Building Sustainable Organizations: Early Warning Systems

May 9, 2012
Agenda

- Introductions
- Early Warning Systems
- Putting the Profit in Nonprofit
Early-Warning Systems

- What is your risk appetite?
- What risk(s) does this project pose?
- Does it align with your risk appetite?
Early-Warning Systems

Feasibility

Develop go/no-go criteria

Create internal underwriting guidelines
Feasibility – Develop go/no-go criteria

**Mission/Core Competency**
- Geographic area
- Project type
- Constituents

**Risks/Rewards**
- X amount of developer fees
- Guarantees < X% corporate assets
- Strong likelihood of obtaining funding
# Feasibility – Develop go/no-go criteria

<table>
<thead>
<tr>
<th>Threshold</th>
<th>Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RISKS</strong></td>
<td><strong>RISKS</strong></td>
</tr>
<tr>
<td>• Guarantees must be less than ___% of corporate assets</td>
<td>• Guarantees must be less than (___ - 5)% of corporate assets</td>
</tr>
<tr>
<td>• Strong likelihood of obtaining funding as measured by a score of at least ___ based on the state Housing Finance Agency’s scoring system for projects</td>
<td>• Score of ___ based on the state HFA’s scoring system for projects</td>
</tr>
<tr>
<td>• Projected positive cash flow for 15 years after stabilization without recapitalization</td>
<td>• Projected positive cash flow for 25 years after stabilization without recapitalization</td>
</tr>
<tr>
<td>• Projected operations generate enough cash to pay for property management and asset management fees</td>
<td>• No carrying costs if project not funded</td>
</tr>
<tr>
<td></td>
<td>• No political costs</td>
</tr>
<tr>
<td><strong>REWARDS</strong></td>
<td><strong>REWARDS</strong></td>
</tr>
<tr>
<td>• ≤ 50% of developer fee is deferred</td>
<td>• No developer fee deferred</td>
</tr>
<tr>
<td>• ≥ $ ___ amount of developer fee*</td>
<td>• $1 million anticipated developer fee</td>
</tr>
<tr>
<td></td>
<td>• Projected operations generate $ ___ amount annual surplus cash after accounting for cost of services</td>
</tr>
<tr>
<td></td>
<td>• Strengthens community and/or political support</td>
</tr>
</tbody>
</table>
Early-Warning Systems

Feasibility

Staff
• prepares report demonstrating whether or not a project meets go/no-go criteria

Senior Management
• recommends go/no-go criteria
• reviews and approves report to the board or board real estate committee on whether or not a project meets go/no-go criteria

Board
• adopts go/no-go criteria
• approves projects based on go/no-go criteria
Feasibility

Create Internal Financial Underwriting Guidelines

- Realistic revenue and expense trending
- Inclusion of all fees – asset management, property management, resident services
- Long-term property performance
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**Predevelopment**

Review risk criteria at various milestones

- Preacquisition spending over X amount or beyond specific items that the board has approved
- Entering into a contract over X% of the organization’s liquid assets

Mitigate risk at acquisition
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Predevelopment

Staff
• prepares report demonstrating whether or not a project meets go/no-go criteria when a triggering event occurs

Senior Management
• reviews and approves report to the board or project review committee on whether or not a project still meets go/no-go criteria

Board
• determines which triggering events require review
• approves at those junctures
Use risk categories to prioritize focus of monitoring

Risk category criteria
Construction

Risk Categories

- **On Target**: the project requires no special action, and should continue as planned.
- **Monitor Closely**: the project faces major problems that will need further action if the problems are not remedied.
- **Workout**: the project faces serious problems that require action and decision making by the board and senior management.
Construction

Risk Category Criteria

- Scope
- Schedule
- Sources and Uses
- Tax Credit Adjusters
Early-Warning Systems

Construction

Staff
• manages construction projects, and provides updates to the board, including the risk status

Senior Management
• reviews and approves report to the board on risk status, and makes day-to-day risk mitigating decisions

Board
• determines acceptable financial (and other) risk level of projects, and how to address projects that have exceeded acceptable risk levels.
Early-Warning Systems

Operations

Create a dashboard to provide at-a-glance information

Include performance categories in the dashboard

Performance criteria
**Operations**

**Performance Categories**

- **Performing**: require no special action and limited board review
- **Watch List**: are at risk, and should be monitored more frequently, with appropriate actions taken as needed
- **Workout**: face serious problems that require action and decision-making by the board and senior management
Operations – Dashboard criteria

- Compliance
- Occupancy
- Physical Condition
- Accrued Fees
- Replacement and Operating Reserves
- Cash Flow
- Organization’s Share of Cash Flow
- Must Pay Debt

Enterprise

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Operations – Dashboard criteria

- Compliance
- Occupancy
- Physical Condition
- Accrued Fees
- Replacement and Operating Reserves
- Organization’s Share of Cash Flow
- Cash Flow
- Must Pay Debt
- Organization’s Share of Cash Flow
- Must Pay Debt
## Early-Warning Systems

<table>
<thead>
<tr>
<th>Project</th>
<th>Green Briar</th>
<th>Middle City</th>
<th>View Point</th>
<th>Wiggin</th>
<th>Quimby</th>
<th>Bella Vista</th>
<th>Chateau</th>
<th>Whitby</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>180</td>
<td>185</td>
<td>24</td>
<td>115</td>
<td>106</td>
<td>64</td>
<td>40</td>
<td>100</td>
</tr>
<tr>
<td>Occupancy</td>
<td>95% - A</td>
<td>98% - A</td>
<td>80% - C</td>
<td>95% - A</td>
<td>85% - B</td>
<td>64% - C</td>
<td>99% - A</td>
<td>99% - A</td>
</tr>
<tr>
<td>Reserves</td>
<td>5 mths - B</td>
<td>6 mths - A</td>
<td>7 mths - A</td>
<td>4 mths - B</td>
<td>8 mths - A</td>
<td>4 mths - B</td>
<td>2 mths - C</td>
<td>1 mth - C</td>
</tr>
<tr>
<td>Debt Service</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>Accrued Fees</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>B</td>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>Cash Flow</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>B</td>
<td>C</td>
<td>C</td>
<td>A</td>
</tr>
<tr>
<td>CF to Sponsor</td>
<td>$3,655</td>
<td>$0</td>
<td>$89,017</td>
<td>$1,543</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Compliance</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>B</td>
<td>A</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>Physical Condition</td>
<td>C</td>
<td>A</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>A</td>
<td>C</td>
<td>B</td>
</tr>
<tr>
<td>Taxes</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
</tr>
</tbody>
</table>

### Scores

<table>
<thead>
<tr>
<th>Project</th>
<th>Current</th>
<th>12 months prior</th>
<th>24 months prior</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>C</td>
</tr>
<tr>
<td></td>
<td>B</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Notes</th>
<th>Imp planned for 2012</th>
<th>All vacant units have applicants</th>
<th>Occupancy Increasing</th>
<th>Restructuring Debt</th>
</tr>
</thead>
</table>
## Early-Warning Systems

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<td><strong>Staff</strong></td>
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<tr>
<td>• prepares the portfolio dashboard report to the board on projects in operations with recommendations for action on Watch List and Workout properties</td>
</tr>
<tr>
<td><strong>Senior Management</strong></td>
</tr>
<tr>
<td>• reviews and approves dashboard report to the board</td>
</tr>
<tr>
<td>• Monitors trends in a portfolio and property specific performance, and makes the day-to-day risk mitigating decisions</td>
</tr>
<tr>
<td><strong>Board</strong></td>
</tr>
<tr>
<td>• provides expectations for the portfolio as a whole, monitors portfolio performance and provides leadership for underperforming projects</td>
</tr>
</tbody>
</table>
Early-Warning Systems

Year 15/End of Compliance

Perform analysis of properties starting in Year 5

The board needs to know:
- Status of limited partner accounts
- Projected value of the property at Year 15
- Debt and potential for refinancing
- Cost of capital improvements and deferred maintenance
- Potential tax liability for the investor upon exit
- Project reserve balances
Early-Warning Systems

- www.EnterpriseCommunity.org/strengthen

- Questions?