Portfolio Recapitalization:
Planning & Implementing Strategies

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Introductions – Housing Development Center

Oregon based nonprofit consulting group which provides:

- Development consulting for new construction & recapitalization projects – housing & facilities
- Asset management training & technical assistance
  - Year 15
  - Portfolio Planning
  - Staff & Board Development
  - Systems Development
- Policy research and advocacy (e.g. capital needs study)
- HDC Community Fund – loans for mission driven development.

Introductions - Recap

- A real estate consulting firm offering strategic and transactional advice focused on affordable housing
  - Strategic advice with portfolio reviews, repositioning, valuation, policy analysis and business planning
  - Transaction services such as recapitalizations, refinancings, redevelopment planning, year-15 exits, acquisitions and sales, public housing conversion
  - Asset management services such as asset monitoring, asset repositioning and valuation of partnership interests
- On-Site Insight is a Recap subsidiary which does Capital Needs Assessments and Green CNAs

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Foundations

- What are the challenges your portfolio faces?
- Certain challenges align more acutely with certain types of properties, funded by certain programs
- Constraints and opportunities associated with your organizational DNA
- The external context for your work
- Organizational objectives
- Challenges and opportunities inherent in the portfolio itself

Common Issues Across the Nation

- Scarce recapitalization funding
- Sustainability of small & special needs properties
- Low revenue (appropriations, market, inflators, etc.)
- Expiring use and conversion to market
- Repositioning or retargeting
- Unfunded program mandates
- Inter-partner issues
- Sponsor capacity or property management issues
- "Social assets" with mission, not economic, value

Issues Vary by Program

- LIHTC – Year 15, inter-partner issues, investor exit
- Public Housing – deferred maintenance, low appropriations/rents, RAD
- Rural Development – weak markets, small deals
- State-Funded (such as Housing Trust Fund & HOME properties) – operating subsidy to match targeting
- Section 8 – expiring use and conversion to market
- "Orphan" Properties – program focus is elsewhere
  - Rent Supp, RAP
  - Section 202/811

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Organizational DNA

- Incubator or Guardian?
  - Incubator is about high-touch solutions, complexity and tailoring of transactions to each unique circumstance
  - Guardian is about efficiency, standardization & stewardship
- Capital providers prefer scale
- Collaborations or Integrated Delivery Systems?
  - Pooling properties, consolidating activities and outsourcing
  - Building internal capacity

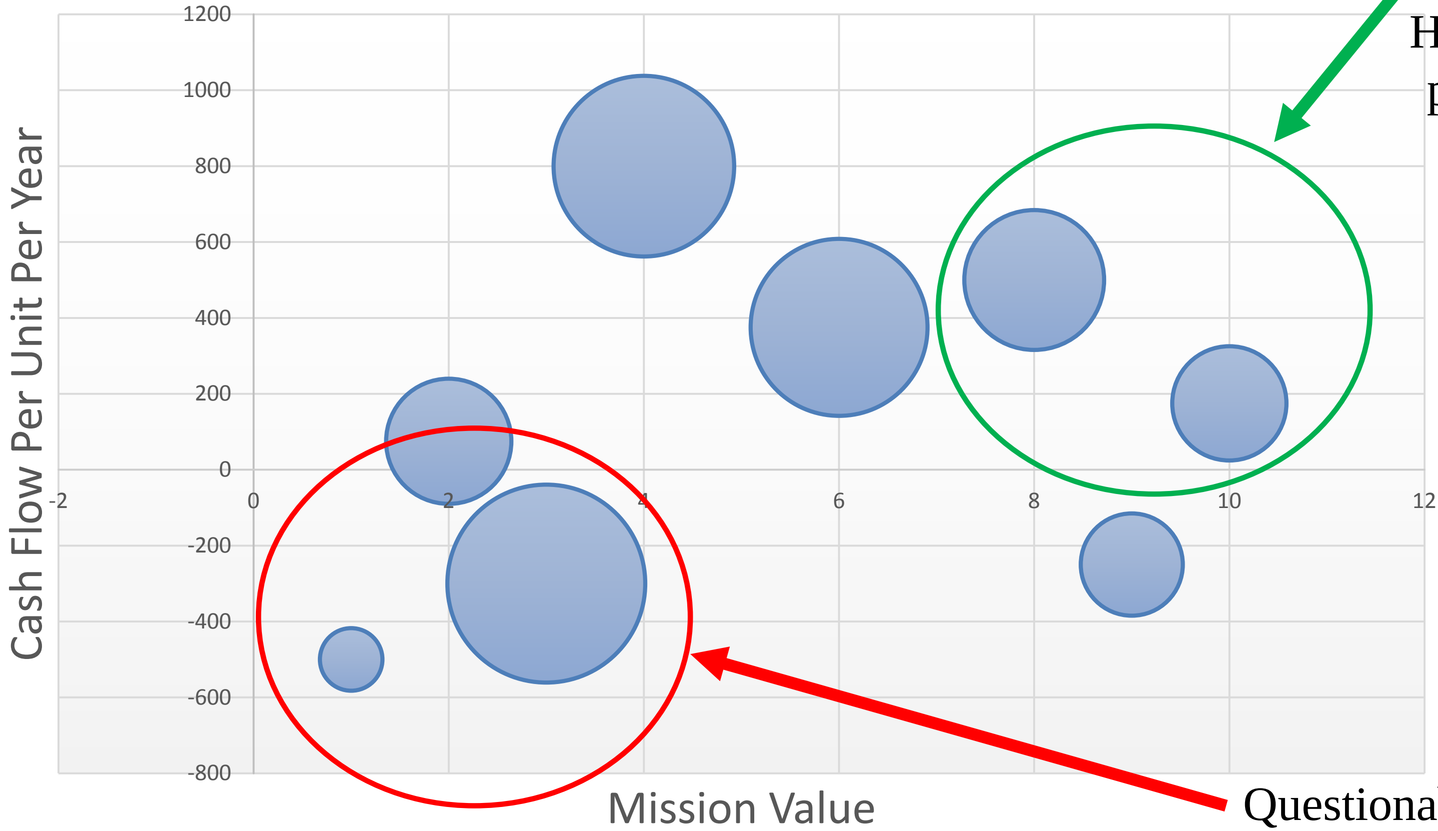
Organizational Landscape

- Demographic shifts
  - Demand for various unit sizes
  - Aging population, with increasing health needs
  - Growth in different market segments
- Shifting expectations of the properties
  - Affordable housing as a locus for life change
  - More working-from-home and home-based businesses
- Emphasis on data and documentation of results
- Can the environment even sustain all the current organizations?

Your Organization's Objectives

- Mission clarity
  - Target populations
  - Housing and service objectives
  - Green and environmental goals
  - Geography
- Measuring mission outcomes (affordability, program outcomes, green measures)
- Measuring financial outcomes
  - NOI and cash flow
  - Energy & water
  - Sustainability

Economic Assets and Mission Assets



Ideal properties – High mission value, positive economic value

Questionable properties – Low mission value, negative economic value

Size of circles represents number of units
Source: Modified from NeighborWorks

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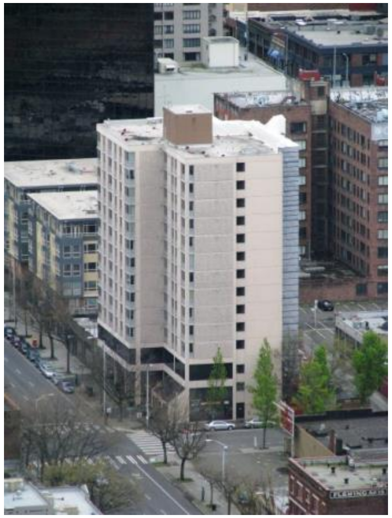
Ways to Evaluate Your Portfolio

- By Activity
  - In development
  - Stabilized
  - Troubled
- By Use
  - Residential
  - Office
  - Retail
- By Location
- By Size
- By Population
  - Family
  - Elderly/Disabled
  - SRO
  - Special Needs
- By Ownership
- By Self-Managed or Third Party Managed
- By Milestones = Those with cliffs or debt maturities



Preparing for the Milestone Events

Looking for red flags & opportunities

- Rigorous oversight of operations
- Trending financial performance
- Capital needs assessments
- Capital accounts and investor or partner relationships
- Program constraints and milestones

Synthesis/ Plan

- Priorities
- Action Steps

Rigorous Oversight of Operations

Revenue Trends

- Occupancy
- Rent Increases
- Collections
- Concessions

Extra-ordinary Expense Drivers

- Utilities

Deferred Maintenance

- Impacting Marketability
- Impacting Maintenance Costs

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Trending Financial Performance

- Does the property cash flow now?
- Detailed Projections
  - Proforma projections by property by year
  - Rolled up net cash flow on a per unit or per project basis
- Efficiency Ratio
  - Calculate individual ratios (a)/(b)
  - About 50-55% is usually stable net cash over time
  - Over 75% = scary decline in net cash

Net Revenues **(b)**
Minus Operating Expenses (a)

Equals Net Operating Income
Minus Debt Payment(s)

Equals Net Cash Flow

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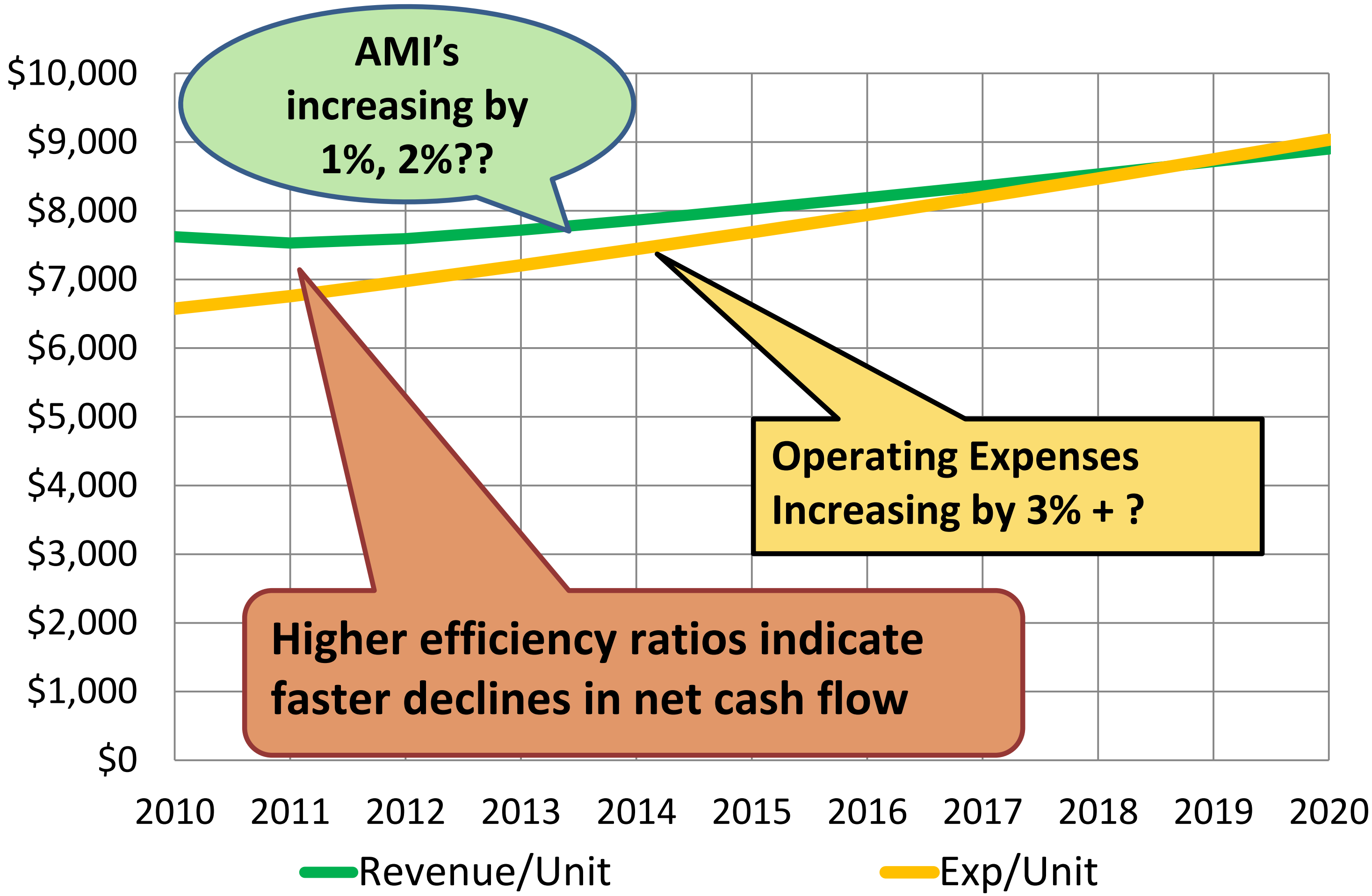
Example: Ballpark Financial Trending

Operating Expenses / Revenues= Efficiency Ratio



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Washington Efficiency Ratios

	Total portfolio n=649	HTF & LIHTC n=199	LIHTC only n=262	HTF only n=188
2013	77%	80%	65%	87%
2012	76%	77%	63%	89%
2011	75%	76%	64%	86%

Source: Table 4 – WBars Report Information from Dept. of Commerce

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Rolling Up Capital Needs Information

Order of Priority	Small Nonprofit	CNA - Rehab Needs 2014 - 2019	CNA- Rehab Next Five Years 2019 - 2024	Total CNA in 10 Years
	Non LIHTC Properties			
1a	Suzy Street	$107,511	$142,955	$250,466
2a	Winter Street	$148,544	$371,235	$519,779
4a	Cherry Lane	$225,416	$448,277	$673,693
7a	Mrs. Magoo	No updated CNA since fire - the property does need new fencing and keyless entry		
8a	Leander Grove	$67,564	$143,424	$210,988
	Tax Credit Properties			
5a	Margaret Gardens	No CNA has been completed.		
6	Mill Place	No CNA has been completed.		
9a	Riverside Apartments	$130,244	$209,925	$340,169
3a	Amity Place	$188,439	$208,604	$397,043
10a	Redland Place	$155,486	$132,282	$287,867
11	MF - Appletree	$393,704	$250,944	$644,648
	Portfolio Totals	**$1,416,908**	**$1,907,646**	**$3,324,653**

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Milestones to Track

Challenges

- LIHTC Year 15 Dates
  - Retaining reserves – spending down vs negotiating
  - Exit transaction – exit tax or rate of return obligations
- Rent Subsidy Contract Terminations
- Mortgage Terms Ending
- Financial Trends
  - Expense to income ratio
- Major Recapitalization
- Commercial Lease Terms
  - TI Needs

Opportunities

- LIHTC Year 15 Dates
  - Back on balance sheet
  - Relief from audit costs & some compliance requirements
  - Re- syndication if all else fails
- Refinance
  - End of Prepayment Periods
  - Available Equity/ Debt Service
- End of Compliance Periods (e.g. HOME)
  - Change in income targeting to stabilize property?
  - Disposition if doesn't fit portfolio needs

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Portfolio Milestone Chart

- Develop Portfolio Milestone Chart as key part of asset management systems
- See Page 26 of the Preservation Guide

PROJECT	2014	2015	2016	2017	2018	Notes
Fir Tree Commons	*Prepayment period ends*				*Year 15*	*Explore refinance after Year 15 transfer*
Stoneway Park	*New loan payment starts*					*Make sure we include new loan payments on projections.*
Clark View			*Loan term ends/Balloon payment due*			*Refinance now (w/o penalty) for better interest rate*
Broadway Terrace				*End of HOME restrictions*		*Explore option to sell when restrictions expire*

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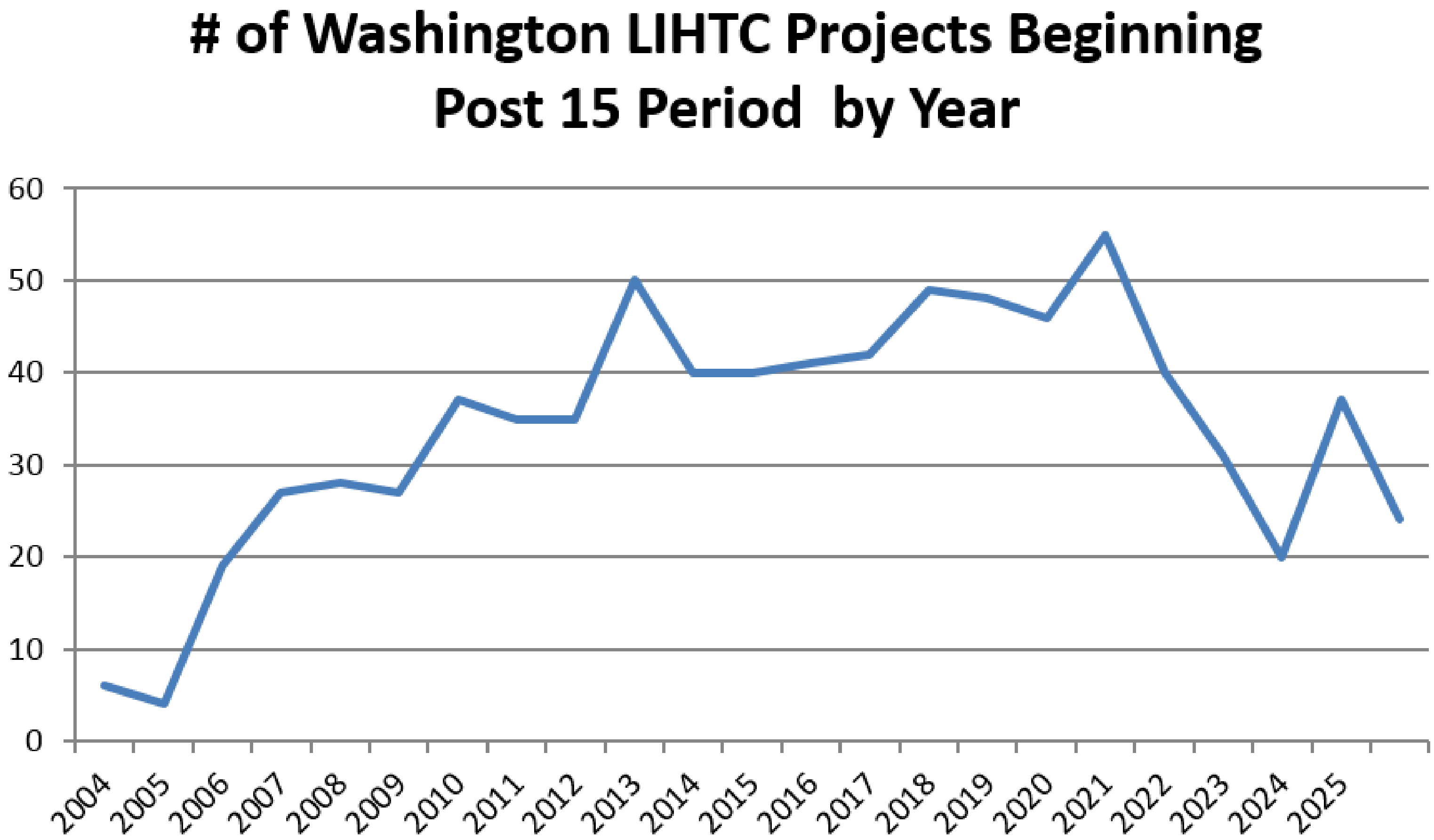
LIHTC Data in Washington



* Information from WSHFC – a couple of years old, but shows trends

Issues Particular to Multi-Partner Deals

- (Mis)Alignment of Interests between GP and LP
  - Identify different partner motivations
    - Residual distributions (cash out), incentives to force a sale
    - Desire to retain control and property management
    - Originally, the whole was worth more than the sum of the parts. That often reverses during the course of ownership.
  - The documents should define the rules – do they?
- Co-General Partners
  - For-profit/non-profit, PHA/developer, owner/residents
- Fiduciary and Disclosure Duties from GP to LP

Partner Issues (cont.)

- Valuation of the property for each party – as-is and post-discontinuity. Consider mission value (affordability), economic value (cash) and business plan
- Minimize investor exit issues and taxable events
  - Losses, depreciation and capital accounts
  - Forgiveness of soft debt
  - Estate planning
- Liquidity constraints
- Agree on objectives and renegotiate partnership terms

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Examples of Program Constraints

- Acquisition/Rehab transactions under LIHTC add several overlays
  - Interplay between surviving regulatory constraints and new requirements (rent, income restrictions, etc.)
  - Debt and equity position of the property
  - Your operating history will be used in underwriting
  - You know the property
- Public housing conversions under RAD
  - Rent levels
  - Changing HUD regulations

Synthesis of Portfolio Evaluation

- Data is key – operational data, deal data, mission data
- Resolve current problems – ensure cash flow
- Identify challenges and opportunities in the portfolio to set priorities based on risks and opportunities
- Consider disposition, bundling or disaggregating of properties
- Develop options for priority properties
- Competition for resources (funding and staff time) requires reconciling with you development pipeline

Case Study – Salem Housing Authority

- **Two non-contiguous properties:** Robert Lindsey Tower (62 units) and Parkway Village (124 units), 186 units total
- **Problem**:

  Both properties had substantial capital needs. Parkway Village was too large for a 9% LIHTC project (Oregon per unit limit) but needed too much rehab for a 4% LIHTC transaction.
- **Other Resources:**
  - Typical owner contributions (deferred fee, NOI during lease-up and stabilization)
  - Sale of small scattered site properties yielded $435,488
  - Sale of public housing provided $1,000,034

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Robert Lindsey Tower

Description:

62 Units (all 1BR)
Public Housing for Seniors
Built in 1966
SHA Offices in ground floor

Needs:

Needed moderate rehab of $46K/ Unit
SHA wanted to <u>remove the property from the public housing portfolio</u>

Resources to Bring to Project:

RAD Project = rent subsidies
PH Operating Reserve = $800K
Equity in Property = $27,581/unit

Parkway Village

Description: 124 Unit Property (not public housing)
Family Housing (2 & 3 BR)
10 buildings + garages
LIHTC Yr.17, Existing HOME

Needs:
Over-leveraged private debt
Needed significant rehab
($8.4 M, or average of $68K/unit)

Resources to Bring to Project:
Equity in property of $7,533/unit
Operating Reserves of $2,464/ unit

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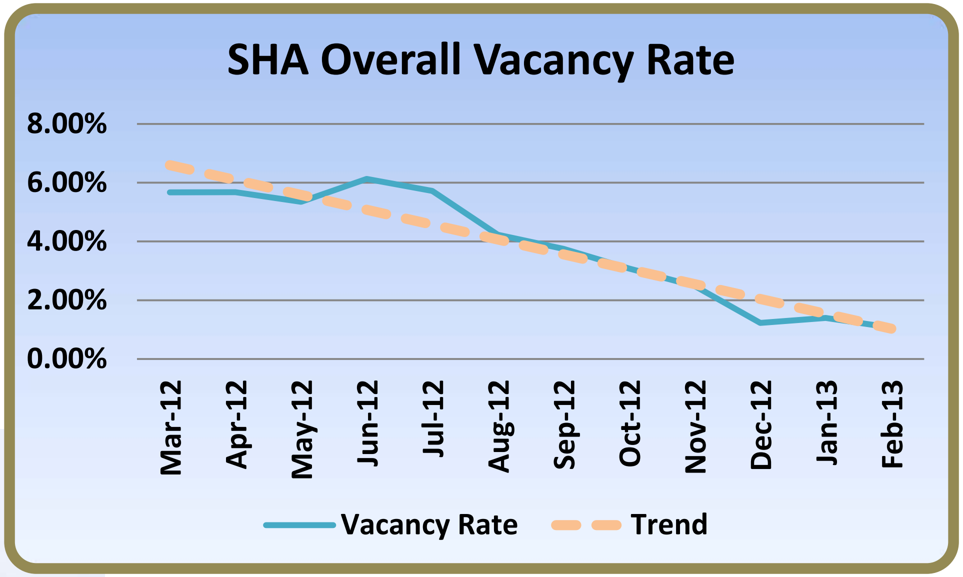
So What Did We Do?

1. Improved property management at Parkway West



Salem HA Staff graduated with Housing Development Center's 2nd class of the 18 month Asset Management & Portfolio Preservation Program

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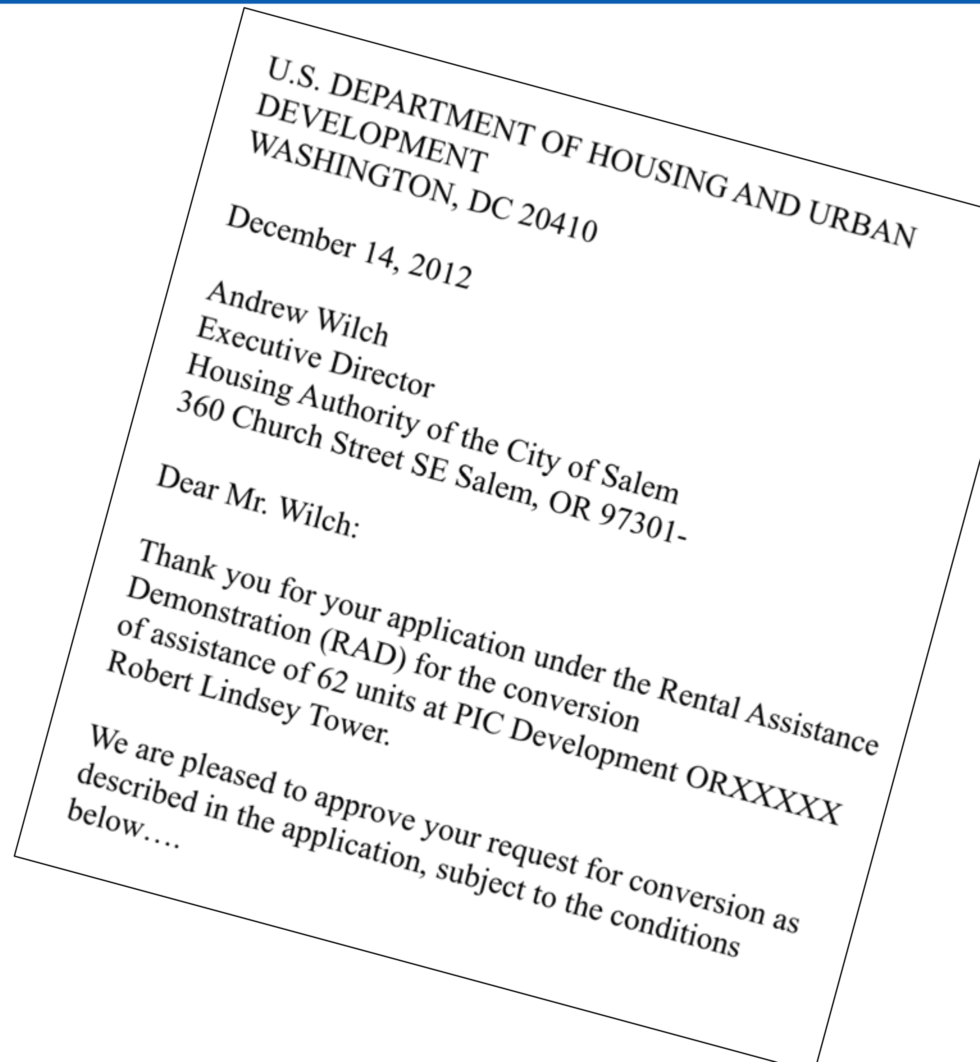
So What Did We Do (cont.)?

2. Applied for and were awarded HUD's Rental Assistance Demonstration Project – moving Public Housing operating subsidy to Project Based subsidies for the **Robert Lindsey Tower**



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410

December 14, 2012

Andrew Wilch
Executive Director
Housing Authority of the City of Salem
360 Church Street SE Salem, OR 97301-

Dear Mr. Wilch:

Thank you for your application under the Rental Assistance Demonstration (RAD) for the conversion of assistance of 62 units at PIC Development ORXXXXX Robert Lindsey Tower.

We are pleased to approve your request for conversion as described in the application, subject to the conditions below….

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So What Did We Do (cont.)?

3. Figured out a Financing Plan

Parkway West
78 Unit LIHTC Project
w/ bldgs that needed the most rehab
9% LIHTC

Parkway East
46 Units
Became part of a
4% LIHTC

with

Robert Lindsey Tower
62 Unit
RAD Conversion

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So What Did We Do (cont.)?

4. Applied for and were Awarded 9% LIHTCs & CDBG for **Parkway West**

5. Sold several small scattered site properties – required HUD & state approvals to move rent restrictions to other properties to get equity for **Parkway West**

6. Legally subdivided Parkway site into East and West – working with existing lender(s)

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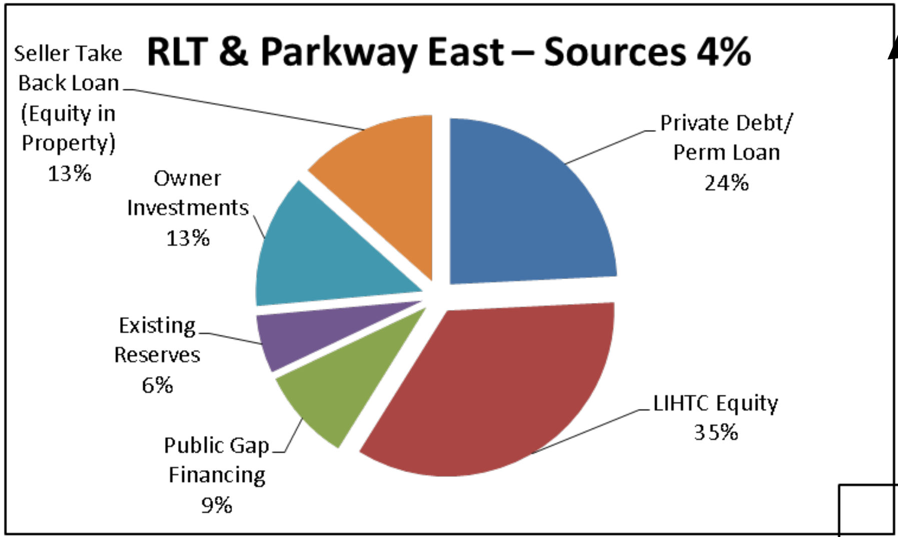
Simultaneous Closing – 300 Documents

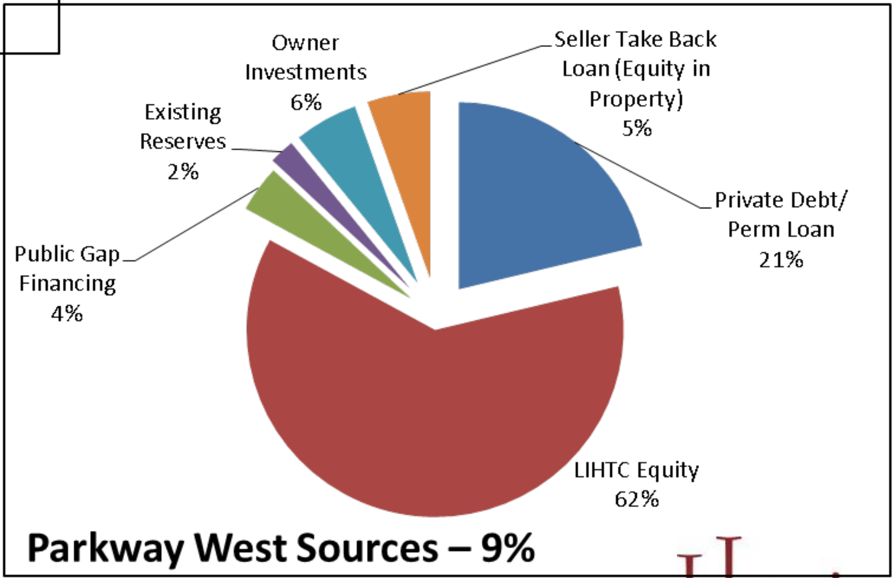


RLT & Parkway East:

- 108 units
- $19,270/ unit in Seller Note
- Average rehab of $57,086/ unit
- Perm debt for RLT supported by PB rent subsidies
- Perm debt = $43,740/ unit

Parkway West

- 78 Units
- $ 8,273/ unit in Seller Note
- Rehab of $68,538 per unit
- Perm debt = $32,577 per unit



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Rehab is Under Way!

A completed building at Parkway West

Window testing at Robert Lindsey Tower

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Lessons from This Project

- Get property operating as well as possible first
- Identify internal resources to bring to project
- Identify & secure external resources
- Emerging order of source of funds

1. Reserves
2. Refinancing

3 or 4. Owner Equity

3 or 4. 4% LIHTCs

When to use 4%'s versus equity is a good discussion

5. 9% LIHTCs & other public funds

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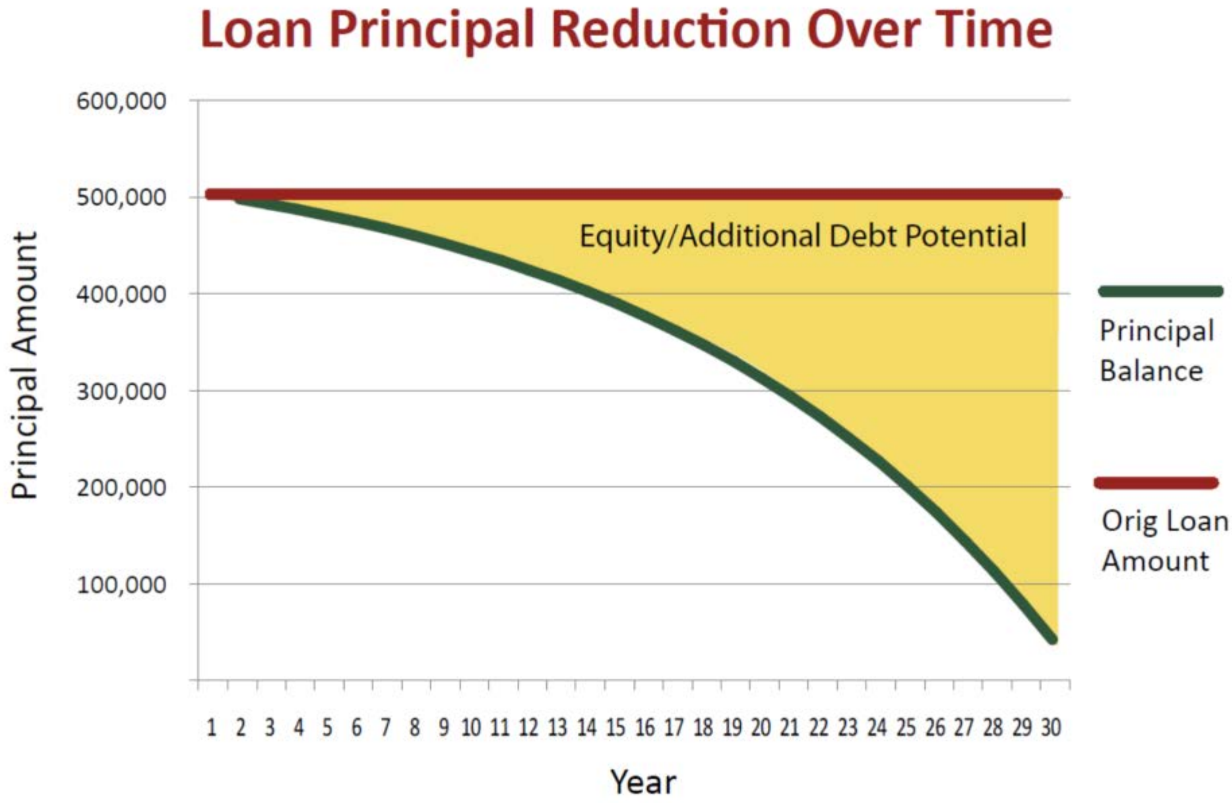
Additional Lessons

Loan Principal Reduction is critical to reducing gap:

- Additional private debt capacity through refinance
- Value of building = LIHTC basis, equity = seller note



Other Considerations

- Partial rehabs to fully utilize the remaining useful life of building systems can make sense
- We may need to look at modifying rent restrictions on some properties (upward)
- 4% LIHTC model works better with lower rehab amounts, larger projects, more equity in property, higher rent level projects…
- Not all properties are worth the added cost to save them.

Thank you.

Please contact either of us with questions

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