

2009 OPPORTUNITY FINANCE NETWORK CONFERENCE

THE NEW NORMAL

Managing Delinquency: Affordable Housing

(or How to Make the Best Out of a Bad Situation)

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Managing Delinquency: Affordable Housing

This session will provide the fundamentals to evaluate, develop, and execute successful strategies to resolve troubled affordable housing loan relationships

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The Three Commandments

- ✦ Know Thy Borrower
- ✦ Know Thy Transaction
- ✦ Know Thy Self



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Know Thy Borrower (and Guarantor)

- Best way forward usually is w/ borrower as partner
- Review what you know
- Update your information
- Engage your borrower

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Review What you Know

- What did your underwriting say about the borrower?
- What do your asset management reports tell you?
- What do their financials show?

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Update What you Know

- How is the borrower being affected by current market conditions?
 - Get a cash flow projection
 - Analyze their development pipeline
 - Are other business lines affected?

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Update Your Information

- Does the borrower have a viable business?
 - Cash reserves/burn rate
 - How much can they be expected to support the delinquent loan?

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Engage the Borrower

- How do they see themselves in the current context?
- Is senior management responding appropriately to market challenges?
 - How are real estate, financial management, asset management engaged?

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Engage the Borrower

- Try to get on the same page
 - Projects: fish or cut bait
 - Operating portfolio: how long to support?
 - Principal pay-downs within borrower capabilities


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Key Loan Transaction Elements

1. Repayment/take-out sources
2. Collateral
3. Legal documentation

Case Study:
"Woody Acres Homes"

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"Woody Acres Homes"

- Acquisition financing for \$1.2MM parcel of land on which 20 self-help (sweat equity) homes would be built
- \$800,000 senior loan with local bank participant (LIIF lead)
- \$400,000 LIIF junior loan
- Acquisition loan is maturing

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"Woody Acres Homes" - 1. Repayment/take-out

- Repayment source: Interest reserve for monthly interest payments during the loan term - depleted
- Take-out source: Construction financing backed by state commitments for end loans and soft seconds . . .

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"Woody Acres Homes" – 2. Collateral

- Reappraisal ordered in advance of upcoming maturity date
- Land value declined 33%, from \$1.2 million to \$800,000.
- Original senior loan LTV increased from 67% to 100%
- Junior loan fully under water

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"Woody Acres Homes" – 3. Legal Documentation

- Hired legal counsel (other than closing attorney) to review all loan and loan participation documentation
- Understand rights and leverage points with borrower and all other lenders in the transaction
- We had not provided a payment subordination to the senior loan, so we could consider payment demands on the junior loan

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"Woody Acres Homes" – Resolution

- **Identified new repayment/take-out sources:**
 - Borrower pays monthly interest from its organizational cash flow
 - Six-month extension on senior loan (with bank partner consent) to allow refinancing with local public subsidies, supported by the collateral value
 - Two-year extension on junior loan with amortizing payments by borrower until a new (financeable) development plan is in place

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"Woody Acres Homes" – Resolution

- **Restructured junior loan given lack of collateral value:**
 - Released lien on property (related to California's single action law, and to avoid need to negotiate subordination terms with the local jurisdiction taking the senior lien)
 - Direct recourse to borrowers balance sheet, but with an understanding of borrower's other lines of credit

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"Woody Acres Homes" – Resolution

- **Tightened up loan documentation on now unsecured loan**
 - Negotiated financial covenants that will inform lender of unexpected adverse changes
 - Negotiated benchmarks for re-evaluating the development scenario necessary to repay balloon at end of 2-year extension term

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For your CDFI, ask yourselves:

- How patient is your capital?
- What is your risk tolerance for:
 - unsecured or inadequately secured loans?
 - loss of interest earnings (non-accrual loans)
 - portfolio concentrations by loan type or geography
- What is your political risk tolerance?
- What is your staff capacity to manage these risks?

Case Studies: LIIF and HPN

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A. Financial:

- Deteriorating liquidity
- Cash flow problems
- Deteriorating trend in accounts payable (stretched payables)
- Deteriorating trend in accounts receivable
- Accelerated growth or decline in revenues
- Non-payment of taxes (eg. payroll, real estate)
- Filing of tax liens, judgments
- Changes in fiscal year end
- Changes in accounting policies
- Increasing bad debt accounts
- Waivers, extensions, restructures by creditors
- Increasing leverage, reliance on debt
- Overdrafts and uncollected fees
- Trends contrary to peers
- Increasing concentrations with customers, funders
- Delayed completion of audit
- Aged payables to auditor, accountant
- Deferred salaries to management

B. Industry:

- Changes in funder priorities
- Changes in competition
- Technology shifts
- Economic slowdown



C. Management:

- Change in key management
- Lack of good, regular financial reports
- Lack of transparency
- Barriers to access auditors, funders, creditors
- Change in business plan
- Missing important information
- Delayed reporting
- No management succession plan
- Slow to react to market changes
- Lack of balance between program and fiscal focus
- Deteriorating relationship with funders, community

D. Credit:

- Increasing payment delinquency (frequency and/or days)
- Delayed financial reports
- Overadvances, out of compliance with borrowing base
- Unplanned, offseason, or excessive borrowings
- Loan covenant defaults
- Lease defaults
- Request for deferral of payments, restructure of terms
- Request for waivers

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