

NH&RA Annual Meeting

Making the Best of a Bad Situation

2.26.2011 | Stephen D. Roger





The Product Creates its Own Problems

- **TC Properties are designed to operate @ BE. Less CF = more RISK**
- **Credits allocated to Max # of affordable units, not Maximize Cash Flow**
- **Withheld Capital and Reserves mask inherent property weaknesses**
- **Onerous recapture for GP and LP = motivation to ignore the obvious**
- **‘Shadow Deficits’ are often hidden:**
 - **By large payables.. (on balance sheet and in the drawer)**
 - **By developer funding guarantees... but there is a finite limit**
 - **By deferred maintenance (property needs complete rehab after yr 15)**
- **Many underperformers are chronic watch list recidivists for years**
- **At Risk Characteristics: South and Midwest, Rural, No Subsidy, 50-100 units, New Construction, Bond Deals**



AH Sponsorship and Property Management is Critical ...and Challenging.

- **TC Developers are focused on new development fees not Management.**
- **Syndicators/investors are focused on credits/compliance not Management.**
- **Properties must compete with market product so need same amenities**
- **Dubious 10% rent or service advantage under Market rate rents**
- **Management has to compete with conventional properties...BUT**
 - Leasing more challenging due to narrow band of eligible tenants
 - TC Compliance and Tenant Certs complex and time consuming
 - Rents are capped, but expenses increase at normal rates
 - In 2011 Affordable Rents may = the Market Rents



How to determine...What is the Problem?

If it's your property OR If it's a REO or Distressed Opportunity.

- 1. Disciplined detective work is needed**
- 2. that results in a completely new underwriting**
- 3. its the critical step to making a RE-INVESTMENT Decision.**

FYI My top reasons for property failure? ...

Management 80%, Sponsorship 18%, Markets 2%

So lets look for Danger Signs



Danger Signs. Is it the Sponsorship ?

- **Partner unable to provide project information, or corporate financial information and a portfolio rollup.**
- **High cash needs for overhead or other businesses or change of focus (made it here... lost it there)**
- **Slow or unusual responses to questions, (i.e. they get mad)**
- **Blame “ If only you had funded my last bad deal...”**
- **“Cannot afford”...or will not hire 3rd party management.**
- **Partner admits they cannot solve property problems, or refuses even acknowledge problems.**

Troubled partners beget troubled properties.



Danger Signs...is it Property Operations?

Objective Tests - do these in the office.

Track the Trends. Track monthly & see at a glance:

- **Balance Sheet Trends: DSC ↓, liabilities & receivables ↑, payments to related parties ? (AFS may disclose your unintended gift)**
- **Revenue Trends: Increasing concessions, gap between physical and economic occupancy, increasing receivables.**
- **Expense trends.. What is up and down...and what does it mean ?**
 - **Lower utilities.. Less real consumption or under billing ?**
 - **Savings in supplies, but contract costs higher**

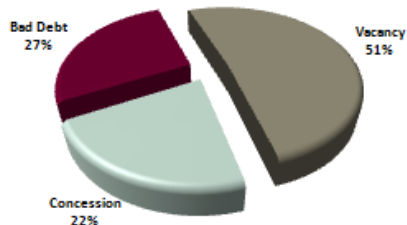
Mix and match: (high occupancy + receivables+ high turns+ high maintenance costs = leasing to bad tenants).

Review last 10 leases and credit checks (Dumpin the kids & stuffin the file)

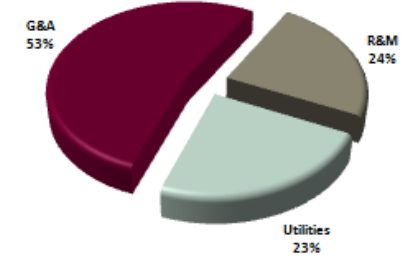
Watch for Change(s) of PM companies, On-site staff changes turnover .

Property Name	CR Claremore
City	Claremore
State	OK
Number of Units	192
Asset Code	BHC
Fund	CCP 16
Asset Status	Stabilized
Spinnaker	Yes
CFIN	No
Guaranteed Fund	No
Fund Guarantor	N/A
FNMA	No
FRDM	No

YTD Eco Vacancy Breakdown

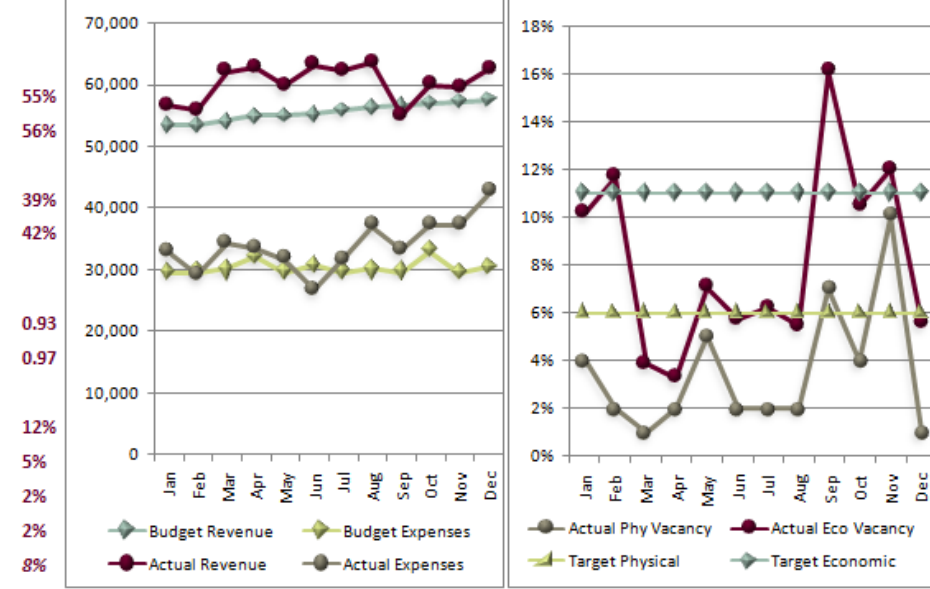


YTD Expense Breakdown



Key Statistics:

- Budget Total Op Exp Ratio
- YTD Total Op Exp Ratio
- Budget Variable Op Exp Ratio
- YTD Variable Op Exp Ratio
- Budget DSCR
- YTD DSCR
- Budget Economic Vacancy
- YTD Vacancy
- YTD Concessions
- YTD Bad Debt
- YTD Total Economic Vacancy



EconVacancy	10%	12%	4%	3%	7%	6%	6%	5%	16%	10%	12%	6%	8%	Remaining Year Proj DSCR	Orig Budget	0.93
Variable Exp	42%	36%	40%	39%	38%	28%	36%	44%	44%	47%	44%	59%	42%	Reforecast	0.95	
DSCR	0.86	0.96	1.01	1.05	1.01	1.32	1.10	0.95	0.79	0.82	0.80	0.72	0.97			

Operating Revenue

Revenue
Vacancy
Concessions
Bad Debt
Other Income
Total Income

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	YTD VARIANCE
Revenue	60,590	61,035	61,524	61,669	62,051	62,187	62,975	62,819	63,289	64,044	63,670	63,292	749,146	32,770
Vacancy	4,808	3,000	1,232	1,182	2,998	2,102	1,504	1,344	4,545	3,316	4,691	3,420	34,142	21,518
Concessions	1,545	3,375	1,172	647	598	835	230	767	1,210	1,809	1,356	818	14,362	5,102
Bad Debt	(155)	769	0	216	803	642	2,204	1,325	4,440	1,595	1,606	(674)	12,771	(1,228)
Other Income	2,331	1,962	3,012	3,084	2,139	4,611	3,198	4,123	2,041	2,683	3,526	2,780	35,489	(1,327)
Total Income	56,723	55,853	62,132	62,708	59,791	63,219	62,235	63,506	55,134	60,007	59,544	62,507	723,359	56,834

Buydown Income Not Tested

Operating Expenses

G&A
R&M
Utilities
Insurance
Real Estate Taxes
Management Fee
Trustee & Issuer Fees
Total Expense
Replacement Reserves

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	YTD VARIANCE
G&A	(15,168)	(11,492)	(16,899)	(15,463)	(13,294)	(9,267)	(14,281)	(14,657)	(12,390)	(16,763)	(15,982)	(24,164)	(179,819)	20,981
R&M	(4,382)	(3,423)	(3,525)	(4,656)	(5,485)	(5,101)	(3,488)	(7,986)	(7,153)	(4,429)	(4,258)	(6,512)	(60,398)	3,177
Utilities	(4,545)	(5,438)	(4,620)	(4,487)	(3,993)	(3,526)	(4,768)	(5,103)	(4,479)	(7,075)	(6,164)	(5,940)	(60,137)	16,505
Insurance	(2,084)	(2,084)	(2,084)	(2,084)	(2,084)	(2,084)	(2,084)	(2,309)	(2,084)	(2,084)	(3,922)	(1,839)	(26,822)	1,814
Real Estate Taxes	(2,332)	(2,332)	(2,332)	(2,332)	(2,332)	(2,332)	(2,332)	(2,411)	(2,332)	(2,332)	(2,411)	626	(25,184)	(3,751)
Management Fee	(2,217)	(2,347)	(2,622)	(2,379)	(2,408)	(2,382)	(2,624)	(2,459)	(2,608)	(2,422)	(2,388)	(2,476)	(29,332)	2,671
Trustee & Issuer Fees	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(703)	(8,430)	
Total Expense	(31,429)	(27,818)	(32,784)	(32,103)	(30,297)	(25,394)	(30,280)	(35,627)	(31,748)	(35,807)	(35,827)	(41,007)	(390,122)	41,397
Replacement Reserves	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(2,187)	(26,248)	

Operating Income (Shortfall)

	23,106	25,847	27,161	28,417	27,306	35,638	29,768	25,691	21,199	22,012	21,529	19,313	306,989	15,437
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Danger Signs...is it Property Operations? (cont)

Third Party Reports... review these in the office:

- 8823s and other compliance Issues, agency issues, unpaid fees
- Low or declining inspection scores from housing agencies, City, or lenders
- Poor accounting (reversing the reversals, reverse engineering the AFS)
- Insipid property reports (the 90% in 90 days lie)
- Liens for non-payment (do a title search)
- Increased lawsuits, higher insurance claims
- Local police crime reports
- No real marketing program... or it's misguided. (Condoms & Coozies)
- Shopping report stinks



Get Depressed... Without Leaving Home

Property	B C	wood	Clk	Dwood	Lakes	Manor	T and H	VW	R Oaks
Property score XYZ Shoppers	68	74.5	71	64.5	77.5	65	54.5	69.5	59
MF Industry 10 Standard									
Questions	60	70	80	40	90	80	60	70	63
February Deficits	\$ 47,099	\$	\$ 25,800	\$ 55,858	\$ 27,528	\$ 54,584	\$ 27,821	\$	\$ 55,669

Would you have leased an apartment?

NO because ...

“Leasing person was not enthusiastic”... “looked overwhelmed”... “did not overcome my objections”... “did not point out features”... “did not try to sell me on the community”... “did not talk much at all”.... “did not take me on the tour, just handed me keys and a map...”

- “I was not asked to fill out an application or leave a deposit...”***
- “ Leasing agent did not mention the amenities or features...”***
- “During first phone call, agent did not mention anything ...except price.”***
- “No follow-up from my visit...No email, no phone call, no thank you note.”***



Danger Signs...At the Property

Do this on the road:

- **Drive the property the day (or night) before the site visit.**
- **Does manager have a budget...on site ?**
- **On-site business plan w/ goals for: occupancy, concessions, closing ratios, tenant retention, cash collections, bad debt, cost controls ?**
- **Does the staff know how their bonus is calculated ? (see above)**
- **Is the staff a team ? or separate turfs for mgt, leasing and maintenance ?**
- **Are the office, the leasing trail, model and rent ready units spotless ?**
- **Can the staff explain basic procedures such as collections, handling of maintenance issues ?**
- **Does the PM company provide its on-site staff appropriate support ...
Technology systems, accounting, training ?**



Danger Signs...At the Property (cont)

Do this on the road:

Listen, particularly to the excuses...

- **Our Spanish radio ads aren't working (el staffo no hablo)**
- **Great security.. (I live too far away to check at night).**
- **Section 8 conundrum (more leases = less occupancy)**
- **Advertising: “We must advertise in “For Rent Magazine”**

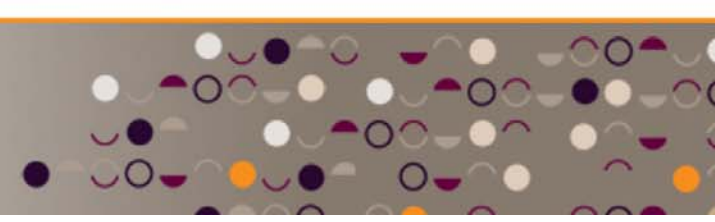
Actual results: =1 qualified lease per month @ \$1,200 per lease.

- **Concessions: “We give 2 months free because our competition gives one.”**

Result: Management company fired. Concessions went to 0.

- **Collections: “We file after 60 days”**

Result: a 6% collection loss on a 50% section 8 property



Diagnosing The Problem

With Disciplined Detective work

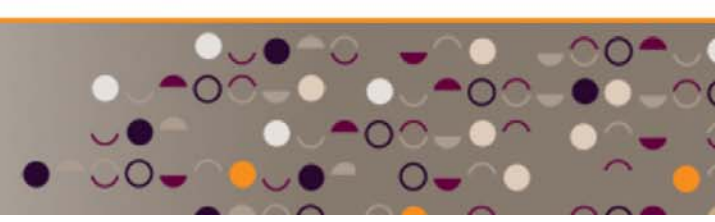
Get a new market and rent study

- Have it shopped
- What are market amenities – what do we need to compete?
- New capital needs study...what is needed in THAT market
- Real rents and concessions
- Someone in the market is 95% leased. Find that property... what they are doing.

Carefully review expenses

- vs. market vs. industry vs. historic
- Operating expenses vs. capital improvements
- What must be increased? What can be decreased?
- Security, security, security

More knowledge = more options to resolve problems



How Big is the Hole?

From Now until it is Fixed

Include all costs:

Construction completion, lease-up, capital needs, deficits until stabilization (everything... including the new kitchen sink)

If you cannot afford it:

Then OPM...Sources: Programs, Grants, Loans, Trades: Tax credits for new equity ,sell the back end for \$ today. This is the sweat equity/creative part of the challenge.

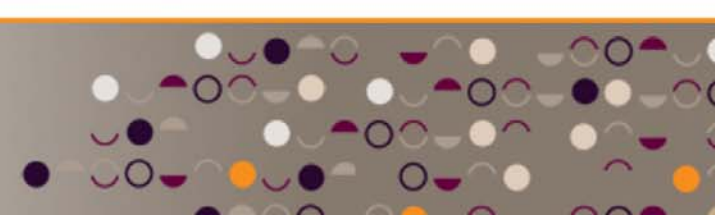
Engage all Stakeholders:

the equity partner, lender, State and Local, old GP, new GP, PM company.

Know the financial costs to each stakeholder...Loss of credits, recapture, loan impairment, guarantees.

Balance your Sources and Uses

Before you Fix it or Fund it, Figure it out



Presenting the problem

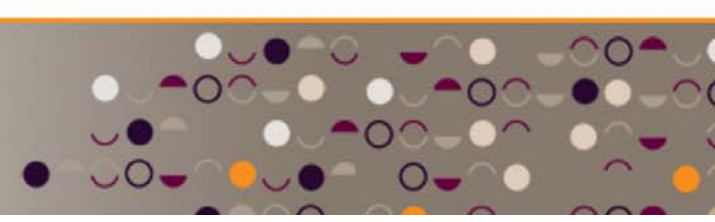
Present a re-investment package for stakeholders.

- **Historical narrative... What went wrong...**
- **Discussion of market, property, all issues**
- **A formal plan with 10-year cash flows**
- **Sources and Uses (deficits, turnover, cap X)**

Identify and quantify stakeholder risks if problem is not fixed

- **Syndicator → lost credits and reputation**
- **Agencies → lost affordability, soft loans, etc**
- **Lender → default, write-down**

Make a compelling written case for reinvestment.



Keys for Fixing Broken Properties

- Know your market and competition (tenants love new appliances)
- Know your documents, restrictions, and motivations of all stakeholders.
(still vacant in OK City)
- Make it a permanent fix...or a business decision that it's a compromise .
- Creativity, Creativity, Creativity
- Control your emotions, if it becomes personal, you lose perspective and discipline.
- Make it fun and good theatre
- Patience, Perseverance, and if all else fails, Prozac.