HUD Exchange, 2017 HUD Preservation Workbook and Recapitalization Excel Tool Webinar, 12-7-17

Minnie Monroe Baldwin: -- Monroe Baldwin. I am an affordable housing branch chief in the Office of Recapitalization here at the U.S. Department of Housing and Urban Development, HUD. I'd like to welcome you to the 2017 HUD preservation workbook and recapitalization Excel tool webinar. This webinar is about introducing you to HUD tools designed to assist developing a recapitalization preservation strategy for your affordable housing property.

There are several people here with me today. The director of HUD's Office of Recapitalization, Tom Davis, he will speak on the importance of preserving your affordable housing properties shortly. Also we have two presenters today, Charlie Wilkins and Anker Heegaard, of The Compass Group. The Compass Group offers government and nonprofit clients with expert advisory services related to the long term success of affordable multifamily housing. The webinar is hosted by ICF.

Throughout the webinar you will hear the terms recapitalization and preservation many times over. So that we're on the same page, let's define preservation of affordable housing. Here at HUD preservation is defined in terms of achieving goals that fall into one or more or all three categories related to, one, safeguarding long term rental assistance for current and future residents; two, improving and modernizing your property; and three, stabilizing and placing the property on a solid financial footing going forward.

So then why a preservation book? Well if you are attempting to achieve either or all of these goals with your property, you know that it takes a lot of time, it may take a lot of review of documents, many, many calculations many times over. So HUD created these tools to help you, the owner of HUD insured or multifamily rental housing, to understand requirements and components of developing a preservation plan through such programs as rental assistance demonstration, RAD, or many other means that are available.

On this premise, at the end of the webinar we hope among the many concepts presented today, you will understand how to use the HUD preservation workbook and recapitalization Excel tool. This will help you develop a comprehensive and feasible plan to keep your property an affordable housing resource for the long term.

The webinar today will last for approximately 90 minutes. Tom Davis will provide the context for this presentation and explain the importance of understanding the process of preserving and recapitalizing affordable multifamily rental housing. After Tom, Charlie and Anker will provide an overview of the recapitalization process, a tour of the workbook and Excel tool with emphasis on how it really can assist with developing your preservation efforts, and of course no webinar would be complete without a case study. And in their case study they will demonstrate how our tools are supported by the owner's recapitalization planning. At the end of the webinar we have allotted about 15 to 20 minutes for questions.

A few logistics to go over. As participants you will be muted throughout the presentation. There will be no live questions. However your questions are welcomed. So please enter them on the

WebEx Q&A box on the screen and as shown here on the slide. We'll do our best to get to as many of your questions as possible during the final segment. An additional note, if you're experiencing any technical issues related to WebEx, please provide a description of what you're experiencing in your chat box, and the webinar host will assist. Okay, let's begin. Tom?

Tom Davis: Great. Thank you all for joining us today. Very glad that you're on the line. And I also want to thank the team here at Recap and the consulting team for putting all this material together. And we hope it's a useful package of materials for you. As all of you know, spending a lot of your professional lives in housing, housing is critically important for the people we serve.

It's often a platform for folks working towards self-sufficiency. Decent, safe, and healthy housing really makes an incredible difference whether it's a place where someone could live without exposure to asthma triggers and lead, or things along those lines, or just stability so that they can focus on education, economic opportunities, or a healthy and happy retirement. We all know the importance of housing for the folks we serve.

But we also know that the existing stock falls far short of the need. The portfolio that we do have of insured and assisted housing is aging, and there are very limited resources for new construction. It's not news to the vast majority of you that market production is generally at the mid level or high level of the market. There are a variety of barriers -- NIMBY barriers or others -- that limit production at the more affordable end of the market. And there's a constant risk of loss for rental units at the lower end of the market. So here at HUD we are very focused on preserving the units that we have in the affordable portfolio and particularly in the insured and assisted portfolio. And we are trying to do what we can to support all of you in that common goal.

So today we're pleased to offer some new tools that we hope will be useful, helpful perhaps to exploring your options, helpful for owners to think through what strategies they might employ. Certainly preservation is a complex topic. There's a lot of expertise. Just scanning down some of the names and organizations represented on this call, there's a lot of expertise on the call and out in the world. But there are also many folks who are involved in owning and operating assisted housing for whom the complexity of preservation is not front and center in your professional lives because you're trying to run the properties. And so some of the material is an effort to try to cut through some of that complexity and provide more guidance or strategies that you may wanna think about.

We hope that the tool and the Excel is something that might be able to be shared among owners and their teams. Hope that it's relatively accessible for the non-expert as well as useful to the experts and folks who do this work all the time. And fundamentally we're trying to help owners, consultants, other professionals involved, in supporting the assisted housing portfolio, to preserve these incredibly critical assisted multifamily rental properties.

So I think that there's an incredible need for preservation of the stock as it ages. And we hope that the tools that we have developed here can be helpful to you in preserving that portfolio so that these affordable opportunities are available this year, next year, a decade from now, and well beyond that. So thanks very much for joining us today. And at this point I will turn the presentation over to Charlie Wilkins and Anker Heegaard who will be leading us through the details of these new tools.

Charlie Wilkins: Great. Thank you, Tom. This is Charlie Wilkins. Glad to be with you today. The photo on the slide here depicts two stages of a process of making a sculpture. On the right you see the block of stone with some rough outlines of the sculpture, what the sculptor intends. On the left you see the finished product. Building a preservation transaction is sort of similar to this. And most of what we're gonna be talking about today is the process of making those few rough outline strokes on the stone. And then there's of course a lot of work in getting from there to the end product. But Anker's work and my work in the field have convinced us that there's a huge value in getting a reasonable, accurate, approximate sense of where you want to end up. And we can't emphasize that too much.

As Minnie said, the goal here is preservation. We want the property to be viable, affordable, stable, for as long a period as possible. That may involve getting new funding now. And when new funding is part of the picture, we call that a recapitalization transaction. The goal is to preserve and you would only use a recapitalization transaction if you had to.

One of the things we've all discovered in working in this space is that this is an iterative process. You go through -- you think about the process, you think you know where you're headed, you drill down a little bit more, and then you change your mind. This is natural. And so the workbook at various points asks you to go back to earlier thinking and just confirm that this is where you want to go. And this is particularly true about the owner's goals. Because what we found is the owner's goals often will change during the process. As I said earlier, recapitalization, that is new money up front, may or may not be part of the solution. Often it is. And unfortunately the longer you wait to start this process, the more likely it is that you will need a big chunk of new money up front.

Leadership is important, organization, expertise, perseverance. So this is a complex task. It's very doable. But it requires attention and in particular attention on the part of the property owner. One of the things we discovered in doing the initial research for this project is that owners are quite concerned about losing control of the process. They're very happy with how the property -- their stewardship of the property thus far. They don't want the consultants to take over. They don't want the lender to take over. They want this to happen on the owner's terms with the owner in charge. So the workbook is very focused on how as the owner you stay in charge, and how you get the property preserved not anybody else's way, but your way. And be prepared for it to take a couple of years from start to finish.

Conceptually we are talking about six steps of the process. And this is just our way of thinking about it. You may have a different way. It starts with really understanding your property. Then you think about your goals, where you want to end up, what's important to you. The next step, number three, is to see whether you can get this done without new money. Sometimes you can. If so, great. Step four, decide whether you're going to go after new money or not. Step five, design your recapitalization. And then step six, is take the design to the next level. And what we'll find typically is that you'll go back to earlier steps, particularly step two, setting your preservation goals, several times as you go through the process.

First step, know your property. It's going to take a team. Very few owners are going to be able to get this done on their own. And the kinds of folks you may need on your team include your property manager, almost certainly your attorney, maybe an architect, maybe an engineer. If you need loan money, you're going to need a lender. If you need equity money, you'll need investors. Most owners will need a preservation consultant. Some won't. And particular transactions might require other sorts of expertise. For example, somebody who's really talented and experienced with managing the relocation of residents as they temporarily move to other units or maybe even move off the property for a few weeks.

Knowing your property involves research. Part of it is researching the history. What has it cost you historically to operate the property? Is the answer going to be different in the future? You need to understand the current financing. Many properties have multiple loans and you need to understand each one, understanding the rents, understanding existing subsidies such as Section 8 rental assistance. Then a step that many owners haven't taken before, understanding immediately and long term major repair and replacement needs.

What about your roofs, what about the windows, what about the heating and air conditioning equipment? What's coming up over the next few years, what's coming up long term? What's the right timing for addressing these needs? Should you do a lot of them right now? Should you do them over time as systems expire? And usually you'll need third party help in understanding this. And our experience has been that often owners underestimate the size of these needs. And they also tend to underestimate how quickly those needs may have to be addressed.

Understanding your market. You probably have many units with Section 8 rental assistance and you may think the market doesn't matter much. But it actually matters a lot. And we'll talk about that as we get through the process. You need to understand the neighborhood, you need to understand what choices your current residents and future residents have, and understand how your property can be best positioned to meet those needs. Understanding your residents and their needs, also important. And not just the needs your residents had five years ago, but the needs your residents and future residents will have over the next 5, 10 or 20 years.

Preservation goals. You're always going to have goals about the major repair and replacement needs. You're always going to have goals about affordability. You'll always have financial goals, making sure there's enough revenue to pay for expenses every year, planning your financing, planning your reserves. But the last category of other is actually as important as the big three. Here are some examples of other goals you might have. You might have a need to manage resident relocation during the renovations. You might have a goal to reposition the property so that it can serve a different need in the future. You might need to serve a different resident profile than the one you've been serving. As you go through the preservation process, these kinds of additional goals are particularly likely to come up. So as your team is working through the preservation, you'll want to go back and think about do we have additional goals that we should have thought about earlier.

Earlier we talked about what's your best option without a recapitalization. And this really means can we preserve the property without getting new money now. If you can, we encourage you to do your preservation the simple way. Don't go after the new money. Deal with the needs as they come up. Have a good plan, execute, and then preserve your property long term. But often the answer will be we either started too late, or the needs are too great, or there's some other reason why we need more money, a big chunk of money right now. So it won't be surprising if you do need a recapitalization. But if you don't, so much the better. Preserve without the recapitalization if you can.

So examples of some things you could do to preserve the property without recapitalizing. One is you might be able to get a higher rent than you're getting now and maybe that's enough by itself. Maybe there's a way of getting additional rental assistance. Maybe there's a way of refinancing your existing debt, that you can do without fancy new money like low income housing tax credits. Maybe there are regulatory options that your HUD staff can point you toward that would help shore up your property short of going out and getting new money. And the workbook talks about those kinds of steps in some detail. And this slide basically sums up what we've just been talking about. The stack of paper here is what's involved in a recapitalization. Maybe it takes a three inch stack of paper to get your property preserved without a recap. Enough said.

The first approach to designing a recapitalization is really taking a 30,000 feet above the ground flyover and getting a rough, rough plan. So these are examples of four different rough plans for preserving a property. The column that's titled light rehab starts with about $10,000 a unit of immediate repairs, and ends with needing about $20,000 a unit of money, new money, in order to not only get the repairs done, but pay the people who have to accomplish all of that. And don't be surprised if $1 of immediate repairs results in $2 or more of total money you need to get everything done. The moderate rehab column starts with 20,000 a unit of repairs, and ends with a little more than 40,000 a unit of total money needed. Are you starting to see a pattern here?

Intensive rehab, 3,000 a unit of repairs, ending with a little more than 80,000 a unit of total money. And the final example in the real estate business, call a gut rehab. So this is taking the property all the way back to the walls and rebuilding everything between the walls. Might cost $75,000 or more per unit and might require total funds in the realm of 150,000 to 200,000 per unit. One of the things you can see here pretty clearly is it's very important to figure out what's the right amount of initial repairs. Often the answer is, as little as possible, but sometimes it's not that simple. So your team will really need to focus on what do we really need to do now, and would it be smarter to do more than that. So it's a very important part of the initial process in getting that initial decision close to right, will really start you off on the best foot.

Once you've designed your recapitalization, then in terms of how much it will cost to get it done, then you need to figure out where is the money coming from. And this gets into the art of the deal and where you will need your preservation consultant, and your lender, and your attorney, and other experts on your team. And what's shown here are four columns that correspond to the different sizes of preservation transaction we talked about on the last slide. And what you see here is not the answer. But what you see is a plausible answer, or a typical answer, or a possible answer, about how you might fund each transaction. Now notice that your new first mortgage loan is $15,000 a unit in all four scenarios. And this is fairly common that the amount of the new first mortgage may not change much between scenarios. And what changes much is how much other money you have to get and where you're going to get it.

The workbook will give you a lot of assistance in thinking through this. The financial modeling tool will give you some back of the envelope tools to help you size and help you think about different ways of meeting the funding needs that your transaction will have. When we go through the case study, you'll see an example of this.

Once you've done the rough design, then here are some things you'll want to think about. Often you'll want to refinance your first mortgage loan. Not always, but often. One big question is, do we pay off the existing financing or do we let it mature. Either one could be the right answer. But it's a big decision and the workbook talks about the considerations you want to take into account. If you're going to refinance, should you refinance with HUD or with a different loan type, the workbook talks about pros and cons there. And you would want to talk with your HUD staff to see if they have advice that goes beyond the workbook.

Do you want to make a decision about the type of loan early, or do you want to investigate several different types of loans, possibly several different lenders. Either one could be the right solution for your transaction. Amortization is a real estate term that's really talking about how long a loan are you going for in terms of number of years. Do you want a seven year or ten year loan? Maybe, if you're convinced you're going to want to refinance again pretty soon. Do you want a 25 or 30 or 35 year loan? And that might be the right answer if you think you're going to refinance once and then not again. Or current interest rates are especially attractive, so you want to lock them in for a long period of time.

Balloon financing is what we call in the real estate world, this would be a loan that maybe calculates the payments based on a 30 year term, but you have to pay it off in 10 years. That would be called a balloon loan if you're the lender. If you're the borrower, you might call it a bullet loan, because it sort of looks like a bullet heading for your forehead, when you have to refinance in 12 months, or 6 months, or 18 months. Self-amortizing is the term we use in the real estate world for a loan that may have a 30 year term and has a 30 year amortization and a 30 year term, which is you don't have to pay it off early. And if you think that Anker and I are fans of self-amortizing loans, you'd be right.

Best options for funding your costs, as we'll see as we get into the case study, there are lots of places you can get the new money from. And finding the right mix for your property is part of the art of the deal. And the last question, is it necessary to sell the real estate in order to carry this transaction out. Now this doesn't mean that the current owner won't be the owner on the other end of the transaction. But it might mean that the deed to the property needs to pass from the current owner to a new owner in which current people are also the key people.

So it could be that the actual real estate owner is going to be a different entity at the end, but it may not be that there's any different control. Or it may be that as the owner you've decided you've spent 20 years with the property or 30 years or 35, and that's enough, and it's time for other people to take over. It's very important to be conscious about these kinds of decisions and to be really clear about where you want to end up. So your board of directors really needs to think about what's our current role, what's our desired future role, is that a realistic expectation, and then you make sure everybody on your team is aligned on getting you from here to there the way you want it to happen.

And this step six really occurs many times. You get the rough estimate of your transaction. Then you start fleshing it out. Then you start fleshing it out some more. You change your mind. You go back to square one. You revisit your goals. And you fine tune multiple times. And here are some examples of considerations you'll want to take into account as you go through the transaction. The second bullet, sources, this is where is your money coming from. Uses is what will it cost to get this done. So sometimes one of your lenders or your equity providers will say, we really want you to redo the parking lots. You hadn't planned on it, but maybe that's the right answer because you really want their money. That's an example of the sources affecting the uses.

A reverse example is you may discover that you need a lot of rehab. And that in turn will push you toward using particular sources of funds that have the ability to bring a lot of money to the table. A different example is let's say you want to pursue what are called 4 percent low income housing tax credits. These are the low income housing tax credits that come attached to tax exempt bond financing. And if you go down that route, then you're going to need a tax exempt bond lender. You're going to need an attorney who really understands this. And you should be prepared for pretty transaction costs that will then affect how much money you need. We won't belabor these points, but you should just know this is part of why it's an iterative process. As you go through the process, you will make decisions that will change earlier decisions and will ripple through your transaction.

So it's not only how much money do you need, how much will your transaction cost. But you'll find it'll be important to estimate when will the money come in and when will the money be spent. And make sure you have enough each month to pay for that month's costs. You may need what we call interim financing. So you may need a construction loan. You may need a bridge loan because your permanent financing may come in later than you actually need the money. So you may need interim financing. You always want to think about reserves. And that may be initial reserves such as an operating reserve that your investor might require, a debt service reserve that your lender might require, and then there's always the replacement reserve that everybody will require. So that when the air conditioning units need to be replaced, or when the water heaters need to be replaced, or when the roof needs to be redone, the money will be there.

Lease-up means maybe during your transaction you'll lose some occupancy and you need a plan for rebuilding it once you get the repairs completed. Should I get a development consultant? Most of the time the answer will be yes because you probably don't do this for a living. But sometimes you may be able to get by without one. And if you don't need one, so much the better. And finally guarantees, typically your new funders are going to require somebody to guarantee that the repairs will get done, require someone to guarantee that the repairs will get done on time, require someone to guarantee that the lease-up will happen. And probably someone will have to guarantee that the cash flow will be what it needs to be once the transaction is done with. So you want to make sure you understand all those requirements really well and make sure there's somebody on your team who's able and willing to provide those kinds of guarantees.

Now at this point we're going to introduce you to the workbook and introduce you to the financial modeling tool. And we'll start by explaining why we call it a workbook.

Anker Heegaard: Thanks, Charlie. Yeah, let's start with why we call it a workbook. It's obviously for those of you who've had a chance to leaf through it, you've seen that it's filled with exercises. There's lots of checkboxes that you can check and blank lines that you can write in. It coordinates back to the Excel tool that is meant to be a user completed process. So this is distinct from had HUD published this as a guidebook in which you would simply read and sally forth. In this case it's a workbook and it's designed for you to use, and mark up, and dog ear, and post it notepad, and erase, and scribble, and use it as your go to reference as you begin to sort of initially model your transaction.

So a few words at the top, first of all just so you know, this is pretty important, that the preservation workbook and the financial modeling tool, which we also refer to as the Excel tool, is available on HUD Exchange. The reference is provided on the slide in front of you. And I would imagine that this webinar may well also be found there after it's been recorded and we've completed this. The other thing I'd like to say is that the financial modeling tool and the workbook are very intentionally developed as companion products.

For the most part one doesn't work really fully well or fully as intended without the other. So these two go together. And somebody who's using this tool set to develop their recapitalization strategy or their preservation strategy is going to find themselves going back and forth, and they're also going to notice there's an awful lot in the workbook that is referring you to the financial modeling tool, and there's also a lot in the financial modeling tool that's looking for you to have gotten guidance, and input, and feedback, and thinking, through your efforts with the workbook itself.

The workbook is a process. One is intended to start at the beginning and work your way through. But as Charlie said earlier, it's an iterative process, somewhat circular and looping back upon itself as you go, so that you are expected to and encouraged to continue to revisit sections as you've completed them, and as your thinking has evolved on what your goals and priorities are, what your resources are, and what's important to you. There are detailed sections for each of the preservation steps. And I think at this point I want to pause and point out that the presentation that Charlie just delivered is largely material that's covered in-depth and more comprehensively throughout the workbook itself. So to the extent that the sorts of things that he was talking about in a brief overview presentation are useful and interesting and germane to what it is that you're looking to do, you're obviously encouraged to look at the workbook and find the discussions, and the explorations, and the guidance on those topics there.

The workbook has some appendices. I'll come back to that in a little bit and point those out. And then of course there's the financial modeling tool, also referred to as the Excel tool. In many cases it captures information from the planning process. So when you're in the workbook and it says, do exercise 1.x, you would go and in some cases actually perform or complete that exercise in the companion financial modeling tool. So the modeling tool does really two things. One is that it performs basic calculations to support your decision to recapitalize and also help you to shape the general form of that recapitalization. But it also gives you a place to record a lot of your evolving calculations and considerations.

On the slide in front of you you'll see an image of the HUD Exchange domain for the preservation workbook and the Excel tool. Not much to say about that other than that this is where they live, and where they can be found, and that we strongly encourage you to go there, and download them, and explore them on your own. So at this point I want to do just a short tour of various features and aspects of how the workbook itself was assembled and how it presents to you. But we'll start with the fact that obviously it's narratively based. So there's a lot of guidance, considerations meant to support your thinking, prompt you to go in directions you might not otherwise have considered or might have considered when it was too late in the process. So narrative is really the base of it.

But to make the material more accessible, a little bit easier to deal with, there are a number of sidebars throughout that provide definitions or short pieces of wisdom, let's call it. And then at the end of each of the six chapters, there's a question and answer section which provides good information on what we think might be common questions that would be asked by somebody facing the types of information, or material, or challenges that are covered in that chapter of the guidebook. There are posted notes much like the sidebars that are meant to provide you with little sort of visual cues and guidance. You're free to add your own post it notebooks of course because it is yours.

And then most important to it, and to its coordination with its companion financial modeling tool, are the exercises in the workbook and the references to those exercises in the workbook. So we'll show you some more of that as we go forward, but I just want to point out that when you look at the workbook you'll see that it's been written in something that you might call non-regulatory fashion.

Financial modeling tool itself has a series of features that make it somewhat different and unique. It is of course just a standard Excel workbook. And it is divided into perhaps maybe a dozen sheets or tabs. Within the workbook on the top of each tab there's a reference -- within the financial modeling tool on each tab there's a reference back to the workbook that explains how that tab relates back to the guidance, to the activities, the exercises in the workbook itself. Then as a design feature of it, user inputs occur in green, on a green background. And everything else is essentially black text on a white -- or black calculations outputs on a white background, just to make it easy for you to navigate where exactly it is you would doing input.

And the third thing I'd want to point out is that it has been heavily invested with a series of tips. They look like they're shown here. They're little yellow cells that say tip. When you click on the them they provide context sensitive guidance, not necessarily just on using the financial modeling tool itself, but also on what you'd think about in terms of recapitalization. So for instance the one that's showing here gives you information on FHA project numbers, how they're built, and where they come from, things like that. I'm sure there's something for everybody in here and it makes the financial modeling tool a much easier thing to use.

And then of course as I said before, the workbook has a series of appendices. And I think they're really, really better than average appendices. So one is a glossary of eight or 10 pages that has all of the terminology you might run into in a recapitalization or preservation exercise. And it's quite useful to look at. For people who have been simply operating properties but not transacting on real estate, it might be useful to read through that and understand the terminology that you're dealing with. The second appendix that's extremely valuable is a resource list. And it includes a lot of resources that you'd want if you were going to drill down deeper into many of the more complicated aspects of recapitalizing a property. There's a whole section on resources and links for regulatory options, or types of loans, or tax credits. And I think it's a wonderful resource. And I think it points to the fact that HUD's Office of Recapitalization has of course produced this tool and resource for you. But you'll find on the resource list a large number of tools and resources that they've produced in support of owners' preservation efforts.

And then lastly there's the financial modeling tool that we're going to talk about in a moment in the case study. And that financial modeling tool is provided in the workbook in sample form so that you can sort of see how it might look if it were filled out and completed. So with that, I think we're ready to proceed to the next section of our presentation which is a case study in which Mr. Wilkins and I are going to do a little illustration of how somebody might use the preservation workbook and financial modeling tool. Because of time available it's going to be a little bit quick and dirty. But I think you'll see through this demonstration the intended utility of the tool set. And hopefully this will inspire some folks to go ahead and try and use it themselves. So with that we're going to do case study now.

Charlie Wilkins: So this is Charlie. I'll serve as a tour guide. So think of me as a development consultant, and Anker is the property owner, and we've been working together for about a week maybe. And Anker's completed part of the workbook and filled in some information in the financial modeling tool. I'm familiar with both of those. But we really haven't had more than two or three conversations until now. So we know each other, we're working together on this transaction, and we're sort of having our first real strategy session. So Anker, why don't you introduce yourself and tell us about the property.

Anker Heegaard: Great. Okay, thanks Charlie. So I'm in this capacity, in this presentation, I'm the board president of a group called, Community Change Housing Solutions. We're a not for profit. And we want to explore our options and opportunities around a property we own called Bennington. I'll say a few words about the property. It was developed initially when our then director put it together. She was a retired state housing official who was good at transactions and had good relationships with lenders and government officials. She's since passed away, but the organization has survived. We have a couple of site staff and then a dozen site staff across a few properties. And we have a good active board.

So the staff and the board mostly oversee and support property management and basic regulatory compliance. We rely on a local consultant for rent increases, responses to HUD, and anything out of the ordinary. But the focus of this is going to be on a property called Bennington. It's a 236. It's 100 units. It was built in 1980 and it's nearing mortgage maturity. As you might imagine it's in fair to poor condition. But there are no units that are offline for condition issues. We've never really made any money as an owner, but we've kept the property operational, and we've kept it in compliance with REAC [??]. The rents are low, but we hope that there's good room at the top for increasing the Section 8 rents. And effectively the unassisted renters are paying what you might call a low market rent.

But here we are. We find ourselves where the board's decided it must investigate strategies for preserving and improving this important housing resource. And at the last board meeting, one of the board members came to me and he said, since 1980 this property's provided about 4,000 years of housing. You take 100 units times 40 years, you've got about 4,000 years of unit years of housing. So we're quite pleased with that. And we're looking forward to moving forward. So last thing I'll say is that in preparation for all of this we got a good CNA. The annual needs were so large over the next 20 years, there was no way we could pay for them. So we asked the CNA provider for another perspective. What if we did a mod rehab and then we set an adequate but affordable reserve deposit. So as we proceed through discussion of Bennington, you'll see some large bumpy annual costs for actual capital needs without a rehab, and a second set of determinations around rehab and reserve for replacement.

Charlie Wilkins: Great. Thanks, Anker. By the way, CNA means capital needs assessment, for those of you who haven't done one yet. And if you haven't done one for your property, we highly recommend it. And Anker has discovered in the process of working on this transaction that he should have done this about 10 or 15 years ago. And the preservation would have been easier.

Anker Heegaard: Yeah. Better late than never. But here we are.

Charlie Wilkins: So Anker, you have any photos we could look at?

Anker Heegaard: I just happen to. Thanks, Charlie. So here's some pictures of Bennington. I'll just say a few words about it. It's basic housing. We know that. But we keep it clean and we keep it going. And we do it on a shoestring budget. Longer term building systems like roofs which were last done in '97 and were leaking, windows, and mechanicals, they're all out of our price range. So we fix things if we can, replace them only if we have to. But when we do replace, we're often forced to replace with the least expensive components, even if those don't last very long or provide good utility benefit. So ultimately we're really lucky to have a good maintenance team. We see the situation as a challenge rather than a problem.

The next pictures I've got shows some mechanical equipment from another era, frankly. HVAC condensers are all over the place. In the one picture on the right alone, I think we've got six different models feeding five units. Any folks may be familiar with what properties begin to look like as they get older. And the next set of photographs, I just had them so that I could show you how poor the windows are. They're simple single pane sliders. They don't really provide any energy efficiency. We know that with better windows, tenant paid electricity would go way down. And we know that that accrues to affordability in a really meaningful way for many of our folks.

Last photos that I'd just share quickly is kitchens. We do spend a little bit more money on solid wood cabinets. Our maintenance super, Ernie, can rebuild and refinish them, so they cost a little bit more up front. But in the long run we find that they're well worth it. The cheaper ones rot out when they get wet and there's no repairing them.

Charlie Wilkins: Well thanks, Anker. So we've learned a lot so far. The windows are original, but they're in poor condition. And we really want to replace them, but we haven't been able to find the money yet. Same thing is true for the sliding glass doors. The roofs were last redone 20 years ago in 1997. And they're a little past due for replacement now. We have mechanical systems, water heaters, heating, air conditioning, in various condition. And more of it original than we're comfortable with. And we've got a big problem with utility efficiency we'd really like to make improvements to cut down utility cost. Are those the big items?

Anker Heegaard: Yeah. That's pretty much it.

Charlie Wilkins: Okay. Well it's clear you've done really well with the limitations you faced. Now let's look at options for the future. And let's learn a little bit more about the property. You've read through chapter one in the workbook. And you have a pretty good idea of what you need to begin pulling together in terms of information. And chapter one that has exercises that help you with this process. And often these will point you to the financial modeling tool. Let's start with chapter one. The first exercise, number 1-1, helps you collect background information on your property. And I can see that you've already pretty much completed that.

Anker Heegaard: Yeah. I've done that and I've checked off the boxes, as you can see. It's helped me to see that we're probably going to need HUD permission to prepay. The other thing that I learned was that we're going to really need to be digitally organized to get through this. So we went out and got ourselves a Dropbox account, a good document scanner, and a copy of Acrobat Pro.

Charlie Wilkins: Well I think you'll be glad you did all of those things. And certainly if you end up deciding to prepay your existing Section 236 loan, you definitely need HUD permission. So that's an important bit of learning. So now we're going to go to exercise 1-2. And we'll take a look at the background information worksheet in the financial modeling tool at some point as well. Exercise 1-2 is about the prepayment process. And it gives you a good orientation to the kinds of questions your HUD folks will ask you when you make the approach to them. Now this won't give you the real answer to the question. The real answer is HUD's answer. But it'll give you a sense of the kind of information you'll need to assemble and the sort of conversation you'll have with HUD when you go talk to them. So what about exercise 1-3? This is about your existing financing. And looks like you have the Section 236 loan and no other debt, is that right?

Anker Heegaard: Yeah. We don't have any other debt. This is a question that I had too. We've made some advances to cover capital items over the years. And we were organized enough to record these as subordinate notes back to us, back to CCHS. Any chance we can get these paid back in a recapitalization?

Charlie Wilkins: Well certainly if there's enough money coming in, you might be able to get them paid back. So let's remember to put paying off those loans into our cost of funds for the transaction and then we'll see if there's room for it. And exercise 1-4 is about rental assistance. So most of the people on the call are familiar with that term. HUD's Section 8 program is the most common form of rental assistance, but it's by no means the only form. So what do we have here, Anker, 70 units of project based Section 8?

Anker Heegaard: Yep, 15 ones, 40 twos, and 15 threes.

Charlie Wilkins: Which means there's 30 units without Section 8. What about those?

Anker Heegaard: That's on the next worksheet.

Charlie Wilkins: Well let's have a look. Unassisted units, exercise 1-5. Now by the way, if you have unassisted units, this is a very important part of building your preservation transaction. Sometimes there's opportunities to add some rental assistance. And in any event you'll want to figure out how to minimize the financial impact of your transaction on lower income residents without rental assistance. So you'll spend some time on this part of the process.

Anker Heegaard: Yeah. And I [inaudible] to indicate that only a few of our 30 unassisted households have vouchers, and about half can afford the current rent okay. It's hard though to find people who are well-qualified to pay the rent in full and on time.

Charlie Wilkins: Absolutely. So an important goal is to minimize any rent increases to the tenants in the unassisted units. So we'll note that as an important goal. Exercise 1-6, capital needs. And I'm very pleased to see that you had a capital needs assessment already. And the questions in exercise 1-6 will give an owner a good sense of the kinds of conversations they'll want to have with their capital needs assessor and the kinds of information they'll want to assemble.

Anker Heegaard: Now I found the list to be an excellent trigger for the things that we might not have thought of. And I noted some rough and basic information in the financial modeling tool. So yeah, it's all documented there.

Charlie Wilkins: Okay. And remember it's just important to get a rough sense now. You don't need to get into the weeds and we don't need to fine tune yet. So setting goals is important. And we've already talked about preserving affordability. We've already talked about physical needs. We've also talked about making sure we've got enough money coming in each year to meet property's financial need. There are these other aspects of goals including making sure you and the board really are clear on what your mission is, what you want to accomplish in this preservation transaction, who your residents are, what they need, what your neighborhood is like, and how your property fits in with the residents in the neighborhood.

And on the next slide I think we'll see some examples of additional preservation goals. So maybe if your residents are aging, maybe there's a need to connect them with services available in the community, and a service coordinator might be somebody you might add to your staff, if that's what you've got. Maybe you need to change the mix of units. Maybe 100 units is not the right mix for where this property needs to go. Maybe you need a community room. Maybe you need some recreational amenities that aren't there already. Maybe the property needs to be more affordable than it is. We've already talked about reducing utility consumption. That's going to be really important for this property. And you may have financial objectives. Maybe you have mission needs that require this property to contribute cash flow to CCHS. And if so, it's important to keep that in mind when you're designing your transaction.

Anker Heegaard: That would be nice. But the meta goal that we've got at the moment is making sure that the property's physically in good shape over time. And ultimately we've determined that we could limp along over time if the reserves were adequate, which they're not. And we're also obviously interested and eager to do more than simply stave off disaster. We want to restage Bennington for another 40 years. And the only way we can do that is with a rehab.

Charlie Wilkins: Okay. Well let's move along and take a look at what that might look like.

Anker Heegaard: So for this part of the presentation we're going to go to the Excel tool itself because slides don't support that aspect terribly well. And that's, with any luck, what everybody is now seeing. So where should we start?

Charlie Wilkins: We're going to start with the AFS, annual financial statements worksheet tab. And I see that you've already filled in your actual results for the last three full years. And there's a summary of all this detailed information down at the bottom of this worksheet. There we go, revenue and expense summary. So the revenue's been relatively constant and so have the expenses. That's good news.

Anker Heegaard: And that's what we learned from the exercise, that our expenses have been very level. There's not a lot of ups and downs to explain or account for. So we have a pretty good baseline of what it costs to operate the property.

Charlie Wilkins: Okay. Let's take a quick look at the AFS summary tab. This is just a slightly condensed version of what we just saw. And there are places here to insert owner comments if there are points you want to come back to or questions you want to make sure that you solve for in your preservation transaction. And one of the things you mentioned is that you hope that your operating expenses can come down once you're on the other side of this preservation transaction. And it's certainly possibly that they will. Ernie and his team are doing a great job, but it probably takes a lot more work to keep putting band aids on everything than it will if you get the property into a current maintenance condition and all you're doing is dealing with resident service requests and so forth. So it could well be that your expenses will come down. So let's stick a pin in that and watch for it later.

Anker Heegaard: Yeah. We are paying for a lot of maintenance on an aging property. And we're hoping that those costs will go down with a rehab. So we would note that in the owner's comments, notes and concerns.

Charlie Wilkins: Well let's take a look at the status quo no capital needs tab. And this gives an overview of what might happen if we don't change anything. And it's not what would happen on the bottom, bottom, bottom line, but it's what will happen before major repairs and replacements. And what we're seeing here is a little bit of red ink. You have about $15,000 a year. And then it changes to positive once your Section 236 mortgage loan is paid off and you don't have a mortgage payment anymore. But I suspect when we dial in the major repairs and replacements, it's going to look a whole lot worse than that.

So let's look at the cap needs worksheet. Now Anker, you filled in these already. And this is the first set of information you got from your capital needs assessment. What's it going to look like if we don't do any rehab? And you looked at these numbers, which are actually much larger than you could ever afford, and quickly concluded that you needed to do a rehab. And I think that's absolutely the right decision. And these are thousands of dollars, so 171,000 of capital needs in 2018, 317,000 of capital needs in 2019. And this is on a property where you might be able to spend 10 or 15 or 20,000 a year in the status quo.

Anker Heegaard: That's right. So these are the numbers that the CNA provider told us we should expect to pay if we didn't do any rehab and we just continued to replace building items as they expired. And we even asked them to push that a little bit. But we had another number to work with too, which is that we said, what if we did a rehab now and then funded through reserves the remaining needs. And that number was about rehab of $17,000 a unit, which I guess would classify as a moderate rehab. And if we did that level of rehab, we were told that we should expect about a $500 per unit per annum replacement reserve deposit going forward. But what we're looking at right now is if we didn't do a rehab, what are the capital needs going to cost?

Charlie Wilkins: And the short answer is they're going to cost way more than we can afford, which is why we're pursuing a recapitalization transaction. So let's go to the next worksheet. And this is going to put the last two together. And as predicted, the red ink goes from moderate to distressing. And it stays at the distressing level for a long period of time. So I don't think we need to belabor that any, other than to say this is actually very typical for when the owner of an older property does this kind of analysis. They'll typically discover that the future doesn't look bright at all. And the main problem is roofs, parking lots, windows, sliding glass doors, air conditioners, water heaters, those kinds of things. So it's not surprising, this is typical, and it is distressing. But this is what you're likely to find when you dig in.

Anker Heegaard: Right. So we really only have two choices according to this. One is to find some way of coming up with three, three and a half million dollars over the next 20 years. Or two is we're going to have to let the property deteriorate to the point of three, three and a half million dollars' worth of deferred maintenance.

Charlie Wilkins: Yeah. And neither one of those looks like a good option.

Anker Heegaard: So our best option without a recapitalization is really about continued deterioration of the property and financial crisis. Why don't we look at what a preservation might entail if that's our scenario.

Charlie Wilkins: Okay. And we're going to do the rough cut, which is the S&U, which is sources and uses calculator. And by the way, in real estate jargon, sources of funds are the money that's coming in to pay for the transaction. Uses of funds is the money that's going out to accomplish the rehab and other objectives of the transaction. So it's customary to show sources at the top of a page and uses at the bottom of a page. And you need at least as many sources as uses to have a successful transaction. So I see your $17,000 per unit hard cost of repairs.

Anker Heegaard: Right. That's what they told us.

Charlie Wilkins: Right. And then this particular calculator gives you ways of estimating all the other costs using percentage and other kinds of rules of thumb. We won't spend a lot of time on that here. But when you work with this worksheet you'll find it'll give you good guidelines, it'll get you a rough estimate. Now the number I'd like to focus on now is the supportable hard debt. So you've concluded 20,500 a unit is what you might be able to get with a new first mortgage. How'd you get there?

Anker Heegaard: I got there with this handy finance calculator on the next tab. And it asks for some basic inputs, starting with what we think the gross potential rents will be, what the vacancy loss will be, other income. This is all pulling from the preservation cash flow projection. And what our operating expenses are. And remember I told you before that we were told that with a $17,000 rehab we could support ongoing capital replacement needs with a $500 per unit replacement reserve deposit. So I put that in. And then I'm modeling on a 120 debt cover, and a 4 percent interest rate, with a 45 basis point mortgage insurance premium. And I'm looking at a 30 year amortization. And when you add those numbers in, it tells you, or it told me, that I could get or support a mortgage of $2,051,300. And that's pretty much where I got that number from.

Charlie Wilkins: Okay. And I noticed that Anker used a lot of lending jargon here, which you can get from the workbook. So if debt service coverage ratio, and mortgage insurance premium, and basis point didn't make any sense to you, check it out in the workbook. Because all of those are defined in the glossary and in the text. So there's $2,051,000. That's the 20,500 per unit that was on the previous worksheet. So let's go back to the source and use calculator. And it's going to cost us 36,200 per unit to get this done. We're thinking we'll get 20,000 a unit of that from the new first mortgage. Which leaves us 15,000 to 16,000 a unit short. So we call that the funding gap. So let's just talk briefly about how you might fill that gap.

So one answer is you might get low income housing tax credits. That's a great option. And the flagship variety of tax credits usually are over -- they're so competitive that you have no more than a 1 in 3 or 1 in 4 chance of getting the award. So the good news it produces a lot of money. The bad news is you don't have a great chance of winning the competition. There's another version that comes with tax exempt bond financing that'll get you some money. And the bad news there is you need tax exempt bonds which have very high transaction costs. And so usually people don't use tax exempt bond financing and transactions under about $5 million or $7 million. So this transaction looks a little low for tax exempt bond financing.

So now we're down to various forms of soft debt, which might be home investment partnerships funding from the city, community development block grant funding from the city, the state housing trust fund. But usually the state housing finance agency manages, but it could be a different agency of state government. So we would turn over rocks and figure out what might be a good way of coming up with 15 or 16 or $20,000 a unit of money for this particular transaction. And at this point we have our rough cut of the stone. We've gotten a sense of how much rehab we need. We know how much money we need roughly. We're getting a sense of where that might come from. And that is a great output for an initial preservation conversation.

Anker Heegaard: Thanks, Charlie. With that let's go back to the earlier presentation before the case study tour. Recall the visual from before about roughing out and then refining. We just hope that we have imparted that sort of logic and thinking about how you might proceed. And with that I think we're ready for questions and answers. So I'm going to hand the mic over to Minnie. Minnie, if you're ready, willing and able, I'll give you the show.

Minnie Monroe Baldwin: Thank you, Anker and Charlie. That was an excellent presentation. We have received a few questions and we'll go over those now. The first one that we would like for you to answer is, upon conclusion of the preservation effort, did you increase the rent on this non-Section 8 unit. If so, did you encounter any political community issues? Charlie or Anker?

[audio technical difficulties]

Anker Heegaard: So a couple of things I was trying to say before, was that obviously there's a balance between trying to achieve affordability and trying to achieve viability of the real estate. The perfect outcome is a high level of affordability and a high level of viability. But often those two goals, as we've been characterizing them along the way, can be in conflict with each other. The other thing that I'd say is that the owner in this particular case study would have aspired to increase the number of Section 8 units in the transaction. And in that way be able to both raise the rents and at the same time not impact the existing residents who can ill afford to be paying much more themselves. Minnie, other questions?

Minnie Monroe Baldwin: Yes. The next question is, my property is in a very rural area. What type of companies would provide CNAs? Charlie?

Charlie Wilkins: It's a good idea to talk to other owners in your community, and your property manager company to talk to other property managers in your local area, and see who's providing those services. Now your HUD staff probably also will know answers to that, and also talking to your housing department at the city and the state housing finance agency. All those people will have a good idea of who's providing capital needs assessment services for your sorts of property in your area.

Anker Heegaard: The other thing that I'd say on the back of that, Charlie, is that CNA providers tend to operate either nationally or regionally. They tend not to be local. So it's not like simply being in a rural area is a disadvantage in that respect. Most of the CNA providers expect to travel vast distances. And CNA engineers who perform these studies are road warriors. They're constantly traveling to go to properties around the country. Minnie?

Minnie Monroe Baldwin: Okay. Thank you. The next question is, is there a minimum number of units project size to be able to qualify for preservation funding?

Charlie Wilkins: Typically not. You would want to talk to potential funders to see whether a particular funder may have particular kinds of properties, or sizes of properties, or locations, that they like to focus on. But it's unusual for funders to have goals in terms of property size. Now it's not unusual to find that it's more difficult to do preservation transactions in extremely small properties. And it's also difficult to do them in extremely large properties. So having a property the size that's in the middle, sort of like Bennington here at 100 units, is often an advantage.

Minnie Monroe Baldwin: Okay. Thank you. The next question is pretty much directed to the RECAP staff. The webinar was pretty focused at least thus far on generic thinking that any existing owner would do. Looking for how this question -- this participant is looking for how to work with RECAP and what resources such as tenant protection vouchers, decoupling, etc., HUD offers bring to bear, and how existing HUD ties, that is Section 8, 236, impact -- and I think the question exceeded the space. But wanting to know how to do that. So that is a very project-specific kind of question that you can contact our office, either contact me directly at minnie.x.monroebaldwin@hud.gov. It's kind of long. Or you can send a question to our 236hud@hud.gov mailbox. And you should be able to get an answer. And again if you want to email me or call me at (202) 402-2636.

And we do have one last question. And if anyone wants to -- this is pretty much a last chance for questions. We have one last question. And that question is pretty much part of the wrap up. And it asks if the presentation slides will be made available. And yes, they will. They will be on the HUD Exchange as well.

Anker Heegaard: As will this recorded webinar, I believe, right Minnie?

Minnie Monroe Baldwin: That is correct. We received one last question. How might HR2832, the welfare reform and upward mobility act, affect our ability to conduct recapitalizations? So is there any information that either Anker or Charlie could provide on that? Here at the staff in the room, we are not familiar with how to answer that question at this point.

Charlie Wilkins: Well it's a great jumping off place for doing your own recapitalization transactions. Because every transaction we've ever worked on has lots of rabbit trails like this that you have to go down. So be prepared for some highly technical questions and original research. And good luck, good preservation, and it's been a joy doing this webinar, and we hope the materials will be useful to you.

Minnie Monroe Baldwin: Okay. So thank you. Charlie and Anker. And thanks to all of you who have joined in today. We appreciate your interest and hope that this webinar, and the HUD preservation workbook, and Excel tool, prove to assist you very well as you go about designing a preservation and/or recapitalization strategy. As mentioned earlier, the webinar has been recorded. You can view it later. It can be accessed along with the workbook and the financial model on the HUD Exchange.

With that this ends the 2017 HUD preservation workbook and Excel tool. Good afternoon.

(END)