

Asset Management Workshop

Kentucky Housing Corporation
Affordable Housing Conference

Louisville, Kentucky

October 18, 2016

PRESENTED BY



Agenda

- **Introductions**
- **Section I: Understanding Asset Management**
- **Section II: Why Asset Management is important**
- **Section III: How to get started in Asset Management**
- **Section IV: Advanced topics in Asset Management**
- **Open discussion**

Introductions



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FOR HOUSING

Section I: Understanding Asset Management

- What is Asset Management (AM) vs Property Management (PM)?
- Risk mitigation mentality
- Positioning your portfolio as a source of revenue for your organization
- “Cradle to Grave” approach

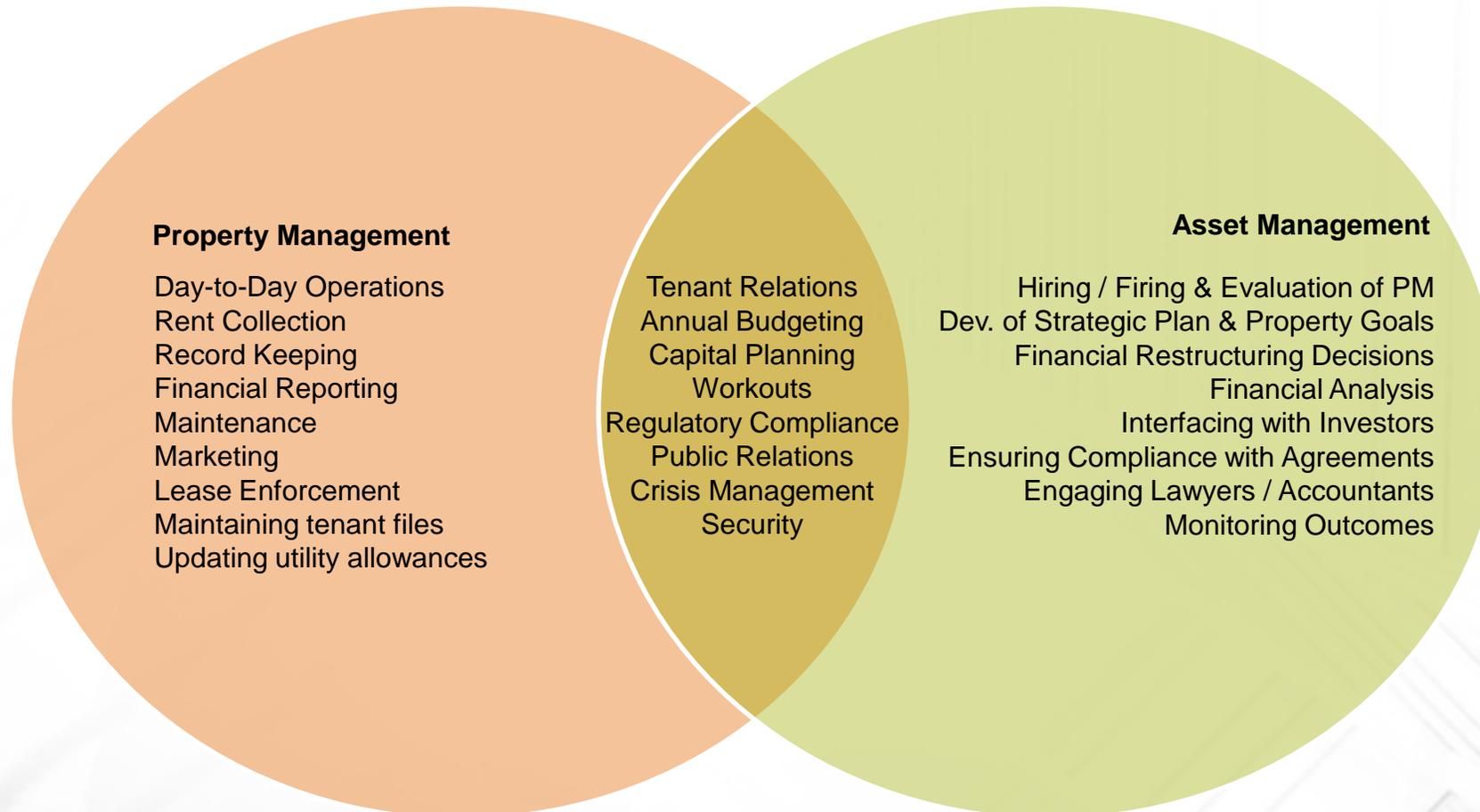
What is Asset Management?

- Asset Management encompasses the acquisition, oversight and disposition of real estate
- Taking a view of the asset focused on **the owner's long-term goals and objectives**
- Asset Management is an ongoing, iterative process whereby the value, direction and positioning of an asset is being continually assessed and evaluated

What is Asset Management versus Property Management?

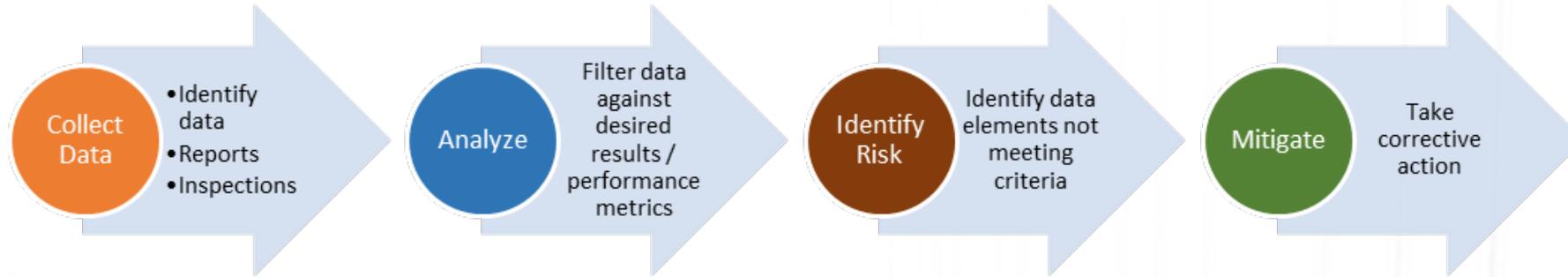
- Day-to-day operations (property management) versus long-term strategic view (asset management)
- **TAKING A LONG-RANGE VIEW IS IMPERATIVE**
 - It is too easy to get 'consumed' with daily operations – a dedicated focus on the long-term trajectory will improve decision making process
 - Short-term decisions need to be evaluated through a long-term lens
- Establishing and monitoring for specific performance metrics will set expectations and provide focus

What is Asset Management versus Property Management?



Risk mitigation mentality

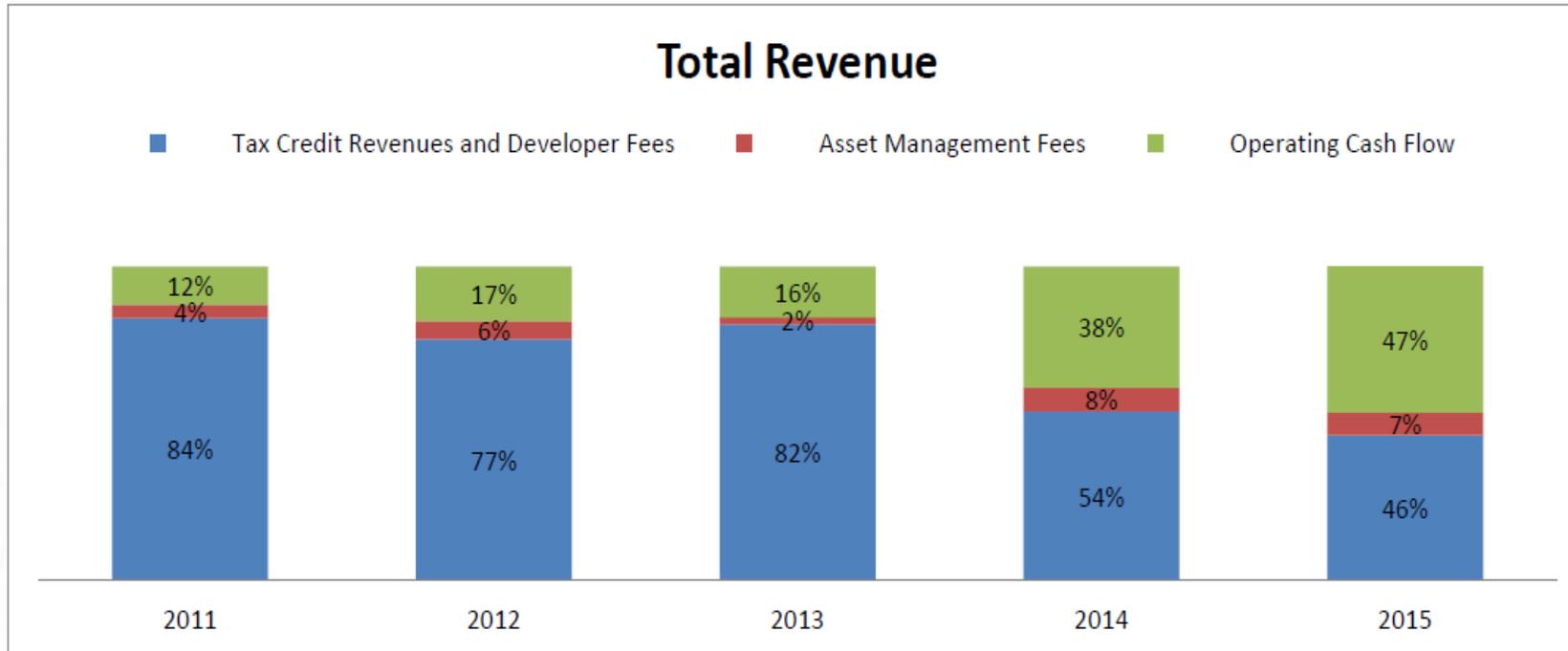
“...active monitoring and risk mitigation...”



Collect Data	Analyze	Identify Risk	Mitigate
Ask the right questions	Know the desired result	Identify unexpected results	Communicate with stakeholders
Be smart with effective data capture	Build efficient systems	Gauge relative risk of deficiency	Develop action plans
Set appropriate frequency	Filter data to identify exceptions	Ask questions to verify results	Fix the problem!

Ask yourself: What does my organization DO?

If you think of yourself as a **development organization** running on **developer fees**, you may miss a real opportunity



Source: NHP Foundation Presentation, AHF Live 2014

Portfolio should be a source of revenue

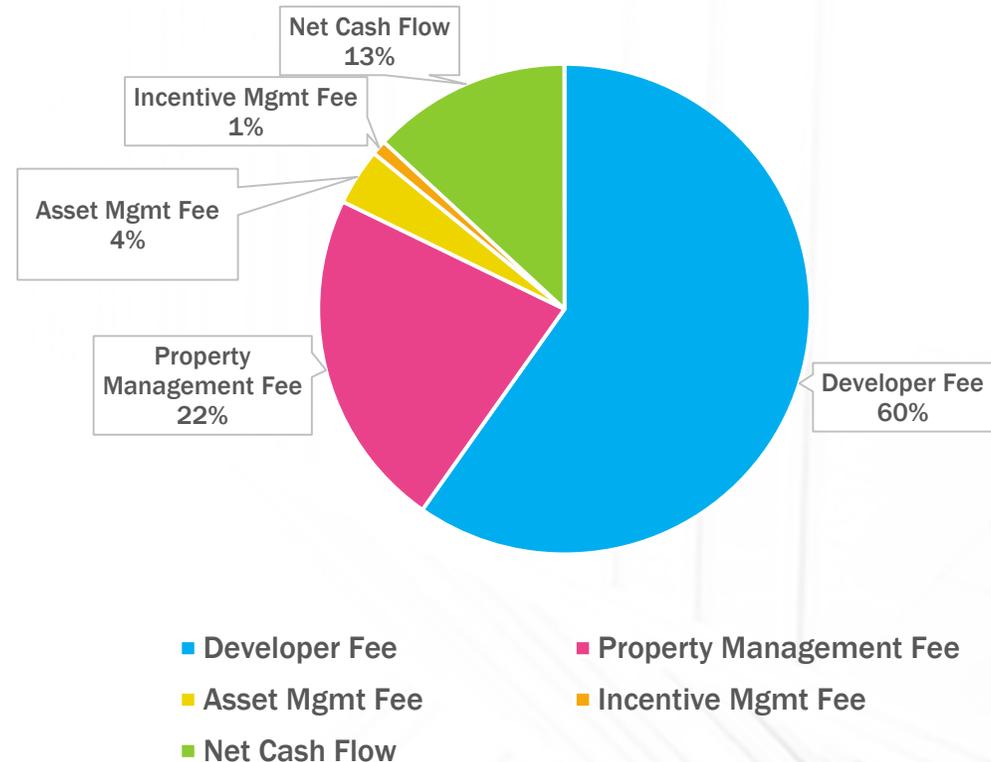
- Developer Fees
- Operating Fees
 - AM Fees
 - Incentive Management Fees
 - Property Management Fees
- Cash flow

SO...

what did you **need to do upfront** in order to **structure the deal to work** this way?

- Negotiate your fees
- Watch your trending & OpEx assumptions
- Don't underwrite to break-even (...because reality definitely won't be *better* than that...)
- Monitor and manage property operations

Total Funds Derived from Project (Sample)



Don't forget about residual value

- Too Low: 704b Issues are a HUGE deal
 - Make sure all the debt *could* be paid off!
- Valuation can be very sensitive to variables like:
 - Accrued Interest
 - Cap Rate at exit
 - Expected NOI

Residual Value at Year 10

Assumes	0% Interest Soft Loan		2% Interest Soft Loan	
	6.5% Exit Cap	5.5% Exit Cap	6.5% Exit Cap	5.5% Exit Cap
Steady NOI	\$ 724,575.51	\$ 1,137,075.51	\$ 560,329.70	\$ 972,829.70
NOI increase 2%/yr	\$ 1,176,251.51	\$ 1,679,086.70	\$ 1,012,005.69	\$ 1,514,840.89
NOI compress 1%/yr	\$ 527,363.54	\$ 900,421.15	\$ 363,117.73	\$ 736,175.34

Acquisition	\$2,250,000	Going-in Cap Rate	6%
1st Mortgage	\$1M at 4% on a 20-year term	Y1 NOI	\$123,750
Soft Loan(s)	\$750,000		

Anticipated residual value can affect:

- Upfront negotiations and deal terms
- Go/No-Go Analysis for developer (e.g. cash-on-cash return)
- Planned recapitalization
- Ongoing operating decisions (managing the NOI)
- How contentious a Y15 process is

“Cradle to Grave” approach to Asset Management

- Original concept & underwriting
 - CRITICAL that AM be involved in the underwriting process
 - Market intel / design & amenities / operating expenses / timing assumptions
- Pre-stabilization
 - Critical time! Focus on credit delivery and flip to permanent financing
- Operational AM
 - Maximize NOI / minimizing risks
- Transactional AM
 - Financial restructuring
 - Y16 planning

Section II: Why Asset Management is Important

- Asset Management is actual, not theoretical
- Monitoring owner's obligations
- How sophisticated owners leverage a strong Asset Management function

Asset Management is ACTUAL versus theoretical information

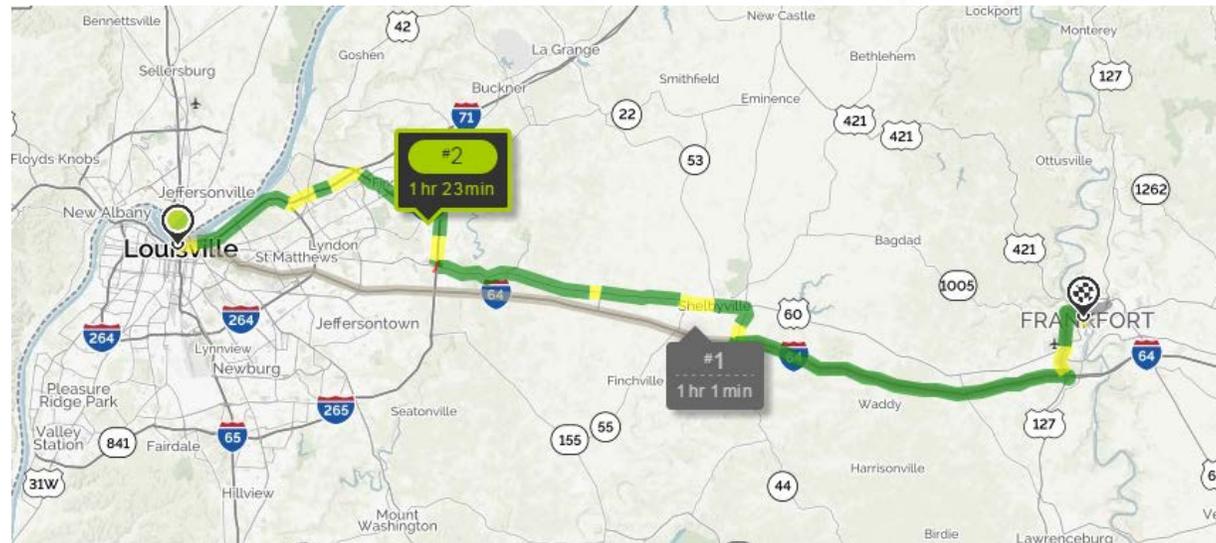
- Can't run business on 'expected' income – are you **actually seeing the net income** you projected?
- Developer pro formas attempt to predict the future – AM is where you **test and verify those predictions**
- AM can tell you what's working and what's NOT working
 - So if we expected things like:
 - Energy savings after a rehab
 - No more than 7% vacancy
 - Construction completion by 12/31
 - Lease-up within 8 months
 - Per-unit OpEx of \$4,500
 - 3% annual expense increases
 - Max LIHTC rents

Is that what actually happened?
If not, what's the financial / compliance /
physical impact?
What can we do about it?

In life, reality rarely goes as planned...

- How long does it take?
 - Depends on...
 - Time of day
 - Specific start and end points
 - Speed limits / recommendations
 - WHY would you take THAT route?
 - “Investor said I had to...”
 - Practical knowledge
 - Shortcuts
 - Construction
 - Your own car

Asset Management incorporates all sorts of **information from the real world** to give a **more accurate picture** and allow for **better response**.



Monitoring for owners' responsibilities

- **Managing the affairs of the Partnership**
 - Interfacing with lenders, investors and other stakeholders
 - Tracking & fulfilling commitments
- **Guarantees**
 - Construction completion
 - Operating deficit
 - Credit reduction
- **Meeting obligations of the Housing Finance Agency**
 - Ensuring compliance with Restrictive Covenant / HDAP agreements / etc
- **Monitoring for adherence to loan covenants**
 - Criteria for stabilized operations
 - Debt coverage ratio
 - Loan-to-value ratio
 - Replacement Reserve obligations

Strong owners know the value of AM

Owners are “closest to the asset”

- Greatest liability in case of underperformance
- Biggest potential upside if strong residual value and/or cash flow



May have a double / triple bottom line

- How do you balance these priorities when making decisions?



It's hard! (And it's impossible without data.)

Strong owners know what's really worth spending time on

BUDGETS

- Establish portfolio-wide goals, then translate them into project budgets
- Look at historical, comparable, and market data when projecting for the coming year
- Balance input from central office and site management
- Getting budgeting wrong will undermine a lot of other processes

CAPITAL PLANNING

- If you were a manufacturer, your properties would be your factory – take care of your physical plant!
- Replacement reserve deposits are **almost never sufficient**
- Balance input from central office and site management
 - Get experts when needed
 - Managing bids is time consuming

Section III: How to get started in Asset Management

- Quick Quiz: How is my organization doing?
- How to get started in Asset Management?
- Key metrics you should be monitoring
- Special consideration – self vs. fee managing

Quick Quiz: Is my organization doing AM?

- Do we have an REO schedule?
 - ✓ Is there a regular process for updating it, and do I know whose job that is?

- Do we have someone whose job is Compliance?
 - ✓ Does that person have a certification (HCCP, C3P, etc.)?

- Do we have a Watchlist?
 - ✓ Are there clear, consistent, objective criteria for it?

- Do we incorporate historical information into the annual budgeting process?
 - ✓ Could we answer if asked, “what is our actual expense growth rate?”

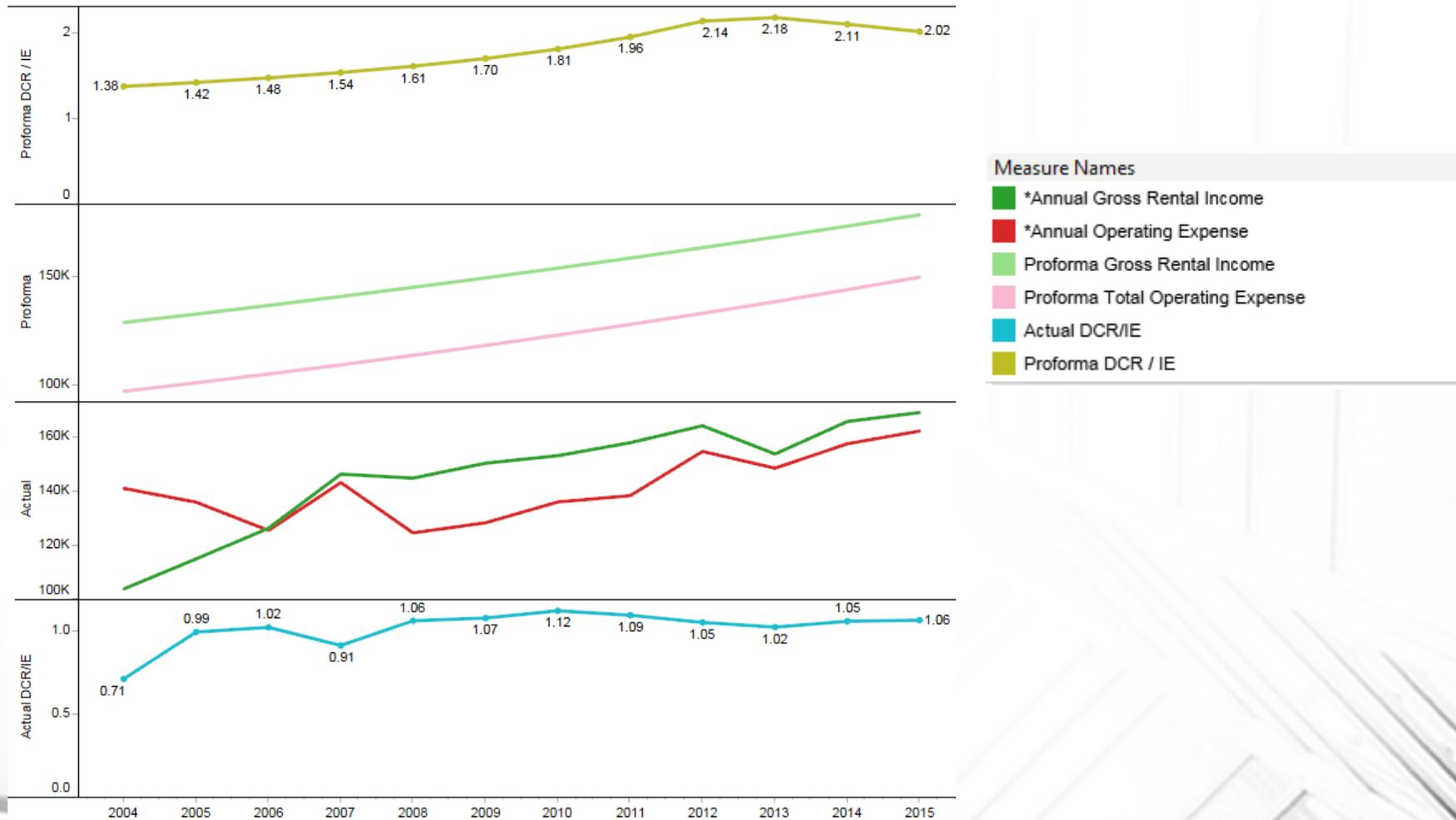
- Do we track variance from budget in our unaudited financials?
 - ✓ Do we track variance from initial underwriting?

- Do we have a rent schedule for each property or the whole portfolio?
 - ✓ Is there a rationale for rent increases?

Bonus Points: Is my organization doing AM?

- Do we know our total monthly debt service?
- Is anyone outside Development expected to read and understand all the regulatory agreements?
- Do we know our exposure to each lender and syndicator?
- How much have we paid in adjusters? Any patterns?
- Do we have an AM data system of some kind? Is it working for us?
 - Does everyone trust the data that comes out of our analyses?
- Is there a long-term capital plan for each asset?
 - Are we strategizing for the disposition (Y15) transaction?
- Is there a clear Single Point of Contact for each property?
 - Who fields questions from tenants? Investors? Regulators? Lenders?

A Visual Example: AM as super-sleuth



How to get started in Asset Management?

- Need 'buy in' from management team – Executive Director / Chief Financial Officer must advocate
- Share with staff that organization is embracing the 'asset management' discipline in an effort to better position the parent organization for long term sustainability
- Talk openly about portfolio impact on organizational success – work with CFO to establish cash flow targets
- Establish and monitor for key performance metrics
- Deliberately involve Asset Manager in every aspect of property life cycle – ESPECIALLY the development phase!

Asset Management Committee of the Board of Directors?

- Establish an Asset Management Committee on the Board of Directors
 - Establishes Board-level focus on key performance metrics
 - Increases level of scrutiny of underwriting process / keeps everyone more accountable for portfolio performance
 - Produces more engaged / informed Board Members
 - “what gets monitored, gets done!”

How to get started in Asset Management?

- The Consortium for Housing and Asset Management (CHAM)

- www.cham.us
- Coursework / professional certification (CHAM)
- Annual conference



- TCAM Asset Management

- www.tcamre.com
- Annual training in Boston (2-3x year)



- OCCH Training Academy

- training.occh.org
- Offers periodic AM trainings



Key metrics to monitor

KHC Portfolio-Level Summary Report -- August 1, 2016								
Type 1 Portfolio Information			Type 2 Portfolio Information					
Number of Properties	209		Number of Properties	636				
Number of Units	7,404		Number of Units	20,351				
Average Physical Occupancy	92.59%		Average Physical Occupancy	91.01%				
# of Watchlist Assets	\$38		# of Non-Compliant Assets	18				
Type 1 Portfolio DSCR	1.21		Type 2 Portfolio DSCR	1.17				
Type 1 Risk Rating Summary			Type 2 Risk Rating Summary					
Risk Rating	# of Properties	% of Type 1 Portfolio	Risk Rating	# of Properties	% of Type 2 Portfolio			
A	148	70.81%	A	501	78.40%			
B	43	20.57%	B	80	12.52%			
C	11	5.26%	C	30	4.69%			
D	6	2.87%	D	22	3.44%			
F	1	0.48%	F	6	0.94%			
Total	209		Total	639				
Type 1 DSCR Summary			Type 2 Risk Rating Summary					
DSCR	# of Properties	% of Type 1 Portfolio	Risk Rating	# of Properties	% of Type 2 Portfolio			
> 1.2	63	30.14%	A	501	78.40%			
1.1 -1.2	52	24.88%	B	80	12.52%			
1.0-1.1	25	11.96%	C	30	4.69%			
0.0 - 1.0	16	7.66%	D	22	3.44%			
<0	8	3.83%	F	6	0.94%			
N/A	45	21.53%	Total	639				
Total	209							
Type 1 Risk Summary			Type 1 DSCR			Type 2 Risk Summary		

Depends on several specifics, but for a typical owner, things like:

- Physical & Economic Occupancy Risk Level
- OpEx: budget & variance
- Actual & Projected NOI
- Compliance status
- Cash Flow & DSCR
- A/R balance & aging
- Turnover volume & speed
- Work order volume & response time

Special consideration – self vs. fee managing

Self Managing?

- *Should you be?*
 - Need sufficient scale for robust systems, to have adequate controls and to achieve profitability
- Asset Manager should NOT be involved in daily operations of management
 - Too easy to get pulled into daily management chaos and lose perspective of 'big picture'

Fee Manager OR Self Managing

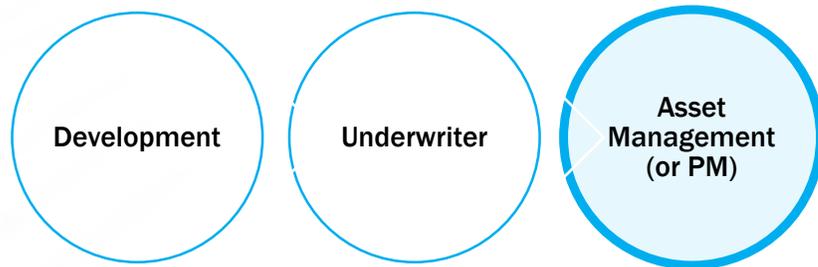
- Hold annual 'expectations meeting' with managing agent
 - Establish standards for quality and timeliness of unit 'turns'
 - Be thoughtful with the establishment of the operating budget and capital needs of properties
 - Identify special initiatives and how they will be executed
 - Set firm targets for cash flow expectations for the year

Section IV: Advanced Topics in Asset Management

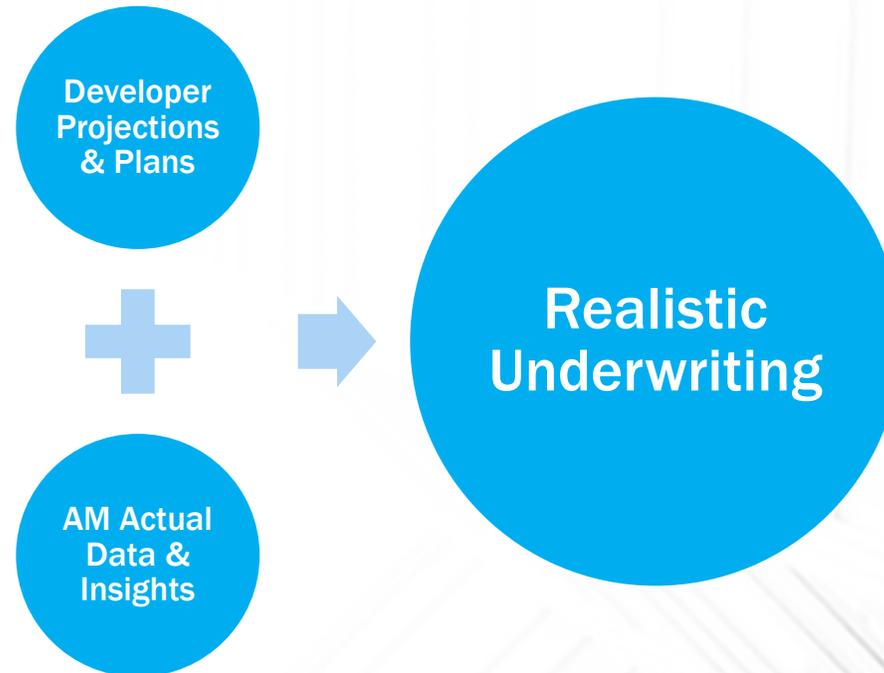
- Asset Management's role in development & underwriting
- Operational considerations
- Thinking about Y15 and long-range capital planning

Why bring AM into underwriting and development?

One group “runs” the development (and underwriting) process

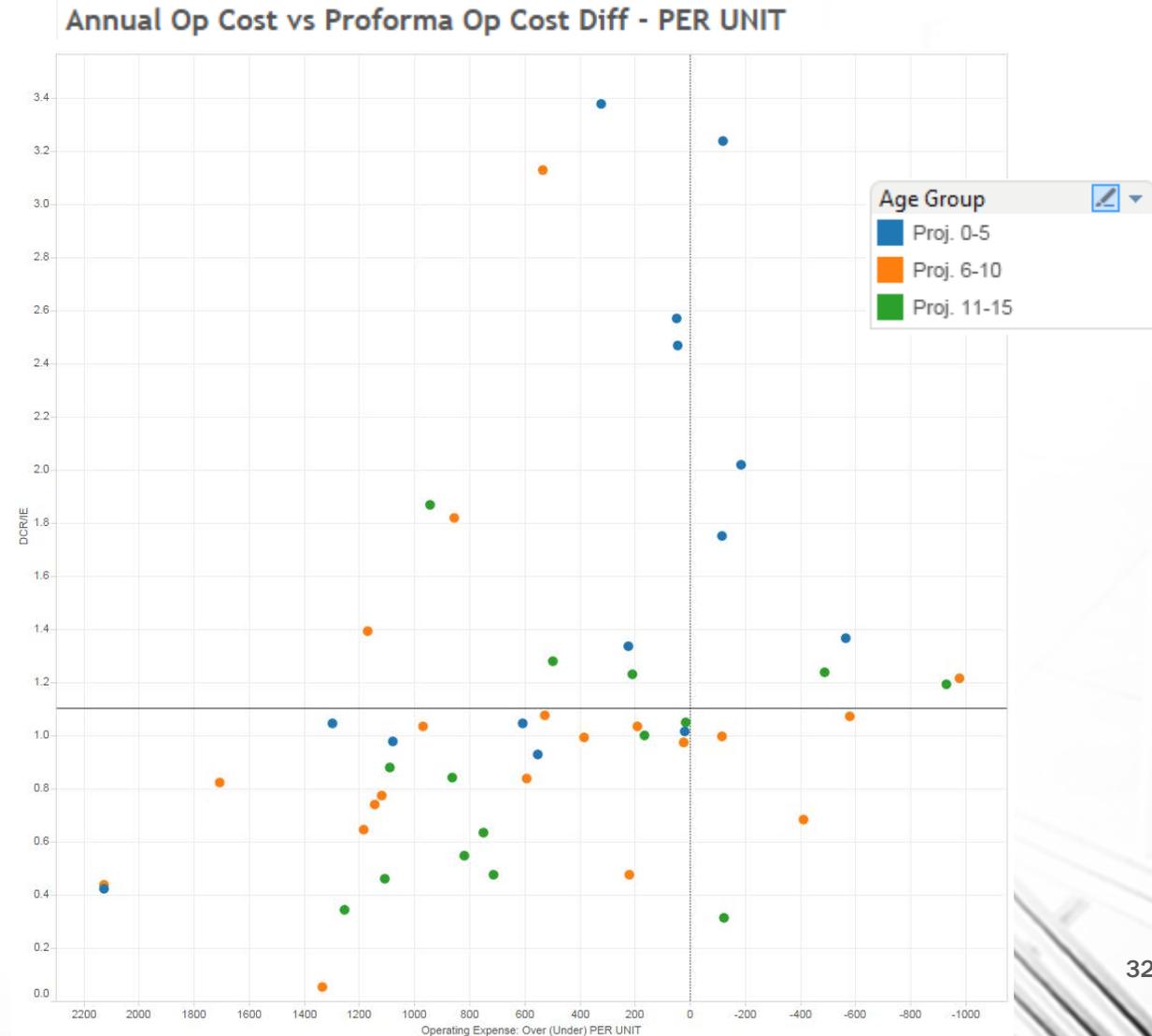


Skill and insight from across the organization go into development



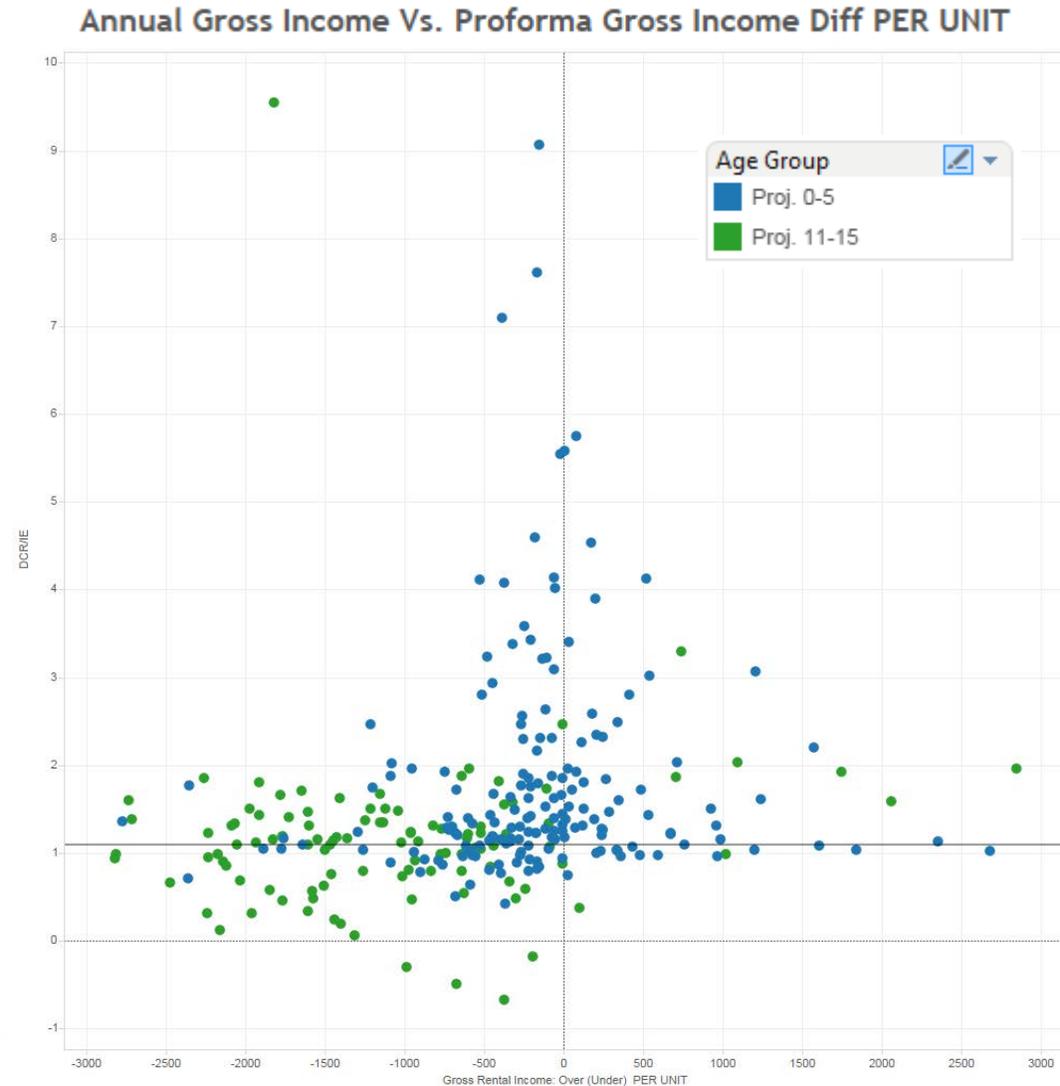
Why bring AM into underwriting and development?

- More likely trending assumptions
- Greater accuracy in per unit OPEX
- Better understanding of sub-markets
- Project surplus cash collections better



Why bring AM into underwriting and development?

- Do you *really* understand how your projects are performing when compared to original proforma?



Operational considerations

- Leave NO STONE UNTURNED in effort to improve NOI!
- Establish routine processes where opportunities for improved revenue / containing costs are CONTINUALLY re-assessed and monitored
 - Seeking continual improvement in operations should be 'engrained' into corporate culture
- Use data analytics to identify 'outliers' in your data
- Stay sharp and focus on new and emerging technologies / services to help you achieve your goals!

Operational considerations

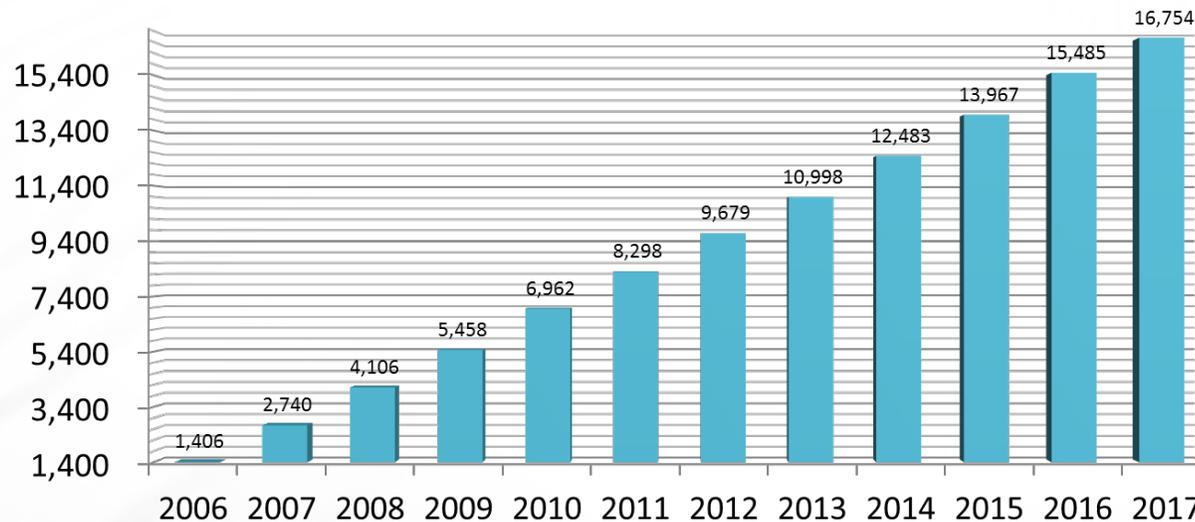
- Maximize Revenues
 - INITIAL RENTS should mirror underwriting
 - Increase rents per proforma / study utility allowance options
- Lower Costs
 - Strategic procurement
 - Consumption analysis
 - Operational efficiencies (regional staff vs site staff?)
 - Smart use of supportive services



Year 15 and long-range capital planning

- Transactional AM (including Year 15 dispositions) is a very **different skillset** than ongoing, regular AM
- Start planning early for exit – as early as Year 8 may be wise
- Understand your relative power in each deal
 - GPs typically drive the timeline, and may have strong rights

Number of properties beyond 10-year credit period



Don't just strategize to get the investor out – think about **what you are going to do with the property** once it's yours!

Open Discussion

Q & A

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