




Managing Rental Assets

(Diligent U/W, Savvy Deal Structures,
Practical A/M, Intervention &
Preservation)




Acronyms



- DSCR – Debt Service Coverage Ratio
- OpEx – Operating Expense
- CNA – Capital Needs Assessment
- PUPA- Per Unit Per Annum
- W/O – Work Out
- U/W – Underwriting
- W/A – Written Agreement
- U/A – Use Agreement
- CF – Cash Flow
- NCF – Net Cash Flow
- AFS – Audited Financial Statement
- RBI – Runs Batted In
- VL – Vacancy Level
- BD – Bad Debt
- A/R – Acquisition Rehab
- N/C – New Construction



The Tao of Asset Management



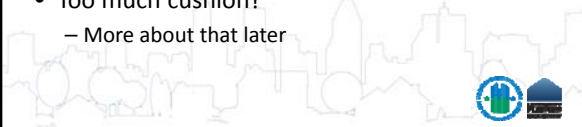
- Asset Management (A/M) is the yin to underwriting's yang
– Front-end and back-end
- Pay now vs. pay later. Housing costs what it costs.



Slide 3

Diligent Underwriting Cushion

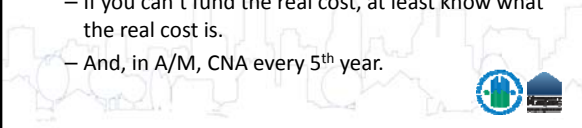
- About cushions
 - Size of cushion depends on risk factors
 - ‘Reasonably foreseeable adverse events’
 - Types of cushion
 - DSCR, OpEx, Rent Caps below max, Escrows
- Too much cushion?
 - More about that later



Slide 4

Diligent Underwriting Capital Needs

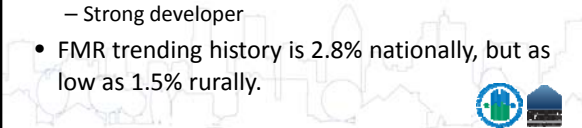
- Preservation is often about paying later for long-term capital needs that weren't funded in the original transaction.
- \$300 PUPA = 15 years; HOME = 20+ years
- Capital Needs Assessment (CNA)
 - If you can't fund the real cost, at least know what the real cost is.
 - And, in A/M, CNA every 5th year.



Slide 5

Diligent Underwriting Trending


- Predicting an out-year crisis
- Address it in the savvy structure of the deal
 - Higher initial DSCR
 - Sinking fund
 - Refinancing
 - Strong developer
- FMR trending history is 2.8% nationally, but as low as 1.5% rurally.



Slide 6

Savvy Deal Structures Intro / Key Concepts


- Underwriting determines the amount of the gap and cushion.
- Structuring addresses the terms of funding, providing options for soft workouts and preservation
- Not *just* about how you asset manage what you've got; it's about how you create something that you can more effectively asset manage.



Slide 7

Savvy Deal Structures Foreclosure Proof Use Agreements


- Recorded first; survive foreclosure
- Impact on mortgage sizing / underwriting
- Always vs. sometimes (when)
- Downside: May constrain 1st mortgage
- Upside: No loss of affordability
- Upside: No repayment requirement to HUD
- Upside: PJ can negotiate workout from safety



Slide 8

Savvy Deal Structures Developer Guaranties

- Not the same as escrows (HOME pays those)
- Operating Deficit Guaranty
 - Sponsor funds deficit: AM monitors and enforces
 - Repaid from cash flow, priority or owner's share
 - Expires after some achievement
 - Developer takes U/W seriously...sets tone
- Completion Guaranty
 - To ensure project is built without requiring more subsidy



Slide 9

Savvy Deal Structures – More HOME Units and/or Lower Rents

MORE UNITS

- Works if HOME rents are less than Not-HOME (revert-to) rents
- More HOME units = reduced income = more affordability = more subsidy
- Soft workout = trading affordability (# of units) for viability

LOWER RENTS

- Relationship between HOME/Not-HOME irrelevant
- Underwrite to lower rents (5 – 10% below HOME) + Limit rents in written agreement
- Lower rents = reduced income = more affordability = more subsidy
- Soft workout = trading affordability for viability...not units, but rents paid



Slide 10

Savvy Deal Structures Phasing of Use Agreement

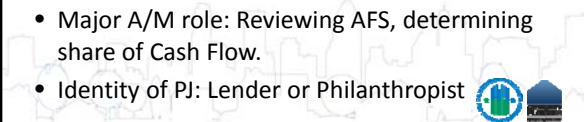
- Options, options, options
- Record HOME minimum affordability period separately from PJ additional/incremental
- Record HOME affordability period with PJ option to extend.



Slide 11

Savvy Deal Structures Overfunding vs Underfunding

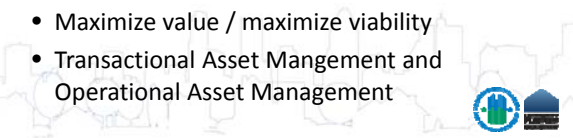
- Cash flow vs. HOME investment
- Overfill the glass, sponge it up
- Sponsor share: adequate to incent cash flow
- Program income – admin budget, A/M staff, legacy
- Major A/M role: Reviewing AFS, determining share of Cash Flow.
- Identity of PJ: Lender or Philanthropist



Slide 12

Practical Asset Management


- Systems, procedures, portfolios, goals – not ‘seat of the pants’
- 80/20 rule
- Staffing relationship to Underwriting / Due Diligence
- Maximize value / maximize viability
- Transactional Asset Management and Operational Asset Management



Slide 13

Practical Asset Management Early Warning Systems


- Collect / input data on operating outcomes regularly: Require AFS in written agreement
- Compare to proforma; Look for trends
- Sort properties based on risk level (triage)
- A/M procedures based on risk level
 - Increased monitoring
 - Meeting with sponsor
 - Analysis of options



Slide 14

Practical Asset Management Reporting Systems

- How others report:
 - Baseball, Weather, Stock Market, Healthcare
 - Industry standards (RBI, heating degree days, Nasdaq index, cholesterol level)

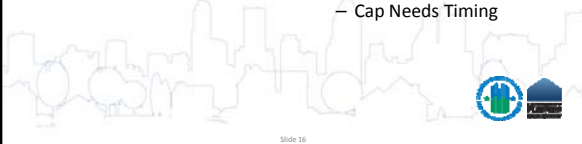





Slide 15

Practical Asset Management Key Indicators


- Concepts
 - Trend
 - Compared to proforma
 - Compared to budget
 - Peers
- Indicators
 - Cash flow, \$/U
 - Cash flow, % of OpEx
 - Cash flow, vs Prior Year
 - Drill-down (rents, expenses, VL, BD, Turnover)
 - Cap Needs Timing



Slide 16

Practical Asset Management Warning Signs of Trouble

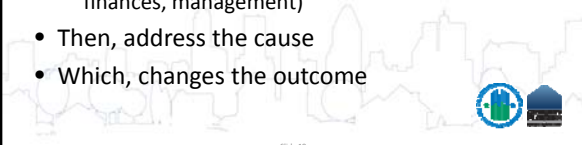
- Deteriorating property condition
 - Code violations
- Increasing and unexpected capital needs
- Poor local economy/increasing crime conditions
- Tenant complaints
- High property management staff turnover



Slide 17

Practical Asset Management Cause and Effect

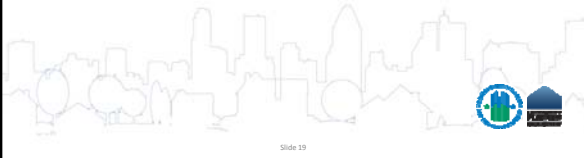
- Follow the flow of effect and cause (drill-down)
 - Effect (NCF) vs. Cause (VL)
 - Effect (VL) vs. Cause (Make-Ready)
 - Effect (Make-Ready) vs. Cause (staffing levels, finances, management)
- Then, address the cause
- Which, changes the outcome



Slide 18

Practical Asset Management Tiered Response

- Frequency and extent of inspections based on A/M triggers and compliance triggers
- HOME minimum frequency



Slide 19

Practical Asset Management Making the Best of Limited Options

- No Savvy Options: dealt a bad hand.
- Quantify the problem (\$\$)
- Assess consequences to all parties
- Is there a champion?
- Improved management



Slide 20

Intervention And Preservation


- Workout / intervention is a decision to preserve
- Know when to walk away
- Consequences to tenants



Slide 21

Intervention – Re underwriting


- Calculate the cost of workout
- Cost is like an iceberg, cost is always much larger than you think
- (Re)underwrite with real income/expense data
- Cost related to term of workout (limp to finish line, or bionic man)



Slide 22

Intervention Applying Soft Workout Options


- Savvy deal structures: come to me, baby
- Affordability protected through recorded U/A: Not my problem, baby.
- Invoke developer guaranty
- Let go of excess HOME units
- Allow HOME rents to rise to maximum
- Require a change in management/ownership



Slide 23

Intervention Principals of Work Outs

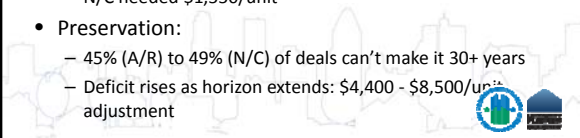
- If soft workout doesn't work out, then a hard workout is what's left
- 2-3 years; ten times as much \$ as you think
- Stages of grieving
 - Denial, anger, bargaining, depression, acceptance
- Need a champion
- Shared pain



Slide 24

Preservation Properties run out of gas


- Analysis of adjusted total development cost
- ~300 properties: A/R and N/C
- Intervention:
 - 14% (A/R) to 21% (N/C) of deals can't make it 20 years
 - A/R needed \$4,400/unit
 - N/C needed \$1,550/unit
- Preservation:
 - 45% (A/R) to 49% (N/C) of deals can't make it 30+ years
 - Deficit rises as horizon extends: \$4,400 - \$8,500/unit²⁰ adjustment



Slide 25

Preservation Obsolescence & Shifting Market Dynamics

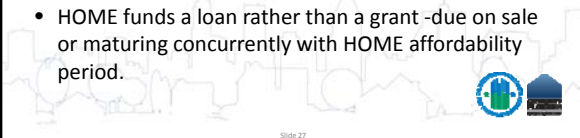
- Are the units worth preserving?
- Meet current market demands
 - Location
 - Affordability
- Unit types, features and/or amenities are competitive
- Re-underwrite for financial viability & sustainability



Slide 26

Preservation Savvy Deal Structures, Are You There?


- Location, location, location
- Require periodic CNAs – know needs at the end of the affordability period
- Require realistic replacement reserves and monitor for compliance
- HOME U/A separate from PJ's
- HOME funds a loan rather than a grant -due on sale or maturing concurrently with HOME affordability period.



Slide 27

Preservation Investing Additional HOME Funds


- Cannot provide additional HOME funds during affordability period without waiver from HUD
- Provide new HOME funds for rehab to extend and preserve affordability
- “Greener” to preserve existing units than build new
- Consider providing enough HOME funds to add energy efficient features



Slide 28

Preservation Rental vs. Homeownership


- Political will and market conditions may favor homeownership
- During or after the affordability period, may sell HOME units to tenants to preserve affordable units
 - Tenant must be income eligible
 - Can use additional HOME \$\$ to assist tenants to buy and/or to rehab the units
- Affordability period based on homeownership requirements



Slide 29

Closing – Key Take Aways

- Housing Development and Asset Management are a continuum, where the characteristics of development influence the asset management needs and the asset management experience informs the characteristics and requirements of subsequent transactions
- Diligent underwriting reduces the need for workouts
- Forewarning of financial distress provides opportunity for intervention
- Early intervention is less expensive than late intervention
- Savvy loan provisions enhance the likelihood of success in a workout
- Preservation should be approached strategically, and options should be preserved in the initial structure



Slide 30
