having made it possible for me to pursue this worthy course

## **ACKNOWLEDGEMENTS:**

Many thanks go to my Dad and Sponsor, Dr. Musonik arap Korir for having enabled me to pursue this worthy course. To my Mother, I shall forever be indebted to you for the continued support, and to my children, for their kind understanding and perseverance during my long hours of absence.

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**TO YOU ALL, I SAY THANK YOU AND GOD BLESS!!**

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## **ABSTRACT**

There are several reasons why people invest in real estate chief among them being profit maximization. Due to the complexity of the property market, property owners usually engage the services of property managers, be they in-house employed or out-sourced, with the hope that these managers will help the investors in the attainment of their goals.

The property management duties are many and diverse but most important during the performance of these duties is ensuring that the goals and objectives of the property owners are met. With profit maximization being the primary goal of many property owners, the property managers are usually called upon to manage the funds emanating from the respective properties. Property managers are therefore usually called upon not to only prepare periodical budgets but also to practice proper budgetary control in order to adequately manage the funds emanating from the properties for which they are responsible, thus the significance of this study.

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# CHAPTER 1

## INTRODUCTION AND PROBLEM STATEMENT

### 1.1 INTRODUCTION

The Oxford Dictionary has defined management as the control and making of decisions in an organization. It has also defined property as land and buildings. Property management therefore involves the making of decisions relating to land and buildings.

Thorncroft (1965,3) has further defined estate management as the direction and supervision of an interest in landed property with the aim of securing optimum returns. The returns need not always be financial but could also be in terms of social benefits, status, prestige, political power, and so on.

Macey & Baker (1973,1-2) on the other hand have defined good management as the application of skill in caring for the property, its surroundings and amenities; and in developing a sound relationship between the landlord and the tenant and also between the tenants themselves; in order that the estate, as well as the individual houses may give the fullest value to both the landlord and the tenants. From the landlord's point of view, it is desirable that the property should be as efficiently and economically maintained and managed as possible while from the tenant's point of view, the house should provide a home, set in surroundings where there are opportunities for attaining the wider goal of a full and happy life.

The property manager is usually called upon to interpret the goals and objectives of the various clients with the aim of ensuring that these are met. The success of property management is gauged not only by the extent to which it achieves its aims but also by the economy of effort, money and material with which these aims are met. The goal of property management is therefore to ensure maximization of returns to the landlord. The manager, in order to maximize

the returns must be competent and well versed with the provision of optimum returns at the least cost possible thus the need for budgeting and budgetary control.

## 1.2 PROBLEM STATEMENT

The property management duties are diverse and range from the collection of rent, carrying out of repairs, lease administration, maintenance of proper records, financial control, etc.

Financial control is necessary in ensuring economy in estate operations. For a property manager to efficiently control the finances emanating from a property, he or she should have a clear understanding of the estate aims and objectives.

The manager usually relies on various financial instruments in ensuring adequate financial control of the properties under his or her jurisdiction. The main instruments available to the property manager are estate accounts as these provide essential information necessary for making management decisions. The accounts show where expenses are incurred - the manager should be able to identify where there is a possibility of reducing non-essential expenses in order to make savings, that is, cost effectiveness. The accounts should also show where profits and losses are being made and explain variations in the income and expenditure. They should as such present the accurate picture of the current position of the estate and in so doing not only show the estate's level of liquidity but also the relationship between assets and liabilities.

Thorncroft (1965) indicated the principal means of financial control as being the budget and said that the other accounts, namely the revenue and the capital accounts, provide information on which budgets are constructed. The manager, when preparing a budget, is usually called upon to refer to the previous year's performance (in what is known as historical accounting), while at the same time making an allowance for the future. The over-reliance on past performance can however destroy the motivating force that the budget should have in the progressive plan. There is therefore need to look at the other methods of budgeting available to the managers. This notwithstanding, the budget being a tentative document should reflect the past performance though its reliability actually depends on the intelligence and the precision with which the manager can predict the future, Syagga & Aligula (1999).

A problem has been encountered whereby managers find themselves in the awkward position of presenting one document (the budget) at the beginning of the year and varying actual income and expenditure statement at the year-end. The manager is usually put on the defense to explain in what way the assumptions upon which the budget was based were proved false by events. In the process of ensuring budgetary control, managers therefore adopt the constant process of analysis and adjustment thus making a number of revisions to the budget as the outcome becomes clearer. This is meant to ensure that the progress does not deviate so far off the planned course of action. These constant revisions actually make the entire process of budgeting seem to be of little use.

Budgetary control, being one of the most difficult tasks of property management, this study proposes to investigate the various tools and techniques available to the property manager and recommend on the most appropriate methods of budgeting and budgetary control measures to adopt.

### **1.3 STUDY OBJECTIVES**

The following are the objectives of this study:

- ❖ To establish the role of the property manager in ensuring the management of client's funds.
- ❖ To determine the various methods used by property managers in the preparation of budgets.
- ❖ To determine the effectiveness of the budget preparation methods in predicting the future income flow.
- ❖ To establish the various tools and techniques that are used by managers in ensuring budgetary control and establish how effective these are.
- ❖ To recommend on the most appropriate methods of budgeting and budgetary control.

### **1.4 HYPOTHESIS**

- ❖ Inappropriate budgeting and budgetary control techniques are the main cause of the variance between the budget and the actual outcome.

## 1.5 RESEARCH METHODOLOGY

### Data collection:

The methods of research to be used include the following:

- ❖ **Primary data:** The study aims at establishing the budgeting function in the management of commercial buildings in Nairobi. The researcher will conduct a comparative study of those buildings whose management is done in-house and those whose management is outsourced. The buildings will be selected using random sampling after which further systematic sampling will be done to ensure that they are not managed by the same agent. . Questionnaires are to be issued to the various managers with five buildings being chosen in each category through systematic sampling to ensure that they all are not located on the same street in town (this will aim at establishing the effect of location on the management/profitability of property). The researcher will only study those buildings whose income is purely rental, have a total lettable area of more than 3,500 square meters and are older than five years. Thus such properties as hotels, churches or what are generally known as special properties will not be studied. The study will be confined within the last five years, that is, between 1998 and 2002 to ensure availability of data.
- ❖ **Secondary data:** Literature review will be conducted in the various libraries for background information on the budgeting and budgetary control function of property management. The researcher will collect data on the general management functions before narrowing down on the budgeting function of property management.

### Data analysis and presentation:

- ❖ **Trend analysis:** Graphs and pie charts will be used to show the average performance of the different property managers during the period under study.
- ❖ **Ratios** will be used to show the variance between the actual and budgeted income and expenditure.
- ❖ **Cross tabulation** will be used to determine the effect of the budgeting and forecasting methods on the variances so established

## **1.6 SCOPE OF THE STUDY**

The study aims at establishing the various measures property managers apply in ensuring budgetary control.

- ❖ The researcher will carry out a comparative study between buildings that are in-house managed and those whose management has been out-sourced with the aim of showing the various budgeting and budgetary control measures adopted by the respective property managers. Due to time and financial constraints, the researcher will study ten commercial properties concentrated in the Central Business District. Buildings to be studied will have to be more than five years old for a proper trend analysis to be done.
- ❖ The researcher will only study buildings, which have a total lettable area of more than 3,500 square meters. An effort will also be made to ensure that those buildings that are studied are multi-user in that they comprise both offices and retail outlets.
- ❖ An attempt will be made to ensure that the properties so chosen are not managed by the same property management firm with the hope of capturing the different management styles in place.
- ❖ The in-house managed buildings will be selected in such a way as to represent the different kinds of ownership and also ensuring that they are not located within the same area in town thus trying to establish the effect of location on the total income of the building.

## **1.7 ORGANIZATION OF THE STUDY**

The study is divided into five chapters with the first chapter containing the introduction, problem statement, hypothesis and the objectives.

The researcher will in chapter two and three carry out literature review. Chapter two will describe the management principles in real estate while in chapter three the researcher will carry out a detailed study on the budgeting and budgetary control function of property management. At the end of chapter three, the theoretical conceptual framework upon which the study is based will be given.

In chapter four the researcher will collect and analyze data on budgeting.

In chapter five, conclusions from the study will be drawn and recommendations given. The researcher will also recommend on possible areas of further study.

### **1.8 DEFINITIONS:**

- ❖ **Management:** this is the process of using resources effectively in the attainment of desired objectives.
- ❖ **Property management:** This entails the using of land and building resources effectively thus ensuring the attainment of the goals and objectives of the client.
- ❖ **Budget:** This is the overall plan of operations expressed in quantitative terms. Welsch has further defined it as a formal expression of the policies, plans, objectives and goals established by top management for the concern as a whole.
- ❖ **Budgeting:** This has been defined as the entire process of budget planning, preparation, control, reporting, utilization and related procedures.
- ❖ **Budgetary control:** This is the use of the budgets and performance reports throughout the period to co-ordinate, evaluate and control day to day operations in accordance with the goals specified in the profit plan.



## CHAPTER 2

### MANAGEMENT PRINCIPLES IN REAL PROPERTY

#### 2.1 FUNDAMENTAL ACTIVITIES OF MANAGEMENT

The management functions that are relevant to property management are:

1. Forecasting
2. Planning
3. Commanding
4. Controlling
5. Motivation

##### **Forecasting:**

This management function involves taking decisions that affect the future. Forecasts are made partly by analysis and interpretation of obtainable facts and partly by hunches in which there is often an element of subconscious analysis (Syagga & Aligula 1999). As many relevant facts as possible should be collected before a prediction is attempted. Every forecast must be based on a time horizon be it short term, medium term or long term. Long term forecasts are concerned with the general trends whereas short term ones are based with business cycles within them. Thorncroft (1965) has stated that it does not matter so much that a forecast is inaccurate so long as its reliability can be judged.

Budgeting as a property management function involves the making of decisions affecting the future in that the property manager has to project well ahead of time on the amount of income that he or she expects to be derived from the property for the period. This gives the property owner a clearer picture on the returns that he or she expects from the investment thus the need for not only accurate but also reliable forecasting.

## **Planning:**

This encompasses the development of basic objectives of the firm and depends on forecasting in getting its objectives right and for ensuring that the means of achieving the objectives are in place.

Below are the basic planning fundamentals as illustrated by Welsch (1964):

- ❖ The plans should be based on a careful evaluation of external and internal factors affecting the future. In property management, the manager has to determine the effect of such things as occupancy levels, cost of services, and so on the total income emanating from the property.
- ❖ Alternative courses of action should be developed and evaluated to the fullest extent possible. The manager in drawing the budget and having the concept of cost minimization in mind should put into consideration the entire alternative courses of action that will lead to profit maximization.
- ❖ The alternatives selected should be carefully drawn to express definite plans and objectives.
- ❖ Plans should be formalized to the fullest extent practicable; they should be clear comprehensive and simple.
- ❖ The plans should be drawn in terms of responsibility and time and in so doing specify how, when and who is responsible for carrying them out.
- ❖ The plans should be clearly understood and acceptable to those responsible for their attainment.
- ❖ Finally the plans should be developed so as to facilitate control.

In property management, plans are essential as they:

- ❖ Devise ways of reducing costs especially by taking advantage of economies of scale and standardization.
- ❖ They also ensure that estate resources are utilized fully and profitably.

### **Commanding and Motivation:**

Though not directly related to the budgeting function of property management, this function is important as it is concerned with creating a high morale among the persons engaged in an undertaking by giving them a sense of purpose and enthusiasm for their work. A good attitude of the property tenants to the aims and policies of the landlord may make property management not only easier but also more successful than where it is pathetic and hostile (Syagga & Aligula, 1999, 3).

**Motivation** involves the stimulation of one or more individuals to contribute their separate or joint efforts and skills effectively in accomplishing the tasks and overall objectives of the firm.

Motivation can be done through:

- Giving financial incentives e.g. bonuses to employees at the end of the year, or even rent-free periods for the tenants who pay their rents promptly. The managers should however get the landlord's approvals before doing this. A careful analysis needs to be done to establish the effect of this on the overall performance of the building.
- Recognition of accomplishment and status e.g. by giving recognition certificates.
- Definite assignment of responsibilities
- Fairness in evaluation
- Responsible participation in the decision making process. A motivated staff will also work hard towards the attainment of the clients' objectives.

Morale is fostered by:

- ❖ Taking command and giving prompt and clear decisions where they are required,
- ❖ Fairness in the treatment of staff and tenants
- ❖ Encouraging all those who are associated with the property so as to create a sense of partnership thus establishing a joint endeavor.

### **Controlling:**

Control is the action necessary to assure that objectives, plans, policies and standards are being achieved. This involves the anticipation of problems and shaping the conduct of the property in

such a way as to reach the desired objectives most economically. In so doing the manager does the following:

- ❖ Evaluates performance
- ❖ Compares actual performance with objectives, plans, policies and standards
- ❖ Analyzes deviations from such objectives, plans, policies and standards.
- ❖ Takes corrective action as a result of the analysis
- ❖ Follows up to appraise the effectiveness of the corrective action
- ❖ Gives feedback information to the planning process so as to improve future cycles.

Of great importance, is not just the mere preparation of the budget but also the exercising of adequate control to ensure that the expected results reflected in the budget are met. This management function will be discussed in chapter three.

## 2.2 Why own property?

There are many reasons why people invest in property some of which are:

*To satisfy a social and economic need:* This is mainly to preserve the fabric of the building, to make it more useful and earn profits while maintaining its value over time

*To provide a social benefit:* this mainly has to do with ensuring the welfare of the tenants/general public and thus the property has to have the necessary amenities the provision of which ensures high rents and thus high profits to the owners of the property.

*Environmental objectives:* These are concerned with preserving the quality of the environment against pollution and insecurity. The property manager can alter the conditions to cater for the diverse needs of the tenants and the landlord is called upon to ensure that the property is conducive to good living.

Whereas all property owners should have their properties managed in such a way as to ensure the protection of the environment against pollution, the primary reason why people invest in property is profit maximization. The Kenyan Law, namely the Factories Act, Cap 544 of the Laws of Kenya requires all the property owners to maintain their properties in such a way that

they are safe to both the tenants and visitors to the building. The property manager, having being assigned the duty of managing the building and subject to the management agreement, should ensure that a certain percentage of the income emanating from the property is utilized towards the proper maintenance of the same. It may be the duty of the manager in corroboration with the property owner to from time to time come up with the safety and security policies in the building which he or she ensures are complied with at all times. It is recommended that all persons visiting the building be made aware of the safety procedures thus minimizing the risk that may occur as a result.

## **2.3 Property Management**

Thorncroft (1965) has defined estate management as the direction and supervision of an interest in landed property with the aim of securing the optimum return. This need not always be financial but could also be in terms of social benefit, status, prestige or even political power. Miles & Wartzeback (1994) on the other hand have defined property management as the process of overseeing the operation and maintenance of real property with the aim of achieving the aims of the landowner.

### **2.3.1 The Origin Of Property Management**

The origin of estate management, as described by Thorncroft (1965) can be traced back to the feudal days and to the manorial days with the strip cultivation when tenants had obligations towards each other and also towards the landowners. The industrial revolution made the housing conditions of the workers very harsh. The level of overcrowding experienced led to the rapid and haphazard construction of houses. The situation was so bad especially because there were no building by-laws and no level of building control was in place. This state of affairs worsened rapidly during the earlier part of the 19<sup>th</sup> Century and no effective legislation to deal with bad housing was in place till the 1870s.

Octavia Hill, having seen the bad housing conditions that the workers lived in, can however be described as the originator of modern principles of housing management. She had to combat the generally held idea that landlords and tenants are warring parties whose interests were

considered to be always conflicting. She made it clear to the tenants that if they were prepared to play their part in paying the rent regularly and looking after the property, she would see to it that landlords played their part in carrying out the repairs. Before long she was able to prove that conditions could be improved and rent arrears and losses could be reduced by establishing a good landlord tenant relationship in which both parties fulfilled their obligations faithfully. She was able to show that, despite great expenditure on repairs, the properties, if well managed, could yield a reasonable rate of interest on the capital invested as well as providing better homes thus satisfying the needs of not only the tenants but also of the property owners.

Despite the above, the need for any kind of professional management did not become apparent until the depression of the 1930s when numerous foreclosures revealed a pattern of management deficiencies. It was sometimes assumed that if a property owner, having made a very large investment in the permanent structure, the property would run itself with very minimum supervision. This concept has however changed dramatically in the last two decades.

In an era of rising costs, it has dawned on owners that good property management is the major controllable influence on residual cash flow. Whereas both the rent rates and operating expenses are shaped largely by market forces which are beyond the control of any one property owner, it is also true that comparable properties in the same geographical area often show significant variances in rental income and operating costs. According to Miles & Wartzback (1994), these above average operating costs and lower than average rent levels usually result from inadequate property management.

### **2.3.2 Properties in which one can invest:**

These go towards describing the different levels of management required in any one property as this is determined by not only the level of services provided in the property but also the frequency of tenant turnover. The property manager can be called upon to manage any of the following types of properties:

1. **Residential:** These involve a lot of tenant relations therefore presenting the greatest challenge to managers. Residential tenants expect a well-run property with services and utilities available as promised but at the least cost possible. The leases for these properties are usually short and as such require constant renewals. The personal relationship between the manager and the tenants is crucial in maintaining high occupancy levels. The manager should aim at reducing the tenant turnover as these result in higher operating costs and lower rental levels.
2. **Office buildings:** The leases for these are more complex and as such the manager must be familiar with the more complex provisions. The rent in office blocks is chargeable on per square meter/foot basis and as such the manager must be familiar with the measurement of the rental areas. In the preparation of the lease, the manager must ensure to include an escalation clause failure to which this could result in a controlled tenancy (this will be discussed in a later part of this chapter). The manager must be enough of a lawyer to read and interpret the lease, enough of an engineer to ensure that services work as desired, enough of a marketer to sell the space based on the quality of the services provided; and last but not least, enough of a financial accountant to report it all to the owner.

The value of an office block is directly related to:

- **Rent per square meter:** The higher the rental levels, the higher the gross income.
- **Quality of tenancies:** The more credit worthy the tenant, the more assured the owner might be that the rents will be paid.
- **Length of leases:** The longer the lease terms, the lower the risk of vacancies and turnover in the future.
- **Cost of providing the promised services:** The lower the operating costs the higher the net operating income.

Since the amount of rent payable is secondary to the efficient provision of services provided, the manager must ensure that the premises are kept clean and secure and that the utilities work.

3. **Retail complexes:** The competent management of these is extremely important and especially important is the maintenance, the attractiveness of the property and the proper tenant mix as the different retail outlets in the complex usually complement each other in terms of customers. The manager must be prepared to negotiate the most favorable terms

for the owner and also to ensure that percentage rents (based on the actual profits made by the tenant but not widely practiced in Kenya) are correctly computed and paid as they become due.

4. Industrial properties: These require specialized management, as they are usually special purpose built. Of utmost importance in the management of these is ensuring their safety.
5. Hotels and motels: These require constant management as they have frequent turnover of guests and services are crucial.
6. Special purpose facilities: Examples of these are hospitals and worship places. These require very specialized management talent that is frequently recruited from the professionals involved.

The main problems of management are attributable to the following:

- ❖ The physical identity of the property in terms of size, shape and degree of improvement. The bigger the property and the more developed it is the more complicated is its management.
- ❖ The economic condition of the property in terms of the use (whether owner occupied or rental), the extent of development (this determines whether it can absorb more capital). The debt loading capacity of the estate and the availability of further credit is also an important factor. The extent of both physical and functional obsolescence also determines the level of management desirable.
- ❖ Legal status of the property: The manager is usually called upon to determine the rights, which are legally enforceable, as these determine the quality and degree of control that is necessary.
- ❖ Managerial character of the property: The success of this depends on:
  - Suitability of the estate organization
  - Appropriateness of the units of supervision
  - The smoothness of the chain of command from higher to lower levels of the control hierarchy and
  - The proper delegation of responsibility

The property manager should interpret the above factors adequately and then relate these to the property owner's aims and objectives so as to ensure that the goals of the estate are met.



### 2.3.3 The Main Property Management Functions in Commercial Properties:

These are summarized as follows:

#### **Making the management plan:**

As the agent of the property owner, the property manager carries out his duties so as to ensure that the objectives of the owner are met. Making clear these objectives is the first step in creating a management plan.

The plan is necessary as it:

- Gives an explicit statement of the owner's objectives and assumptions thus avoiding misunderstandings that could arise in future.
- It provides continuity in case that particular manager is no longer with the company
- Provides the framework and the discipline for thinking it through

The plan should contain the following:

- An analysis of the competitive environment: This is necessary, as the manager needs to understand the regional and neighborhood trends with respect to the building under management.
- Property analysis/audit: This is important as it enables one to know the physical condition of the building and the extent to which it suffers obsolescence (the manager will be in a position to predict the operational costs of the property, though he or she may not be accurate). The property analysis also enables the manager to measure the amount of lettable space, which will determine the rental income expected from the property. The manager will also be in a position to determine the desirable tenant mix.
- Owner's objective and market analysis: The market analysis will enable the manager to know the rents being charged for comparable properties and in so doing be able to establish the rent to charge in the property under management. The rents charged will go a long way in establishing whether the objectives of the owner will be met.

#### **Making a budget:**

Since the property manager is responsible for rent collection and payment of bills, there is need for her to prepare a budget so as to:

- Regulate cash flow thus ensuring that there is sufficient cash in hand to meet the obligations e.g. payment of mortgage, taxes and operating expenses
- Measure performance: The budget acts as a standard for measuring the manager's success in meeting the investor's objectives.

### **Showing and renting space:**

The duties of the manager include:

**Setting rental levels:** A rent schedule should be established with the objective of maximizing future rental income from the property. The setting of rents calls for the exercise of good judgement based on knowledge of rental rates and available space in comparable buildings as well as the features, functions and benefits of both the subject property and competing space.

The manager in renting the space has to advertise the space through various channels. These may include the use of billboards, print media, placing the property on the website or even writing introductory letters to various parties who could be interested in the property. To ensure that the message reaches the right people, the manager has to discuss with the property owner so as to decide on the desirable tenant mix. *The best type of advertising is that which produces the most prospective tenants at the least cost and at the shortest time possible.* While deciding on the tenant to allocate space to, the manager should determine the ability of the tenant to pay rent. Asking for the prospective tenant's bank statement as well as asking for financial references can do this. On allocation of space, the manager prepares a letter of offer, which lays down the terms, and conditions, which will be incorporated in the lease.

### **Lease Administration:**

A lease is a legal document in which the owner of the property transfers the right to use and occupy the property to another for a specified amount of rent and time. The major objective for the drawing of a lease agreement can be described as protection which encompasses the landlord's desire to assure occupancy and income for the period which it covers and therefore preventing any loss in income due to sudden vacancy.

### Essential elements of a lease:

There is no particular wording or form of agreement that is required by the statute to create a valid contract so long as the intention to transfer from one to the other possession of a certain real property for a determinate period of time is expressed.

When creating a lease, the property manager must incorporate the essential elements of a valid contract, which are namely:

- The parties must be legally competent. The basic elements of a contract require that both parties to the contract be of age. In the Kenyan case, the parties must both be above eighteen years and must be of sound mind. The law also states that for a contract to be legally enforceable, neither of the parties should be bankrupt. It is therefore the property manager's duty to determine the financial position of the potential tenant.
- The objective of the lease must be legal. For example, the user cannot be drug trafficking purposes.
- There should be mutual agreement between the parties. A contract signed under duress does not amount to a legally enforceable contract.
- Consideration must be given. This is usually in the form of rent. The lease stipulates the rent payment modes and in many cases security deposit is usually asked for.

The following are the additional elements, which are necessary, so as to make a contract a lease:

- There must be a named lessor and lessee
- An adequate description of the property must be given - The property must be identifiable failing which the lease will be void for vagueness. As such it is usually a requirement for the manager to forward a floor plan which must be registered, as leases are specific in terms of area and location. If a tenant wishes to move from one area of the building to the other, then a deed of surrender must be signed for the area currently occupied and a new lease drawn with respect to the new area.
- There must be an agreement to convey the premises from the lessor to the lessee. This is of course subject to the tenant fulfilling all the obligations.
- The starting time and length of the arrangement must be stated.

- The agreed rental sum payable, mode of payment, payment intervals and rent reviews and when these fall due must be clearly laid out.
- The agreement needs to be appended by both parties and the same registered for authenticity purposes.
- The lease needs to stipulate clearly the responsibility of both parties when it comes to repairs and maintenance and the payment of various bills. As such, the leases may be described as inclusive or exclusive. They may also be classified as occupational leases, building leases or subleases.

The principal types of leases can be described as follows:

**Gross (inclusive) lease** in which the tenant pays a fixed rent and the owner pays the property's operating expenses.

**Net (exclusive) lease** in which the tenant pays rent and also assumes responsibility for specific expenses connected to the leased premises.

**Percentage leases** under which the rent is based on a percentage of gross sales or income made on the premises or a minimum fixed rent, whichever is higher. This, though not common in Kenya, ensures that the landlord shares in the financial benefits of the leased premises.

Other types of leases include the following:

**Building leases** are granted for vacant land, which is ready for development. These are granted to developers who are in this case the lessees at a yearly ground rent. The developers erect buildings on the land and undertake to keep them in a good state of repairs. The ground rent represents the rental value of the bare site at the time the lease was granted, and the difference between this and the net rent obtainable from the developments represents the net income to the developer (Syagga, 1999, 14).

In most cases, the government for 99 years normally grants building leases. However in urban areas under county councils, the leases are normally for shorter periods, some being for 33 years whereas those under the site and service schemes being for as long as 50 years. In the agricultural areas, the leases are usually for 999 years.

**Occupational leases:** This is a lease for developed property in which the lessee lets a part or the entire property. Most residential properties are let for a period of two years with the option to renew, whereas commercial buildings are normally let for more than five years. The occupational leases can either be inclusive in which the landlord is responsible for all the repairs; or they could be exclusive in which the lessee is responsible for all or part of the repairs as the lease may stipulate.

The function of the property manager in lease administration begins from when a tenant signs the lease and only ends when that particular tenant moves from the building. According to Syagga and Aligula (1999, 11), the principal accomplishment of a competent property manager is the ability to advise on the preparation of leases from a commercial point of view. The manager should be sufficiently versed in laws that relate to landlords and tenants so as to interpret leases and give advice on the same when necessary. The property manager in so doing has to ensure that he or she does not enter into controlled tenancies. Grounds under which one may enter into controlled tenancies are clearly stipulated in the various Acts of Parliament, which govern the landlord and tenant relationship.

The Rent Restriction Act, which deals with residential properties, describes a controlled tenancy as one, which is for a monthly rent less than Kshs 2,500.00. The Landlord and Tenants Act (this deals with commercial properties) on the other hand describes a controlled tenancy as one which is for a period less than 5 years and also one which does not contain ground for rent reviews. The property manager in ensuring that he or she does not enter into a controlled tenancy has to ensure that all leases are reduced into writing.

#### **Rent collection:**

Rent is the consideration paid by a tenant to property owner for its use. The payment is usually set out in the lease and may be monthly, quarterly, half-yearly or even yearly in advance. The mode of payment must be clearly stated in the lease.

Systems of rent collection:

- ❖ **Door to door rent collection:** This is risky in terms of theft and especially when the same is paid in cash.

- ❖ Office collections: Ideal for cheque payments.
- ❖ Collection by post, credit transfer, bank standing orders.

According to Syagga (1999, 13), in Nairobi, 47% of tenancies use office rent collection while payment by credit transfers and bankers orders are used by about 40% of the tenancies. A small portion of tenancies, about 13%, use door to door rent collection method.

The greatest challenge experienced by property managers is dealing with rent arrears. Syagga again says that a survey of rent arrears in major commercial buildings in Nairobi revealed that on average, 17% of the tenants had arrears for periods of 3 to 6 months. Usually rent arrears are higher in buildings containing small tenants whereas those buildings that house international organizations such as the United Nations and Airlines rarely experience the problem of arrears. This brings to light the role of the manager in deciding on the proper tenant mix in a building and also in selecting tenants.

#### *How to deal with rent arrears.*

Thorncroft (1973,279) says that it is the tenant's duty to ensure that the rent is paid to the landlord and the latter has no responsibility for collecting it, nor is it his duty to send out any demand for payment. The tenant in arrears can therefore not legally forward a legal defense that the landlord failed to call for the rent. Irrespective of the above, there is need for managers to apply diplomatic methods in collection of rent. The manager should write notices to tenants who are in arrears reminding them that rent has not been paid. This should be followed with a second and final reminder detailing to the tenant that if the rent is not paid within a particular time, then the manager shall be left with no option than to refer the tenant to the auctioneers for recovery of the full amount at the tenants own costs and consequences.

If the tenant does not respond affirmatively after this notice, the manager may be forced to levy distress according to the provisions of the **Distress for Rent Act Cap 293 of the Laws of Kenya**, which authorizes the landlord to send a bailiff to attach the property in the premises. This levying of distress proves especially useful in recovering rent from tenants who can otherwise afford to pay the rent but just willfully withhold it.

The other resort available to managers in recovering of arrears is the eviction of tenants (one may require a court order to do this). The manager in doing this may not necessarily recover the debt but this could of course have an effect on other tenants who could be contemplating not paying rent.

The manager, depending on the significance of the arrears may also opt to apply the court process in recovery of the same. This is usually very lengthy, tedious and expensive and it is always advisable to carry out a cost and benefit analysis before engaging the process.

Some property owners have also not only found it important to take up insurance against loss of rent, but have also introduced an aspect of interest based on the landlord's bank lending rates for all rents that are not paid within a stipulated time. This proves very efficient in ensuring very low rental arrears (if any).

#### **Maintaining good tenant relations:**

Cordial relations with tenants go far toward obtaining tenants co-operation and also make collection of rent easier. The manager should be quick to cure deficiencies in services to which the tenants are entitled. There should also be no favoritism when dealing with the tenants. It is always therefore important to ensure that there is no conflict of interest in allocating space as this may cause difficulties in future. The manager must use good judgement when enforcing the rules and regulations of the property.

#### **Paying expenses**

Costs must be incurred to operate and maintain the property. Many costs such as electricity and water are recurring and therefore their payment is more or less routine. For the non-routine services such as repairs and maintenance, close monitoring and inspection is necessary to ensure that value is received prior to any payment.

The following are the factors that affect the level of outgoings in any commercial building;

- ❖ Users of the building: Some tenants such as hotels and hair salons are heavy water and power consumers whereas others such as bookshops use very little. The property manager

may advise the landlord on the need of installing separate check meters for such tenants therefore ensuring that they pay their own bills.

- ❖ Type of property: This is in terms of the actual structure, materials used in the construction and the design of the building. Those buildings, which are tile finished on the walls both internal and external, require little in terms of periodic redecoration.
- ❖ Owner requirements: Some owners require very high standards of maintenance whereas others are a bit lax on the maintenance
- ❖ Type of clientele served by the tenants in the building: If the tenants in the building mainly deal with multinational clientele, then they will usually demand very high levels of maintenance
- ❖ Type of fittings attached: The more they are, the more the outgoings in terms of replacement costs
- ❖ The management agent involved: This is in terms of the management fees charged by the agent
- ❖ Location of the building: A building in a prime area will pay more costs than one in a subsidiary area.

### **Insurance:**

The property manager is also responsible for making statutory payments such as insurance whose overall effect is to spread the cost of a disastrous event, which would otherwise fall on the property owner, to many other persons who may be exposed to the same risk. It is the manager's responsibility to arrange protection for the owner against all major insurable hazards. In so doing, the manager identifies and evaluates the risks involved and secures the best and most economical protection available in the insurance market.

The manager should keep accurate records regarding all insurance matters and renew coverage well in advance of expiration. The various insurance covers that a manager could advise the property owner include standard fire insurance, workman's compensation, casualty compensation - this includes insurance against theft, plate glass, etc, rent insurance and consequential losses, among others.



There is an on going debate on whether this should be a service charge expense or whether the same should be a cost attributable to the property owner.

### **Maintaining the property:**

Maintenance is the work undertaken in order to keep or restore every facility to an acceptable standard which must be no less than to meet the statutory requirements. The property must be maintained in such a way that it is not only in an efficient state but also must be in an efficient working order and in a good state of repairs. Effective maintenance management requires the knowledge and experience necessary to identify the maintenance needs and to specify the right remedies. It also requires an understanding of modern techniques of business management; a knowledge of property and contract law and an appreciation of sociology (Seeley, 1976, 6).

### **Why maintain?**

- ❖ It is a legal requirement to do so. Both the Public Health Act and the Factories Act require property owners to maintain them to such standards as to ensure the safety of the occupants, visitors and the general public. Breaches of law with respect to this may not only involve the owner in criminal proceedings but may also result in heavy losses as a result of subsequent civil action.
- ❖ Due to owner's policy decisions which spell out the necessary maintenance standards. This is necessary so as to ensure tenant retention.
- ❖ Budgetary systems: These influence the level of maintenance by either limiting the necessary expenditure or by enabling money to be transferred to and from the maintenance fund. This not only has an effect on the preservation and enhancement of property value but also has an effect on the operating costs of the building. The maintenance budget should be clear and well reasoned and supported by full information on the consequences of neglecting maintenance.

The division of legal responsibility between the landlord and the tenant in respect to maintenance and repairs will depend partly upon any express covenants in the lease agreement, partly upon common law and also partly on statute law (Thornicroft, 1973, 295).

Property owners often endeavor to keep maintenance costs to a minimum ignoring the adverse long-term effects of such a policy. Neglect of maintenance has cumulative effects with rapidly increasing deterioration of the structure. The property manager, being an agent of the landlord has the responsibility of advising the owner on the required maintenance works. In so doing, the manager should establish maintenance schedules, which specify the timing and amount of services required. In carrying out the works, the manager should see to it that these are done in the most efficient but cost-effective way.

### **Conserving energy**

The property manager should aim at keeping the energy costs to a minimum irrespective of whether these are the responsibility of the owner or the tenants. Energy costs can be cut through:

- Regular inspection of the building equipment to ensure their effective performance
- Careful timing of the ventilation system, where they exist, to see to it that these operate at lower rates after working hours.
- Sensitizing to the tenants and other workers in the property of the need to turn off all the unnecessary lights after working hours.
- Careful monitoring of lights during working hours so that excessively high level of lighting is not supplied.

### **Providing security:**

Some are the times when a property owner can be held liable for loss or injury to tenants' goods resulting from inadequate safety precautions. It is therefore the manager's responsibility to minimize the risk of crime while at the same time keeping the operating costs to a minimum.

### **Supervising personnel:**

The manager determines the personnel requirements in a property and hires them within a budget approved by the landlord. The salaries and wages of these personnel could be paid directly by the owner or the manager could be responsible for the payment after which he or she passes on the costs to the owner. This of course depends on the management agreement signed between the owner and the manager.

### **Maintaining property records and rendering reports:**

A professional property manager must keep an adequate system of accounts. The records are necessary as they not only give the historical data on the property but also are the basis for management decisions.

The basic requirements of a good accounting system are that it should accurately record transactions, provide a statement of receipts and payments and transfer funds at agreed intervals. The objectives of such a system are as follows:

- ❖ Accuracy: The system should be simple but flexible enough to absorb and process a variety of receipts and payments.
- ❖ Immediacy: The system must be ready to show the latest financial position of the account in order to allow emergency decision making regarding expenditures.
- ❖ Promptness: The property manager must be able to uphold the agreed accounting dates and to promptly inform the property owner if deadlines are not going to be met.
- ❖ Proof against fraud: the system must have in-built precautions against the possibility of deliberate fraud. Payments should always be authorized by at least two signatories.

The accounts so maintained are used as instruments of financial control. The accounts show where expenses are incurred and should also show where savings are possible by reducing non-essential expenditure. They should show where profits and losses are being made and explain the variations in the income and expenditure. They should also present an accurate picture of the current position of the property. By comparison to past performance, they should point to future trends. The accounts should make it clear whether the assets are being fully utilized and also draw attention to areas of possible improvement.

Following are the different types of accounts that should be maintained by any professional property manager:

*Revenue accounts:* These are important as they show the achievement of the management as measured by the annual profits and losses. The accounts should point out ways in which profits may be increased. This could be by:

- Expanding the income keeping expenditure constant e.g. by increasing the rental rates.
- Reducing the expenditure keeping the income constant, or
- Expanding the income faster than the expenditure

*Capital accounts:* Sound financial control requires that the property manager knows where the property stands in terms of its assets and liabilities. In so doing, the manager should always review the extent of indebtedness of the property in terms of loans and mortgages so as to ensure that these are adequately covered.

*Budgets:* These are the principal means of financial control as the other types of accounts mainly provide information upon which the budget is constructed.

The property manager should maintain separate accounts relating to each client be it a landlord or a tenant.

- ❖ The tenants' accounts should show the rent outstanding up to a certain date and in it show the amount billed to the tenant for the subsequent period be it a month, quarter, half year or year depending on the agreement in the lease. The records should also show any subsequent payments made by the tenant.
- ❖ The client's accounts should show the amount that is being paid to the client. This is basically the amount paid by the tenant less any expenditure on maintenance, management and letting fees and statutory payments made by the manager on behalf of the property owner. Out of this report, the property owner should be able to discern the amount owed by each tenant. At the end of the year or quarter whichever is appropriate, these monthly reports are compiled together to produce what is known as the income and expenditure statement for the period and is subject to audit.

## **2.4 CONCLUSION:**

As has been discussed in the previous sections, the property management duties are many and diverse but chief among them is ensuring that the goals and objectives of the property owner are met. The property manager in trying to ensure that the profit maximization goal of the landlord is met is usually called upon to exercise some financial control. He or she has at his/her disposal various tools and techniques which assist in ensuring the proper control of the property in question. Among these, and as will be discussed in the next chapter, is the

budgeting and budgetary control technique, which, if properly employed acts as a measure of the general performance of the property.

### **3. CHAPTER THREE:**

#### **THE BUDGETING AND BUDGETARY CONTROL FUNCTION OF PROPERTY MANAGEMENT**

As indicated earlier; the budgetary making function of the property manager is one of the most important functions and thus the reason for this chapter.

##### **3.1 BUDGETING**

A firm should be efficiently and effectively managed. By so doing, the firm should be able to achieve its objectives by minimizing the use of resources. This can only be achieved through proper management that should ensure that the efforts of the firm are not only properly coordinated but also controlled with the aim of achieving the organization's goals and objectives. Pandey (1999, 228) indicates that the process of managing is facilitated when management charts its future course of action in advance, and takes decisions in a professional manner, thus utilizing the individual and group efforts in a coordinated and rational manner. He further states that one systematic approach for attaining effective management performance is through financial planning and budgeting.

A budget is the overall plan of operations expressed in quantitative terms. Welsh, 1964 has defined it as a formal expression of the policies, plans, objectives and goals established by top management for the concern as a whole. It is therefore a formal, quantitative statement of management plans and policies for a given period and is used as a blueprint for that period.

The budget acts as a standard of measure against which actual performance can be measured.

The major purposes of budgeting are as follows:

- i. To state the firm's expectations in clear and formal terms thus avoiding confusion. In property management, the budget facilitates the attainment of the client's objectives.

- ii. To communicate expectations to all concerned with the management of the property so that they are understood, supported and implemented.
- iii. To provide a detailed plan of action for reducing uncertainty and for the proper direction of individual and group efforts to achieve goals.
- iv. To coordinate the activities and efforts in such a way that the use of resources is maximized. The budget compels management to plan for the most economical use of resources.
- v. To provide a means of measuring and controlling the performance of the management thus providing information on the basis of which necessary corrective action can be taken. The budgetary control function also sets a framework, which helps expenditure to be kept within agreed limits. This is because a well-prepared budget pinpoints efficiency or lack of it.
- vi. A budget helps to clarify assumptions underlying future goals. The assumptions are however based on a number of factors such as the economic conditions, political and social environment, supply and demand forces, technological changes, etc. The short term goals and policies are usually modified whenever these factors change and this should be incorporated in the budgeting system.

**The essentials of successful budgeting as given by Pandey (1999, 239) are as follows:**

a) **Top management support:** It is desirable for top management to realize that the budget is not merely an accounting device but that it is an essential management tool. The management must therefore

- ❖ Understand the nature and characteristic of the budget
- ❖ Be willing to devote all the effort required to make the budget operative
- ❖ View the results of the planning process as performance commitments

All in all the budget plan can only be implemented effectively if the top management has a positive attitude towards the budgeting process thereby giving directions for its implementation. The top management must be convinced that it can predict the future course of action with reasonable accuracy.

- b) **Clear and realistic goals:** Budgeting is a means to achieve predetermined goals and objectives, which must not only be stated clearly but must also be systematic. The property manager is therefore usually called upon to interpret the goals of the property owner, which must also be realistic and attainable. The goals must neither be too high so as to make them unattainable nor should they be too low so as not to provide a challenge to the employees.
- c) **Assignment of authority and responsibility:** A sound organizational structure is essential for the success of the budgetary system.
- d) **Creation of responsibility centers:** These are necessary for the purpose of control though they actually depend on the size of the firm.
- e) **Adaptation of the accounting system:** This is of importance since budgeting is based on data generated by the accounting system. The accounting system should be structured in such a way as to facilitate the planning and control process.
- f) **Effective communication:** A sound budgeting system requires effective communication of the objectives and goals. This ensures that a unified effort is directed towards the accomplishment of these goals.
- g) **Flexibility:** The budgeting system should be flexible enough to take advantage of all opportunities that may arise from time to time.

### **3.2 BUDGET PREPARATION**

The budget is usually similar in form to a profit and loss account, the only difference being that the budget is based on forward estimates of costs and revenues and is therefore only a forecast of the anticipated profit to be earned. Harris and McCaffer (1989, 275) indicate that, from the forecast profit, it is possible to project other future expectations such as the rate of return on



capital employed, dividends to shareholders, capital to be retained in the business for reinvestment in assets.

**The budgetary preparation process as illustrated by Lucey (1989) is as follows:**

1. The property manager is usually called upon to interpret the goals and objectives of the client. With these in mind, the manager then refers to past records such as the previous year's client's income and expenditure statement to which a percentage is added. This is the process that is used by most organizations in the preparation of budgets and is known as historical budgeting. Alternatively, the manager could start with a zero budget in what is known as zero rate budgeting upon which the anticipated revenue and expenditure is built to determine the next year's budget. For the manager to be able to predict the following year's budget, it is important that he or she determines the external factors that could affect the performance of the property. This includes studying the market to determine not only the economic trends but also the market indices, which are of importance to the property market. In so doing, the manager could study the base market lending rates especially where the property is under mortgage loaning. The market surveys could also pinpoint the rental levels prevalent in the market, as this would assist the manager in determining the rents for a particular property.
2. The next step is the derivation of key forecasts with a forecast being a prediction of the future events, which are expected to happen. The accuracy of the budget depends on the manager's precision in predicting the future. The manager in predicting the future may assume that the variable costs behave linearly with respect to the level of activity. In real life however, this need not always be true as the relationship could also be non-linear in which case it could be
  - Convex - This is when the cost increases less proportionately with each increase in the level of activity.
  - Concave - this is where each extra unit of activity (in property management, this could be the occupancy level) causes a more than proportionate increase in cost.

Linear approximation is however preferable as it is not only convenient but it also greatly simplifies calculations.

The manager could apply the following statistical methods during the forecasting of income and expenditure:

- ❖ **Economic rhythm method:** This involves a projection of historical trends into the future. The manager may obtain rental values (both rent and service charge) and related expenditure values as far back as it is thought to be representative of current trends. The manager then computes an adjusted rental value by dividing the actual rental data derived above with an index derived from the market. With so doing, the manager is able to predict with some certainty the expected income flow expected from the property. This method however assumes that future data will essentially follow the patterns of historical data.
- ❖ **Correlation method:** This is based upon the selection of a basic series of economic data which property values tend to follow. A statistical analysis is then used to measure the correlation between this basic series with the properties of the actual property in question.
- ❖ **Special historical analogy:** This is based upon the idea of selecting some previous situation and a period in the past that appears to have most of the earmarks of the present situation thus implying that what happened then is likely to happen again.

The manager in deciding what method to use takes into account the following:

- ❖ The characteristics of the particular property.
- ❖ The environment within which that property operates
- ❖ The general state of the economy
- ❖ The availability of data

3. The third step is the actual preparation of the budget in which the manager takes into account all the factors that affect the income stream from the property. These are:
  - **Rent:** In commercial buildings, these are charged on per square meter basis
  - **Service charge:** This is a periodic charge made or incurred for the cost or expenses of running a building especially a cost or expense that benefits more or one party in a multi-occupied building. These are charged with accordance to the terms of the lease and may

from time to time be adjusted according to the actual expenditure incurred in running the building. For a new building, the rate of service charge is based on the budget prepared by the manager showing anticipated expenses within the year. This is allocated to the respective tenants relative to the area they occupy. At the end of the year, if there is a debit in the service charge account, the shortfall is usually apportioned to each tenant on a pro-rata basis. The new adjusted service charge is then used as a yardstick in reviewing the service charge in the following year.

From these the expenses are then deducted.

Detailed expense budgets should be included in the annual budget due to the following:

- ❖ So that the effects of various planned revenues and related expenses may be aggregated in a budgeted income statement
- ❖ So that the cashflow required for costs and expenses can be estimated realistically
- ❖ To provide an initial expense limitation
- ❖ To provide a standard to be used in the period covered by the budget for each item of expense for comparison with actual costs.

The manager while drawing a budget should aim at cost effectiveness in which possible areas of cost reduction should be identified. This may be made possible through the improvement of such factors as the work methods and arrangements applied. The manager could also aim at cost control in which he or she applies efforts aimed at keeping costs at or below a preset standard.

The expenses of property management could be classified as either fixed costs or variable expenses. The fixed expenses are those which accrue with respect to the passage of time and which with certain activity limits tend to be unaffected by fluctuations in the level of activity. In property management, these include the ground rents, land rates, and insurance. The security and cleaning costs, especially when these are out-sourced, also tend to be fixed to some extent in that the manager can predict their costs with precision as these are charged as per the contract. These however tend to be affected by the labour laws and the manager has to make allowance for the annual increments which normally fall after the Labour Day celebrations.

The manager could study previous years' trends in predicting the percentage increase in the minimum wages.

Other costs, which usually appear in the budget, are the electricity and water costs and these usually vary with the level of activity. Others may include the staff salaries and wages, lifts maintenance costs where these are applicable, capital expenditures such as the cost of external painting and improvements in the building.

The repairs and maintenance costs are also an important component of the budget. Ordinarily the client usually indicates a ceiling figure, which the manager can spend for urgent repairs without reference to the client. For any repairs costing anything above this figure, the landlord's approval would have to be sought. The normal procedure, in order for the manager to achieve cost effectiveness in the maintenance of the property, is for him or her to source out for quotations from various contractors in what is known as competitive bidding and the same taken through the tender board (where these exist) for approval. Except for the urgent repairs, there is need for proper planning of the maintenance works in order of priority. Seeley (1976, 7) states that ad hoc maintenance with an open-ended budget may seem attractive but it is unlikely to obtain full value of monies spent or an efficient maintenance system. There is therefore need to improve the methods of managing and executing building maintenance.

Other costs that are included in the budget are the management costs and letting charges. These are usually agreed upon during the drawing of the management agreement and are a function of the occupancy levels. Management costs are also dependent not only on the commitment of the tenants in paying rent but also on the diligence of the manager in demanding for the same.

A typical service charge budget would take the following form.

BUDGET FOR XYZ FOR THE YEAR 2003														
ITEM	JAN	FEB	MAR	APR	MAY	JUN	JULY	AUG	SEP	OCT	NOV	DEC	TOTAL	VARIANCE
S.CHARGE														
TOTAL														
LESS: EXPENSES														
GROUND RENT														
RATES														
INSURANCE														
REPAIRS & MAINTENANCE														
ELECTRICITY														
WATER														
SALARIES														
SECURITY														
LIFTS														
GROUNDS MAINTENANCE														
CLEANING														
MANAGEMENT FEES														
SUBTOTAL														
SURPLUS(DEFICIT)														

Table 3.1

Source: Author

4. After preparing the budget, the manager then submits it to the landlord for approval or amendment. If the same is approved, the manager may be required to circulate copies of the same to tenants to justify the rates charged within the year.
5. Following this is the budgetary control stage. This normally takes place after the actual events and may be carried out on a regular basis be it monthly, quarterly or even half yearly. This has to do with the recording of actual results and the comparison of these with the budgeted figures. According to Lucey (1989, 315), the speedy production of budgetary control statements and the immediate investigation of the revealed variances provides the

best basis for bringing operations into line with the plan, or where there have been substantial changes in circumstances, making agreed alterations to the plan.

6. The last step in the budgetary process is the variance investigation and developing of solutions to problems revealed by the budgetary control. This is an important step as it provides a link between budgetary control and planning. In so doing, the performance levels and the difficulties experienced in the attainment of the goals are identified and fed to the planning process thereby continually refining the budget.

During the preparation of the budget, there is need to identify the limiting factor also known as the principal budget factor. This is that factor which, at any given time, effectively limits the activities of the organization. The limiting factor in any budget could be either of the following:

- Customer demand
- Production process
- Shortages of labour, materials, space or even finance.

It is important to not only identify this factor but its effect on the budget must also be carefully considered during the budget preparation process. This is because this constraint usually has a pervasive effect on all plans and budgets.

The customer demand in terms of occupancy levels in a particular property could be the limiting factor as it determines not only the level of voids in the property but also the income receivable.

#### **Limitations of budgeting:**

- The budget plan is based on estimates thus the strength or weakness of the budget program depends on the accuracy with which the basic estimates are made.
- A budget plan must be continually adapted to fit changing circumstances.
- The execution of the budget plan is not automatic and thus effort must be exerted towards its accomplishment.

- Budgeting does not take the place of management, as it is only a tool of financial control. It is therefore important to make sure that all the possible attainable benefits are derived from the budget.

Typical problems which may arise with budgeting

- ❖ Variances: These may not only be due to changing circumstances and poor performance but could be also due to managerial performance
- ❖ The existing organization structure around which budgets are developed may at times prove inappropriate for current conditions
- ❖ The existence of well documented plans may cause inertia and lack of flexibility in adopting to change
- ❖ Budgetary slack: This is a term used to describe the way some managers obtain a budget larger than necessary so that they can spend more liberally up to the budget or appear to be containing costs very efficiently by beating their budget. This can be overcome by adopting the zero-budgeting system in which the manager starts with a nil budget to which an agreed budget allowance is added for each planned activity. In so doing, tighter limits are set and as such there is no perpetuation of past anomalies and inefficiencies which occur as a result of historical budgeting.

**Recommendation:**

As has been stated above there are many limitations to the budgeting process and as such the property manager has to apply some level of budgetary control to ensure that these limitations are kept to a minimum. The manager also has to exert some effort in his or her daily work to ensure the accomplishment of the budget targets which must be continually adapted to fit changing circumstances.

**3.3 BUDGETARY CONTROL**

Control as applied to budgeting may be thought of as a systemized method for providing definite plans and standards for prior control action and procedure for keeping management informed of conformity to such predetermined plans, objectives and policies.

### Essential elements of control:

- ❖ There must be definite policies, objectives, plans and standards of performance
- ❖ There must be enlightened and aggressive efforts to attain the goal
- ❖ There must be adequate reporting of actual performance. This is usually in the form of the monthly statements the managers submit to the client.
- ❖ There must be a comparison of actual results with the plans, that is, a measurement of the effectiveness of control
- ❖ There must be a careful analysis of deviations from the plans and objectives and a determination of the causes
- ❖ There must be corrective action by persons having designated responsibilities to correct unsatisfactory performance
- ❖ There must be follow up procedures to determine the effectiveness of the corrective action
- ❖ There must be a feedback of basic information to provide a basis for improving future planning and control processes

For control to be effective, it must be exercised prior to commitment. The comparison of actual results with predetermined objectives, plans and policies constitute the measurement of the effectiveness of control for a past period though it may also lead to improved effectiveness of control in the future.

Budgetary control is the use of budgets and performance reports throughout the budgetary period for the purposes of coordination, evaluation and control of day to day operations. It has also been defined as the establishment of budgets, relating the responsibility of executives to the requirements of a policy and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision. It therefore involves:

- ❖ Setting targets
- ❖ Monitoring progress
- ❖ Taking corrective action where necessary



The mere preparation of the budget could be of considerable value to the organization but its ultimate value lies in its planning aspect and its utilization for purposes of coordination and control. The process of budgetary control involves the constant check and evaluation of actual results against budget goals resulting in corrective action where indicated.

To devise an effective budgetary control system, Seeley (1976, 274) has given the following criteria which must be satisfied:

1. A clear understanding of objectives and their order of priority
2. A systematic analysis and evaluation of the needs and demands stemming from the objectives
3. A rational balancing of these demands against the desired objectives within the known constraints of labour, materials, time, managerial skills and funds.
4. The avoidance of waste of financial resources
5. The development of a control system based upon the identification of needs, adequate measurement or resource requirements, setting of work standards, measurement of performance, evaluation of significant deviations from standards, and the control of present and future opportunities through this knowledge.

From these principles implementation of the budgetary control system will require:

1. Organizational plans for a specified period
2. Definition of resources required accomplishing the allotted tasks
3. Establishing operating standards and targets to be achieved
4. Information systems to generate, collate and evaluate data for decision making and control purposes.
5. Detailed plans and programmes for achieving objectives.
6. A framework for decision taking and a basis for measuring efficiency, effectiveness and profitability.

### **3.3.1 Methods Used in the Determination of the Effectiveness of Control**

**Trend analysis:**

This involves a comparison of current results with those of some past period. An assumption is made that if the performance in the current year is better than that of the previous period then the manager can be said to have been more effective in ensuring budgetary control. This method is inadequate for control purposes due to the following:

- ❖ Conditions may have changed - there could be improved technology or even labour efficiency may have improved.
- ❖ The accounting classifications used in the current period may be different from those used in past periods.
- ❖ The previous year's performance may have been unsatisfactory.

### **Cost volume - Profit analysis:**

The manager in ensuring budgetary control may use the **cost volume - profit analysis** which aims at establishing the break-even point, a point at which the revenue equals the total cost.

The manager will therefore be concerned with the effect on profits of the following:

- ❖ Changes in the fixed cost - These may include the costs of insurance, rates, ground rents, etc.
- ❖ Changes in variable costs - These may include the costs of electricity and water
- ❖ Changes in the activity level, in this case the activity being the occupancy level as this determines the rents accruable from the property.

The break-even point is arrived as follows:

$$\text{Fixed cost} / (1 - (\text{variable cost} / \text{corresponding rental levels}))$$

This gives the amount of rental revenue that is necessary to exactly recover the fixed costs and should be the lowest level that any business should operate at. There are however basic assumptions underlying this analysis. These are summarized here below as follows:

- ❖ That cost can be resolved into its fixed and variable components
- ❖ That fixed costs remain constant
- ❖ That variable costs vary proportionately with volume changes expressed in terms of a common measure of activity.
- ❖ That the revenue and cost estimates, and hence the results of the analysis, are valid only within a definite relevant range of activity

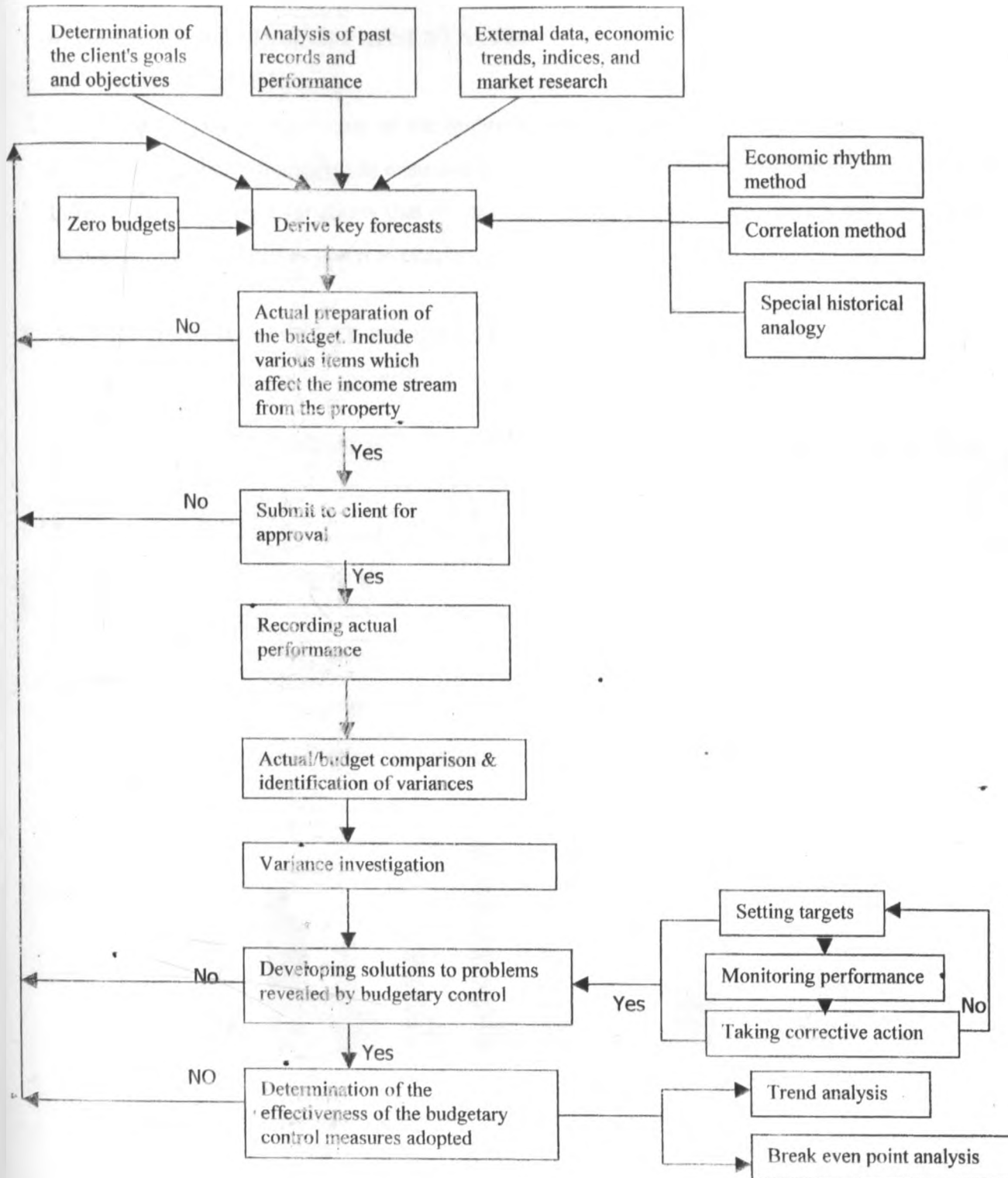
- ❖ That rent per square foot is not to change as occupancy level changes

### 3.4 CONCLUSION

As can be discerned from the discussion above, there are several methods that the property manager can employ in the preparation of budgets. It however does not matter the accuracy of the forecast as long as its reliability can be proved. The various assumptions made during the process must be clearly stated. The manager must also exercise proper control so as to ensure that the forecast results thereby reducing the variances to a minimum. Corrective action must also be taken as necessary

### 3.4 CONCEPTUAL THEORETICAL FRAMEWORK

The budgeting and budgetary control function can be summarized as follows:



Source: Lucey (1989, 314 - 315)

## CHAPTER FOUR

### 4. DATA ANALYSIS AND PRESENTATION

#### 1.1 INTRODUCTION

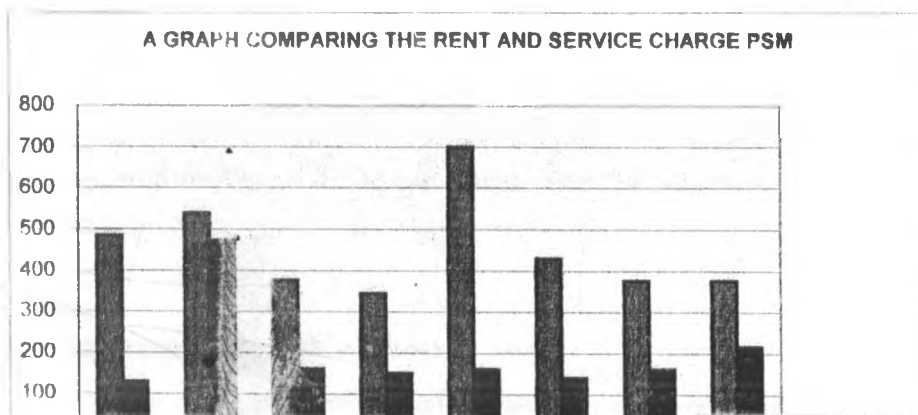
This chapter gives a description of the budgeting and budgetary control procedures applied by the various property managers in ensuring the management of the client's funds. It also seeks to define the other major functions that are performed by the various property managers. This is in line with the objectives given in chapter one.

#### 1.2 DESCRIPTION OF THE PROPERTIES

A table showing the type of properties studied

Table 4.1

LOCATION	TYPE OF PROPERTY	LETTABLE AREA	AVG RENT (PSM)	S/CHARGE (PSM)
C.B.D	Office block	3,885	484	129
C.B.D	Office block	16,729	538	473
C.B.D	Office block	13,848	377	161
C.B.D	Office block	18,959	344	151
C.B.D	Commercial building	8,968	699	161
C.B.D	Commercial building	12,212	430	140
C.B.D	Office block	10,764	377	161
C.B.D	Office block/shopping centre	5,483	377	215
C.B.D	Commercial building	9,665	430	151
C.B.D	Commercial building	6,456	377	151



Graph 4.1

Of the properties studied, all are multi-storied above five storeys, are located in the Central Business District and have total lettable areas ranging from approximately 4,000 square meters.

Most of the buildings comprise of shops, travel agencies, hotels and restaurants on the ground and mezzanine floors. The upper floors mainly comprise of offices.

#### **4.2.1 Rent:**

For all the buildings, the rent on the ground floor is much higher than that of the upper floors. Of the buildings studied, the one that charges the highest rent on the ground floor charges an average of Kshs 700.00 per square meter while the lowest rent charged on the ground floor is approximately Kshs 350.00 per square meter. The disparity in the rent is not only due to the exact location of the building within the Central Business District but is also due to the extent of development of the particular property mainly in terms of services offered. The high rents on the ground floor is due to the very high demand of space on the particular floor especially due to the fact that businesses located here rely mainly on walk-in walk-out customers.

Of the buildings studied, 30% charge the same rents for the ground floor and the mezzanine floors while the rest charge a much lower rent for the mezzanine floors, some as low as half of that charged for the ground floor.

Of all the buildings studied, all charge a much lower rent for the upper floors with 40% charging at a rate more than half of that charged for the ground floor whereas the rest charge a rate that is less than half of that charged on the ground floor.

Of the buildings studied, 10 percent charge a lower rent per square meter for the mezzanine floors as compared to that of the upper floors. The rest otherwise charge a higher rate for the mezzanine floors.

#### **4.2.2 Service charge:**

The service charge of the properties studied ranges from approximately Kshs 130.00 per square meter to Kshs 470.00 per square meter. The disparity of this is as a result of the diversity of the services offered in the particular buildings, the type of clientele and also as a result of the services for which the landlord is responsible and those for which the tenant is responsible.

Of all the buildings studied only 20% charge a different rate for tenants on different floors. The remaining 80% charge the same rate per square meter irrespective of the floors on which one is situated.

#### **4.3 OWNERSHIP OF THE PROPERTY**

The different types of ownership go towards defining the goals and objectives of the clients. Of the buildings studied, 10% are owned by church based organization whose main objective is profit maximization. Another 10% are owned by government bodies whose main objective is profit maximization. Some of these are however developed for the purpose of fulfilling a social goal whereas others are developed for the political reasons. The other kinds of ownership that the researcher came across are pension funds with these mainly investing in real estate due to the statutory requirement that requires fund managers to invest a certain sum of the pensioners' money in real estate. These however have the ulterior motive of profit maximization. Private companies, who apart from investing with the main aim of profit maximization, also invest for prestige purposes, have developed some of the properties.

A conclusion can therefore be drawn that the main reason why people, be it in their private capacities or otherwise, invest in real estate is profit maximization. Due to the complexity of the property market, the property owners appoint qualified property managers, be they in-house or out-sourced, with the hope that these property managers will see to it that the owner's objectives are met.

#### **4.4 MANAGEMENT FUNCTIONS**

50% of the properties that have been studied are in-house managed whereas another 50% have their management out-sourced. The research showed that irrespective of the type of management applied the property management duties remain the same, what differs at times is the importance that the property managers place on each of the duties

#### **4.4.1 Property Management Functions:**

The main duties that the property managers are usually called upon to perform are as follows:

- ❖ Showing and letting space
- ❖ Lease administration
- ❖ Rent collection
- ❖ Management of service charge
- ❖ Overseeing the maintenance and repairs of the property. This also includes the managing of service contracts.
- ❖ Supervising personnel
- ❖ Making a budget and ensuring budgetary control
- ❖ Dealing with tenant complaints therefore ensuring good tenant-landlord relationships

The research showed that the different managers place different levels of importance on the above functions, this mainly being a function of the management agreements drawn between them and the property owners.

#### **4.4.2 Challenges of Property Management:**

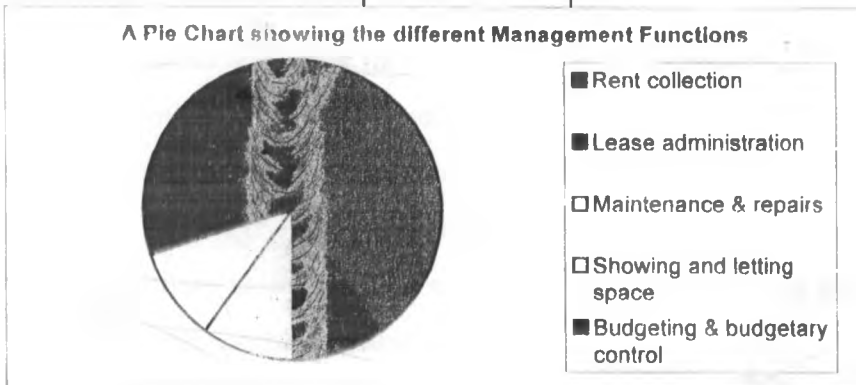
These can be summarized as follows:

A table showing the property management challenges



**Table 4.2**

<b>Function</b>	<b>Percentage</b>
Rent collection	40.00%
Lease administration	10.00%
Maintenance & repairs	10.00%
Showing and letting space	10.00%
Budgeting & budgetary control	30%
<b>Total</b>	<b>100</b>



**Pie Chart 4.1**

Of the functions given above, the most challenging as identified by the various managers are as follows:

- ❖ Rent collection: From the diagrams above, it can be seen that 40% of the property managers view the rent collection function as being the most challenging. This has mainly been attributed to the poor state of the economy prevalent in the country. This makes most tenants have a difficulty in meeting their rental obligations. Some managers have also stated that the collection of rent is usually a problem in cases where tenants do not prioritize payment of the same. The problem is however more prevalent for those properties which are in-house managed as the managers do not view this as their core business. This is mainly so in buildings which do not employ qualified property managers. The researcher has further discussed the solutions for this in the next page.
- ❖ Budgeting and budgetary control: The table above shows that 30% of the property managers interviewed view the budgeting and budgetary control function as being the most challenging. This is discussed in section 4.5 below.
- ❖ Lease administration: Though the table 4.2 above shows that only 10% of the managers view this as being the most challenging function, the outsourced property managers have stated that they usually experience a lot of problems when they take over buildings which were previously in-house managed. This is because most in-house managers, especially those who are not professionals, are not usually conversant with the tenancy legal requirements such that many of them do not even bother to enter into leases with the tenants and when they do, then they do not pay keen interest such that the same expire unnoticed with the tenants still continuing with the occupation. It is up to the manager to advise both the tenants and the landlords on the importance of not only having the leases executed on time but also on having them registered within the shortest time possible. Failure to do so may lead to many controlled tenancies which not only render the building unmanageable but also unprofitable.
- ❖ Showing and letting space: The diagrams above show that 10% of the managers view this function as being the most challenging. This is also attributed to the poor economic trends prevalent in the country. Whereas the property owners would like to see the space let at the same rental levels, if not higher, this is most of the times not attainable. As discussed in chapter 2, the property manager should adopt the advertising mode which produces tenants

within the shortest time possible and at the least time possible. The study established that majority of the property managers rely on newspaper adverts (these are expensive but have the advantage of reaching clientele far and wide) whereas others rely on placing sign boards various locations thus informing the passers by of the available spaces. Rarely do property managers write introductory letters to prospective clients as these are seen to take a lot of time and may not yield the required results. The more expensive the advertising mode and especially where this does not produce worthwhile tenants, the more adverse its effect on the budget. There is therefore need to vet the clients properly as this reassures one on the quality of the tenancies.

- ❖ Maintenance and repairs: The above shows that 10% of the managers view this function as being most challenging. This is usually a problem especially where the building is old and where new technologies have been developed thus rendering the service provisions in such buildings almost obsolete. The maintenance of these becomes very expensive especially where the property manager intends to retain the tenants who expect very high standards of maintenance.

Measures taken to overcome the challenges identified above:

- ❖ Rent collection: As most managers agree, their performance is measured by the amount of rent they manage to collect as this determines the income that will be passed on to the investor. It is therefore important for the manager to ensure optimum collection of rent if he or she is going to retain his or her job. The manager therefore has to enter into agreements with the rent defaulters on how the arrears are to be paid. When a tenant falls into arrears, there is need to send first, second and even third reminders to the tenant before resulting into legal measures to ensure that the rent is paid. Whereas there is need for the managers to apply soft stances on the tenants with the aim of retaining them, the manager also has to be strict on the payment of rent as there is no point of having a building which boasts of full occupancy but no income. The managers should also carefully screen the incoming tenants in order to ensure that they have the ability to pay rent. Asking for their bank statements and also names of possible referees to whom the manager should refer to ascertain the capability of the incoming tenant to pay rent can do this. 10% of the property managers suggest that of importance is the insistence in the payment of service charge.

This is because most of the tenants are aware that the manager cannot result to any legal measures to enforce the payment of the same. When this has been paid, the manager should then apply all measures available to ensure that the rent is paid.

- ❖ **Budgeting and budgetary control:** The measures that managers should apply to ensure these are given in the following section.
- ❖ **Lease administration:** The most important thing in the administration of leases is to ensure that one does not enter into controlled tenancies. The manager should therefore ensure that he or she is aware of the grounds that result into controlled tenancies. The research has shown that the managers, in ensuring that they do not enter into controlled tenancies, have all the tenants execute the lease documents. They also ensure that the leases have a rent escalation clause and are careful on the duration of the leases. 30% of the property managers to whom the questionnaires were administered said that they also ensure that the lease documents do not leave any grounds for sub-tenancies because where these exist, the collection of rent becomes impossible and the management of the building eventually becomes very difficult.
- ❖ **Maintenance:** Whereas this is not as challenging, there is need to ensure that very high standards of this are observed so as to ensure the retention of the tenants. The manager should ensure that this is done at the least cost possible. 40% of the managers have indicated that they have employed their own in-house maintenance teams, these being plumbers and electricians. Therefore, when a fault arises it is immediately attended to. When the problem is too complicated to be sorted out by the in-house team, the work is then out-sourced to contractors who are approved by the property owner if the property is in-house managed or by the management firm if the management is out-sourced. In so doing, the managers ensure that the maintenance job is awarded to the contractor who will yield cost effectiveness in what is known as competitive bidding. It is also the role of the manager to advise the landlord on the need of establishing a sinking fund aimed at ensuring that there will be money at hand to carry out major renovations of the building in future.

## **4.5 THE BUDGETING FUNCTION OF PROPERTY MANAGEMENT**

As is shown in table 4.2 above, the budgeting function is not viewed to be as challenging as the rent collection function. However of importance to any investment are the returns deriving from it thus the need for the management of funds.

The research has shown that all property managers are usually called upon to prepare budgets for the clients. 70% of the property managers are required to prepare annual budgets, another 10% usually call for monthly budgets whereas another 20% require budgets to be prepared on a half yearly basis.

### **4.5.1 Items taken to account during the preparation of the budgets:**

Of the properties studied, 70% of the property managers take into account both the service charge and rent accruing from the property when drawing a budget. The remaining 30% do not, in the making of the budget, take into account the rent as this is remitted to the property owner intact. It is out of the budget income that the property manager pays for the expenses accruing from the building.

The research has shown that all the property managers refer to the previous year's performance. The property managers agree that in considering the previous year's performance, it is necessary to take the following into account as this establishes the total income that they may be able to collect from the property.

- ❖ Arrears level for the financial year that has just ended and the anticipated rate of recovery of the same.
- ❖ Rate of voids in the building. This is important as it gives a clear picture of the expected rental income taking into account the letting level in the building.
- ❖ Repair costs incurred in the previous year and the expenses that are anticipated in the future.

Having taken into account the rates of voids in the property plus the anticipated arrears recovery level, the property manager then predicts the total income from the building. This includes the rent, service charge and car-park charges where applicable.

It is out of this anticipated total income that the manager subtracts the anticipated expenses so as to arrive at the total income payable to the property owner at the end of the year. The expenses taken into account include the following:

- Cost of repairs and maintenance
- Utility accounts. If the tenants are sub-metered, the property manager only takes into account the water and electricity consumed in the common areas.
- Other expenses include the statutory payments such as the ground rents, land rates and insurance. These are ideally rental expenses as opposed to being service charge expenses.
- The manager also takes into account both the cleaning and security costs that in many times are done under contract.
- Also taken into account are such cost items as salaries and wages of personnel associated solely with that property. These may be the caretaker, electrician, plumber, e.t.c.
- The cost of lifts and grounds maintenance, where applicable, are also taken into account.
- Capital expenses such as the cost incurred in the replacement of lifts, water pumps, etc
- For those properties whose management is out-sourced, the manager also takes into account the management and letting fees charged, these being a function of the occupancy levels.

The study has shown that all managers irrespective of whether they take both service charge and rent into account when drawing the budget or whether they only consider the service charge take these expenses into account.

#### **4.5.2 Budgetary Preparation Methods Used.**

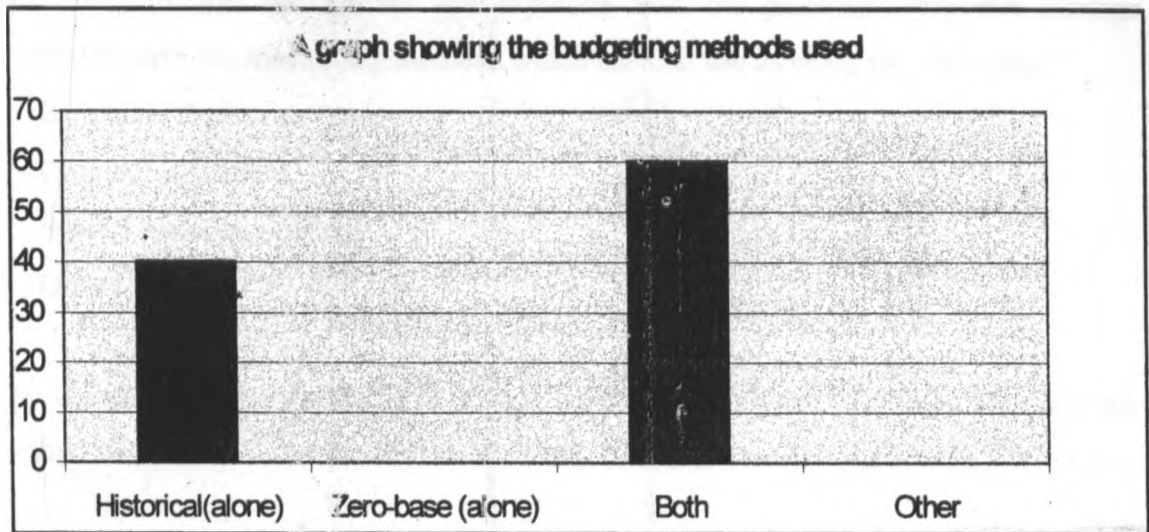
This section aims at establishing which method property managers use during the preparation of the budgets. These methods have been identified as either the historical budgeting method or

the zero-base budgeting method. The researcher also sought to know whether there is any other method that the property managers use.

A Table showing the Budget Preparation Methods used

Table 4.3

Method Applied	Historical(alone)	Zero-base (alone)	Both	Other	Total
Percentage of use	40	0	60	0	100



Graph 4.2

The Table and graph above show that 40% of the property managers interviewed use the historical method during the preparation of budgets while the remaining 60% apply both the historical and zero-base methods. The research has not identified any other method of budget preparation.

In the historical method, the manager takes into account the previous year's performance to which he or she adds a certain percentage in order to predict the current year's performance.

For those property managers who apply both methods, the historical method is applied as given above. The manager applies the zero-base method in which he or she starts with a zero budget to which certain figures are allocated to the budget items according to the specific needs of that

building. The actual income receivable taking into account the occupancy levels is determined from which the anticipated expenses (arrived at using the zero-base method) are deducted thus arriving at the expected surplus or deficits for the period under consideration.

#### **4.5.2.1 Forecasting Methods Applied**

In this section, the researcher sought to know the methods that the manager uses in the forecasting of both the income and expenses from the properties that they manage. The researcher gave the forecasting methods which one can use as being the following:

- Economic rhythm method.
- Correlation method
- Special historical analogy
- Others

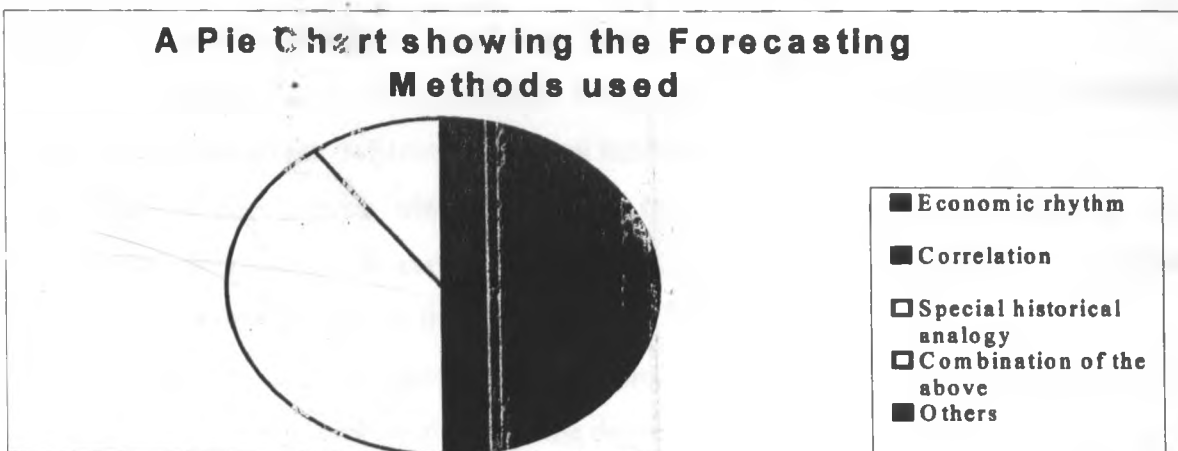
The managers were asked to indicate the method that they use and those who use any other method were asked to briefly explain the method. The following results were arrived at:

A table showing the forecasting methods used by the various managers during Budget Preparation



Method	Percentage of use
Economic rhythm	20
Correlation	30
Special historical analogy	40
Combination of the above	10
Others	0
<b>Total</b>	<b>100</b>

**A Pie Chart showing the Forecasting Methods used**



Pie Chart 4.2

Tables 4.4 and Pie Chart 4.2 above shows that 20% of the managers of the properties studied use the economic rhythm method during the forecasting of the income and expenditure flow from the property. Another 30% use the correlation method whereas another 40% use the special historical analogy method while another 10% combine all the methods when making a forecast.

The percentage that uses a combination of all the methods stated that this is necessary as the various methods could be used for predicting different things that are of importance to the property. For example, the economic rhythm method is used to predict the anticipated occupancy levels in the property. The special historical analogy method can be used to predict the expenses for the current period while taking into account a period in the past that had characteristics similar to those of the current period. For example, if the country is facing a dry spell which is expected to reduce the water supply in the country and hence affect the cost of water provision, the manager can refer to a period in the past during which the country faced such a spell to predict the possible cost of water for the period under consideration.

#### **4.5.2.2 Challenges faced by managers during the Preparation of Budgets**

In this section, the manager sought to know the various challenges that the managers face during the preparation of budgets. These were given as follows:

- The most challenging item was given as being able to forecast the future thus making the correct estimate on the projected and actual income and expenditure.
- Another challenging item, which ties closely to the ability to accurate forecasting, is the occurrence of voids due to early surrenders that were not earlier anticipated. This gravely affects the income payable to the property owner.
- Of challenge to the managers are the macro-economic factors of which the property managers have no control over such as the depression of the economy. This affects not only the ability of the tenants to pay rent but also the cost of maintaining the building as provision of services becomes expensive.

- The other major challenge facing the managers is the attitude of the property owners towards maintenance of the building. This mainly affects those buildings which are publicly owned. The owners of such buildings tend to neglect the periodical maintenance of the building and only carry out works when the item cannot function. This tends to make the cost of replacing these very expensive thus adversely affecting the budget.

#### 4.5.3 Budget Vs Actual Figures

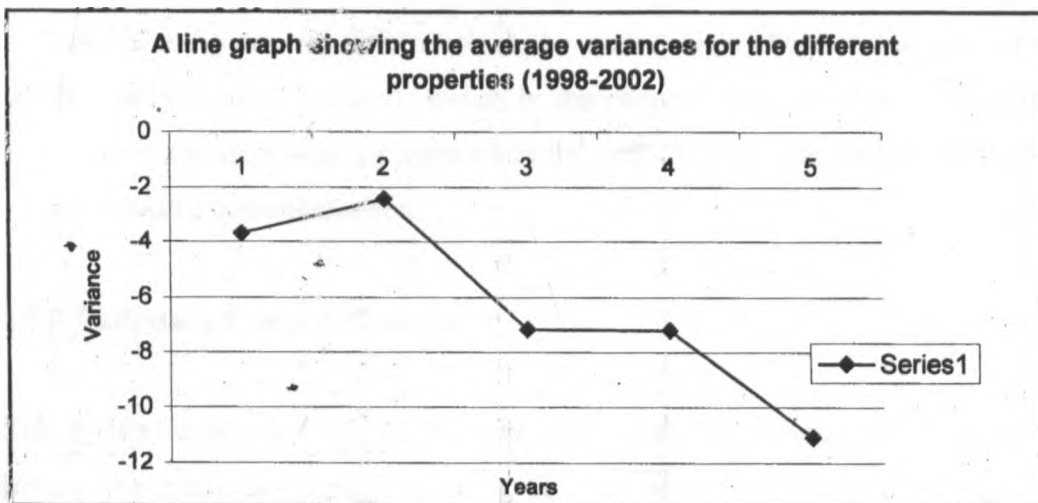
In this section the researcher sought to establish to what extent the budgets prepared by the managers differ with the actual income and expenditure statements submitted to the clients at the end of the year. This was confined to the period between 1998 to 2002.

The following results were obtained from the various properties:

Table showing the variances between the budget and actual results for the period 1998 to 2002

Years	Property 1	Property 2	Property 3	Property 4	Property 5	Property 6	Property 7	Property 8	Property 9	Property 10	Average
1998	-15.59%	-11.20%	20.84%	2.50%	-5.50%	3.50%	-10.84%	-9.62%	4.25%	-15.25%	-3.25%
1999	-23.48%	-3.28%	28.42%	5.28%	2.75%	-2.80%	-12.36%	-7.25%	2.75%	-12.25%	-2.25%
2000	-10.09%	-15.07%	18.56%	-10.78%	-13.25%	-10.75%	-14.55%	-4.26%	-4.25%	-7.25%	-7.25%
2001	-3.87%	3.31%	-13.01%	-5.46%	-19.56%	-13.20%	-5.50%	-2.25%	-8.25%	-5.25%	-7.25%
2002	-10.87%	-0.03%	-23.47%	-13.25%	-9.43%	-15.55%	-15.25%	-10.75%	-9.75%	-2.25%	-11.25%

Table 4.5



Graph 4.3

The table and graph above shows the average variances between the actual results and the budget figures for the properties studied. From the graph above it can be seen that the property managers experienced negative variances in their budgets for the period under study. The least average variance was experienced in 1999 while the highest was experienced in 2002. The variances for the years 2000 and 2001 were almost equal.

The variances have mainly been attributed to the inaccuracy in making the forecasts. The managers attribute these to the uncertainty of the future that results in circumstances that the managers had not foreseen. Such circumstances include the following:

- ❖ The inability of the managers to foresee the occurrence of voids due to early surrenders which the managers had not foreseen.
- ❖ The incidence of high arrears in both the rent and service charge accounts whereas the manager had assumed full collection of the same.
- ❖ Rising costs of maintenance and utilities which could be due to macro economic factors which are beyond the control of the managers.
- ❖ The over-reliance on the historical budgeting method that assumes the same conditions as those of the previous period to which the manager just adds a certain percentage.
- ❖ The unpredictable economic trends in the country. It is important to note that the highest negative variance was experienced in the year 2002, a year during which the country was faced with a general election.

#### **4.5.3 Budgetary Control Measures**

This section sought to establish the measures that managers apply to ensure budgetary control. In this the researcher sought to know how the managers go about setting the performance targets, how they monitor the progress and the corrective measures usually applied.

##### **4.5.3.1 Setting targets**

The managers usually apply the following measures in setting targets:

- ❖ They ensure that the targets they set are not only realizable but also measurable. The study established that there is usually a tendency of some managers to set very high targets in their budgets with the aim of giving the property owner the impression that they will be able to outdo the previous year's performance. In this, the managers, in preparing the budget give the impression that they will not only be able to fully collect the rent and service charge accruing from the property but that they will also be able to keep the costs

of maintaining the property to a minimum and at the same time filling up the voids in the building. This they do without establishing the reasons for the previous year's variance or where these have been established, assuming that they will fully be able to correct the variance. The managers stated that the targets should not be set too high above the actual results of the preceding period. For example, if in the previous year the manager was not able to collect all the rent, then assuming that rent for the current period would be fully collected would only result in unrealistic targets for the manager especially where there have been no changes in the factors that affect the payment of rent.

- ❖ The targets should also be clear as the manager is expected to give all assumptions underlying any budget items. The assumptions should be clearly stated and based on some facts. For example, the rent and service charge collectable should be based on the expected occupancy level in the property.

#### **4.5.3.2 Monitoring the Progress**

This section sought to know how the managers go about monitoring the performance and how often this is done.

80% of the managers interviewed stated that monitoring of progress is done on a monthly basis whereas the remaining 20% monitor the progress on a quarterly basis. This is achieved by preparation of either monthly or quarterly reports based on the actual performance of the property. Only the actual costs of the budgetary items are taken into account during the preparation of these reports. These are then compared with the budget for purposes of evaluating the performance.

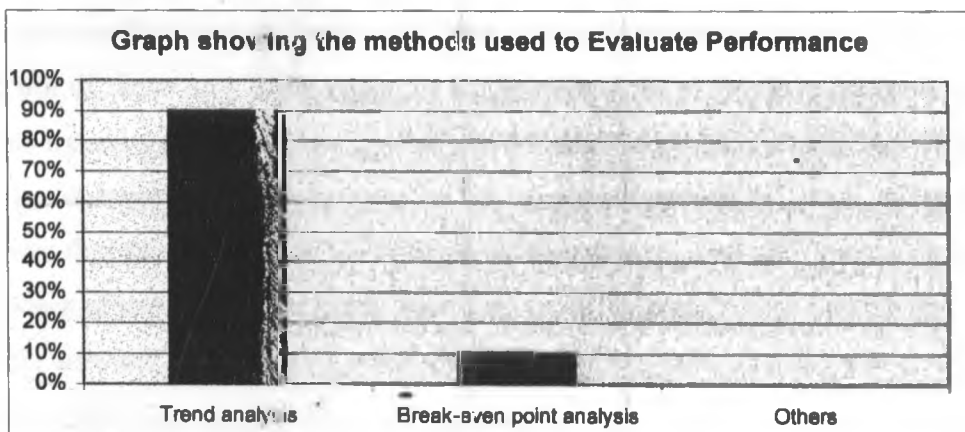
#### **4.5.3.3 Evaluation of Performance**

This section sought to establish the various methods that the property managers use to evaluate their performance in terms of meeting the budget targets. The researcher gave the possible methods that can be used as either the trend analysis method or the break-even point analysis. The interviewees were asked to state and explain any other methods that they use. The following results were established:

Table showing Performance Evaluation Methods applied by the various Managers

Table 4.5

Method	Percentage of use
Trend analysis	90%
Break-even point analysis	10%
Others	0
<b>Total</b>	<b>100%</b>



Graph 4.4

1. Table 4.5 and graph 4.4 above shows that 90% of the property managers interviewed use the trend analysis method to evaluate their performance. In this method, if the actual performance of the current period is better than that of the previous period, the manager concludes that his

or her performance for the current period is better. However as has been explained in Chapter 3.3.1, this method has the following disadvantages and should therefore be used sparingly:

- ❖ Conditions related to the property may have changed, for example, technology may have improved thus rendering the maintenance of the property more cost effective leading to a saving in the maintenance of the building.
- ❖ The previous year's performance may have been unsatisfactory. Table 4.4 above shows that most of the properties experienced negative variances during the period under study. Thus achieving a lower negative variance, though an indicator of better performance still means that the manager's performance is not satisfactory.

2. The above also show that 10% of the property managers interviewed use the break-even point analysis in evaluating their performance. This method is also known as the cost volume-profit analysis and aims at establishing a point at which the revenue equals the total cost as this is the lowest point at which the property manager should operate. This is mainly applied by those managers, who only take into account the service charge during the preparation of the budget. Though section 4.5.1 above showed that only 30% of the managers interviewed take into account the service charge only from which the expenses are paid, the research has shown that out of these only 10% apply the break-even point analysis in evaluation of performance. These managers aim at ensuring that the revenue they receive from the building (in terms of service charge) is enough to pay for the expenses accruing from it. With this the manager ensures that the property owner is never called upon to surrender part of the rental income for purposes of paying for expenses emanating from the building. In cases where there is a surplus in this account, it is credited to the tenants' accounts thus lowering the service charge payable in the following period. If a deficit occurs, it is debited into the tenants' accounts thus increasing the amount payable in the following period.

#### **4.5.3.4 Taking Corrective Action:**

This section sought to know the corrective measures that the managers apply in ensuring effective budgetary control. Cross tabulation will be done with the aim of showing the



relationship between the budgetary preparation and forecasting methods and the variances experienced in the different properties.

In order to take corrective action, there is a need first and foremost to establish the reasons behind the variances. The reasons as explained in section 4.3.3 are as follows:

- ❖ The early surrenders of space within the properties, which the manager had not foreseen.
- ❖ The high incidence of rent arrears as a result of unforeseen circumstances
- ❖ The rising costs of maintenance
- ❖ The over-reliance on the historical budgeting method.
- ❖ The fluctuating economic trends in the country

The managers gave the following as the corrective strategies they apply in order to reconcile the budget differences:

- ❖ **Early surrenders:** The occurrence of unforeseen voids is usually viewed as being very expensive not only in terms of what it would cost to get that space re-occupied but also due to the fact that these seriously affect the income anticipated from the property. In order to discourage this, the managers have stated that any tenant who wishes to prematurely surrender space is usually penalized. The manager also takes note of lease renewal dates and before these fall due, usually write to the tenant asking if he wishes to renew the lease. If the tenant expresses his or her wish not to renew, the manager starts marketing the property immediately with the hope that a new tenant will have been identified for the space by the time the old tenant vacates.
- ❖ **Rent arrears:** Remedies that the manager can apply to keep these to a minimum have been given in section 2.3.4. In addition to these, the managers interviewed have stated that another method of discouraging late payment of rent is to penalize late payers. 10% of the managers have stated that for all rent that is paid fourteen days after it falls due, the tenant is charged a 5% penalty. The managers have also stated that of importance is the careful screening of prospective tenants with the aim of establishing their ability to pay rent.
- ❖ **Maintenance:** In order to keep the cost of this to a minimum, the managers have given the following as the measures that can be taken to ensure efficiency and cost effectiveness of the same.

- Ensuring the conservation of energy. The managers' said ways in which this can be done are sensitizing the tenants on the need to put off all the lights when these are not in use.
- The managers also carry out periodic inspections and maintenance of the building equipment to ensure their effective performance.
- Of importance in doing this is ensuring that the maintenance works and service provision contracts are competitively tendered for. The property managers should however ensure that the costs reflect the services provided.

#### **4.5.3.4.1 Variance Investigation:**

This section aims at establishing the effect of the budgeting and forecasting methods used on the resulting variances.

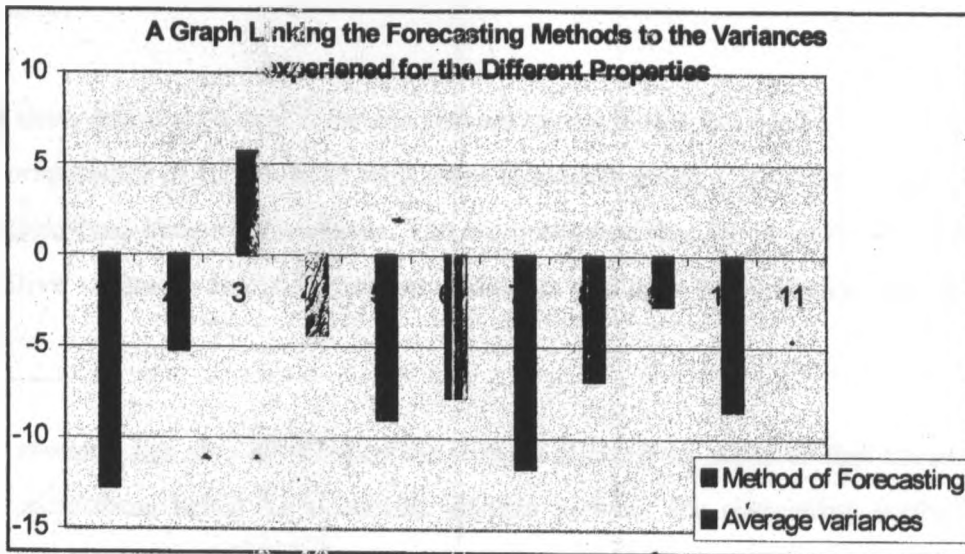
#### **Methods of budgeting used:**

Cross tabulation will be done to show the variances resulting from each method of budgeting and forecasting used.

A Table showing the relationship between the Forecasting Methods used and the variances experienced

Table 4.7

	Method of Forecasting	Average variances
Property 1	Special historical analogy	-12.78
Property 2	Special historical analogy	-5.18
Property 3	Correlation method	5.65
Property 4	Correlation method	-4.34
Property 5	Economic Rhythm method	-9
Property 6	Special historical analogy	-7.76
Property 7	Economic Rhythm method	-11.66
Property 8	Combinations	-6.83
Property 9	Correlation method	-2.65
Property 10	Special historical analogy	-8.45



Graph 4.6

Table 4.7 and graph 4.6 above show that although majority of the property managers interviewed use the special historical analogy method, on average the managers who use the correlation method experience a lower variance in their budgets.

#### **4.6 SUMMARY**

The study showed that the property management duties, though being similar, represent different challenges to the property managers therefore the importance with which the different managers place on the different functions. Whereas the most challenging property management function has been identified as the collection of rent, this mainly being attributed to the fluctuating economic trends in the country, the budgeting and budgetary control function is also of great importance as it ensures the efficient management of funds emanating from the property.

The study has shown that there are various methods that are used by the property managers in the preparation of the budgets with most managers using a combination of both the historical and zero-base budgeting methods. The study showed that the properties which experience high negative variances are those whose managers use only the historical method in drawing the budget.

The research has also established the various forecasting methods that are usually used by the managers these being the economic rhythm method, the correlation method and the special historical method. Whereas it is not possible to give an accurate picture of the anticipated incomes and expenditure, the forecasting method used usually determines the variances that the property managers expect from the properties they manage. The study has shown that on average, the correlation method results in the lowest variances.

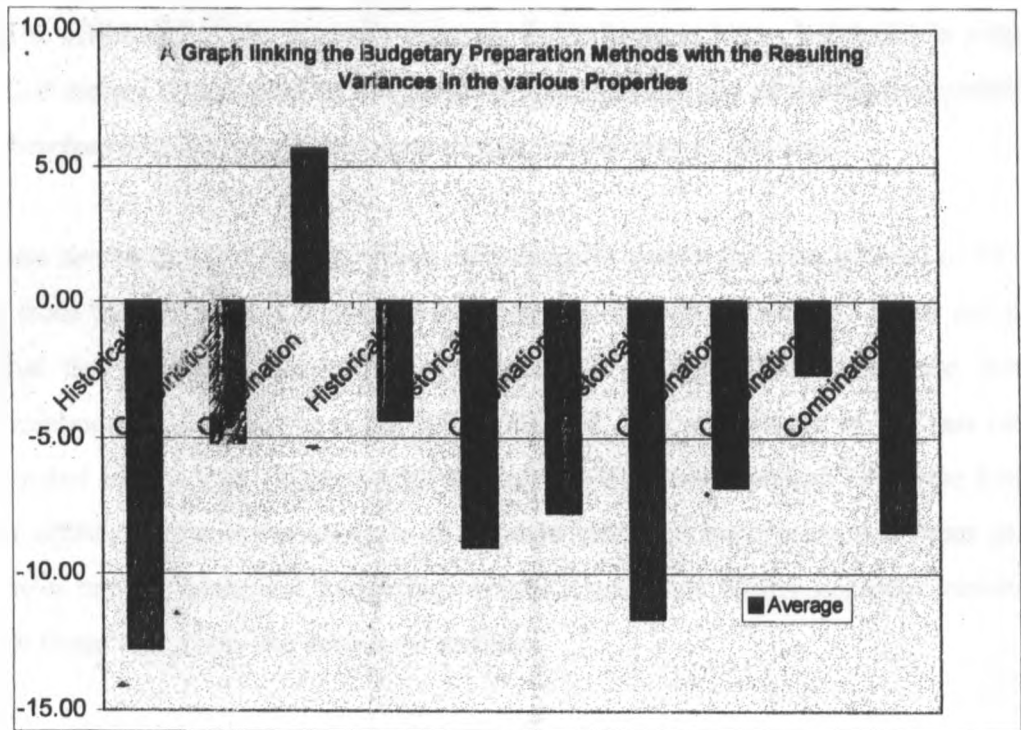
The mere identification of the variances is not in itself important if the property managers do not establish the reasons behind these variances and take corrective action. The study has shown the corrective measures applied by the various managers.

The methods that the property managers can use in determining the effectiveness of the budgetary control methods used were identified as being the trend analysis and the break-even point analysis. The study showed that majority of the property managers use the trend analysis to do this irrespective of its many disadvantages.

A Table showing the relationship between the Budgeting Methods used and the Variances experienced

Table 4.6

	Method of Budgeting	1998	1999	2000	2001	2002	Average
Property 1	Historical	-15.59	-23.48	-10.09	-3.87	-10.87	-12.78
Property 2	Combination	-11.20	-3.26	-15.07	3.31	0.33	-5.18
Property 3	Combination	20.64	26.42	18.56	-13.91	-23.47	5.65
Property 4	Historical	2.50	5.28	-10.79	-5.46	-13.25	-4.34
Property 5	Historical	-5.50	2.75	-13.25	-19.56	-9.43	-9.00
Property 6	Combination	3.50	-2.80	-10.75	-13.20	-15.55	-7.76
Property 7	Historical	-10.64	-12.36	-14.55	-5.50	-15.25	-11.66
Property 8	Combination	-9.62	-7.25	-4.26	-2.25	-10.75	-6.83
Property 9	Combination	4.25	2.75	-4.25	-6.25	-9.75	-2.65
Property 10	Combination	-15.25	-12.25	-7.25	-5.25	-2.25	-8.45



Graph 4.5

The diagrams above show that generally, the properties whose managers use the historical budgeting method experience higher negative variances as compared to those who combine both methods when drawing the budget.

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The study has come up with findings based on the stated objectives and hypotheses stated in chapter one.

There are several reasons why people invest in property with the main one being profit maximization. Property owners usually engage the services of qualified property managers, be they in-house or out-sourced with the hope that the managers will help them attain this objective. The efficiency of the property manager in performing his or her duties is judged by the amount of money that is paid to the property owner at the end of the trading period. The managers therefore aim at cost effectiveness during the delivery of services.

The study has shown that one way in which the managers ensure the management of the funds emanating from the property is through budgeting and budgetary control. There are several methods that the managers use in the preparation of budgets these being the historical budgeting method and the zero-base budgeting method. The advantages of the two methods have been stated in previous chapters with the most widely used method being the historical budgeting method. However the analysis of the data collected has shown that those property managers who use the historical budgeting method experience higher negative variances as compared to those who apply the zero-base method.

Since budgeting involves predicting the events of the future, there is need to apply some forecasting methods that aim at predicting the future occurrences as approximately as possible. The forecasting methods that the managers use have been identified as being the economic rhythm method, the correlation method and the special historical analogy. The study has shown the most widely used method as being the special historical analogy method in which the managers refer to a period in the past which had characteristics similar to those of the period in question. To this the property manager adds a certain percentage to reflect the expected

outcome in the current period. The data analysis has however shown that on average the property managers usually operate below their budget targets. The forecasting method that yields the least negative variances has however been established as the correlation method, a method that is mainly used by those managers who use the zero-base method while preparing the budget. In this method, the manager identifies the various items that affect the income stream from the property and using regression analysis determines the amount payable to the client at the end of the trading period. This method can therefore be said to be the most effectiveness budgeting method.

The mere preparation of the budget is not enough but the precision with which the budget is prepared is of utmost importance thus the need for budgetary control. The study has established the various methods used by the managers in ensuring this. The property managers stated that it is important to ensure that the budgetary targets set are not only realistic but also measurable. The property manager should not set high targets with the aim of giving very high hopes to the property owner as when these targets are not met, then the performance of the manager is deemed as being unsatisfactory. There is also for the manager to continually revise the budget based on the actual occurrences. In so doing, the manager should aim at establishing the reasons for the variances and corrective measures taken as necessary.

The study also established the various methods that the managers can use in measuring their performance as being the trend analysis and the break-even point analysis. The study showed the most widely used method as being the trend analysis in which the manager compares the current period's performance with that of the preceding period. A conclusion is then drawn based on the comparison with the manager's performance being deemed as more satisfactory if a lower negative variance has been experienced. The disadvantages of using this method have been given in chapter three.



## 5.2 RECOMMENDATIONS

The findings of this study show that property managers often operate below their budget targets as the average variances for the period studied are all negative. The main reason behind this has been given as the uncertainty of the future and the over-reliance of the property managers on the historical budgeting method while preparing the budget.

As has been established in the study, the properties whose managers use a combination of both the historical budgeting method and the zero-base method experience lower negative variances than those who use the historical budgeting method alone. The use of the historical method is deemed as being inappropriate because the managers just add small percentage to the previous year's figures which may have been unsatisfactory therefore presenting an even more erroneous target for the period under consideration. The property managers in predicting the future also use various methods of forecasting with the most widely used being the special historical analogy method. However as has been established in the previous section, the method, which yields the least negative variances, is the correlation method.

The recommendations can be summarized as follows;

1. Property managers in drawing a budget should strive to use the zero-base budgeting method as this has been seen as yielding the lowest negative variances.
2. The forecasting method that managers should apply is the correlation method as it has been seen to yield the best results.
3. In order to ensure effective budgetary control, the property managers should continually review and monitor the performance and take corrective measures when deemed necessary.

### **3.3 AREAS OF FURTHER STUDY**

There is need for further research into:

- ❖ Other methods that can be applied to ensure the management of funds emanating from the property.
- ❖ A detailed research can be carried out on the budgeting and forecasting methods that have been identified in the study.

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**QUESTIONNAIRE ON THE BUDGETING FUNCTION OF PROPERTY MANAGEMENT**

*The property management duties are many and diverse. However, of importance in the performance of these duties is ensuring that the goals and objectives of the property owner are met. Though there are many reasons why people invest in real property, the main objective of most property owners is the maximization of profit. The manager in striving to meet the goals of the owner usually prepares a budget, which gives the client a picture of what to expect in the period under consideration. The mere preparation of the budget is not enough but the precision with which the budget is prepared is of utmost importance. The manager therefore has to apply some degree of control in the preparation of the budget thus the importance of budgetary control.*

**1. DESCRIPTION OF THE PROPERTY**

- a) Give the name of the building(optional) \_\_\_\_\_
- b) Indicate what type of property it is, whether a retail outlet (shopping center) or an office block. \_\_\_\_\_
- c) Where is the property located? \_\_\_\_\_
- d) What is the total lettable area of the property in square feet? \_\_\_\_\_
- e) What is the average rent per square foot? \_\_\_\_\_

	Rent	Service charge
Ground Floor		
Mezzanines		
Upper floors		

**2. OWNERSHIP OF THE PROPERTY**

- a. Who is the developer of the property? Tick where appropriate

- Individual
- Company (*Specify what type of company e.g insurance*)
- Members' SACCC
- Government body
- Others (Please Specify) -----

b. Is the ownership of the property governed by any statutory legislation?

- ❖ Yes (proceed to part C below)
- ❖ No (Proceed to part D below)

C. How does the statutory legislation indicated above affect the ownership of the property? --

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 -----

D. What according to your opinion are the goals and objectives of the ownership? *Tick where appropriate*

- Profit maximization
- Prestige
- To fulfill a social need (e.g) to provide office space at the least rents possible
- Political reasons
- Others - *Please specify* -----

**3. MANAGEMENT FUNCTIONS**

a. Has the management of the property been outsourced or is it in-house? *Please indicate* ----  
 -----

b. What are the main functions that you perform as the property manager? (*Indicate in order of preference*)

- Showing and letting space
- Lease administration

- Rent collection
- Management of service charge (*Please give the service charge per sq ft*)
- Overseeing the maintenance and repairs of the property
- Supervising personnel
- Making a budget and ensuring budgetary control
- Others - *Please specify* -----

C. Of the functions indicated above, which do you consider to be the most challenging? Give reasons why. -----

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D. What measures do you put in place so as to overcome the challenges indicated in © above?

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**4. THE BUDGETING FUNCTION OF PROPERTY MANAGEMENT**

A. Do your clients require you to prepare budgets? If so, how often? If not, please go to part --

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B. What items do you usually take into account when preparing the budget? These could be rent and service charge collectable and all expenses for which the manager is responsible such as the payment of electricity and water bills, statutory payments, maintenance and repairs, e.t.c (*Please indicate*) -----

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C. What methods do you use in the preparation of the budget? *Tick where appropriate.*

- i. **Historical Budgeting:** This refers to a method of budgeting where the previous year's performance is taken into account and a certain percentage added onto it when making a forecast for the period in question.
- ii. **Zero-base budgeting.** This refers to a method of budgeting where the manager starts with a nil budget then allocates certain figures to the budget items. The manager in deciding which figures to allocate takes into account the particular needs of the property for that particular period.
- iii. **Others - Please specify**-----  
-----  
-----

D. What methods of forecasting do you use when making the forecast? *Please tick where appropriate*

- i. **Economic rhythm method:** This is a method that involves a projection of historical trends into the future. The manager gets data as far back into the past as it is thought to be representative of current trends. The manager then computes the budget values by dividing the actual data derived above by an index obtainable from the market.
- ii. **Correlation method:** This is based upon the selection of a basic series of economic data which property values tend to follow. Multiple regression analysis is then used to derive the correlation between this basic series and the properties of the particular building in question.
- iii. **Special historical analogy:** This is based upon the idea of selecting some previous situation and a period in the past that appears to have most earmarks of the present situation thus implying that what happened then is likely to happen again.
- iv. **Others:** Please specify -----  
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F. What, in your opinion, are the major challenges that property managers face in the preparation of budgets? -----  
 -----  
 -----

G. Are there some instances in which your budget figures do not tally with the actual results for the year? Please indicate in the table below the budgeted and the actual results for the last five years. Alternatively you could indicate the variances for the respective period.

	1998	1999	2000	2001	2002
Budget results					
Actual results					
Variance					

G. Which budgetary control measures do you put in place to ensure that the goals of the property owner are met? Please expound on how you do the following, which are essential for budgetary control.

i. Setting targets -----  
 -----  
 -----

ii. Monitoring the progress and how often this is done. -----  
 -----  
 -----

iii. Taking corrective action -----  
 -----  
 -----  
 -----

2. How do you evaluate the effectiveness of the control measures taken and how often is this done? *Please tick where appropriate.*

i. **Trend analysis:** This is a method where the manager compares the previous period's performance with that of the current period. If the current period's performance is better in terms of lower deficits or higher surpluses, then it can be concluded that the budgetary control measures adopted in the current-period are more effective.

ii. **Break even point analysis:** This gives the rental income that is necessary to exactly recover the costs of running the property assuming that this is the lowest point at which any business should operate. If the property is able to operate beyond this point, then it is assumed that the control measures taken to ensure this are effective

**Others:** *Please specify and expound* -----  
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