

# **Restructuring and Refinancing Affordable Housing Projects**

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

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# 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

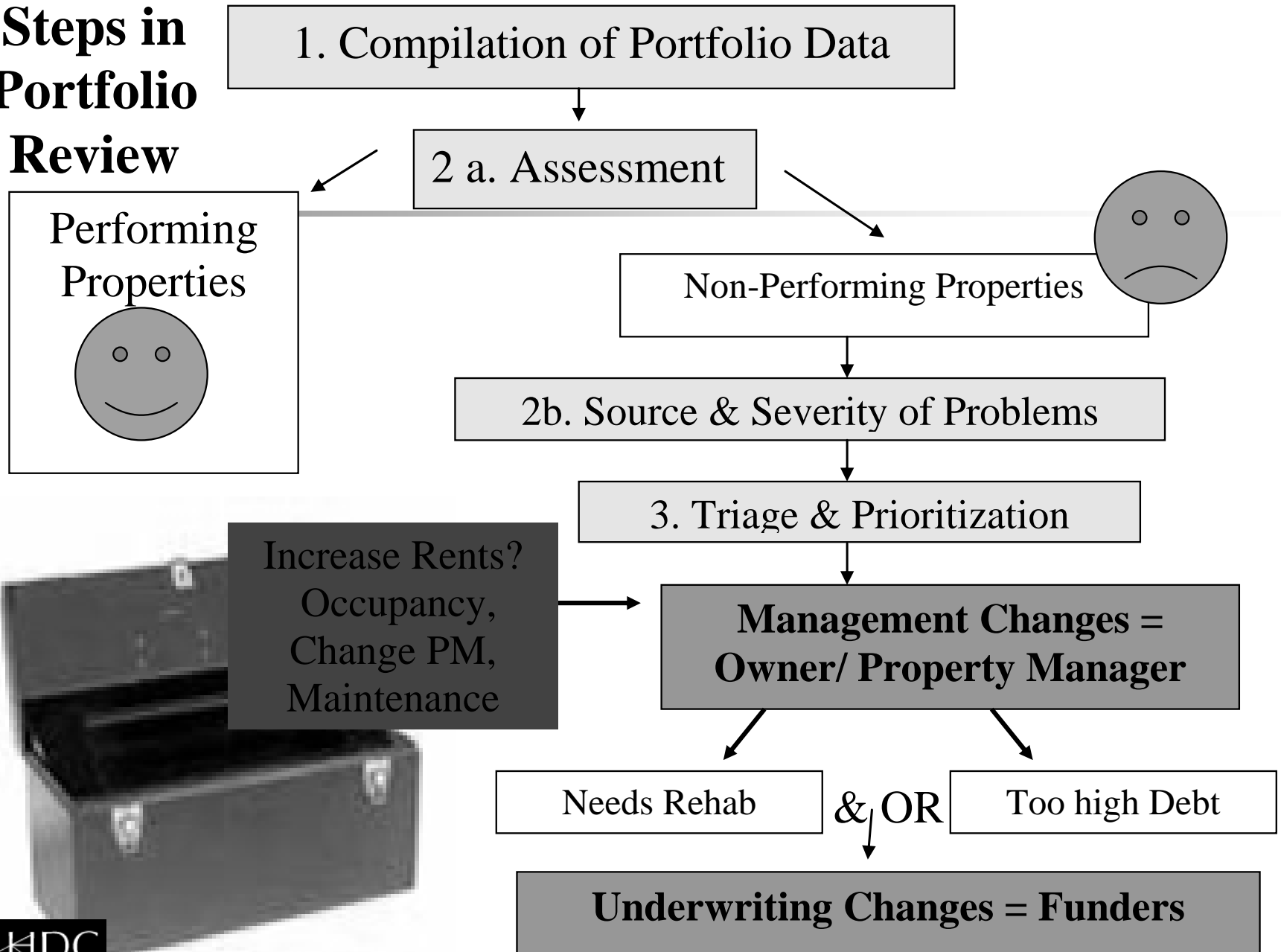
## ✓ **Physical Condition**

- 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:

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## 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



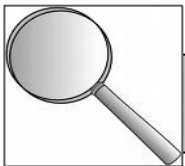
*This is a "peel the onion" type process that typically meshes into planning"*



# PERFORMANCE INDICATORS

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- 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



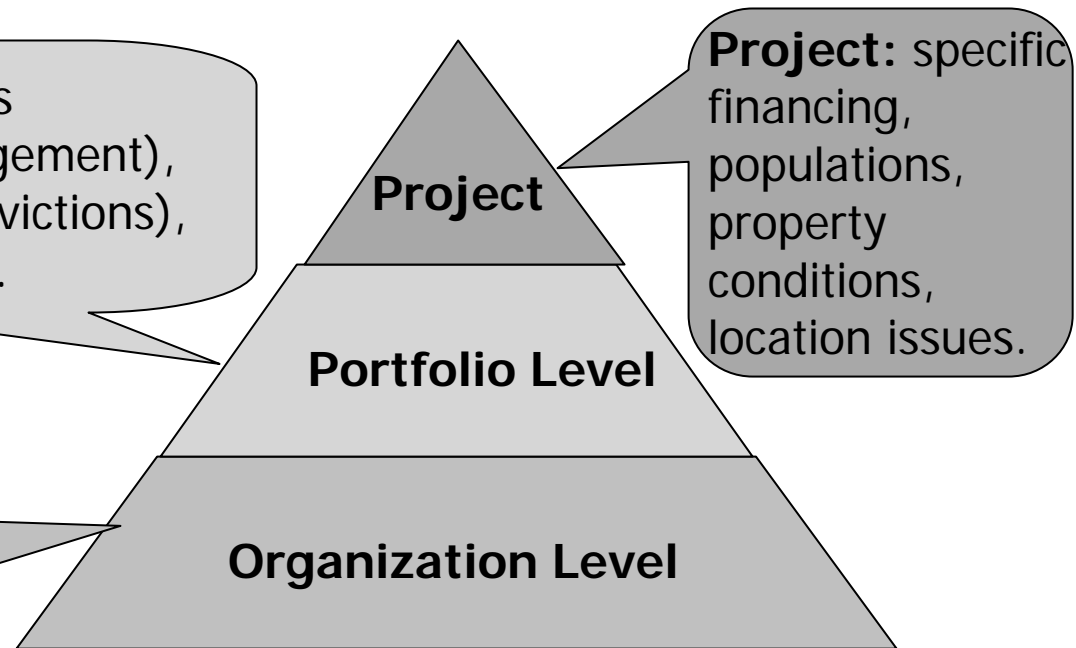
*The earlier you catch it, the less it costs.*

# 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





# FINANCIAL INDICATORS

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

# 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.*

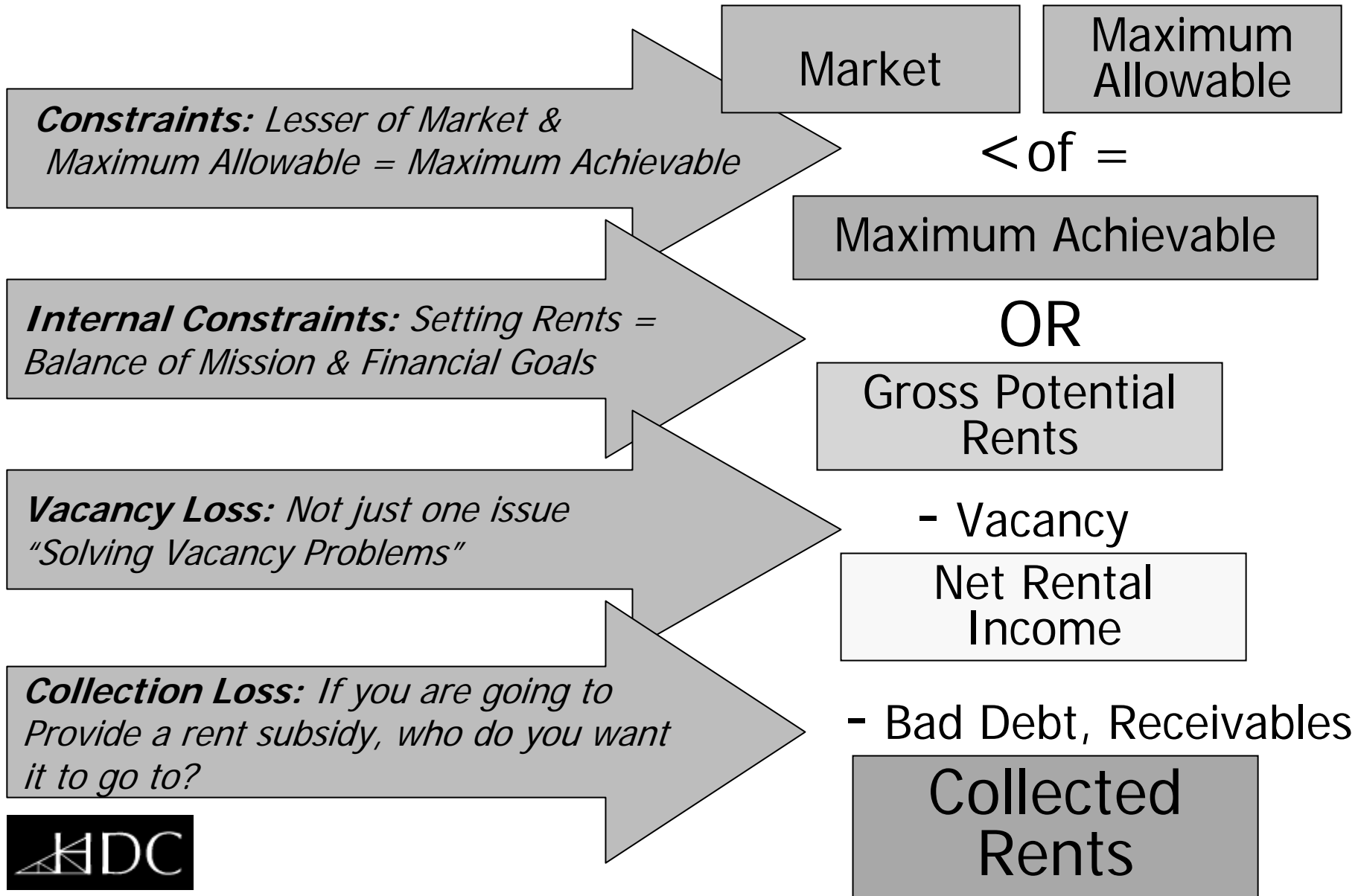
# Other Ways to Think About Net Cashflow:

- 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

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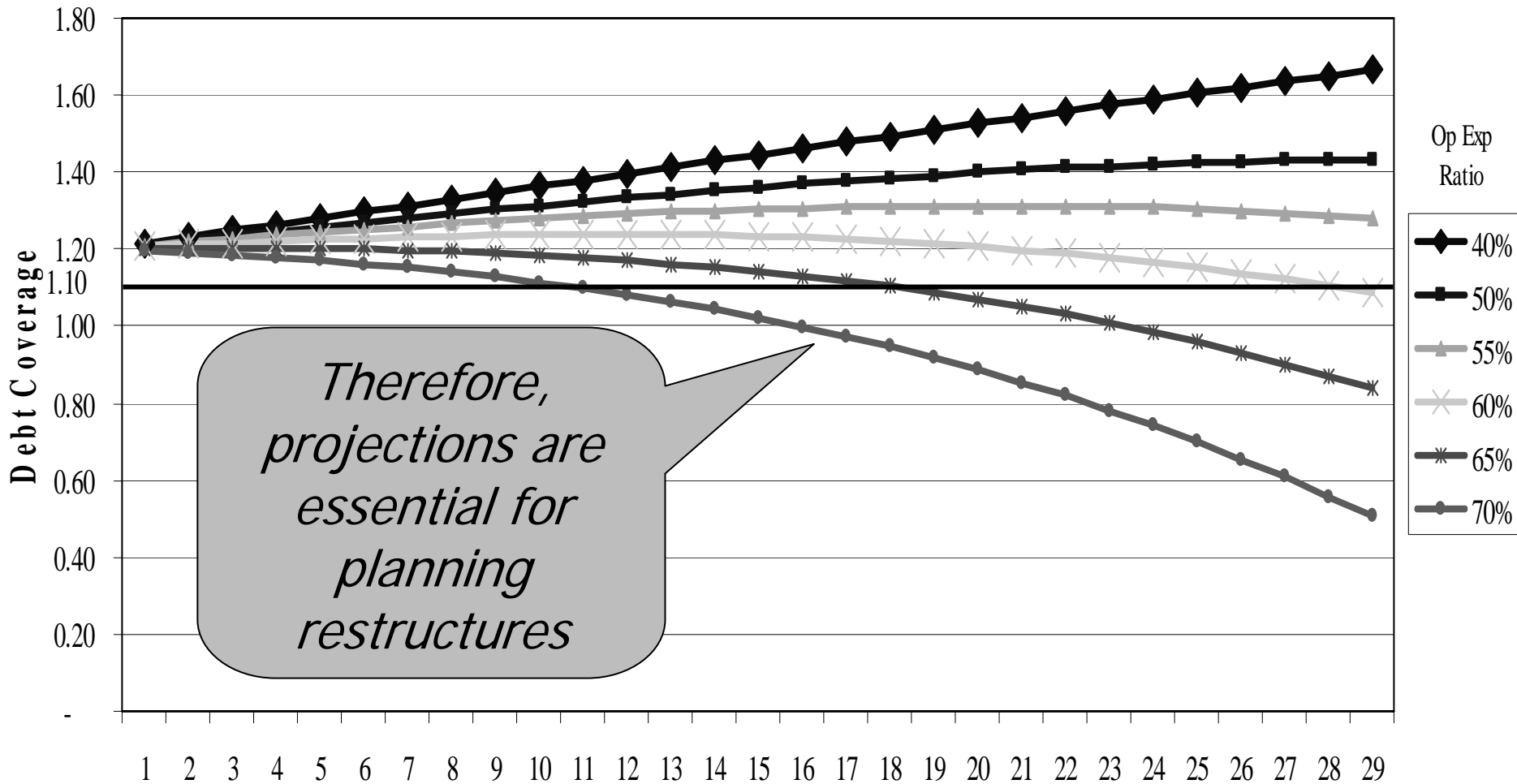
- Debt Per Unit Per Year
- Debt Coverage Ratio

*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

<b>SAMPLE: TWO BEDROOM APARTMENT, ONE UNIT</b>				
<b>Median Income Served</b>	<b>@ 30%</b>	<b>@ 40%</b>	<b>@ 50%</b>	<b>@ 60%</b>
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)



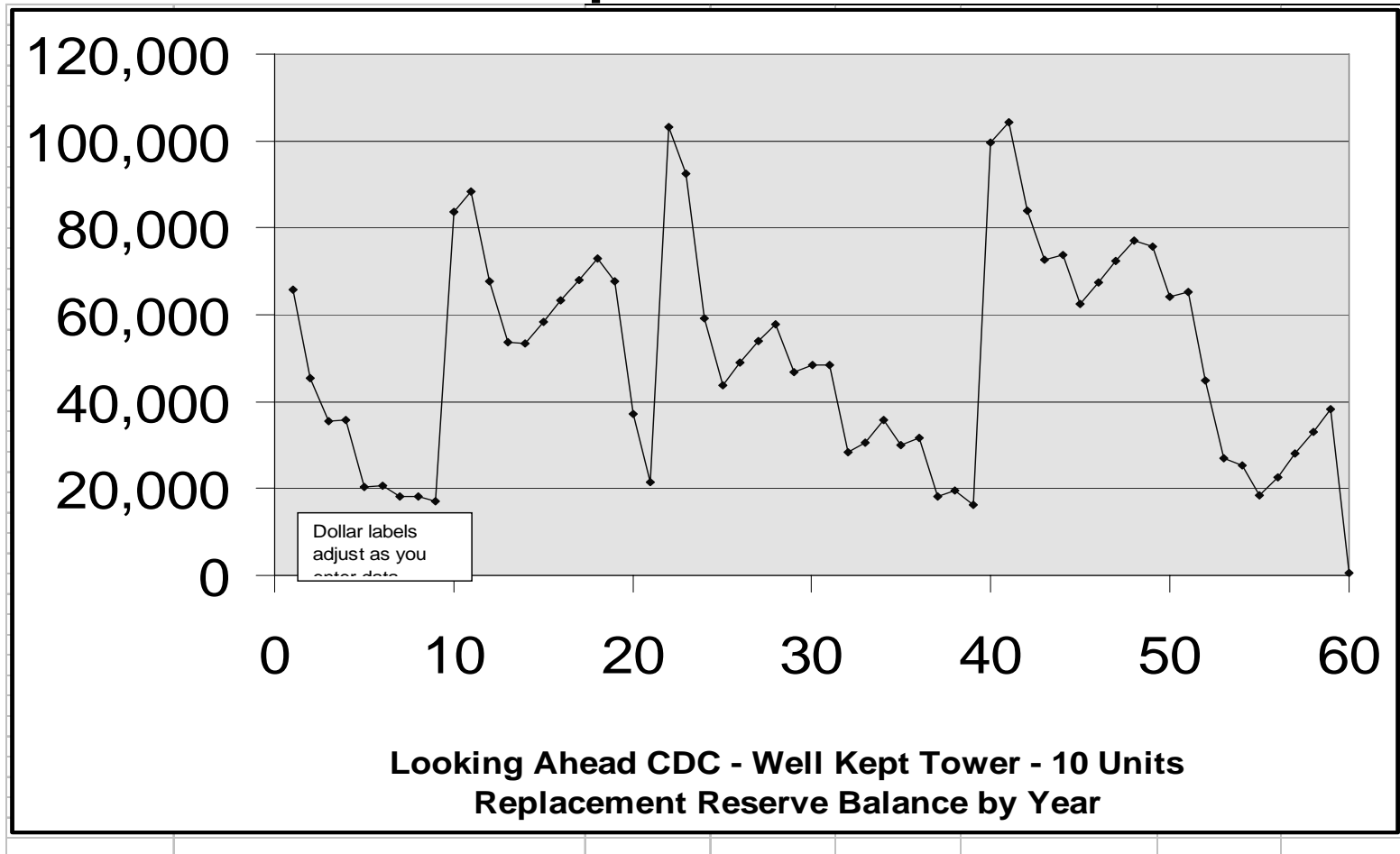
*What is your check and balance system if you self manage?*

# Long Term Capital Planning:

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- 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

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- 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

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- 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:

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- 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

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## 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:

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## A. Revenue Approaches

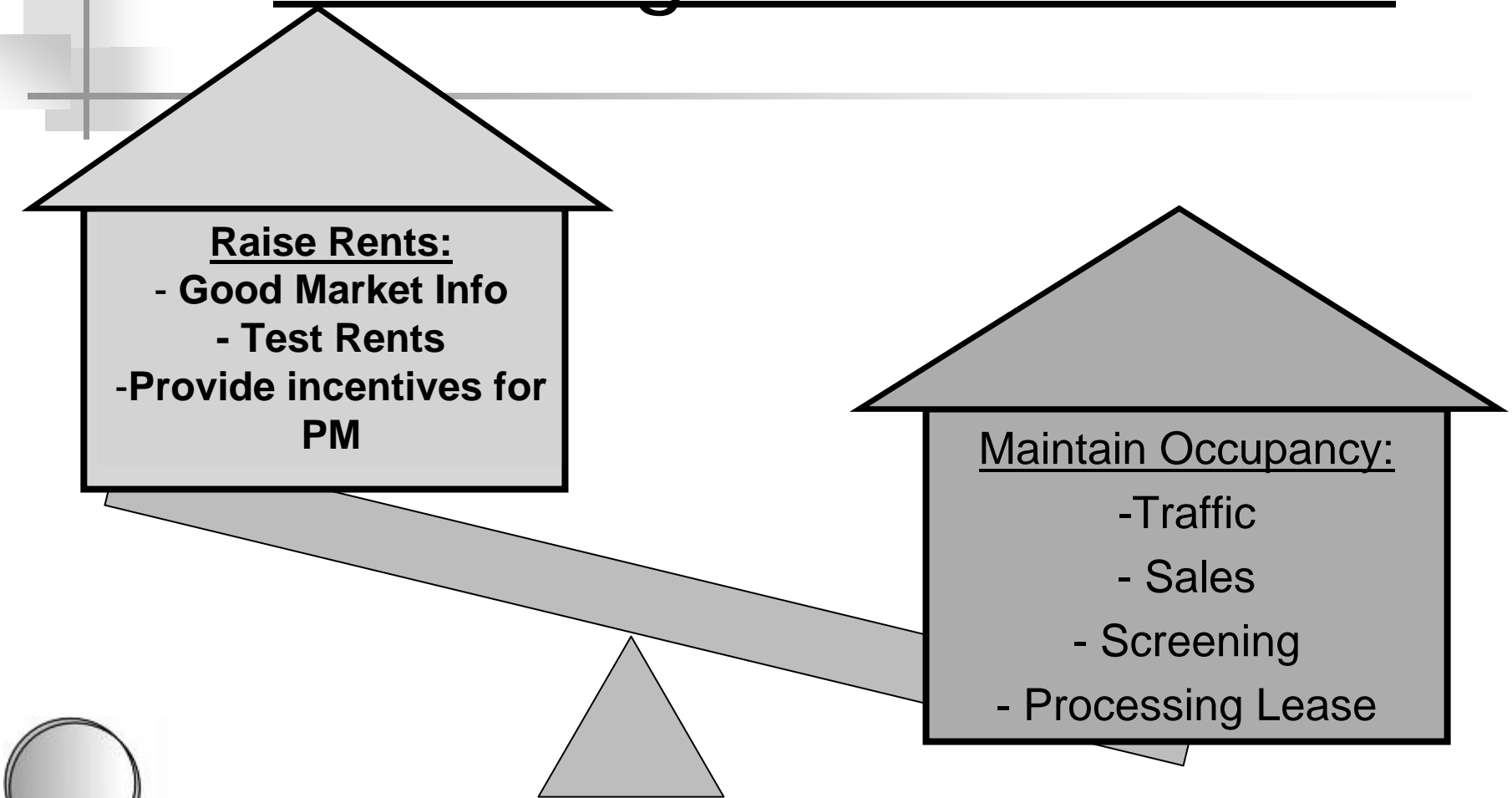
- rent increases
- occupancy
- collections

## 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

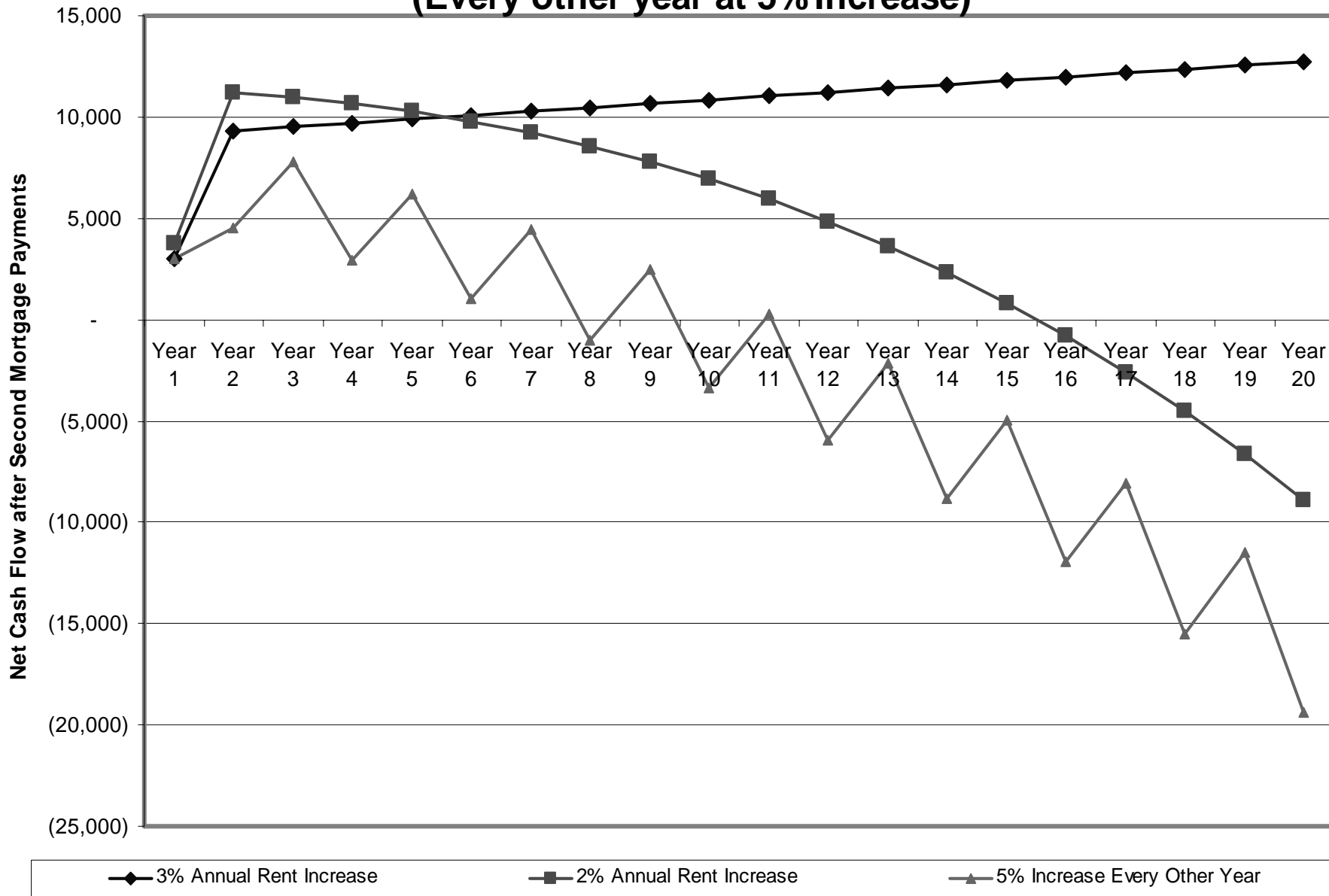


*Collection Loss = subsidizing someone. Is this  
The household you chose to subsidize?*

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



(Every other year at 5% Increase)



# Solving Vacancy Problems

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## 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*

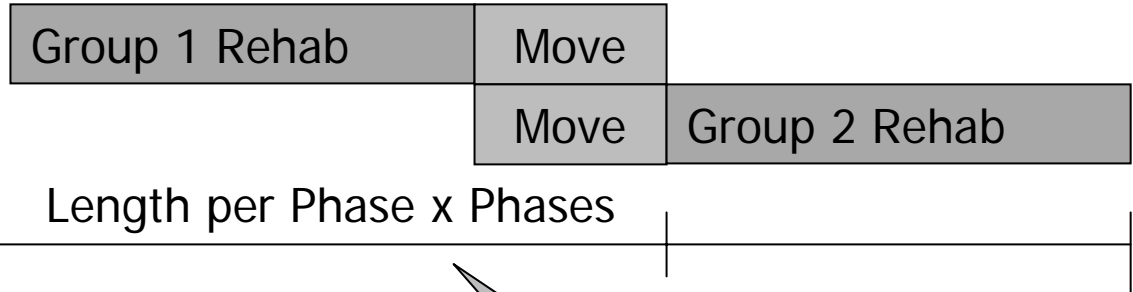
# Developing a New Proforma

- 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 – 3<sup>rd</sup> 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

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- 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 1<sup>st</sup> 15 years – same investor
    - At Year 15: 10 Year Hold rule
- Rehabilitation:
  - Occupied Properties/ Relocation
  - Usually means phased rehab



# Note on LIHTC Year 15

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- 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 31<sup>st</sup> of 15<sup>th</sup> Year (Year 1 is first year credits are taken)



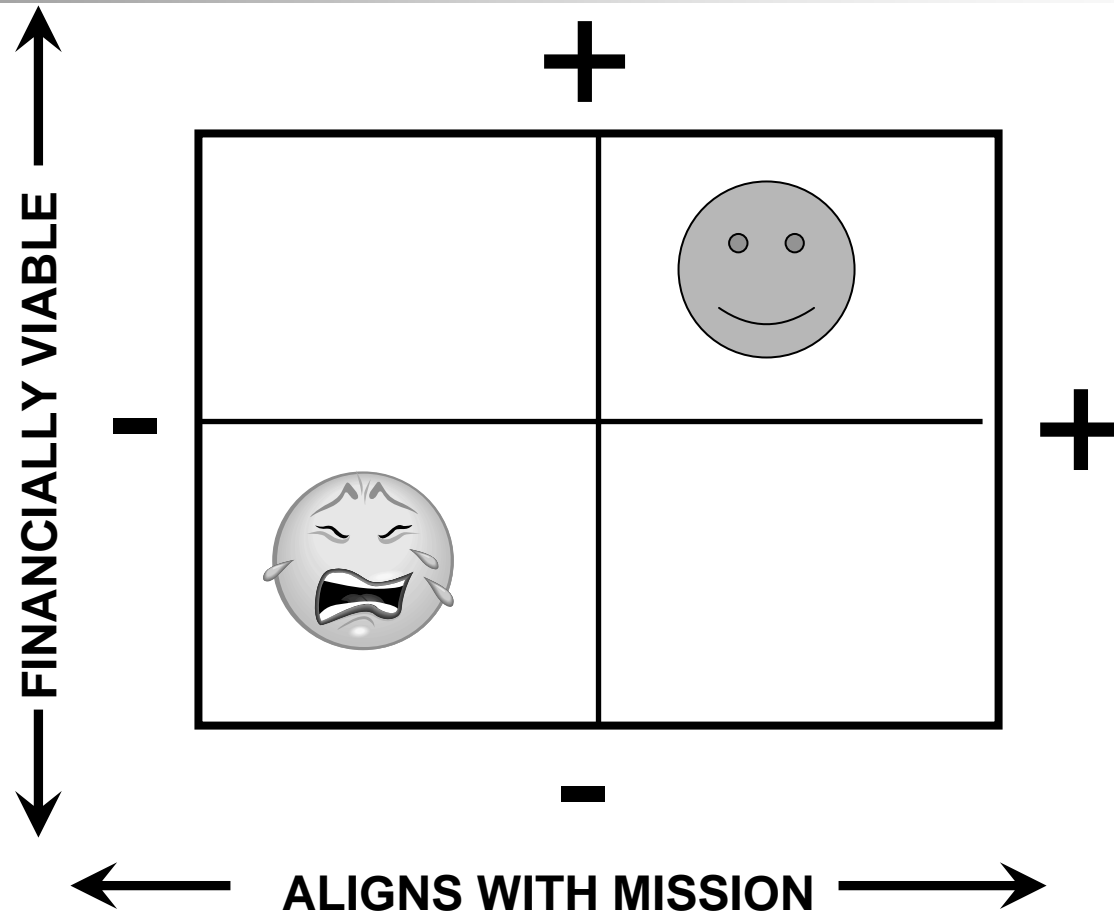
# 3. Dispositions

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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:

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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

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# Contacts:

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## Housing Development Center

Robin Boyce, Molly Rogers or Philip Dochow

847 NE 19<sup>th</sup> Ave

Portland, OR 97232

(503) 335-3668

[www.hdc1.org](http://www.hdc1.org)

## Community Development Law Center

Leon Laptook

921 SW Washington, Suite 454

Portland, OR 97205

(503) 471-1180

[www.cdclweb.org](http://www.cdclweb.org)