Oregon’s Affordable Housing: Analysis of Performance and Trends

Presentation to OHCS Housing Stability Council
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Housing Development Center:
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Thank You

• Meyer Memorial Trust for leadership on the Affordable Housing Initiative, and for funding the Sustaining Portfolios Strategy program

• The JPMorgan Chase Foundation for funding Cohort 1 data analysis

• Meyer Memorial Trust for funding Cohort 2 data analysis

• Housing Stability Council for the invitation to present
Presentation Outline

• Project Background
• Describe Data
• Describe Portfolio
• Review Performance
  • Financial
  • Physical
• Discuss Key Findings and Observations
Meyer Memorial Trust’s Sustaining Portfolios Strategy

• Improving the long-term sustainability of Oregon’s existing affordable housing

• Program includes: portfolio assessment, sustainability planning, and technical assistance during plan implementation

• Multi-year program for 19 organizations across Oregon

• Meyer awarded to each organization: $75k in flexible funding per year and up to 180 hours of technical assistance
Data Sources

• Meyer’s Sustaining Portfolios Strategy (SPS)
• Multifamily properties in service before 2012, 4+ units
• 2-3 years of financial information, detailed property and portfolio information
  • Audits, financial reports/dashboards, interviews, Capital Needs Assessments (CNAs) and internal staff knowledge
• Most recent full year of operations
  • 2014 for Cohort 1
  • 2015 for Cohort 2
• Performed data quality checks, omitted some properties and outliers

241 Properties and 9,816 units across Oregon
Description of the Portfolio

- 48% of properties in Portland MSA
- 58% of units in Portland MSA
- 53% of properties are self-managed
- 12.7 average age
- 41 average # units
- 43% have C.N.A.
- 81% have must-pay debt
Description of the Portfolio

Age Since Placed in Service

- <10 Years: 41% (111 properties)
- 10-14 Years: 23% (100 properties)
- 15-19 Years: 17% (24 properties)
- 20+ Years: 19% (6 properties)

Average is 12.7 years
(##) indicates number of properties in each category

Properties by Funding Type

- LIHTC: 51% (123 properties)
- RD: 9% (22 properties)
- CDBG/HOME: 12% (28 properties)
- HUD: 12% (28 properties)
- Other: 16% (40 properties)

LIHTC: 4% and 9%, past and present
RD: includes properties with both LIHTC & RD funding
HUD: includes properties with LIHTC & HUD, properties with HOME & HUD
Overall, the Portfolio is Performing Well

- 96.8% average economic occupancy in 2014/2015
- 1.48 average hard debt coverage ratio (DCR)*
- 61% of properties have hard-debt DCR ≥ 1.20*
- $5,193 average 2014/2015 operating expenses per unit*
- $690 average 2014/2015 net cash flow per unit*
  - This is **before waterfall payments** such as
    - Payments to outside entities: soft debt and investor service fees
    - Deferred developer fees
    - Asset management & resident services fees

*Average excludes outliers, includes net deposits to replacement reserves*
Overall, the Portfolio is Performing Well

- Can define underperformers financially or physically
- Our definition **only considers financial performance**
- If a property had 2 of 3 indicators of financial distress it is an “underperformer”
  - Negative Net Cash Flow (41 properties)
  - DCR ≥ 1.10 (60 properties)
  - Expense-to-Revenue Ratio > 70% (120 properties)
- 23% (55 properties) are defined as underperformers
Impact of Different Expense-to-Revenue Ratios

- Financial institutions typically require debt coverage between 1.10 and 1.20
  - 75% line crosses 1.10 in year 7
  - 70% line crosses 1.10 in year 12
  - 65% line crosses 1.10 in year 19
- Assumes revenues increase 2% and expenses increase 3% annually
Underperformers Have Many Characteristics

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>% of Total Portfolio</th>
<th>% of Underperformers</th>
<th>Disproportionate by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>RD, HUD, other funding source</td>
<td>37%</td>
<td>53%</td>
<td>16 percentage points</td>
</tr>
<tr>
<td>Fewer than 10 units per building</td>
<td>64%</td>
<td>78%</td>
<td>14 percentage points</td>
</tr>
<tr>
<td>2.0+ bedrooms per unit</td>
<td>45%</td>
<td>55%</td>
<td>10 percentage points</td>
</tr>
<tr>
<td>Properties 10-19 years old</td>
<td>40%</td>
<td>49%</td>
<td>9 percentage points</td>
</tr>
<tr>
<td>3rd party managed</td>
<td>47%</td>
<td>56%</td>
<td>9 percentage points</td>
</tr>
</tbody>
</table>

Underperformers...
- Are not concentrated in any single organization, PJ or region
- Have almost equal hard debt profiles compared to OK performers
Underperformers Have Higher Vacancy and Expenses

**Economic Occupancy Differs**

- OK Performers (186): 97.3%
- Underperformers (55): 94.7%

**Revenues and Operating Expenses Differ**

- OK Performers (169):
  - Revenue Increase: 2.0%
  - Operating Expense Increase: 3.9%

- Underperformers (45):
  - Revenue Increase: 1.9%
  - Operating Expense Increase: 6.6%

*Point-in-time analysis (2014 or 2015)*

*Average across total portfolio: 96.8%*

*Nominal change from 2013-14 or 2014-15*

*Averages exclude outliers*
Expenses Differ by Property Structure

- Different types of properties have different financial realities
- Underwriting by unit count is not specific enough
  - Bedroom density (average number of bedrooms per unit)
  - Unit density (average number of units in a building)
- Population
- Location

<table>
<thead>
<tr>
<th>Property Characteristic</th>
<th># of Properties</th>
<th>Average PUPY Total Operating Expense</th>
<th>Average PUPY Operating &amp; Maintenance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whole sample</td>
<td>241</td>
<td>$5,193</td>
<td>$1,496</td>
</tr>
<tr>
<td>Larger families</td>
<td>109</td>
<td>$5,572</td>
<td>$1,621</td>
</tr>
<tr>
<td>Lower density</td>
<td>153</td>
<td>$5,198</td>
<td>$1,536</td>
</tr>
<tr>
<td>30% AMI units</td>
<td>12</td>
<td>$5,065</td>
<td>$1,479</td>
</tr>
<tr>
<td>Rural</td>
<td>104</td>
<td>$4,856</td>
<td>$1,418</td>
</tr>
<tr>
<td>Seniors</td>
<td>36</td>
<td>$4,841</td>
<td>$1,362</td>
</tr>
</tbody>
</table>

Averages exclude outliers
Total operating expenses include reserve deposits net of withdrawals
Maintenance Costs Increase with More Bedrooms

Averages exclude outliers
Underperformers have 12.7 units per building compared to 21.5 for OK properties.

Averages exclude outliers
Large Bedroom Properties More Expensive to Operate

Revenue and Operating Expenses Diverge

Nominal change from 2013-14 or 2014-15
Averages exclude outliers

Higher Debt Payments

Averages exclude outliers
Debt Is the Largest Financial Outlay

- 81% of properties have hard debt
  - $23,644 average balance per unit
- 86% of properties have some debt
  - 5% of properties have only soft debt
  - $38,090 average total balance per unit
- 61% of properties have hard debt DCR ≥ 1.20
- 14% of properties have no debt
Physical Condition Is Also a Big Factor in Performance

- Many factors determine extent of capital needs:
  - Design, materials, construction quality assurance, level of maintenance
- 101 out of 241 properties (42%) submitted physical condition reports with cost information
- Reports assume different levels of rehab and have varying accuracy in cost information
- Average $15k in capital needs per unit over next 10 years
- 31 properties have more than $20k per unit in capital needs identified in next 10 years
- 15 properties have more than $40k per unit in capital needs identified in next 10 years

(Averages exclude outliers)
Underperformers Have Higher Capital Needs

Averages exclude outliers
Analysis is limited to the 94 properties with reserves and non-outlier, immediate capital needs estimates (10-year hard construction costs only)
Capital Needs Gap: we assumed the 2014/2015 deposit was made annually for 10 years, escalating 3% annually and no withdrawals were taken
Capital Needs Gap Grows as Properties Age

Averages exclude outliers
Analysis is limited to the 94 properties with reserves and non-outlier, immediate capital needs estimates (10-year hard construction costs only)
Capital Needs Gap: we assumed the 2014/2015 deposit was made annually for 10 years, escalating 3% annually and no withdrawals were taken
• How many properties could potentially refinance to cover all their capital needs?
  • Sources: Existing replacement reserves + New debt
  • Uses: Retire current debt + Pay for capital needs (assumes 25% soft costs)
  • *Not considering maturity dates, prepayment penalties, etc.*

• Look at properties with C.N.A., reserves, and positive 2014/2015 NOI
  • 92 properties to consider refinancing

• New debt assumptions
  • 1.20 DCR requirement
  • 6% interest rate
  • 25 year amortization
1/3 Properties Can Refinance to Cover Capital Needs

• How many properties could potentially refinance to cover capital needs?
  • 30 out of 92 (32.6%) could potentially retire current debt and cover all 10-year capital needs
  • An additional 8 properties could potentially retire current debt and cover 75% of 10-year capital needs
    • 38 of 92 or 41.3%
  • An additional 13 could potentially retire current debt and cover 50% of 10-year capital needs
    • 51 out of 92 or 55.4%

• Of the 55 underperforming properties:
  • 19 met the refinancing criteria (+NOI, some reserves, and C.N.A.)
  • 1 property could potentially retire current debt and cover all 10-year capital needs
  • 2 additional properties could potentially retire current debt and cover 50% of 10-year capital needs
Owners Are Working to Improve Conditions

### Workout waterfall for owners

- Improve operations
- Use reserves
- Consider refinancing
- Then consider new funding sources

1. **Operations**
   - Increase Revenues
   - Evaluate Expenses

2. **Reserves**
   - Use Reserves Strategically

3. **Refinance**
   - Lower Loan Payments
   - Fund Repairs

4. **Public Reinvestment**
   - New Gap Funds
   - 4% LIHTCs
   - 9% LIHTCs
Key Findings from Data – Operations

• Owners are meeting mission, very strong economic occupancy
• Underperformers are not concentrated by location or owner
• Expenses are increasing much faster than underwritten
• Properties with larger bedroom sizes are more expensive to operate
• Building density impacts utility and maintenance expenses
• Not a lot of room to improve operations, problems mostly structural
Key Findings from Data – Capital Needs

• Significant capital needs gap in Oregon, widens with age
• Reserves can help, but are insufficient to address capital needs
• Only a few properties can solve their problems without additional resources
• Properties that underperform financially and face backlogged capital needs have compounding problems
• Difficult to accurately quantify capital needs—and approximate future demand for public resources—across 241 properties
Observations from Technical Assistance

- Owners are optimizing property performance, using available resources
- No dedicated funding stream available for necessary recapitalization
- Useful life of building components is shorter than affordability period
- Need to consider a variety of factors when underwriting operating expenses
- Poor material choices and lack of quality control during construction have lead to expensive building envelope failures
- Different tools and strategies are required for large, urban properties and small, rural properties
Next Steps

• Kicking off Meyer Preservation Convening, developing policy proposals for preservation

• Adapting WA’s Life Cycle Cost Analysis Tool to inform OR’s affordable housing development projects

• Eager to work with Margaret and her staff at OHCS on preservation solutions

• Optimistic about opportunities to collaborate
Questions and Discussion

Thank you

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