U.S. Department of Housing and Urban Development
Office of Recapitalization

2017 HUD Preservation Workbook and Recapitalization Excel Tool Webinar

Conceiving a Recapitalization Strategy Using HUD's Support Tools
Presented Thursday, December 7th, 2017, 3:00 p.m., EST.

Introductions

<u>Moderator</u> – Minnie Monroe Baldwin, Affordable Housing Branch Chief, HUD Office of Recapitalization

<u>Welcome</u> – Tom Davis, Director, HUD Office of Recapitalization

<u>Presenters</u> – Charlie Wilkins and Anker Heegaard, The Compass Group Affordable Housing

Foundation and Goals

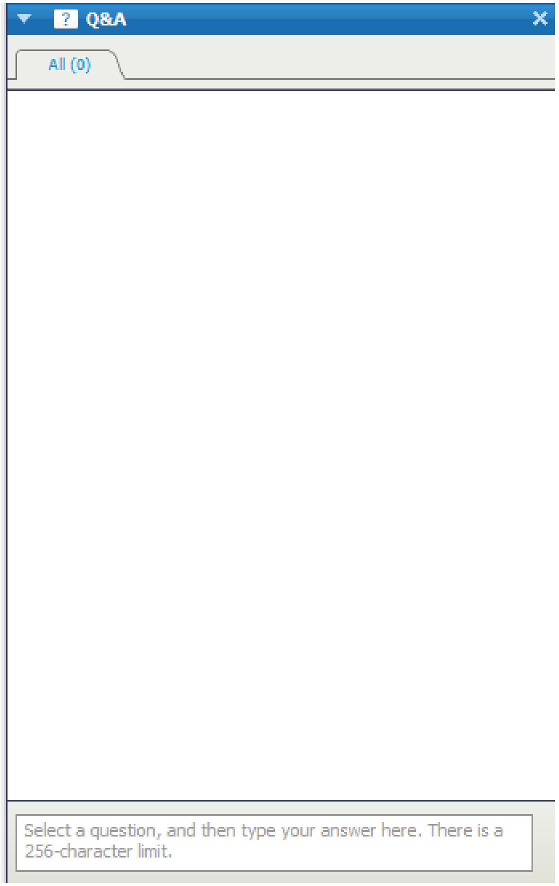
- Foundation
  - Why did HUD create these tools, and who are they designed to help?
- Goals of this Webinar
  - Demonstrate how to use the HUD Preservation Workbook and Excel tool to develop a strategy to preserve your affordable multifamily rental housing.
  - Educate how to take initial steps to determine the physical and financial parameters of a recapitalization.
  - Stabilize, improve, modernize and safeguard housing for low-income renters.

Agenda

- Framing and context
- Walk-through of the recapitalization process
  - Start with big concepts and goals, and refine these with data and decision making
- Guided tour of the Recapitalization Workbook and Financial Modeling Tool
  - What it is and how it can help preservation efforts
- Case-study based demonstration of these resources
  - A deeper dive, demonstrating how these resources support strategic recapitalization planning
- Questions and Answers
- Wrap-Up

Webinar Logistics

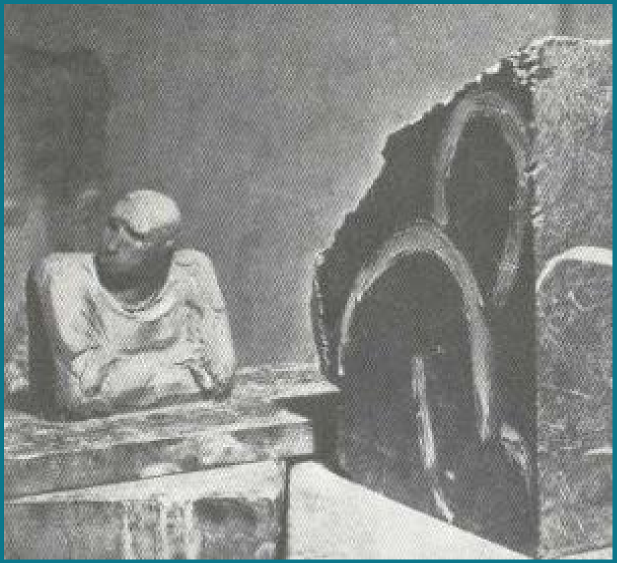
- Participants on mute
- Ask questions via the WebEx Q&A box
- If technical issues related to WebEx, insert them in the Chat Box



Why this Matters

- Unrelenting need for affordable housing
- Aging portfolio
- Supply of affordable housing dwindling while need increases and federal subsidies decrease
- HUD has preservation tools in our toolbox and we are active partners

The Recapitalization Process



Preservation through Recapitalization

- Preservation
  - Safeguard, Improve and Modernize, Stabilize
- Recapitalization
  - …is preservation that involves new funding

Recapitalization refers to a preservation transaction that involves new funds, such as from refinancing the first mortgage loan or obtaining HOME Investment Partnerships Program funds, Community Development Block Grants (CDBGs), State Housing Trust funds, or obtaining tax credits.

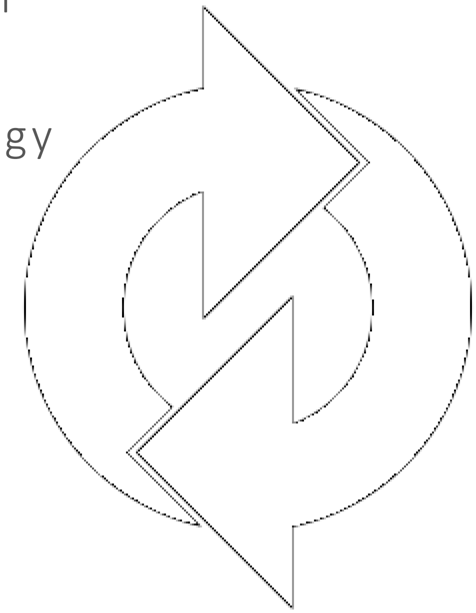
- But…preservation may or may not require recapitalization:

Key Concepts

- Be prepared for changes as your strategy develops
  - The ‘right’ answer might not be the one you start with
- Explore whether preservation without recapitalization is an option—if so, this is the simplest path; if not, recapitalize
- Recapitalization requires leadership, organization, expertise and perseverance
- Recapitalization is a *process which may take 1-2 years to complete.*

The Six Steps of Recapitalization Planning

1. Know your property
2. Set your preservation goals
3. Identify your best option without recapitalization
4. Decide: Preserve with or without recapitalization
5. Design a recapitalization
6. Fine-tune and evolve your recapitalization strategy



Goals and strategy are iterative: Your goals inform your strategy, and as your strategy evolves you will have to revisit and reprioritize your goals.

Step 1 – Know Your Property

- Build (and lead) a team
  - Property manager, attorney, architect/engineer, lender(s), investors, preservation consultant, and others reflecting your property and needs
- Do your research
  - What does it cost to operate your property? What should it cost?
  - Understand your property's current financing
  - Understand your rent structure and subsidies
  - Understand your property's immediate and long-term major repair and replacement needs (capital needs)
  - Understand your property's market
  - Understand your residents' needs

Step 2 – Set your (Initial) Preservation Goals

These are goal areas – you determine the actual goals

- Financing Capital Improvements (critical, immediate, market-upgrades, utility efficiency, long-term repair and replacement)
- Maintaining or enhancing affordability
- Stable and sufficient operating income—to pay debt, projected operating expenses, and fund reserves
- Other – achieving mission objectives of the owner, addressing compliance issues, solving other specific problems for this property, do I want to sell, do I want to not sell, …

Step 3 – Best Option without Recapitalization

- Can you achieve your goals without new money?
- Develop a 'status-quo cash flow projection'
- Modify this to show possible improvements that do not require new money (operational changes, rent increase, tax exemption, etc.)
- Does your modified cash flow projection achieve your goals?

Step 4 – Do I Need a Recapitalization?

- If your goals cannot be met without new money, then you need a recapitalization
- Identify all needed changes
- Revisit your preservation goals

Answer the question: “Can I preserve the property and meet my goals without recapitalizing?”

If YES, pursue preservation without new money

If NO, design a recapitalization

Step 5 – Design a Recapitalization, I

- Estimate the Uses of Funds (Costs)

Total Uses of Funds/Total Development Costs*

Uses of Funds	Light Rehab	Moderate Rehab	Intensive Rehab	"Gut" Rehab
Hard cost of repairs	$10,000	$20,000	$40,000	$75,000
Hard cost contingency	$2,000	$4,000	$8,000	$15,000
General contractor costs	$1,700	$3,400	$6,700	$12,600
Miscellaneous soft costs	$2,700	$6,900	$16,400	$35,900
Soft cost contingency	$500	$1,400	$3,300	$7,200
Developer fee	$2,800	$5,800	$12,100	$23,700
Total uses of funds	$19,700	$41,500	$86,500	$169,400

**Dollars per unit*

Step 5 – Design a Recapitalization, II

- Determine the Sources of Funds

Typical Preservation Sources of Funds at Different Levels of Rehabilitation*

Sources of Funds	Light Rehab	Moderate Rehab	Intensive Rehab	"Gut" Rehab
New first mortgage	$15,000	$15,000	$15,000	$15,000
9% tax credit equity	$0	$0	$0	$136,000
4% tax credit equity	$0	$12,000	$26,000	$0
HOME funds	$0	$12,500	$22,500	$12,500
Community Development Block Grants (CDBGs)	$4,500	$0	$0	$0
State Housing Trust Funds	$0	$0	$20,000	$0
Deferred developer fee	$200	$2,000	$3,000	$5,900
TOTAL SOURCES OF FUNDS	$19,700	$41,500	$86,500	$169,400
TOTAL USES OF FUNDS	$19,700	$41,500	$86,500	$169,400
Higher cost transactions require more complex financing approaches.				

*Dollars per unit

Step 5 – Design a Recapitalization, III

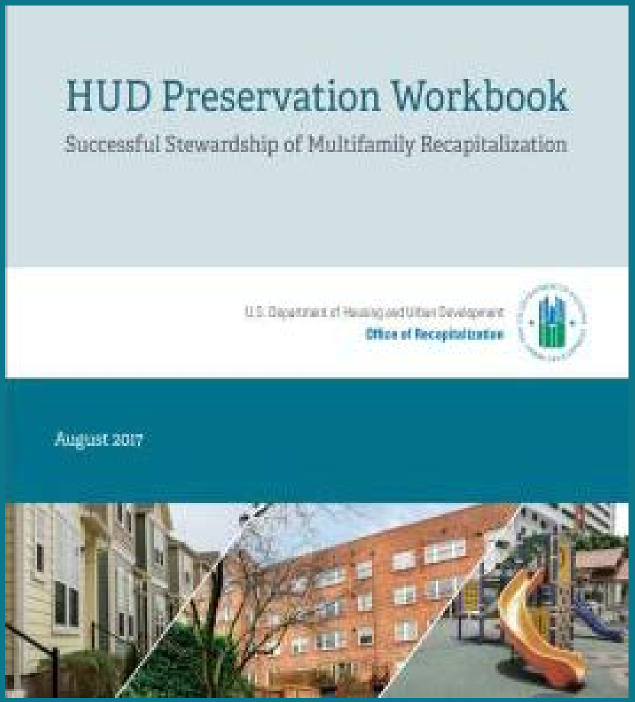
- Refinancing the first mortgage loan
  - Prepay or wait?
  - Refinance with HUD?
  - Start with loan type or lender?
  - What is the right amortization?
    - Balloon?
    - Self-amortizing?
- What are the best options for funding costs?
- Will the recapitalization require a sale?

Step 6 – Fine-Tuning your Recapitalization

- Recapitalization is iterative
- Sources affect uses; uses affect sources
- Timing of sources and uses
- Interim costs and closing costs
- Reserves
- Lease-up
- Should I get a development consultant?
- Guarantees

Introducing the Preservation Workbook and Financial Modeling Tool

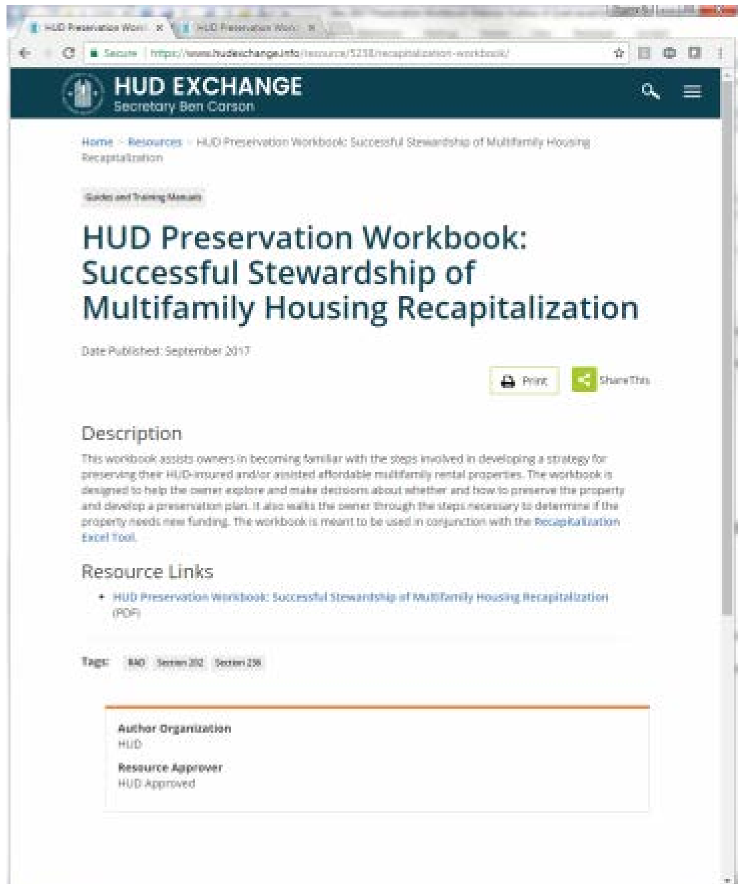
How they're structured, and how the workbook and financial modeling tool support each other



The Preservation Workbook and Excel Tool

- Available on HUD Exchange
  - https://www.hudexchange.info/resource/5238/recapitalization-workbook/
- The Financial Modeling Tool and Workbook are ‘companion products’
  - The Workbook
    - Is a process – start at the beginning and work your way through
    - Detailed sections for each of the Preservation Steps
    - Appendices
  - The Financial Modeling Tool
    - Captures information from the planning process (Know Your Property)
    - Performs basic calculations to support your decision to recapitalize
    - Coordinates with the Exercises in the Workbook

HUD Exchange



Features of the Workbook

Narrative

Chapter 1 – Know Yo

Before you can set out on the road to preservati
must take stock of your current resources, need
options. This chapter outlines basic considerati
that will help you best understand your propert
preservation potential.

To help you, gather a team of professionals who a
familiar with and specialize in affordable housin
preservation. You might start with your propert
manager and attorney. Later, you might add a
preservation consultant, lender, architect, and co

In addition, your board or other governance struc
of your project can and should be a useful resourc

Sidebars

Sample long-term own
statement:

"I want to be the sole general part
member of the property while ens
term physical and financial viabil
funds I need for any needed inves
receiving cash flow and other ben
least my ongoing costs for asset m

Questions and Answers

Common Questions

Q Why do I need the sort of cash flow pro
is recommended in this workbook?

A It's the best way to help you spot potentia
problems and to identify solutions early. I
way to identify opportunities for improv
operations, and having the projection wil
when you negotiate for new sources of fin

Q Why might my property require a reca

A There are lots of possible reasons. Here
of the more likely ones: Maybe you wa

Post-its

Reserve deposit
probably too low.
Get CNA. Talk to
HUD about rent
increase for
larger reserve
deposit.

Exercises

Exercise 3-1, Regulatory Optior

- Which regulatory options are possible **and** loo
good ideas for your property? Why?

____

____

____

- Which regulatory options are possible, but do
like good ideas to you? Why?

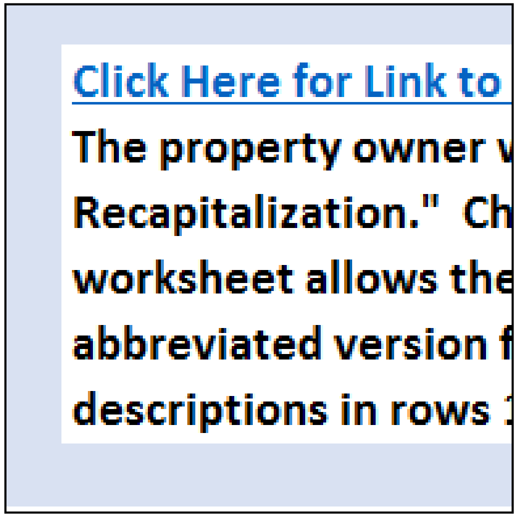
____

Exercise References

COMPLETE EXERCISE 3-7
Optional Preservation Goals

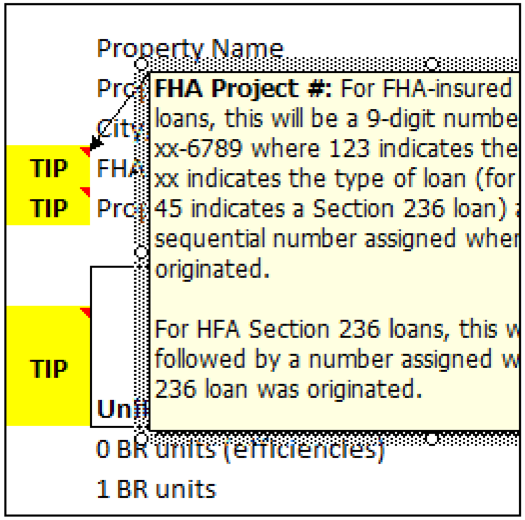
Features of the Financial Modeling Tool

Reference to Workbook



User Inputs

Tips



U.S. Department of Housing and Urban Development
Office of Recapitalization

Workbook Appendices

Glossary

Administering PHA: An administering P
assistance, which may include HCV, MO

Affordable Housing Preservation: This
recapitalization of affordable rental hou

- **Safeguard** long-term rental assistar
generations;
- **Improve** and **modernize** properties
- **Stabilize** properties by placing them

Annual Contributions Contract (ACC):
agreement between HUD and a PHA un

Resource List

General Resources for Preservation

- General information on multifamily housin
HUD's website at:
http://portal.hud.gov/hudportal/HUD?src=
HUD Exchange at: https://www.hudexchan
program information on Section 236 prese
  - https://www.hudexchange.info/sectio
  - https://www.hudexchange.info/rad/
- The application for Section 236 preservatio
Preservation Resource Desk at: http://www
- Detailed information on RAD is available or
Resource Desk at: http://radresource.net/i

Sample Financial Modeling Tool

Dollars Per Unit	Per Unit	
New First Mortgage	$15,000	18% of
9% Tax Credit Equity	$49,000	60% of
4% Tax Credit Equity	$0	0% of
Soft Debt (HOME, CDBG, State trust fund, ...)	$5,000	6% of
Deferred Developer Fee	$6,200	8% of
Funds Shortage (Excess)	$6,700	8% of
Additional funding needed		
Total Sources of Funds	**$81,900**	
Pay Off Existing First Mortgage	$1,500	2% of
Hard Cost of Repairs	$40,000	49% of
Hard Cost Contingency	$8,000	10% of
General Contractor Costs	$6,700	8% of
Miscellaeous Soft Costs	$11,200	14% of
Soft Cost Contingency	$2,200	3% of
Developer Fee	$12,300	15% of

Case Study

Bennington Square (Section 236 Property with maturing first mortgage loan)

Pictures of Bennington

1. Exterior

2. Exterior

Pictures of Bennington

←3. Typ. Furnace and HWH

↓4. Typ. HVAC Condensers

Pictures of Bennington

5. Original Single Pane

6. Original S-P Sliding Door

Pictures of Bennington

7. Older Kitchen

8. Newer Kitchen

Exercise 1-1, Background Information

Exercise 1-1, Background Information

Assemble key information for your property:

- ☑ First mortgage note (or loan agreement), mortgage (or deed of trust), and regulatory agreement (or use agreement)
- ☑ Most recent statement from your first mortgage lender, showing the remaining balance
- ☑ Most recent rental schedule approved by the U.S. Department of Housing and Urban Development (HUD) (HUD-92458)
- ☑ Most recent renewal of each project-based rental assistance contract

Go to the first worksheet of the Financial Modeling Tool, called "Background Information," and complete the following sections:

- ☑ Property Identification and Unit Mix
- ☑ Estimating When Your First Mortgage Loan Will Mature

What did you learn during this exercise that might affect your preservation transaction?

Need to be organized—Set up a digital library for assembling and sharing docs Purchased doc scanner

	Revenue Units				
Unit Mix	Project Based Section 8	Other Project Based	Tenant Based Vouchers	Units With No Rental Assistance	Non Revenue Units
0 BR units (efficiencies)	0	0	0	0	0
1 BR units	15	0	0	10	0
2 BR units	40	0	0	9	1
3 BR units	15	0	0	10	0
4BR and larger units	0	0	0	0	0
Total	**70**	**0**	**0**	**29**	**1**
Total Revenue Units	**99**				
Total Units	**100**				

...can we get 100% §8?

Is this a family property, elderly property, mixed tenancy, something else? Discuss any unusual features of the tenant mix.

Mixed, most 1BRs are elderly, the rest are family.

Is the current owner a nonprofit? A limited dividend owner? Something else? Discuss any unusual features of the property's ownership structure.

Non-profit owner.

Estimating When Your First Mortgage Loan Will Mature

Please indicate when the property was developed (that is, when the first mortgage loan was put in place). If the loan is FHA-insured or HUD-Held and you know the FHA "final endorsement" date, please provide that as well.

The property was new construction, with construction completed in 1980. Don't have the final endorsement date.

Exercise 1-2, Prepayment

(excerpt)

Exercise 1-2, Prepayment

Go to the first worksheet of the Financial Modeling Tool, called "Background Information," and complete the section called, "Determining Whether HUD Permission Is Required to Prepay Your First Mortgage Loan."

HUD permission will likely be required if any of the following are true:

- ☐ The original owner was a nonprofit.
- ☐ ✓The property currently has a Rent Supplement contract.

Indications Whether HUD Permission Is Required In Order to Prepay Your First Mortgage Loan
Note -- the final determination must be made by HUD; the questions below will help you to reach a likely or approximate answer.

If your first mortgage is a conventional loan (not from HUD, never insured by FHA), skip this section.

Is there now, or has there ever been: (1) a default (monetary default or 'covenant' default) under the loan documents? (2) A Forbearance Agreement? (3) Foreclosure proceedings? (4) A Partial Payment of Claim? (5) A loan modification? (6) A workout or other restructuring? This information is important because these events often resulted in a requirement that HUD approve any prepayment.

None

Briefly discuss any transfers of ownership since the property was originally developed. For each, include the date of transfer, the legal name of the seller, and the legal name of the purchaser. Indicate whether any of the owners was a nonprofit or was controlled by a nonprofit.

We've owned it from the beginning. We're a nonprofit.

Did the property ever receive preservation incentives under the ELIHPA ("Title Two") or LIHPRHA ("Title Six") preservation program?

No

Did the property ever participate in the Portfolio Re-Engineering Demonstration Program? Was the debt restructured under the Mark-to-Market program? Is there a Contingent Repayment Note (CRN) or Mortgage Restructuring Note (MRN)?

No

Exercise 1-3, Other Debts

(excerpt)

Exercise 1-3, Debts beyond the First Mortgage Loan

- ☐ For any debts other than the first mortgage loan, assemble the note/loan agreement, mortgage/deed of trust (if any), regulatory agreement/use agreement (if any), and the most recent statement from your lender, showing the remaining balance.
- ☐ Go to the first worksheet of the Financial Modeling Tool, called "Background Information," and complete

Debts Other Than the First Mortgage Loan; Other Unusual Features

Please indicate whether there is any existing debt (secured or unsecured) other than the first mortgage loan. For example, the property may have received Flexible Subsidy or HELP (earthquake relief) funding through HUD, or it may have received a supplemental loan from the city or county or state. For each debt, please briefly explain why it was incurred, who the lender is, how much is currently owed, the payment requirements, and whether the debt will accelerate (become due in full) when your first mortgage loan matures or is prepaid.

No other debts; other than owner advances, subordinated and secured.

Please explain any unusual features of the property (for example: if the first mortgage loan was from a State Housing Finance Agency, if the first mortgage loan was bond-financed, if there is more than one project-based Section 8 contract, if there is a RAP or Rent Supplement contract, if there is any other type of project-based rental assistance contract, if the property has multiple Section 236 or Section 202 loans, if the property is owned by a tenant co-operative, if there is any sort of Use Agreement or deed restriction, if the land is leased, or if the property has any sort of tax credit funding).

None

Exercise 1-4, Rental Assistance Contracts

Exercise 1-4, Rental Assistance Contracts

Locate all of the rental assistance contracts for your property. You may need to contact your HUD multifamily representative or performance-based contract administrator to answer some of these questions. Note: at the end of this exercise there is a question about additional options if you prepay your first mortgage loan. Here's the explanation: sometimes your unassisted tenants can obtain rental assistance as part of your preservation transaction, but only if you prepay your first mortgage loan. Be sure to ask your preservation experts about this.

If the property has multiple contracts, the owner should complete the exercise for each individual contract.

- Of the following, what types of rental assistance contracts does the property have?

  - [ ] Section 8 Loan Management Set-Aside
  - [ ] Rent Supplement, Rental Assistance Program (RAP)
  - [x] Section 8 New Construction
  - [ ] Section 8 Substantial Rehabilitation
  - [ ] Section 8 Moderate Rehabilitation

- What mix of units is assisted under this contract?

	0BR	1BR	2BR	3BR	4BR
Section 8		15	40	15	

- When does the contract expire? 4 / 23 / 20

- How are contract rents adjusted during the term of the contract?

  Annually, OCAF

- Is the contract eligible for renewal when it expires?

  - [ ] YES
  - [x] NO

  If so, which renewal options will likely be available?

Exercise 1-5, Unassisted Units

Exercise 1-5, Unassisted Units

If all of the units at your property have rental assistance, skip this exercise. Also skip this exercise if you have units without project-based rental assistance, but the tenants can afford both your **current** rents and the rents you expect to charge after you close your preservation transaction.

In a typical month, write down **how many** unassisted tenants fall into each category:

- Holders of Section 8 Housing Choice Vouchers (HCVs)

  4 to 5

- Holders of other tenant-based rental assistance

  none

- No rental assistance but can afford the rent

  Half to three-quarters

In a typical month, how many units with no project-based rental assistance are vacant?

5

Why do those units stay vacant?

Difficulty finding qualified tenants

What would have to change in order for you to be able to rent those units?

More project-based Section 8

Exercise 1-6, Long-Term Capital Needs

(excerpt)

Exercise 1-6, Long-Term Capital Needs

Answer the following questions in the first worksheet of the Financial Modeling Tool, called "Background Information":

- ☐ When was the property originally constructed? When, if ever, was it fully rehabilitated by replacing everything inside the exterior walls? When, if ever, was it substantially rehabilitated by bringing all or almost all systems up to date, but not replacing the interior walls, insulation, or pipes?
- ☐ What type of roof does the property have? When will you need to replace it?
- ☐ When will the property need exterior painting? How much did that cost the last time you did it?
- ☐ What type of exterior wall surface do you have? When

Indications of Major Capital Needs

When was the property originally constructed? When (if ever) did it have a full ("gut") rehab (replacing everything inside the exterior walls)? When (if ever) did it have a substantial rehab (bringing all or almost all systems up to date, but not replacing the interior walls or insulation or

New construction completed 1980. No rehab since that time.

What type of roof do you have? When is the next replacement likely to be needed?

Pitched asphalt shingle, last replaced in 1997. Next replacement probably 2020.

When will the property next need exterior painting? What did that cost, the last time you did it?

Probably 2019. Last time (2012) it cost $45,000.

What type of exterior wall surface do you have? When will it need major repairs or replacement?

Mix of brick veneer and T-111 plywood siding. Siding is original and is showing its age.

Does the property have any elevators? If so, how many, and when were they installed? Have there been any major repairs or replacements to the mechanicals, controls or cabs since original

None

Exercises 2-1 to 2-3, Setting Your Preservation Goals

Exercise 2-1, Financing Capital Improvements

Exercise 2-2, Maintaining Affordable Rents

Exercise 2-3, Achieving Sufficient Operating Income

- Goal Areas:
- Preserving affordability
- Meeting physical needs over time
- Optimizing sponsor’s role and mission
- Resident needs
- Evolving role of property in an evolving neighborhood.
- Additional preservation goals

Additional Preservation Goals

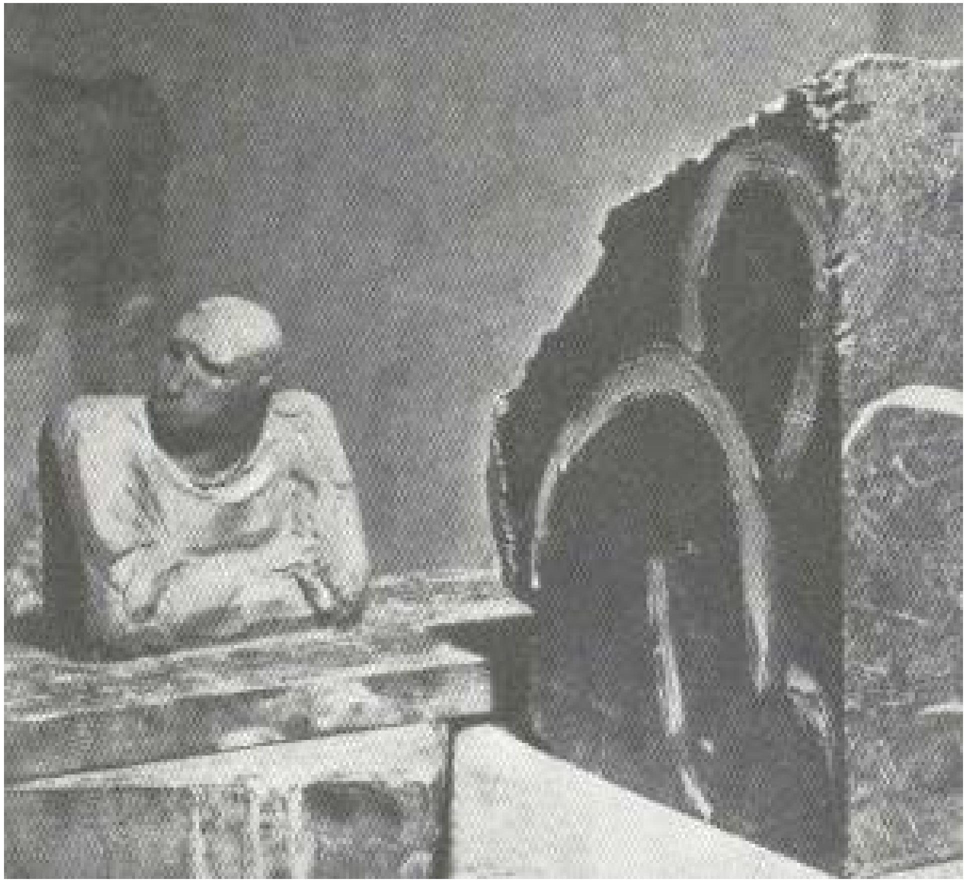
Consider Adding Extra Preservation Goals

Now it's time to think about optional preservation goals, such as:

- Hiring a service coordinator.
- Providing better support for aging residents, like converting some units to include assisted living services.
- Increasing or decreasing the number of units available for rent.
- Making adjustments to the unit mix. For example, by converting unmarketable efficiencies into a smaller number of one-bedroom units.
- Adding common areas. For example, adding community spaces, commercial kitchen/dining rooms, or recreational amenities.
- Adjusting your affordability approach. How affordable are your units, and for whom?
- Reducing utility consumption by a certain percentage.
- Achieving an environmental designation for energy efficiency or some other green measure.
- Improving cash flow by a certain percentage.
- Refinancing to generate a certain amount of net cash proceeds.

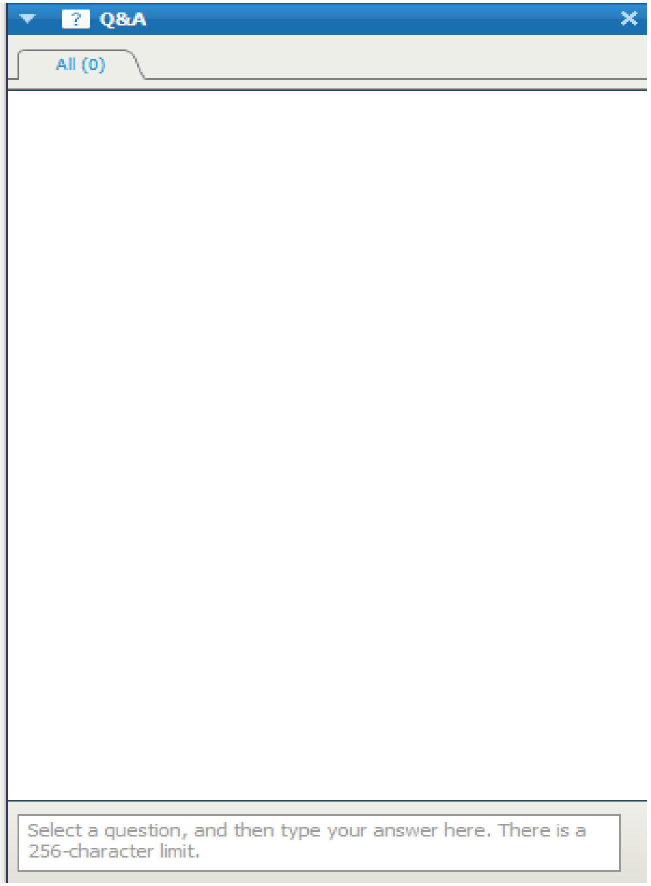
Exercises 3-1 to 3-8: Getting to Best Option Without a Recapitalization

Rough-Out, then Refine



Questions and Answers

- Ask questions via the WebEx Q&A box



Wrap-Up

- Designing a preservation/recapitalization strategy is an iterative process
- Preservation Workbook and Financial Modeling Tool can help you learn about this process
- Ultimately, should lead to preserving a supply of affordable housing for years to come
- Access the tools:

  HUD Preservation Workbook

  Financial Modeling Tool (Excel)

Thank you for participating!