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 housing finance corporation as the general partner of the borrower.
- Using this structure in Texas generally permits the borrower to take advantage of exemptions from ad valorem property taxes and sales taxes on hard construction costs.

Overview of Partnership Structure

- The "partnership structure" in Texas generally involves participation of the housing finance corporation in one or more of the following roles:

  General Partner. GP in a limited partnership with the affordable housing developer and tax credit investor.

  Ground Lessor. Formed to own the land on which the development is located. Leases land back to borrower pursuant to long-term lease.

  Co-Developer. Formed to enter development agreement with affordable housing developer.

  General Contractor*.* Enters into a construction contract (and subcontract) with respect to construction of the affordable housing development.

Limitation of HFC Liability

- Housing finance corporations should consider limiting 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.
- Housing finance corporations generally form limited liability companies to serve in each of these roles.
  - A 501(c)(3) entity is commonly used for General Contractor role
- Housing finance corporations are typically the sole member of limited liability companies formed for these purposes.
  - Capitalize limited liability companies at level commensurate with obligations

Partnership Structure Tax Exemption

Ad Valorem Property Tax Exemption

- Ad valorem property tax exemption has been challenged based on the argument that housing finance corporation does not truly own the land due to long term lease to the borrower.
- Texas courts have upheld the exemption so long as the housing finance corporation has "beneficial ownership." *See Harris County Appraisal District v. Southeast Texas Housing Finance Corporation.*
- Key factors in determining beneficial ownership include:
  i. Land titled in HFC-owned entity
  ii. HFC has right to compel title at any time (i.e. purchase option)
  iii. Reversion to housing finance corporation upon dissolution of subsidiary

Partnership Structure Tax Exemption

Sales Tax Exemption

- Housing finance corporations can obtain sales tax exemption three different ways:
  i. Directly, by acting in the name of the housing finance corporation
  ii. Forming a 501(c)(3) entity
  iii. Forming an LLC to act as agent of the housing finance corporation
- Historically, LLCs formed by a housing finance corporation have served as master contractor and entered into a subcontractor agreement with the developer.
  – Recent proliferation of HUD financings have increased the use of joint venture agreements and caused complications with using an LLC as general contractor

Benefits and Burdens of Partnership Structure

Benefits

- Housing finance corporations typically share in the following fees:
  a) Developer Fee (typically 20-30% split)
  b) Excess cash flows, including cash generated by a sale of the project (typically 30-50% split)
  c) Sales tax savings (typically 25%)
- Typically are granted purchase option and right of first refusal if developer seeks to sell the project
  – ROFR is often granted at a substantially below market price
- Increased oversight of management of project

Burdens

- Liability risk
- Administration of subsidiary entities and project ownership