

MCKINNEY
HOUSING FINANCE
CORPORATION
MULTIFAMILY HOUSING BONDS
& PARTNERSHIP STRUCTURE
101

November 12, 2021

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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 bond?
 - Evidence that money was borrowed and will be repaid at a certain rate of return (interest).
 - Interest on tax-exempt bonds is exempt from federal income taxation and, in certain states, from state income taxation.
 - 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.
- What is a tax-exempt multifamily housing bond?
 - Bonds issued 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.
 - Tax opinion from qualified bond counsel is required in order to obtain a tax-exempt rating.

Multifamily Bond Basics

- Tax-exempt multifamily housing bonds (cont.)
 - 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.
 - 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.**
 - Bond proceeds loaned to tax credit partnership and used to pay for construction.
 - 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% low-income housing tax credits are available on financings financed with private activity bonds
 - At least 50% of the development’s basis must be bond-financed
 - Non-competitive award, unlike 9% tax credit program
 - Tax credits are a dollar-for-dollar reduction of income tax in any year over a 10-year period.
 - Tax credits are sold to a qualified investor, the sales proceeds are utilized within the project.
 - Development must comply with restrictions under Section 42 of the Code for 15 years.
 - Rent restricted at 30% of the 50% or 60% area median income limitation.

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
 - The income restricted apartments financed by those bonds must remain affordable for at least 15 years – 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 \$324,995,000 for 2021).
- The State of Texas received \$3,229,683,490 in PAB allocation in 2021.
- 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 \$156,197,183 for 2021, the 2022 allocation is currently unknown but is likely to increase.

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.

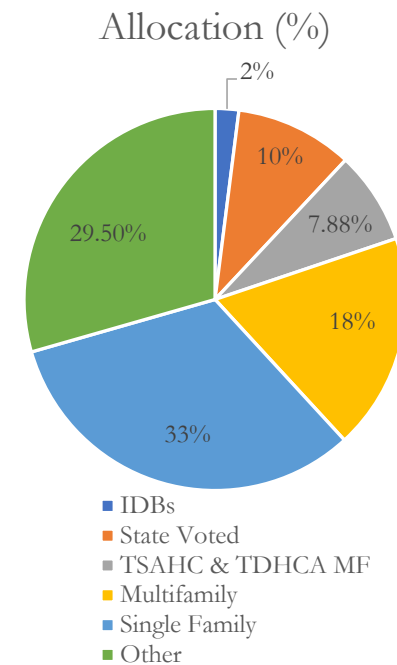
Private Activity Bond Lottery and Reservation Process

- 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.
- There are currently applications totaling \$896 million from Region 3 will be included in the 2022 Lottery.
- 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.

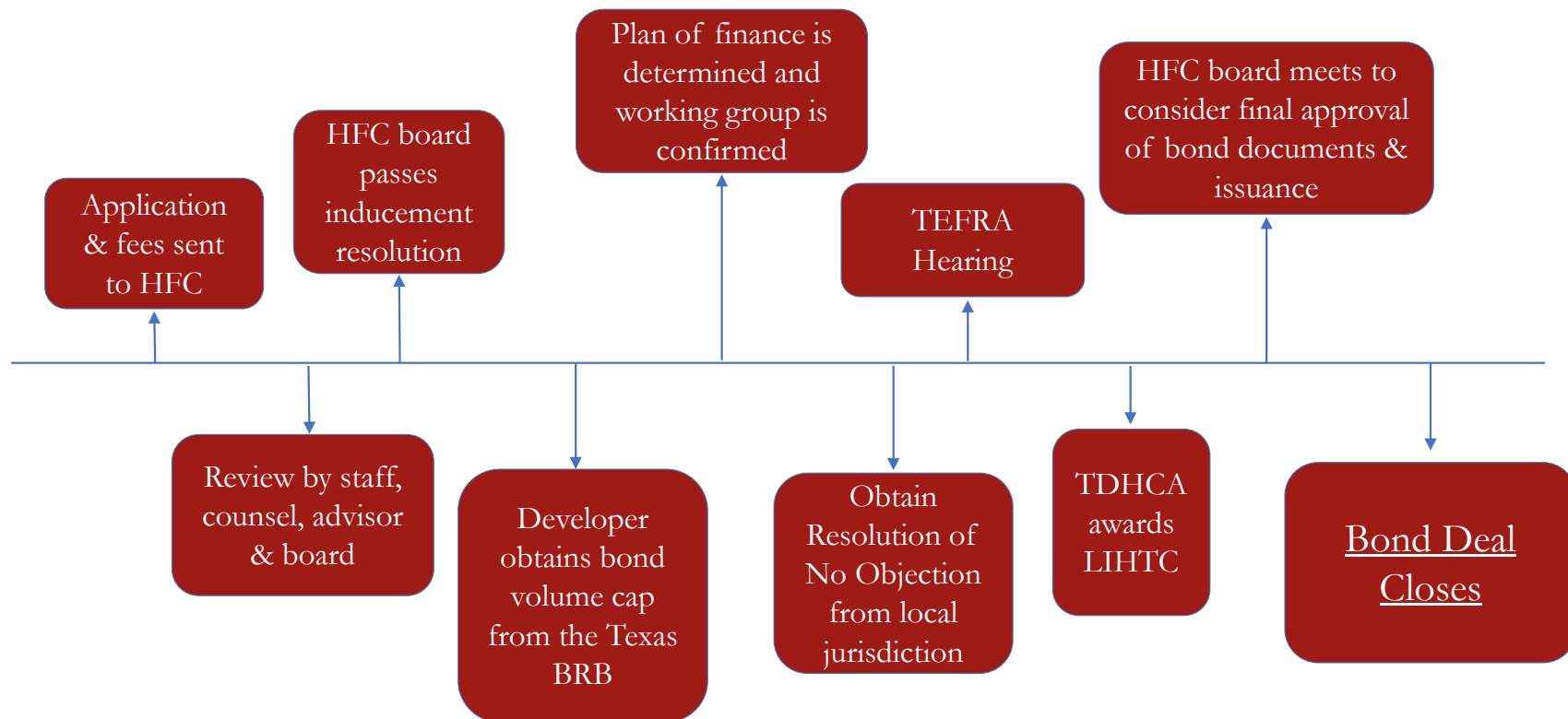
Private Activity Bond Volume Cap

- The State of Texas received \$3,229,683,490 in PAB allocation in 2021
 - **IDBs** 2% - \$64,593,670
 - **State Voted** 10% - \$322,968,349
 - **TDHCA & TSAHC MF** 7.875%- \$254,337,575
 - **Multifamily** 18.375% - \$593,454,341
 - **Single Family** 32.25% - \$1,041,572,927
 - **Other** 29.5% - \$952,756,629

2021 Private Activity Bond Allocation - Texas



Multifamily Bond Transaction Timeline



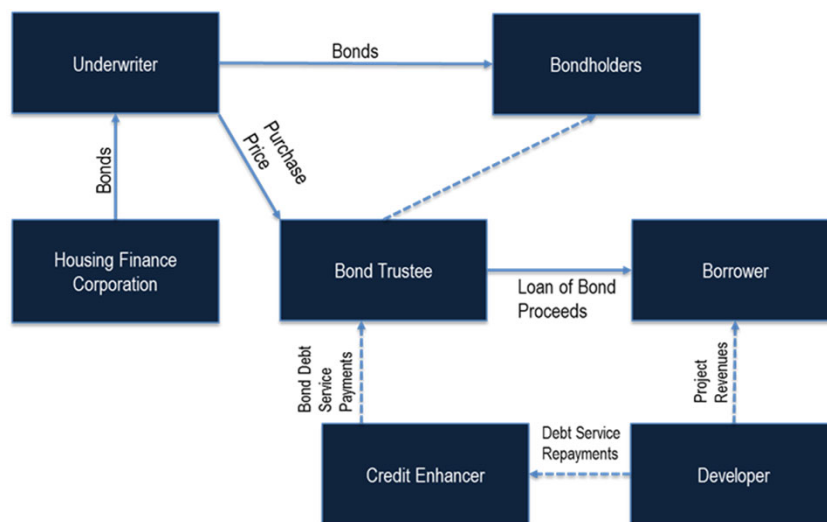
Multifamily Bond Transaction Timeline

- 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 (cont.)

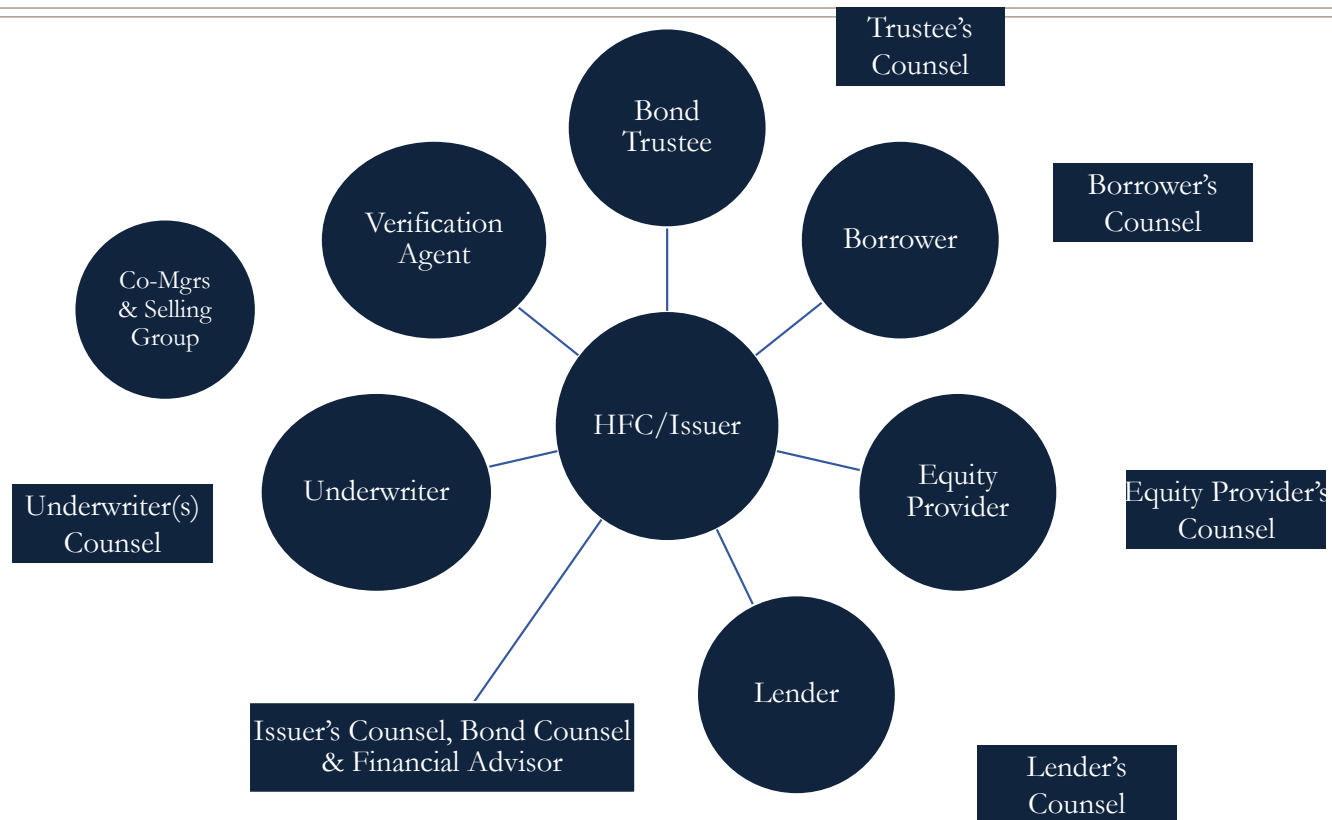
- TEFRA Hearing (1982 requirement & must post publication of TEFRA Notice 7 days in advance)
- Financial bond documents are drafted and commented on over the course of several months
- TDHCA Board Meeting to Approve Award of LIHTC
- **Upon completion of financing and financing documents, the HFC meets 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

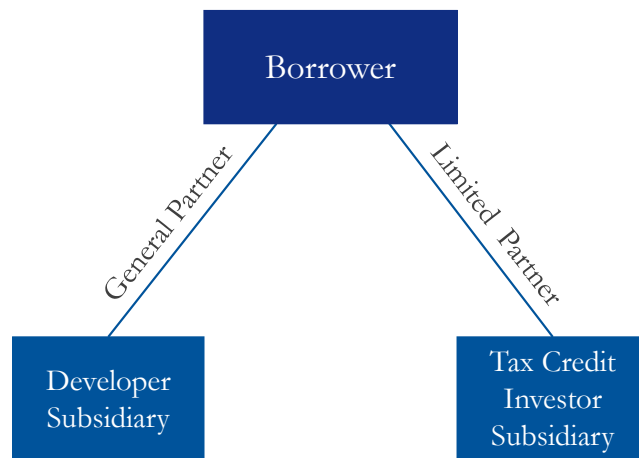
- Key players who underwrite the deal in a LIHTC bond transaction
 - Developer
 - Tax Credit Equity Investor
 - Construction Lender
 - Permanent Lender (or Bond Purchaser)
 - Credit/Liquidity Providers (FHA, GNMA, FNMA, Freddie Mac and large banking institutions)
 - TDHCA

TDHCA Review Process of Tax Credit Application

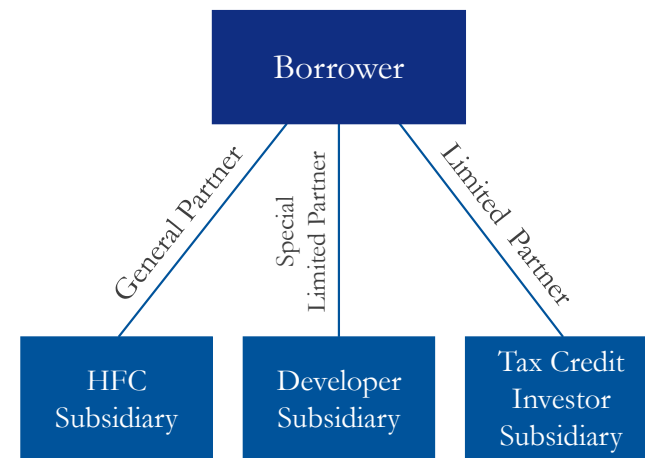
- Compliance with all Department's applicable rules including but not limited to
 - Multifamily Mortgage Revenue Bond Rules
 - Qualified Allocation Plan and Rules
 - Compliance Rules.
- Application reviewed by Real Estate Analysis Division for full financial feasibility and by the Compliance and Asset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

Composition of Borrower Entity

Conduit Structure



“Partnership” Structure



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.
- 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 financing and certain other types of financings.

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.
 - Elects to be taxed as a corporation.
 - **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.
 - **General Contractor**
 - Enters into a construction contract (and subcontract) with the construction company in order to qualify for a sales tax exemption for the purchase of construction materials.

Limitation of Liability

- 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

- Housing finance corporations typically share in the following fees:
 - Developer Fee (typically 20-30% split) (when HFC is Co-Dev)
 - Excess cash flows, including cash generated by a sale of the project (typically 25-50% split) (when HFC is GP)
 - Sales tax savings (typically 25%) (when HFC is GC)
- Typically granted purchase option and right of first refusal (ROFR) if developer seeks to sell the project