HilltopSecurities

MCKINNEY

HOUSING FINANCE CORPORATION

MULTIFAMILY HOUSING BONDS & PARTNERSHIP STRUCTURE 101

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Multifamily Housing Bonds & Partnership Structure 101

McKinney Housing Finance Corporation

Chapter 394

- McKinney HFC was incorporated in 1980.
- Organized by the City and operates under the provisions of the Texas Housing Finance Corporations Act, Chapter 394, Texas Local Government Code (the "*Act*" or "*Chapter 394*").
- Purpose is to provide a means to finance the cost of residential ownership and developments that will provide decent, safe and sanitary housing at affordable prices for residents of local governments.
- Housing finance corporations ("HFC") constitute public instrumentalities and nonprofit corporations and are not considered municipalities, counties or other political corporations or subdivisions of the State of Texas.

Chapter 394

- All directors must be residents of a local government sponsoring the HFC and may be a member of the governing body, an officer or an employee of the local government.
- A HFC and all property owned by it are exempt from license fees, recording fees and all other taxes imposed by the State of Texas or any political subdivision. Exemption includes sales and ad valorem property taxes.
- All powers of the HFC are vested in a board of directors.

Chapter 394

- Powers enumerated under the Act include the power to:
  - make contracts necessary or convenient to the exercise of its powers
  - incur liabilities
  - borrow money
  - issue notes, bonds and other obligations
  - secure such obligations by mortgage of the corporation's assets
  - plan, research, study, develop and promote the establishment of residential development, and
  - make donations for the public welfare or for charitable, scientific or educational purposes

Eligible Activities

Issuance of single-family mortgage revenue bonds for the purpose of providing low- and moderate-income homebuyers with low-cost mortgages and/or down payment and closing cost assistance

Direct loans to homebuyers for down payment or closing cost assistance

Mortgage credit certificate (MCC) programs to assist first time homebuyers with purchasing power

Issuance of multifamily revenue bonds to provide low- and moderate-income housing to be built or rehabilitated

Funding to neighborhood associations in low to moderate income neighborhoods for neighborhood improvements

Any activity with a nexus to affordable housing

Regulatory Bodies

- Texas Bond Review Board
  - Volume cap in the State of Texas is administered by the Texas Bond Review Board.
  - The rules for volume cap allocation are based in statute and are not awarded on a discretionary manner.
- Attorney General
  - Before the issuance of a public security, bond counsel, on behalf of the issuer, shall submit the public security and the record of proceedings to the attorney general.
- SEC
  - The Federal Agency responsible for supervising and regulating the securities industry. Generally, municipal securities are exempt from the SEC's registration and reporting requirements. However, the SEC has responsibility for the approval of Municipal Securities Rulemaking Board rules.

State and Federal Statutes

- State Statues
  - *Chapter 394*. Texas Housing Finance Corporation Act
  - *Chapter 1372*. Private Activity Bonds and Certain Other Bonds
  - *Chapter 2256*. Public Funds Investment Act
  - *Chapter 2306*. Texas Department of Housing and Community Affairs
- Federal Statues
  - Internal Revenue Code of 1986
    - 141 - Private activity bond; qualified bond
    - 143 - Mortgage revenue bonds: qualified mortgage bond & veterans' mortgage bond
    - 145 - Qualified 501(c)(3) bond
    - 146 - Volume cap
    - 148 - Arbitrage
    - 149 - Bonds Must be Registered to be Tax Exempt

HFC Specific Documents/Contracts

- Articles of Incorporation - *Chapter 394*
- Bylaws - *Chapter 394*
- Multifamily Application
  - Approved by the HFC board that outlines specific criteria for multifamily applicants
- Contracts
  - Contracts between the HFC and hired professionals
    - Financial Advisor
    - Issuers Counsel
    - Bond Counsel
    - General Partner Counsel
    - General Partner Advisor
    - Accounting Firm

Multifamily Bond Basics

- What is a tax-exempt municipal bond?
  - Debt/loan issued by a governmental entity (i.e. state or local housing authority/corporation) which is repaid at a certain rate of return (interest).
  - Purchasers of tax-exempt bonds are exempt from paying federal taxes (and, in certain states, from state or local taxes) on interest payments received.
  - Proceeds are generally used to finance public projects like schools, hospitals, infrastructure and airports.
  - The interest rate paid on tax-exempt bonds is typically lower than the interest rate on taxable obligations of equal creditworthiness.
  - Tax opinion from qualified bond counsel is required in order to obtain a tax-exempt rating.

Multifamily Bond Basics

- What is a private activity bond (PAB)?
  - To promote certain private activities (which benefit the public), each state is authorized to issue a set amount of Private Activity Bonds each year which may be used for multifamily housing, single-family housing, student loans and industrial development.
    - This set amount is called "Volume Cap."
  - PAB is a bond issued by or on behalf of a local or state governments for the purpose of financing the project of a private user.
  - Moves the project risk the private sector.
  - Private debt sold like a public security (tax-exempt).

Multifamily Bond Basics

- What is a tax-exempt multifamily housing bond?
  - Typically, a private activity bond issued to by an HFC, PFC or State Issuer (the "Issuer") who loans the bond proceeds to a borrower to finance the construction or rehabilitation of rental housing at rents affordable to low- and moderate-income individuals and families.
  - Tax-exempt financing permits the HFC to assist developers in obtaining a lower cost of financing.
  - Lower interest rates on tax-exempt bonds can reduce a developer's all-in borrowing rate as compared to conventional, taxable financing rates.
  - Allows a developer to access 4% low-income housing tax credits, which can finance as much as 30% of the total project costs.

Multifamily Bond Basics

- Tax-exempt multifamily housing bonds (cont.)
  - The Issuers are general conduit issuers, which requires the bond purchaser and issuer to be separate parties. Conduit Issuers are **not** responsible for the debt obligation.
  - Bonds issued by a HFC under the Act are limited obligations of the HFC and are payable solely from the revenue, receipts and other resources pledged to their repayment, **and do not constitute a legal or moral obligation of any city of the jurisdiction or of the county.**
  - The City of McKinney, the State of Texas and the HFC **are not responsible for the payments.**

Multifamily Bond Basics

- What are Low Income Housing Tax Credits ("LIHTC")?
  - 4% tax credits are available on financings financed with PABs
    - At least 50% of the development's basis must be bond-financed
    - Roughly 30% - 35% of the project can be financed with tax credit equity
    - Noncompetitive
  - 9% tax credits do not require PAB financing
    - Competitive
    - Roughly 65% of the project can be financed with tax credit equity and ~ 30% debt
    - HFCs are typically involved as a general partner and not as an issuer
  - Tax credits are a dollar-for-dollar reduction of income tax in any year over a 10-year period.
  - Tax credits are sold to an investor in exchange for equity in the project. This equity provides additional sources of funds which reduces the amount of debt needed to finance the project.

Multifamily Bond Basics

- Multifamily Federal Tax Law Requirements
  - Multifamily housing developments with bond financing must set aside at least:
    - 40% of their apartments for families with income of 60% of area median income (AMI) or less, or
    - 20% of their apartments for families with income of 50% of AMI or less
  - Rent restricted at 30% residences income
  - These projects must comply with restrictions and minimum term of affordability for at least 15 years (Section 42 of the Code) – the tax credits require a 30-year income restriction.
  - Must be a residential rental housing facility (i.e., no condos, hotels, dormitories, etc.).

Private Activity Bond Volume Cap

- Tax-exempt multifamily bonds must receive an allocation of private activity volume cap. Using volume cap allows PAB issuers to issue tax-exempt bonds to fund projects.
- The IRS sets the volume cap limits annually and each state receives an allocation of volume cap from the federal government based on the state's population (i.e., $110 per capita with a minimum of $335,115,000 for 2022).
- The State of Texas received $3,248,073,510 in PAB allocation in 2022.
- Volume cap in the State of Texas is administered by the Texas Bond Review Board.
- Once a multifamily deal receives its volume cap, the bonds must close within 180 days from receipt.

Region 3 allocation was $164,735,911 for 2022

Private Activity Bond Volume Cap

- **Priority 1 (Must apply for 4% HTC)**
  a) Set aside 50% of units rent capped at 30% of 50% AMFI and the remaining 50% of units rents capped at 30% of 60% AMFI; or
  b) Set aside 15% of units rent capped at 30% of 30% AMFI and the remaining 85% of units rent capped at 30% of 60% AMFI; or
  c) Set aside 100% of units rent capped at 30% of 60% AMFI for developments located in a census tract with median income that is higher than the median income of the county, MSA or PMSA in which the census tract is located.
- **Priority 2 (Must apply for 4% HTC)**
  - Set aside 80% of units rent capped at 30% of 60% AMFI.
  - Up to 20% of the units can be market rate.
- **Priority 3 (4% HTC not required)**
  - Includes any qualified residential rental development. Market rate units can be included under this priority.

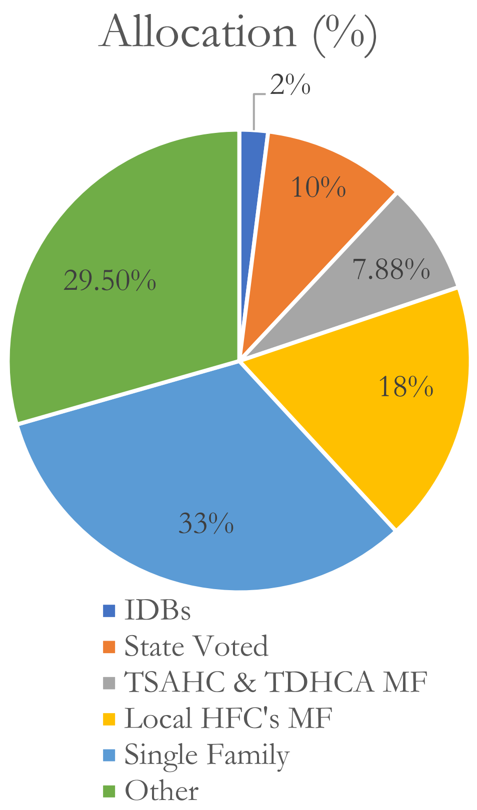
Private Activity Bond Lottery and Reservation Process

- The Texas Bond Review Board holds a Lottery for Private Activity Bond Allocations every November, typically the first Thursday of the month.
- The lottery application period is set-forth in Ch. 1372 of the Texas Government Code as October 5th until October 20th.
- The Private Activity Bond program year begins in January. Applications with better Priorities and lower lottery numbers would be reserved first.
- Until March 1 the sub-ceiling governing HFC applications is divided into 13 Regions. After March 1, any remaining regional volume cap is used to reserve applications remaining in line statewide, on a first-come, first-served basis.

Private Activity Bond Volume Cap

- The State of Texas received $3,248,073,510 in PAB allocation in 2022
  - **IDBs** 2% - $64,961,470
  - **State Voted** 10% - $324,807,351
  - **TDHCA & TSAHC MF** 7.875%- $255,785,789
  - **Local HFC's MF** 18.375% - $596,833,508
  - **Single Family** 32.25% - $1,047,503,707
  - **Other** 29.5% - $958,181,685

2022 Private Activity Bond Allocation - Texas



Multifamily Bond Transaction Timeline

- Application & fees sent to HFC
- Review by staff, counsel, advisor & board
- HFC board passes inducement resolution
- Developer obtains bond volume cap from the Texas BRB
- Plan of finance is determined and working group is confirmed
- Obtain Resolution of No Objection from local jurisdiction
- TEFRA Hearing
- TDHCA awards LIHTC
- HFC board meets to consider final approval of bond documents & issuance
- <u>Bond Deal Closes</u>

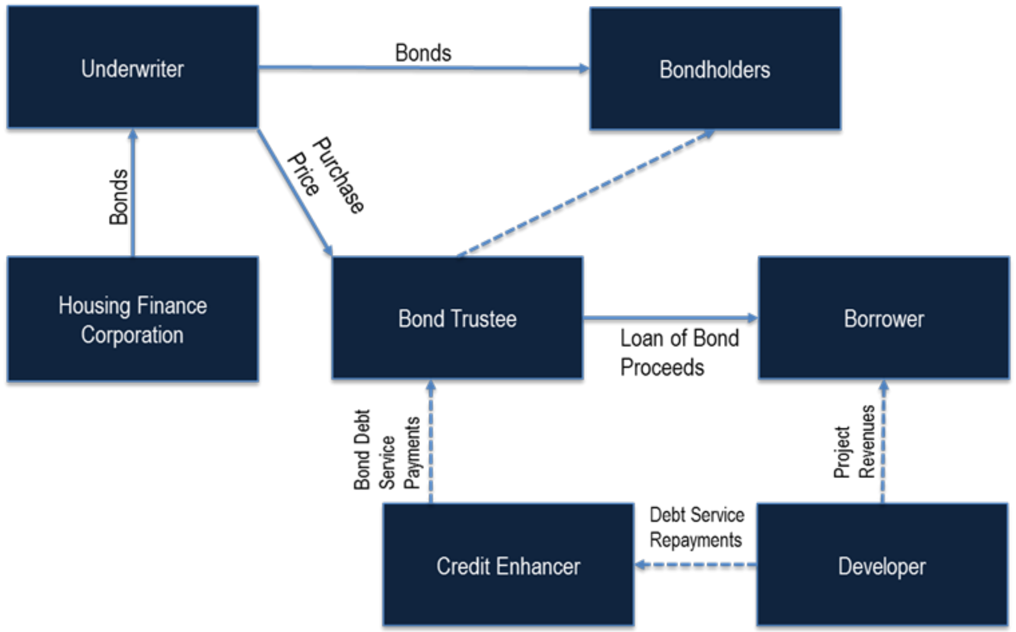
Multifamily Bond Transaction Timeline

- Developer decides to issue bonds to fund an affordable multifamily project
- Developer fills out HFC application which establish a process, identify criteria, and set application fees and deposits paid by developer to the HFC and its professionals
- **Upon receipt of developer's completed application, HFC takes preliminary action to approve or reject at a meeting called the inducement meeting**
- **Preliminary action does not obligate board to issue final approval at later date**
- Working group is confirmed
- Preliminary plan of finance determined
- Developer submits Low Income Housing Tax Credit (LIHTC) Application to TDHCA
- Developer obtains bond volume cap from the Texas BRB
- Developer receives Resolution of No Objection from the local jurisdiction

Multifamily Bond Transaction Timeline

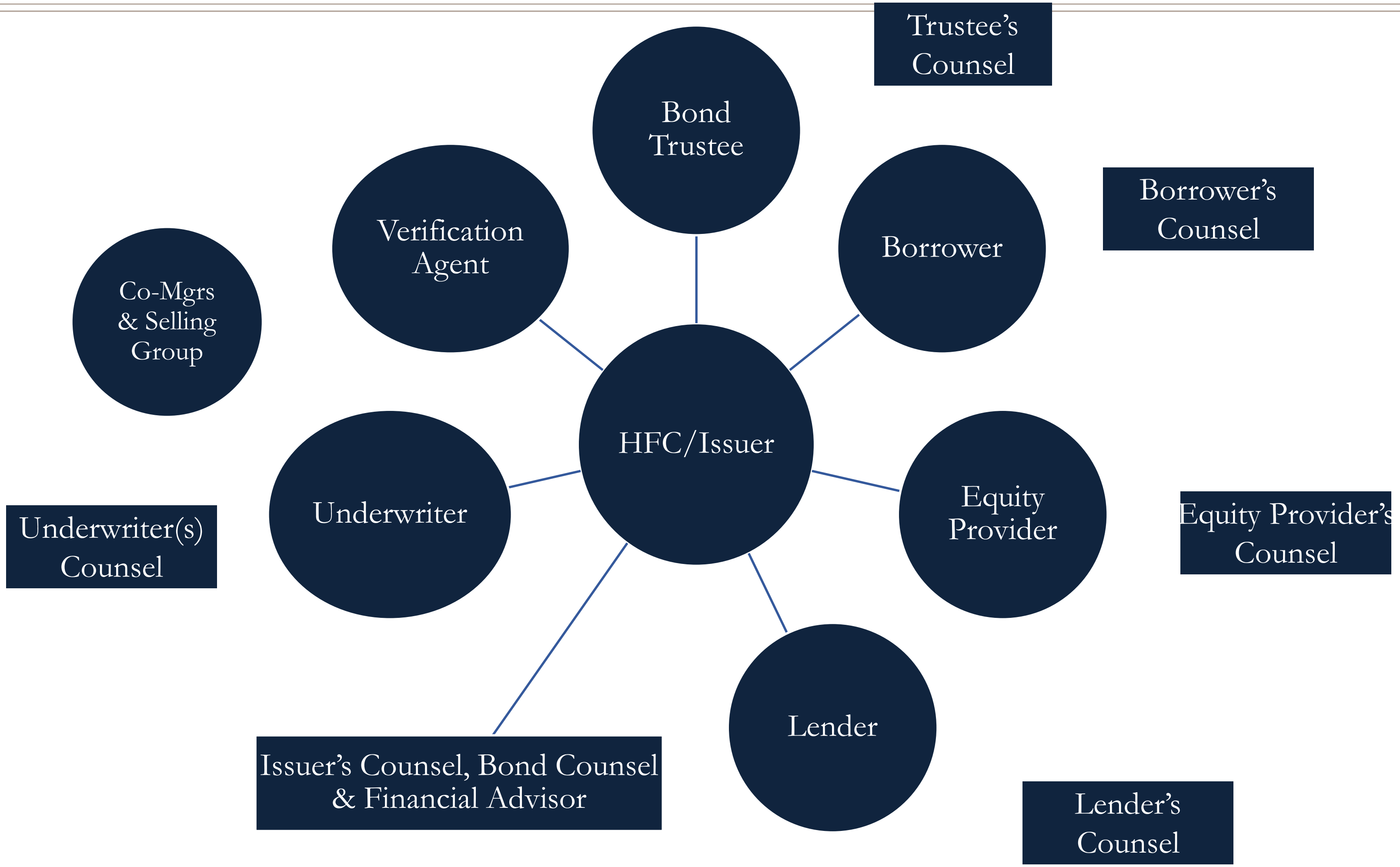
- TEFRA Hearing (1982 requirement & must post publication of TEFRA Notice 7 days in advance)
- Financial bond documents are drafted and commented on over the course of several months
- TDHCA Board Meeting to Approve Award of LIHTC
- **Upon completion of financing and financing documents, the HFC meets to consider final approval of the note documents and issuance**
- Submit substantially final documents at least 12 business days prior to closing
- Executed initial bond due to AG 5 business days prior to closing
- Price/rate lock the bond
- All fully executed documents due to AG 3 business days prior to closing
- On the closing date, AG issues opinion as to the validity of the bond
- Bond deal closes, closing fees are paid to the and on-going annual fees begin to accrue

Multifamily Flow of Funds



- Bonds are sold by the Issuer to the Underwriter pursuant to the bond purchase agreement.
- The Underwriter immediately resells the bonds to investors using the Issuer's official statement.
- The proceeds from the bond sale are immediately deposited by the Issuer with the Trustee.
- Until the bond proceeds are disbursed for their specified purpose, the Trustee invests the bond proceeds in permitted investments as directed by the Issuer.
- The Trustee disburses bond proceeds, at the direction of the Issuer.
- The Trustee receives mortgage/loan payments, invests them in short-term investments until needed to pay bond debt service, and collects investment earnings.
- The Trustee pays principal and interest to bondholders from pledged mortgage payments and investment earnings.

Negotiated Sale Financing Team



Public Offering Versus Private Placement

- Public Offering
  - Bonds sold to public
    - Institutional investors (investment funds, commercial banks and other accredited investors)
    - Retail (individuals)
  - Bonds are offered to public pursuant to an Official Statement
  - Bonds held by The Depository Trust Company on behalf of "beneficial owners"

- Private Placement
  - Sold to banks or institutional investors
  - Generally, no offering document is prepared; sometimes, a private placement memorandum
  - Purchasers typically sign investor letter (acknowledging they are sophisticated investors and agreeing to only resell to other sophisticated investors)
  - Often, privately placed bonds are non-rated

Public Offering Versus Private Placement

- Public Offering Financing Structures
  - Short-term Cash Collateralized Tax-Exempt Bonds
    - FHA/GNMA (221(d)(4) / 223(f))
    - Rural Development (538 / 515)
    - GSE loans (mod/light in-place rehab)
    - Other (taxable) State and/or Local loan programs
  - Fannie Mae M-TEMS Immediate Delivery
  - Fannie Mae MTEB/MTEM Forward Commitment
- Private Placement Financing Structures
  - Immediate Delivery Freddie TEL
  - Cash Collateralized Freddie TEL
  - Forward Commitment Freddie TEL
  - Citibank loans
  - Redstone, Fallbrook, Boston Capital, etc.

Feasibility of the Project

- Key players who underwrite the deal in a LIHTC bond transaction
  - Developer
  - Tax Credit Equity Investor
  - Construction Lender
  - Permanent Lender (or Bond Purchaser)
  - Credit/Liquidity Providers (FHA, GNMA, FNMA, Freddie Mac and large banking institutions)
  - TDHCA

TDHCA Review Process of Tax Credit Application

- Compliance with all Department's applicable rules including but not limited to
  - Multifamily Mortgage Revenue Bond Rules
  - Qualified Allocation Plan and Rules
  - Compliance Rules.
- Application reviewed by Real Estate Analysis Division for full financial feasibility and by the Compliance and Asset Oversite Division.

- Example of factors the Board may evaluate during the approval process:
  - the developer market study; the location
  - the compliance history of the developer
  - the financial feasibility
  - the appropriateness of the development's size and configuration in relation to the housing needs of the community in which the development is located,
  - the development's proximity to other low-income developments
  - the availability of adequate public facilities and services, the anticipated impact on local school districts, zoning and other land use considerations

The Remnant at Greenwood

- Acquisition Rebab of two existing projects
  - 900 Murray Place, McKinney, Texas 75069
  - 1001A Throckmorton, McKinney, Texas, 75069
- Present Owner: Housing Authority City of McKinney
- Developer: Knight Development
- Bond Size: $21,000,000
- Unit Count: demolish 51 existing units and construct 96 new units
- Structure: Private Placement

McKinney HFC Fees

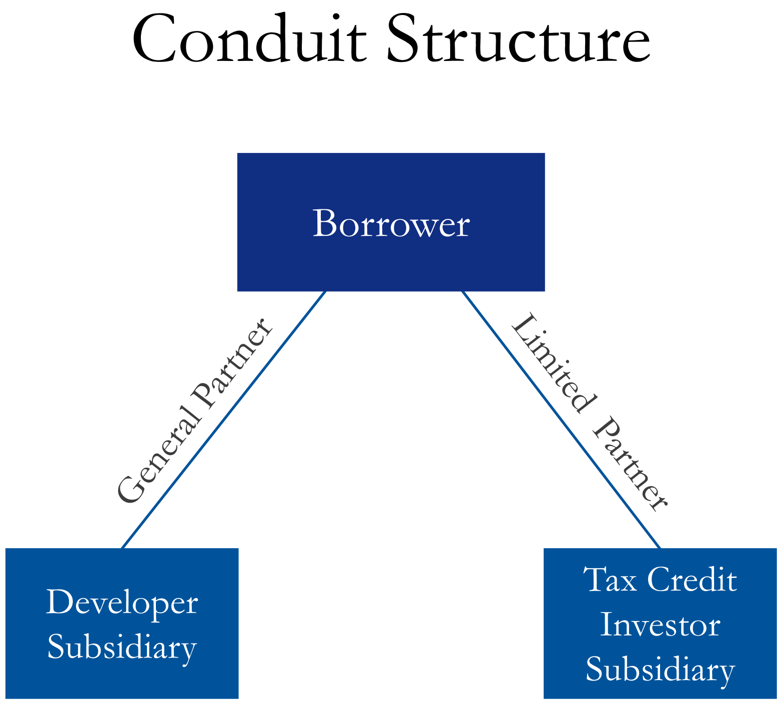
- Application Review Fee
  - $5,000
- Closing Fee – 50bps
  - $105,000
- Closing Issuer Fee – 12.5bps * 2 Years
  - $52,500
- Ongoing Issuer Fee – 12.5bps starting in year 3
  - $26,250

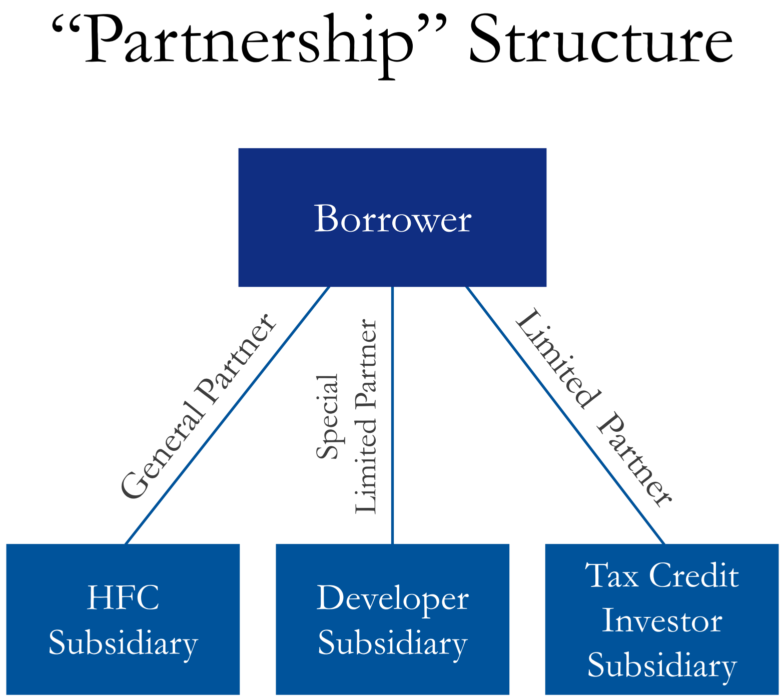
The Remnant at Greenwood – Unit Mix

	Bed/Bath		Sq. Ft.	Rent	Max Program Rent*	Unit Count 96
50%	1 / 1	RAD	700	712	822	6
60%	1 / 1	PBV	700	1,262	1,005	4
50%	2 / 2	PBV	1000	1,484	993	10
60%	2 / 2	RAD	1000	849	1,212	7
60%	2 / 2	PBV	1000	1,083	1,212	5
50%	3 / 2	PBV	1200	1,246	1,150	18
60%	3 / 2	PBV	1200	1,894	1,403	27
60%	3 / 2	RAD	1200	1,096	1,403	9
50%	4 / 2	PBV	1400	2,504	1,275	1
60%	4 / 2	PBV	1400	1,383	1,558	9
*	Excluding utility allowance					

HH Size	1	2	3	4	5	6
50% AMI	34,100	39,000	43,850	48,700	52,600	56,500
60% AMI	40,920	46,800	52,620	58,440	63,120	67,800

Composition of Borrower Entity





Overview of Partnership Structure - Background

- The costs of material and labor have risen increasingly over the past decade and has become increasingly difficult for developers to build low- and moderate-income multifamily housing using tax credits. The rents for tax credit properties are set by the IRS, and therefore the increased debt load and low revenue stream causes a tight constraint on cash flow.
- To help address this issue, developers will include a non-profit general partner to own the land and to receive a property tax exemption.

Overview of Partnership Structure

- Typically, the "borrower" in a multifamily housing financing consists of entities formed by the developer and the tax credit investor.
- Developers often seek to take advantage of the "partnership structure" by including a wholly owned affiliate of the HFC as the general partner of the borrower.
  - Governmental entity, which is typically a wholly-owned and controlled limited liability company, having an ownership interest in the borrower/owner entity in the form of a general partner interest.
  - The governmental entity or an affiliate owns the land upon where the property will be built on and leases the land to the borrower partnership.
- Using this structure generally permits the borrower to take advantage of exemptions from ad valorem property taxes and sales taxes on hard construction costs.
- Partnership structure can be implemented in a bond/4% LIHTC, 9% LIHTC financing, conventional workforce housing financing and certain other types of similar financings.

Advantages

- The HFC will have more leverage to require certain services provided to residents of a particular development as the general partner of the owner.
- As general partner, the HFC can receive a share of the developer fee and net cash flow generated from the project. These funds are generally received for a minimum over 15 years and would provide a predictable revenue stream for the HFC. The funds could be used to assist the HFC in furthering their affordable housing initiatives.
- The HFC may also participate as the general contractor to allow a sales tax exemption on the hard construction materials. The HFC would subcontract to an actual general contractor to perform the actual duties of the general contractor, but the HFC would receive a fee for their role as general contractor.
- At the end of the 15-year tax credit compliance period, the HFC is granted a right of first refusal (ROFR) and has the option to purchase the property at a price equal to the market value.
- The HFC is ensuring long-term viability of the project and is providing affordable housing for as long as possible.

Disadvantages/Burdens

- The HFC could take on business risk of investing time and resources into projects that may not provide a substantial return for a long period of time.
  - If the project does not appreciate and does not cash flow, there is no liability to the HFC.

- The separate limited liability companies require administrative oversight.

- Liability risk from "slip and fall" type cases, but that is limited and minimized to the separate subsidiary entities.

Limitation of Liability

- The financing is structured as non-recourse so that the HFC entities and the HFC have no liability for the debt on the property…except for some liabilities such as fraud or willful misconduct.
- HFCs should limit risk by forming wholly-owned subsidiaries to serve in roles of General Partner, Ground Lessor, Co-Developer and General Contractor instead of serving in such roles directly.
- HFCs are typically the sole member of limited liability companies ("LLC") formed for these purposes.
  - Risk of liability in LLCs, but it is separate legal entity with limited assets ($10,000) except for partnership interest
  - Capitalize LLCs at level commensurate with obligations
  - Obtain appropriate indemnifications
  - Limit representations
  - No Guarantees

Overview of Partnership Structure

- The "partnership structure" generally involves participation of the HFC in one or more of the following roles:
  - **General Partner**
    - GP in a limited partnership with the development entity and tax credit investor and elects to be taxed as a corporation.
    - Fee to HFC: Typical share in excess cash flow and sale of the project of 25% - 50%
    - Fee to HFC: Partnership Management Fee of $10,000 to cover administrative and accounting expenses
  - **Ground Lessor**
    - Formed to own the land on which the development is located. Leases land back to borrower pursuant to long-term lease. Lease will have an up-front lease payment sufficient to acquire land.
  - **Co-Developer**
    - Formed to enter development agreement with development entity to construct project on leased land.
    - Fee to HFC: Typical share in developer fee of 20% - 30%
  - **General Contractor**
    - Enters into a construction contract (and subcontract) with the construction company to bring about a sales tax exemption for the purchase of materials.
    - Fee to HFC: Typical share in sales tax savings of 25%

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