Loan Risk Management

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Michigan State Housing Development Authority

How MSHDA Finances Multifamily Properties

How does MSHDA finance Multifamily Rental Housing?

Three major programs:

- Direct Lending
- 9% Low Income Housing Tax Credit
- Pass-Through Short Term Bond Program

How MSHDA Finances Multifamily Properties

Direct Lending

- Rental Development Division- John Hundt
  - Tax Exempt Bonds with Gap Financing- NOFA
  - Taxable Bond Loans
  - HOME Loan for 9% PSH Developments

How MSHDA Finances Multifamily Properties

9% Tax Credits

- LIHTC Division- Andy Martin
  - 9% LIHTC- Done through the QAP

Pass-Through Short Term Bond Program

- Combines 4% LIHTC credits and limited obligation bonds

Asset Management's Role

The Asset Management Division oversees the financial and physical integrity of MSHDA's $1.5 billion multifamily rental bond financed portfolio, which is comprised of approximately 500 multifamily developments accounting for 52,000 household units.

Michigan State Housing Development Authority

Asset Management

- **Donna McMillan** – State Division Administrator 17
  - **Michelle Locher** – Executive Secretary 10

Finance/Technology
- **Paul Bursley** – Financial Manager 15
  - **Lisa Espinoza** – Auditing Specialist 13
  - **VACANT** – Auditor 9-12
  - **Ryan Armstrong** – Auditor 10
  - **Nikki Miller** – Departmental Analyst 12
  - **Student Assistant**

Federal Compliance
- **Daphne Wells** – Departmental Manager 15
  - **Janice Zanetti** – Economic Community Development Manager 15 (fzn)
    - **VACANT** – Departmental Analyst 9-12
    - **Amy Bucht** – Financial Analyst 12
    - **Rechelle Black** – Financial Analyst 12
    - **Wanda Owens-Bush** – Financial Analyst 12
    - **Linda Ritter** – Departmental Supervisor 11
      - **VACANT** – Departmental Technician 10
      - **Amanda Cater** – Departmental Technician 10
      - **Student Assistant**
  - **VACANT** – Departmental Specialist 13
  - **VACANT** – Departmental Analyst 9-12
  - **Kristin Lautner** – Departmental Analyst 9
  - **Kyle Shaffer** – Financial Analyst 9
  - **Margaret Droste** – Departmental Analyst 12

Core Operations Intake
- **Matt Bergeon** – Departmental Manager 15
  - **VACANT** – Financial Analyst 12
  - **Michele Whitmore** – Financial Specialist 13
    - **Janice Stevenson** – Secretary 9
  - **VACANT** – Financial Analyst 12
  - **VACANT** – Financial Analyst 9-12
  - **John Kuhn** – Financial Analyst 12
  - **Deb Andrew** – Financial Analyst 12
  - **Todd Miller** – Financial Analyst 12
  - **Willa Ray** – Financial Analyst 12
  - **Nathan Thelen** – Property Analyst 9
  - **Kathy Pung** – Departmental Technician 10
  - **Maureen Carden** – Departmental Trainee 9

Transactions and Preservation
- **Michael Witt** – State Administrative Manager 15
  - **Troy Thelen** – Departmental Manager 14
    - **Duane Thelen** – Departmental Analyst 12
    - **Andrew Spitzley** – Departmental Analyst 10
    - **Emily Booth** – Departmental Analyst 9
  - **Justin Wieber** – Financial Analyst 12
  - **Amy Rollis** – Financial Analyst 12
  - **Roger LaRock** – Financial Analyst 12
  - **Kathryn Evans** – Financial Specialist 13
  - **VACANT** – Financial Analyst 9-12

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MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY
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MSHDA Asset Management

Asset Management Division has four Sections:

Operations- Oversee the collection of the financial data that MSHDA receives for the Asset Management portfolio.

Federal Contracts-Oversee everything with project based Section 8 HAP contracts. Includes both the Traditional Contract Administration and Performance Based Contract Administration.

MSHDA Asset Management

Asset Management has four Sections (cont.):

Transactions and Preservations- Oversee the MSHDA financed, non Section 8 developments that are considered higher risk. Also includes the asset management of all of MSHDA's Small Scale developments.

Core Operations- Oversee the MSDHA financed, non Section 8 developments that considered lower risk. Includes everything from bond financed, tax credits, 1602 funds, NSP funds, Rural Development and any other multifamily MSHDA financed program.

MSHDA Asset Management

- What determines if a property is considered Core or Troubled?

- MSHDA has created a Risk Rating that Asset Management staff use to determine when a property might need more oversight.

- Properties can move between the Core portfolio and Troubled portfolio

MSHDA Asset Management Risk Rating

- The MSHDA Asset Management Risk Rating is used for Multifamily properties that submit monthly financial to the Asset Management Division
- New Developments begin getting a risk rating once they begin making mortgage payments, have completed an audit and have begun submitting an annual budget

- Asset Management's Small Scale Unit also uses a risk rating with similar factors however they are done separately from the core multifamily portfolio

MSHDA Asset Management Risk Rating

What are common risk indicators?

MSHDA Asset Management Risk Rating

Based on a scale of 0-5 using the following five factors:

- Liquidity
- Economic Vacancy
- Delinquency/Workout
- Escrow Balances
- Debt Service Coverage

The higher the risk rating the higher the risk

MSHDA Asset Management Risk Rating

Liquidity

- Calculation to determine amount of cash a property has after all of its payables have been paid
- MSHDA's calculation is generated on the MIE and is created by the following formula:

Liquidity = Total Operating Cash + SUM(Tenant Rec+Subsidy Rec+Other Sub./Grants+Laundry Rec+Commercial Inc Rec+Interest Rec+Excees Incime+Other Current Resident Rec + Non-Resident Rec+Related Party/Affiliate Rec.+Other Rec) - SUM(Total Payable+Prepaid Rent+Delinq. Mortgage Interest+Other Accrued Interest+Delinquent Mortgage Prin+Affiliate Contributions/Advance+Repayment to Affiliate+Total Prior Tenant Rec) + ORC Account Balance

- For Risk Rating, if development had negative liquidity for the quarter then it gets a risk point.

MSHDA Asset Management Risk Rating

Economic Vacancy

- Calculation to determine the financial impact of bad debt and rent concessions to the income of the property
- MSHDA's calculation is generated on the MIE and is created by the following formula:

EVL = (Vacancy Loss + Bad Debt/Former Residents + Marketing Rent Concessions)/Gross Rent Potential

For Risk Rating, if development has EV for the last quarter greater than 12% it gets a point, if between 8% and 12%, it gets ½ a point and under 8% no point.

MSHDA Asset Management Risk Rating

Delinquency/Workout

- If a property is 1 or more days delinquent in a calendar year or currently in a workout it gets 1 point.
- Workout would be considered a modification of the MSHDA mortgage loan that alters the debt payment required by the original Note.

MSHDA Asset Management Risk Rating

Escrow Balances

- If a property’s per unit escrow balance is less than $2,000 or if the property has a replacement reserve need it gets a point.
- Escrow Balances included in the calculation are ORC, OAR, Replacement Reserve, ODR, and DCE Principal and Interest
- Replacement Reserve Needs is based on the funding level outlined in the most recent Capital Needs Assessment

MSHDA Asset Management Risk Rating

Debt Service Coverage

- Measures the properties ability to pay its debt service
- MSHDA measures it annually based on the annual audit
- Formula used by MSHDA is:

    Net Operating Income/Annual Principal and Interest

- For MSHDA Risk Rating, developments with a DSC less than 1.0 get 1 point, developments with DSC between 1.0 and 1.10 get ½ point

MSHDA Asset Management Risk Rating

Liquidity:

Last quarter average liquidity positive = 0
Last quarter average liquidity negative = 1

Economic Vacancy Score:

Average EV greater than .12 (12%) for the quarter = 1
Average EV between .08 (8%) and .12 (12%) for the quarter = .5
Average EV less than .08 (8%) for the quarter = 0

Delinquency/Workout Score:

1 or more days mortgage delinquency in calendar year or currently in a workout = 1
No delinquency in calendar year and not currently in a workout = 0

Escrow Score:

Per Unit Escrow balances exceeds $2000 = 0
Per Unit Escrow balances less than $2000 or Development has an RR Need = 1

Debt Service Coverage:

Development has DSC greater than 1.10 = 0
Development has DSC between 1.0 and 1.10= .5
Development has DSC less than 1.0 = 1

MSHDA Asset Management Risk Rating

What does MSHDA do with it?

MSHDA Asset Management Risk Rating

Use the Risk Rating to determine oversight level by AM staff

- Developments Risk Rated 4 or 5 are assigned to a Transaction Specialist in the Troubled Properties Unit
  - Get closer oversight
  - Transactions Specialist have smaller portfolio
  - More sight visits, maybe need an action plan
  - Work with management to solve root ailment causing the property to be troubled

MSHDA Asset Management Risk Rating

Use the Risk Rating to determine oversight level by AM staff (cont.)

- Developments Risk Rated 3 or lower are assigned to a Core Asset Manager
  - Typically have portfolio of 35-40 properties
  - Complete annual development review report and conduct site visit at least every three years

MSHDA Asset Management Risk Rating

Use the Risk Rating to determine strength of the multifamily portfolio

- Calculate a weighted average risk rating on a portfolio level based on outstanding balance
- Gives a general idea of how the health of the portfolio while taking note of the amount of debt at various risk levels

MSHDA Asset Management Risk Rating

Use Risk Rating to feedback to MSHDA underwriting guidelines

- Use the health of the portfolio to adjust underwriting parameters
  - Example-Higher DSC ratio in 2009-2013, vacancy projections
- Notice various programs that were not as successful
- Sort risk based on size of property

MSHDA Asset Management Risk Rating

What do you do with a high risk property?

Assigned to a Transaction Specialist
Close look at expenses and income based on underwriting projections
Work with management to create an action plan
See what the problem is and how best to solve it

MSHDA Asset Management Risk Rating

Tools for fixing high risk rated properties:

- Workout
- Preservation/Refinance
- Ownership change
- Changes in management

MSHDA Asset Management Risk Rating

Workouts:

- Change in the mortgage note payment
    - Typically a principal deferral for a short period of time to fix a certain ailment
    - Can be longer term fix
    - Reserve funding
- Look for a management plan to address to financial issues
- Look for the property to be able to be stable long term after the workout end
- Owner contribution
- Each property is different and has a different solution

MSHDA Asset Management Risk Rating

Preservation/Refinance

- New financing to get new long term solution
- Re-underwrites operations of a property
- Address the physical needs of a property
- Bring a new life to the tired/troubled property

MSHDA Asset Management Risk Rating

Ownership Change

- New general or limited partners can enter partnership
- New owners can bring operating efficiencies
- Usually coupled with a refinance in mind

MSHDA Asset Management Risk Rating

Changes in Management

- Can breathe new life into a property
- Bring a new prospective to a property
- Perhaps bring lower costs and operating efficiencies
- Could be a simple as a change in site staffing

MSHDA Asset Management Risk Rating

QUESTIONS?

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