

Restructuring and Refinancing Affordable Housing Projects

June 19th, 2008

**Robin Boyce
Housing Development Center
&
Leon Laptook
Community Development Law Center**

**Sponsored by the Neighborhood Partnership Fund
With funding provided by the
U.S. Department of Housing and Urban Development**

SESSION AGENDA

- 
- | | |
|-------------|---|
| 8:40 | Welcome & Intros |
| 9:00–10:30 | Presentation on “The Analysis” |
| 10:30 | Break |
| 10:45 | Small Group Activity |
| 12:00–12:45 | Lunch Break |
| 12:45 | Small Group Meetings |
| 1:15–2:00 | Small Group Reports on “The Analysis” |
| 2:00–2:45 | Presentation on “The Plan & Implementation” |
| 2:45–3:00 | Afternoon Break |
| 3:00–3:30 | Small Group Exercises |
| 3:30–3:50 | Small Group Reports on “The Plan” |
| 3:50 | Wrap Up |



Your First Clue:

Something Must be Done

▪ **Occupancy Problems**

- Less Traffic
- Fewer applications
- Increased turnovers (more move-outs)

▪ **Financial Problems**

- Rents constrained – not competitive in market
- More maintenance/ turnover costs
- Falling net cashflow
- Projections look bad

▪ **Physical Problems**

- falling curb appeal
- less market appeal (fewer apps)
- increased maintenance calls
- failed inspection reports

*Clue:
Restructures are a
blend of asset
management &
development, you
cannot approach
as a developer
only.*

So Why Isn't It Performing?

What will it take to fix it?

✓ **Management**

- Not Skilled Enough
- Not responsive
- Not held accountable

✓ **Market**

- Not competitive
- Overall market slump

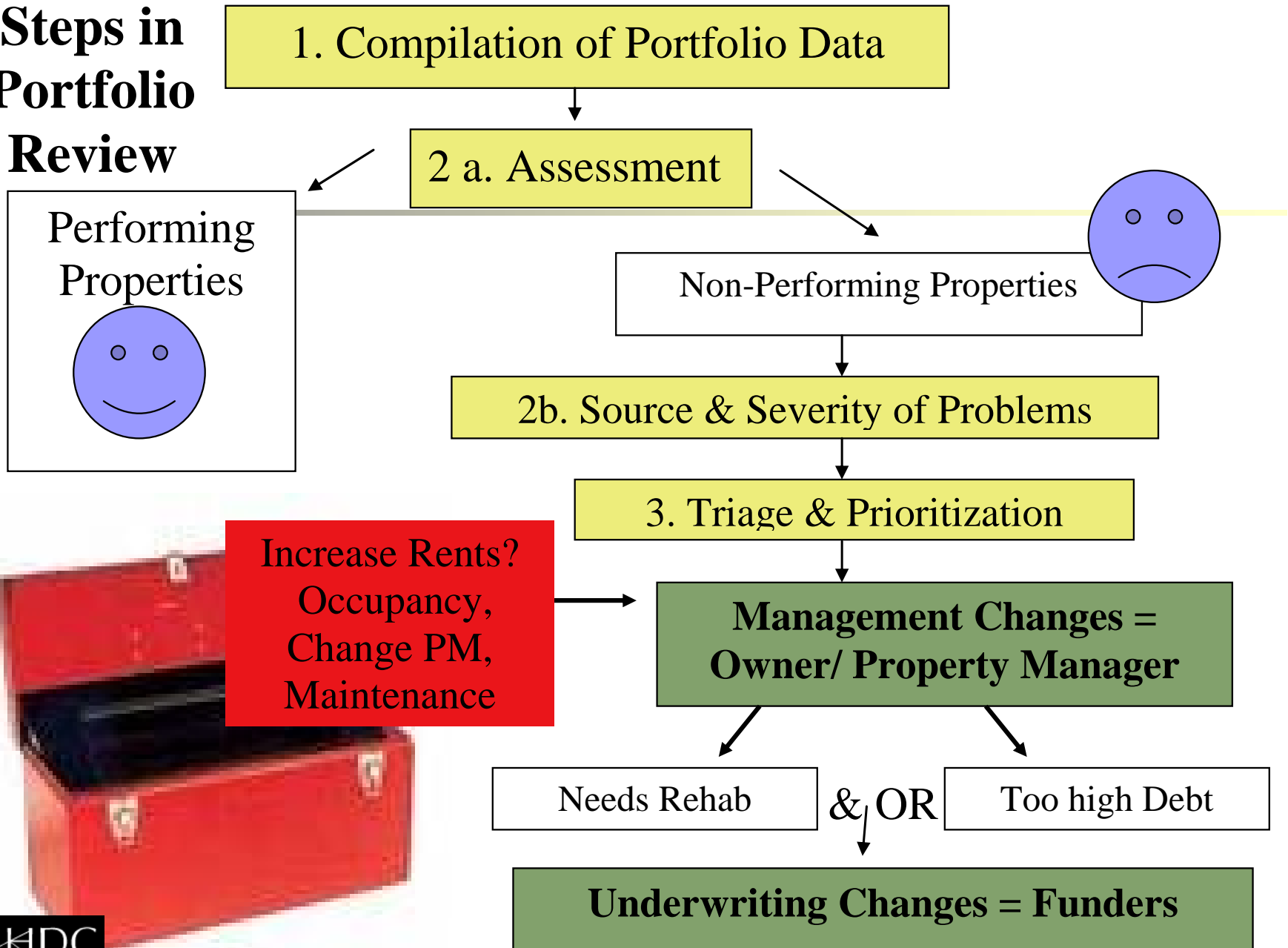
✓ **Physical Condition**

- Functionally Obsolete
- Deferred Maintenance
- Construction Defects
- Hazards

✓ **Initial Project Structuring**

- Overleveraged Debt
- Unrealistic Rent Assumptions
- Unrealistic Expense Assumptions

Steps in Portfolio Review



Restructuring Process

- The Analysis
 - What is needed
 - When
- The Plan
 - Scope: (Management Changes, Rehab, Refinancing)
 - The Team
 - The Timing
 - The Resources
 - Buy-in (staff, board, funders, residents)
- Implementation



Morning Presentation:

Analysis:

- Performance (Occupancy, resident satisfaction)
- Financial
- Physical Condition


The Assessment

Types of Information:

- Financial Information
- Capital Needs Assessment
- Market Information
- Organizational Goals

Types of Analysis:

- Performance Indicators
- Financial Indicators & Projections (Income Statement and Balance Sheet)
- Capital Needs Inspections/, Replacement Reserve Analyses and Cost Estimate
- Market Studies
- Portfolio Scattergrams



This is a “peel the onion” type process that typically meshes into planning”



PERFORMANCE INDICATORS

- Average Turnovers per Year
- Average Days Vacant per Month/ Year
- Physical Occupancy
- Collection Rate
- Number of Maintenance Calls
- Response Time on Work Orders
- Resident Surveys/ Exit Interviews



The earlier you catch it, the less it costs.

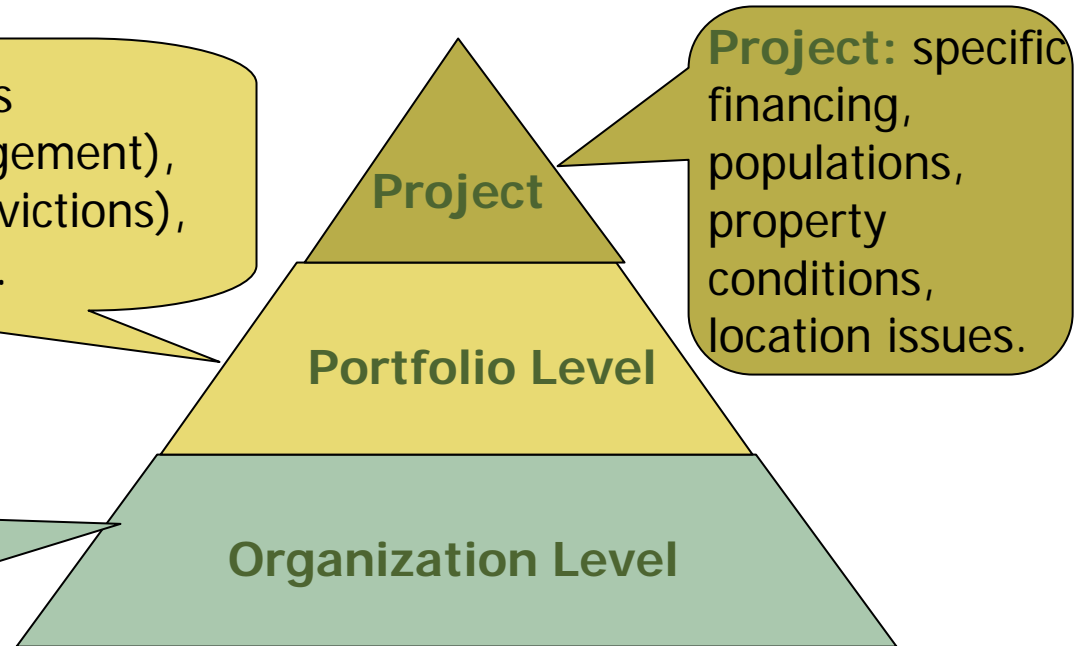
Reminder

Asset & Property Management changes can be implemented the most quickly, are generally the least expensive, and can impact your entire portfolio.

Asset Management: Systems (accounting, information management), and Practices (rent increases, evictions), hiring & supervision of PM staff.

Organization: Mission, policies, staffing, in-house vs external management, development strategies

Project: specific financing, populations, property conditions, location issues.





FINANCIAL INDICATORS

| | |
|----------------|--|
| Net Cashflow | <ul style="list-style-type: none">■ Net Cashflow per Year (organizational goals)■ Net Cashflow PUPY■ Net Cashflow as % Gross Revenues■ Net Cashflow as % Total Operating Expenses |
| Revenue Side | <ul style="list-style-type: none">■ Gross Potential Rents Compared to Maximum Achievable■ Occupancy Rate■ Collection Rate |
| Expense Side | <ul style="list-style-type: none">■ Operating Expenses per Unit per Year■ Expense Categories per Unit (e.g. Maintenance)■ Expense Categories as Percent of Total Expenses |
| Debt Structure | <ul style="list-style-type: none">■ Debt Coverage Ratio (over time)■ Debt Payment Per Unit Per Year |



Net Cashflow

Net Cashflow / Net Cashflow per Unit

Net Revenues

- Operating Expenses

Net Operating Income

- Total Must Pay Debt

Net Cashflow

Net Cashflow per Year / # of Units = PUPY



When reviewing portfolios, start with biggest picture indicators (net cash flow), then delve into the whys: revenue issues, expense issues, debt issues.

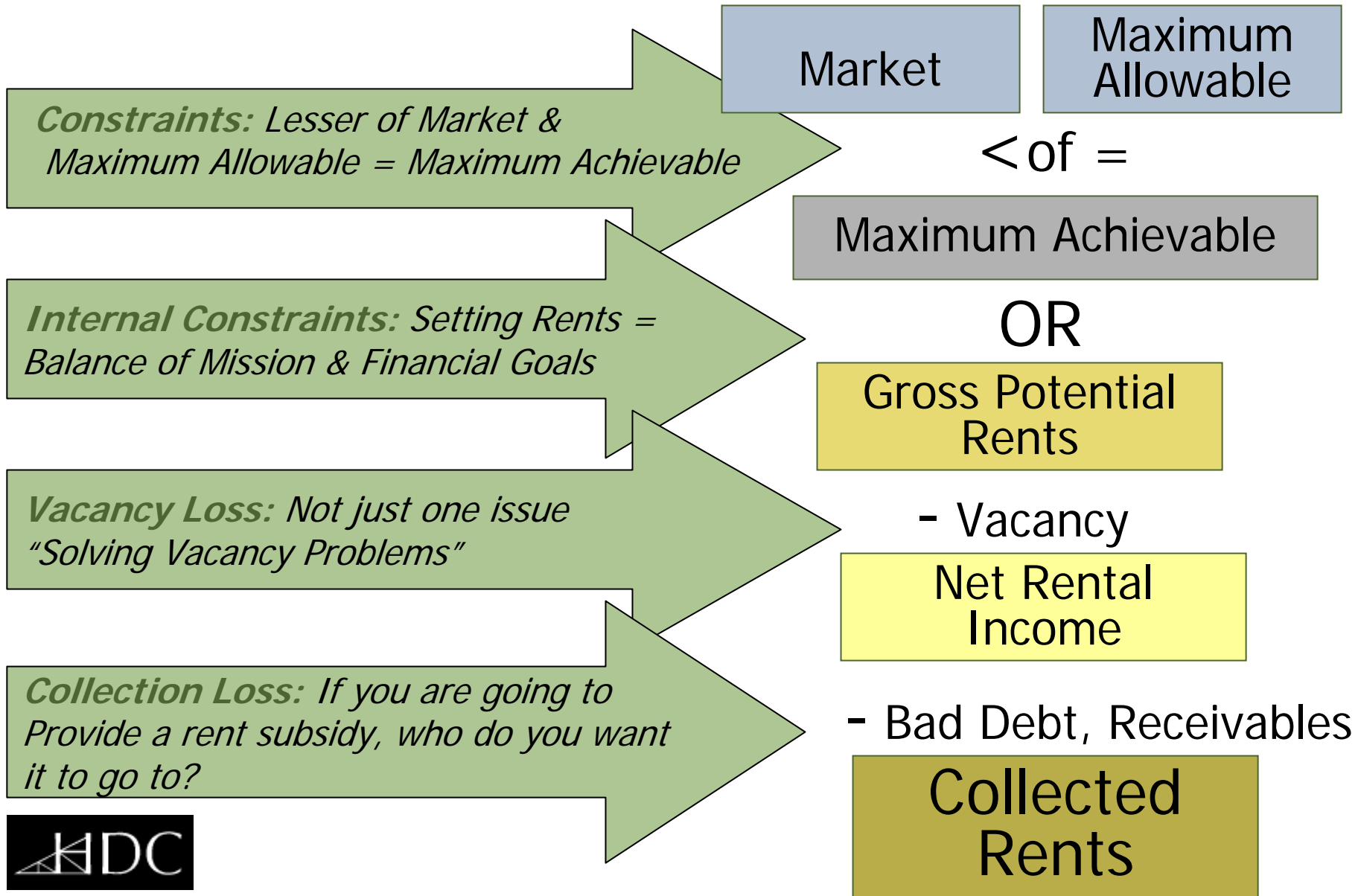
Other Ways to Think About Net Cashflow:

- What costs does it have to cover (what isn't included above the line)
- How much cushion against risk does it provide:
 - Net Cashflow / Gross Revenues (minimum of 4 – 8%)
 - Net Cashflow / Total Operating Expenses (minimum of 8 – 12%)



OK, so now you want to know WHY this number.

Revenue Side Issues:



Expense Side Issues:

INDICES:

- Total Expenses Per Unit per Year: \$4,000 - \$4,800 average
- Cost of maintenance, repairs, janitorial & landscaping: average \$800 - \$1,200 per year
- Utility Costs: compare to other projects
- Property Management (on & offsite) as % of Total

ADVANCED ANALYSIS:

- Sorting portfolio by Cost Category
(from highest per unit for an expense category, does it make sense?)



Most funders closely monitor expenses, most restructures are due to physical condition, revenue or debt structure issues.



Balance Sheet Indicators

Assets:

- Cash - liquidity
- Are reserves adequate?
- Are receivables: Large? Growing? Collectible?
(Tenant/ Housing Authority)

Liabilities:

- Short Term Payables (how old?)
- Long Term Liabilities: Principle + Accrued Interest (terms, ability to refinance)

Net Worth – Available Equity?



Initial Project Structure

FINANCIAL ASSUMPTIONS:

- Rent Assumptions
- Occupancy Assumptions (incl. bad debt)
- Operating Expense Assumptions
- Debt Burden

Can you cover debt & operating expenses over the long term?

CONSTRUCTION ISSUES

- Level of Rehab
- Construction Defects – LP Siding, flooring
- Quality & Type of Finishes- hollow core doors
- Landscaping, security, marketability

Will your reserves cover needed repairs over the long term?

RESERVE ASSUMPTIONS

Can you bridge to next re-capitalization opportunity?



Right Sizing Debt

- Debt Per Unit Per Year
- Debt Coverage Ratio

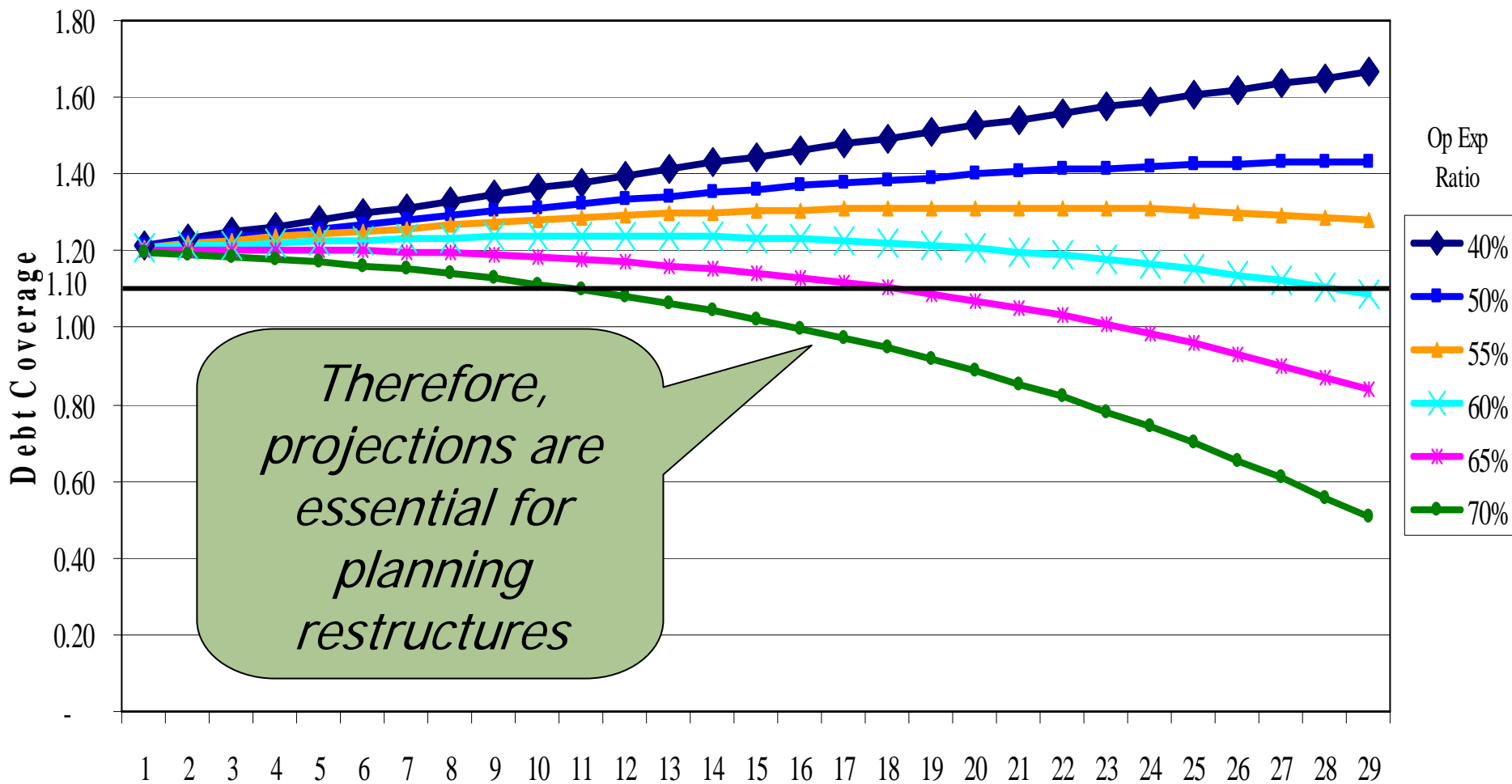
New Industry Recommendations from owners working on changing underwriting standards:

Base debt on ability to achieve Net Cashflow Target at Year 15: Net Cash Flow at Year 15 = 8% of Operating Expenses

Debt Coverage Ratio: What We've Learned

| SAMPLE: TWO BEDROOM APARTMENT, ONE UNIT | | | | |
|--|---------------|--------------|--------------|--------------|
| Median Income Served | @ 30% | @ 40% | @ 50% | @ 60% |
| Annual Net Revenue (7% vacancy) | \$4,046 | \$5,725 | \$7,405 | \$9,084 |
| less Operating Expenses | \$4,200 | \$4,200 | \$4,200 | \$4,200 |
| Net Operating Income | -\$155 | \$1,525 | \$3,205 | \$4,884 |
| Available Debt Service at 1.15 dcr | \$0 | \$1,326 | \$2,787 | \$4,274 |
| Net Cash Flow Per Unit Per Year at 1.15 | -\$155 | \$199 | \$418 | \$637 |
| Operating Expense to Net Revenue Ratio | 104% | 72% | 56% | 45% |
| Net Cash Flow as % operating expenses | -3.7% | 4.7% | 10% | 15.2% |
| Net Cash Flow as percent gross rents | -3.8% | 3.5% | 5.6% | 7% |

Long Term Projections: Efficiency Ratio: Operating Expenses as a Percent of Revenues





PHYSICAL PROPERTY CONDITION

Roles in Monitoring:

Asset Management:

- Routine Inspections: Every 6 months or once a week if vacant or at risk
- Capital Budget: Every year
- Capital Needs Assessment: Every 5 years

Property Management:

- Unit interiors: At least once a year, and on turn-over
- Grounds and building exteriors: Based on inspection schedule (s)



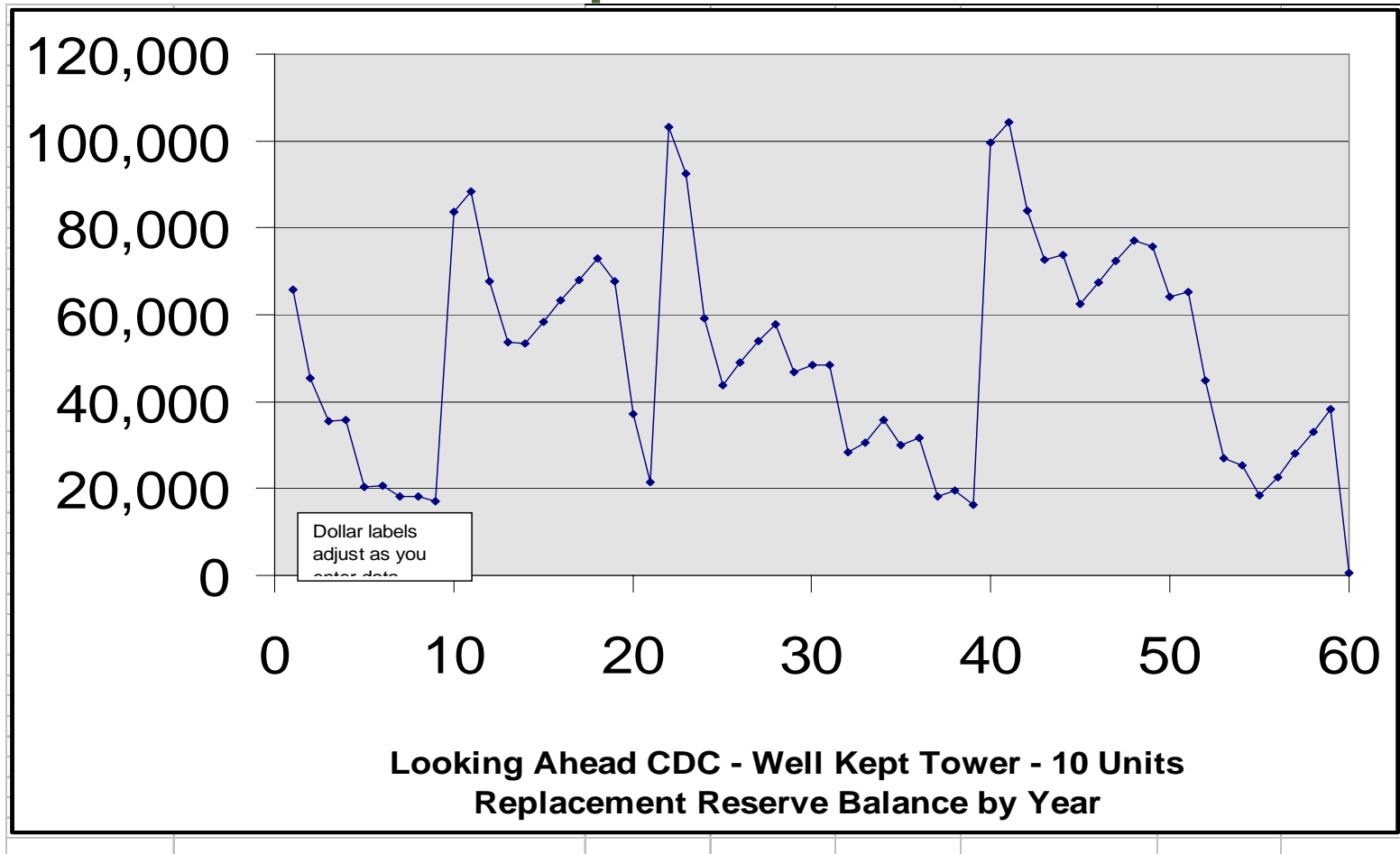
What is your check and balance system if you self manage?



Long Term Capital Planning:

- Do your capital plan and finance plan match?
 - When will major capital expenditures occur?
 - What is the Replacement Reserve account build-up?
 - When will you have ability to refinance?

The Replacement Reserve Model: The Output





MARKET ISSUES

What you assume VS
What you know

Market Rents?

Occupancy Rates?

Amenities?

Concessions?



Do not get this information solely from Property Manager.



General Observations

- Good management trumps bad markets
- Excessive debt trumps good management
- Inadequate rehabilitation trumps debt
- Expense controls are rarely the driver of long term problems

Slide adapted from NeighborWorks America

Exercise:

Using the Financial Model

- Input Income & Expense Data On Second Tab: "Income Statement"
 - You can change expense categories
 - Get debt payments from Loan Note or Notes to Audit
- Input Balance Sheet Info on Third Tab
- First Tab is Summary

AM SMALL GROUP WORK SESSION:

1. Complete Initial **Financial** Analysis
2. Review what you know about **Performance Indicators** and **Physical Condition**
3. What do you know about **Market** – what do you need to find out?
4. What do you know about **Constraints** on property? (prepayment, rent regulatory constraints, Year 15 terms)

PM SMALL GROUP ANALYSIS REPORTS:

- Project Name, # of Units, Location, Age, Market
- Financial Condition:
 - Overall performance – over time
 - Revenue Side Issues
 - Expense Side Issues
 - Debt Structure
- Physical Condition:
 - What do you know, need to know
 - Reserves available
- Can you fix this by Improving Property Management?



Afternoon Presentation

Approaches to Restructures

Why: We've identified a problem (s) – our partners/stakeholders may see it much differently

What: Refinance, Rehabilitation, Year 15

When: Immediate needs, most ideal timing, phased

Who: Putting together the team

a: Who leads in your organization? Who else involved?

b: Team: funders, financial modeling, construction management, relocation, others



We have yet to meet a nonperforming property that:

- *Could not be somewhat improved by changes in management practices,*
- *Was not significantly a revenue side problem,*
- *Would not have been less costly to address if caught earlier...*

Stages of Grief Applied to Restructures:



1. Denial (and Isolation)



2. Anger

*With apologies to Elizabeth KUBLER-ROSS, MD
On Death and Dying (1969)*

and....



3. Bargaining



4. Depression



5. Acceptance

Partners go through these stages at different times.



1. MANAGEMENT STRATEGIES:

A. Revenue Approaches

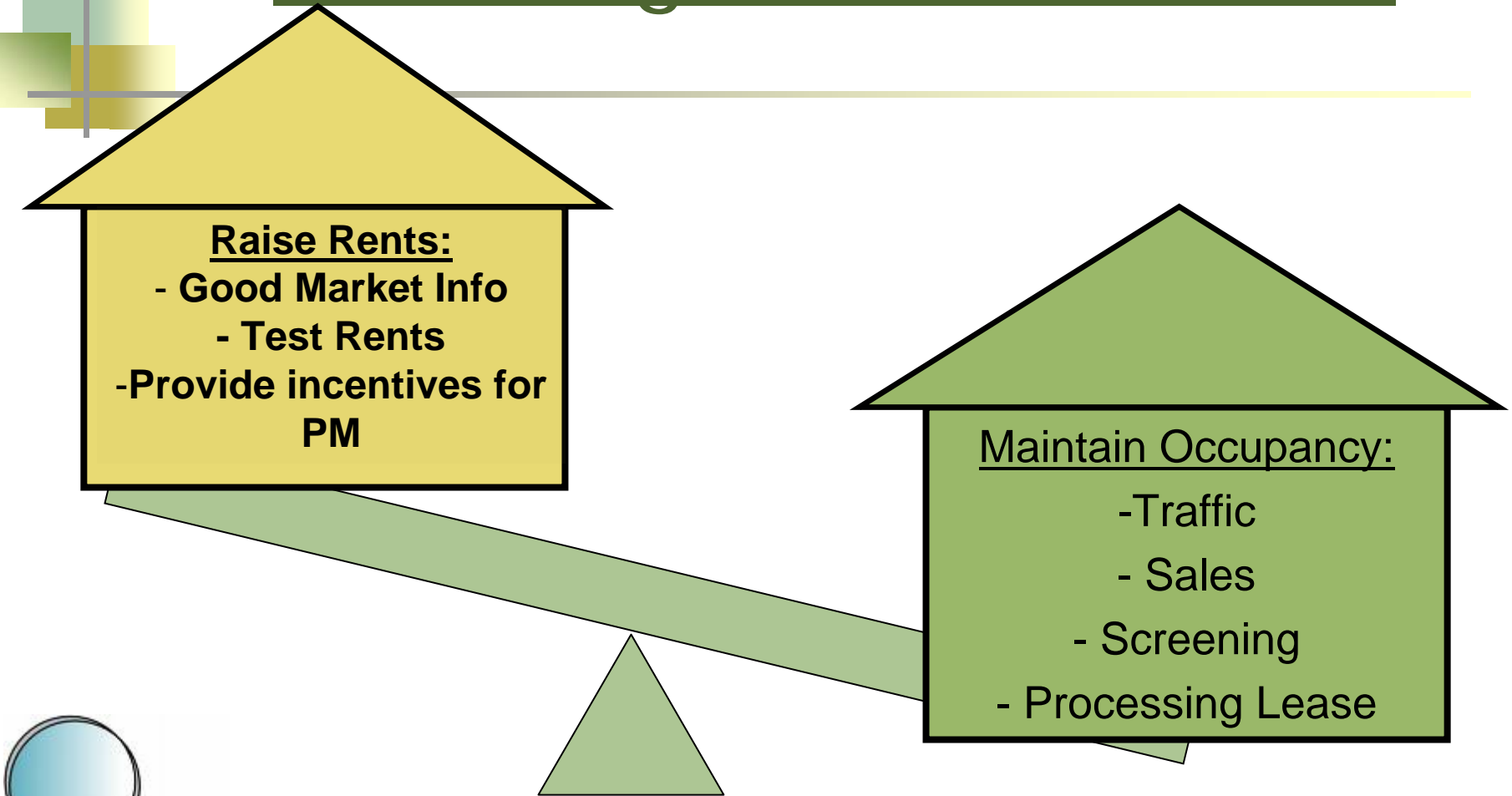
- rent increases
- occupancy
- collections

B. Operating Expense Approaches

- Reduce Turnovers
- Minor Rehab: improve curb appeal, amenities, reduce maintenance costs
- Energy Conservation
- Water Leaks?
- Property Management Structure?
- Insurance??

C. When do you seek a new Property Manager?

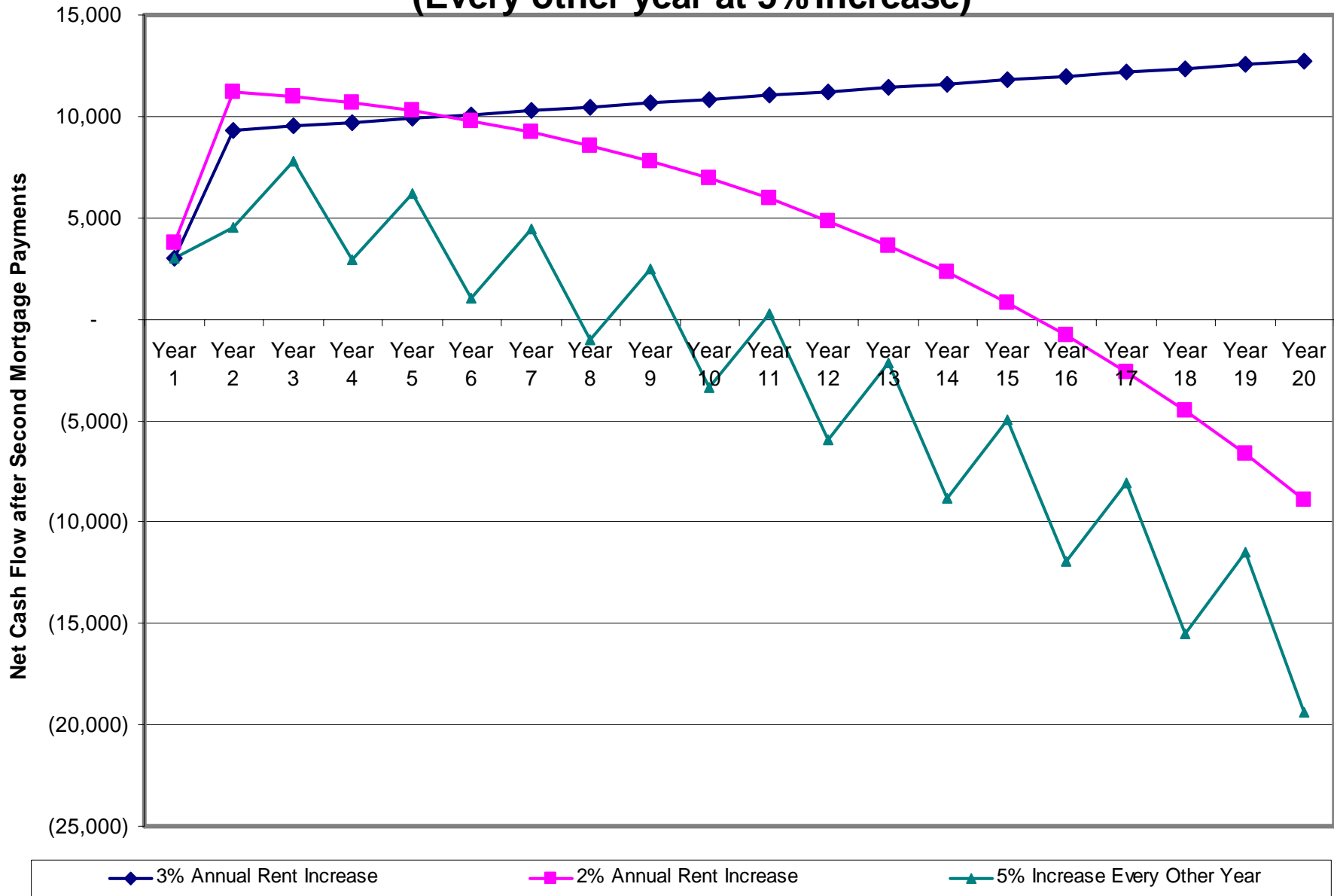
Balancing Revenue Issues



*Collection Loss = subsidizing someone. Is this
The household you chose to subsidize?*

Comparison of Cashflow with 2%, 3% & Every Other Year Annual Increases

(Every other year at 5% Increase)



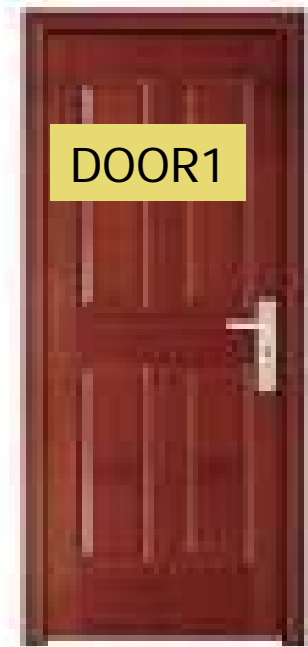


Solving Vacancy Problems

NOT JUST ONE PROBLEM:

- Is there traffic? Marketing
- Are applications being received? Sales, Unit Condition
- Are applications being approved? Screening
- Move Ins Prompt? Onsite Staff, maintenance
- Retention? Management, maintenance, customer service, rents

2. RESTRUCTURING/ REPOSITIONING



REHAB ONLY:

- Rehab level varies
- Reserve Balances
- Additional Subordinate Debt



REHAB & REFINANCE:

- Major Rehab
- Refinance Primary Debt
- Might re-syndicate
- Usually more subordinate debt



REFINANCE ONLY:

- New Primary Debt
- Addtl. Subordinate Debt



Portfolio wide versus one project only



Developing a New Proforma

- Income Statement:
 - Realistic Rent Assumptions
 - Rent Subsidies?
 - Vacancy Assumptions (bad debt, collection losses)
 - Other Income
- Expense Side:
 - Actuals
 - Changes from rehab
- Debt Structure:
 - Long Term Projections
 - Stress Test



Sources Budget Issues

- Primary Sources

- Primary debt: prepayment penalty, fees
- Bonds – hard to refinance
- OAHTC – remaining life, getting additional

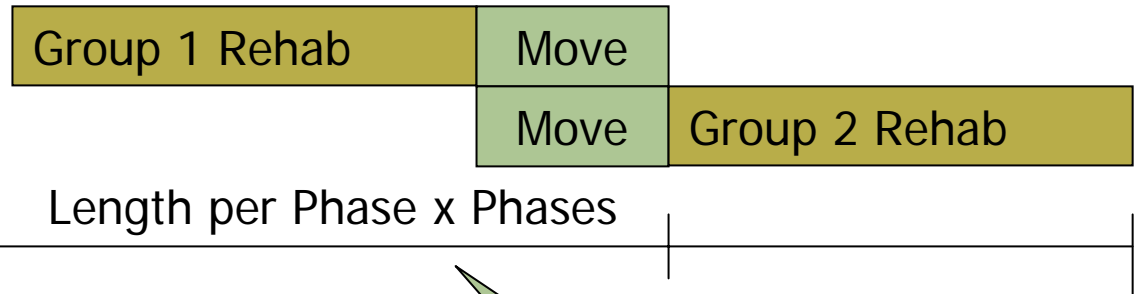
- Subordinate Debt & Grants

- Home requires waiver to get second allocation
- CDBG is good! (although Davis Bacon)
- Contributed developer fee – an expectation

- Re-syndication

- Not OHCS's favorite idea to pay twice
- Year 15 counts as capital "P" Preservation, but lower priority
- If within first 15 Years, same investor

Uses



■ Construction Approach:

- Costs – unit pricing
- Occupied or relocation, length of rehab period
- Design costs higher as percent
- Manage resident's expectations

■ Relocation:

- Uniform Relocation Act or not
- Rehab Approach – can you phase (onsite/ offsite relocation)
- Outsource or Not

■ Financing Costs:

- Prepayment Penalties
- Legal Costs
- Usually takes longer to negotiate
- Takes more in-house effort – political chits

■ Developer Fees: Owners – cover costs only

- How many households can you relocate onsite
- Vacancy Loss versus construction management overhead & financing costs
- Building configurations

Approaches to Capital Needs Assessments – 3rd Party

- Who – Architect, Engineer, Approved Inspector
- When – Planning for major financial milestone, e.g. Year 15 or if major rehab necessary as part of restructure
- How – Interview property management & maintenance staff
 - Review maintenance records
 - Review other available documents, e.g. original drawings & contractor schedule of values
 - Then walk the buildings
 - Exterior, common, all unit interiors (unless lenders/funders agree to representative # of units)
- Cost – Range of \$5,000 - \$20,000 (level of drawings, specs)
- Deliverable: Report with quantities, life expectancy, unit cost, and possibly as-built drawings
 - Immediate needs
 - Bridge period needs
 - Needs over life of new refinance



Major Differences From Developing New Projects

- Funder Attitude (Stages of Grief)
- Expectations for Developer Fee (Blame)
- Refinancing:
 - Can you refinance & Prepayment Penalties
 - May not be able to support any new debt
 - Home used only once unless HUD waiver
 - If re-syndicating:
 - In 1st 15 years – same investor
 - At Year 15: 10 Year Hold rule
- Rehabilitation:
 - Occupied Properties/ Relocation
 - Usually means phased rehab



Note on LIHTC Year 15

- Main USE OF FUNDS could be exit tax obligation:
 - Know your documents
 - Know your deal – expected return, actual return, estimate exit tax obligation, reserves available
 - Know your investor – how have they handled exit taxes in the past, what is your overall relationship
- Everything is a negotiation
 - Start at Year 10 – there are ways to minimize exit tax
 - Be ready to exit December 31st of 15th Year (Year 1 is first year credits are taken)

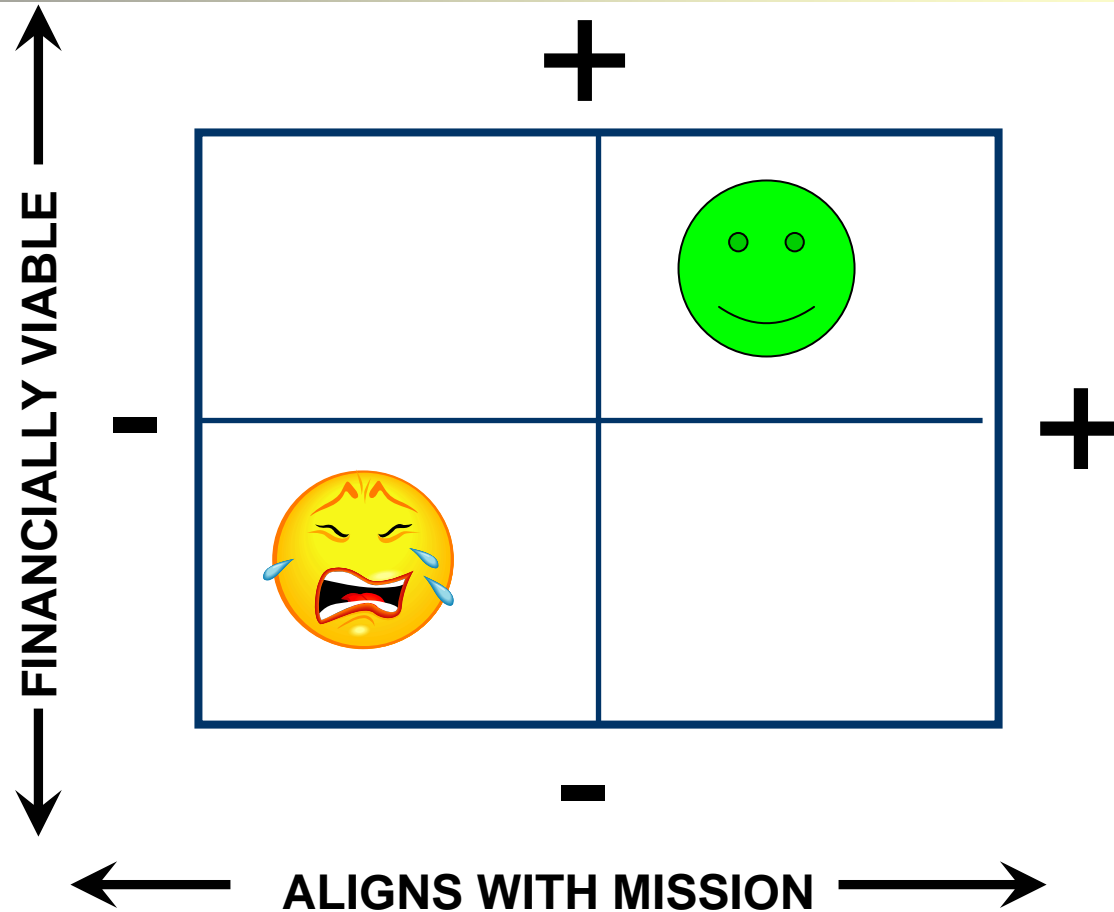


3. Dispositions

Why?

- Obsolete Housing Type (single family, SRO, group homes don't meet some needs)
- Rehab Condition – cost to maintain, repair
- Changes in Mission – location, type of housing
- Need for equity to recapitalize Portfolio

Scattergrams: Analyzing a Portfolio



Slide adapted from NeighborWorks America



PM SMALL GROUP REPOSITIONING REPORTS:

1. Goal of Restructure
2. Management Improvements: list strategies
3. Major Uses of Funds:
 - a. Level of rehab
 - b. Debt becoming due?
 - c. Year 15 – tax obligation?
4. Potential Sources:
 - a. Primary Debt: Do you want to refinance, can you, estimated cost?
 - b. Subordinate Debt: Options?
5. Timeline
6. Team



Questions



Contacts:

Housing Development Center

Robin Boyce, Molly Rogers or Philip Dochow

847 NE 19th Ave

Portland, OR 97232

(503) 335-3668

www.hdc1.org

Community Development Law Center

Leon Laptook

921 SW Washington, Suite 454

Portland, OR 97205

(503) 471-1180

www.cdclweb.org