

# McKinney Housing Finance Corporation

.....  
Housing Bonds and Partnership 101 Presentation

October 2024



Tim Nelson	Claire Lastrapes	Braxton Parsons	Megan Rahmes
<b>Hilltop Securities Inc.</b> <b>Senior Managing Director</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.481.2022 tim.nelson@hilltopsecurities.com	<b>Hilltop Securities Inc.</b> <b>Vice President</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.481.2044 claire.lastrapes@hilltopsecurities.com	<b>Hilltop Securities Inc.</b> <b>Vice President</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.481.2003 braxton.parsons@hilltopsecurities.com	<b>Hilltop Securities Inc.</b> <b>Assistant Vice President</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.481.2023 megan.rahmes@hilltopsecurities.com

Lina Linehan	Chelsey Tran		
<b>Hilltop Securities Inc.</b> <b>Analyst</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.481.2091 lina.linehan@hilltopsecurities.com	<b>Hilltop Securities Inc.</b> <b>Analyst</b> 2700 Via Fortuna, Suite 410 Austin, TX 78746 Phone: 512.340.1810 chelsey.tran@hilltopsecurities.com		



McKinney Housing Finance Corporation was incorporated in 1980.



Organized by the City of McKinney 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.



---

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.





## 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

## Examples of Eligible Activities

- Issuance of single-family mortgage revenue bonds and/or direct loans/grants for the purpose of providing low- and moderate-income homebuyers with low-cost mortgages and/or down payment and closing cost assistance
- Mortgage credit certificate (“MCC”) programs
- Issuance of multifamily housing revenue bonds to provide low- and moderate-income housing to be built or rehabilitated
- Ownership by an HFC of multifamily development to provide affordable housing Establishment of in- fill housing construction programs utilizing both donated lots and lots purchased in the open market
- Zero or low interest loans to senior citizens for purposes of rehabilitating their existing homesteads
- Construction, ownership, and operation of senior citizen housing
- Assistance to builders to rehabilitate substandard single-family housing
- Establishment of emergency rental assistance programs
- Community Land Trusts
- Social services
- Scholarship donations
- Any activity with a nexus to affordable housing



- At least 90% of the units in a residential development must be reserved for occupancy by persons of low and moderate income, as determined by the housing finance corporation.
- For bond-financed developments where a wholly-owned affiliate of the housing finance corporation is participating as a general partner in the transaction, 50% of the units must be reserved for individuals and families earning less than 80% of the area median income (“AMI”).
- Most current Low Income Housing Tax Credit (LIHTC) include 100% of the units at or below 60% AMI.



- 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.



- 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).





- 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.



- 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 the City.**
  - The City of McKinney, the State of Texas and the HFC **are not responsible for the payments.**



- 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 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.).



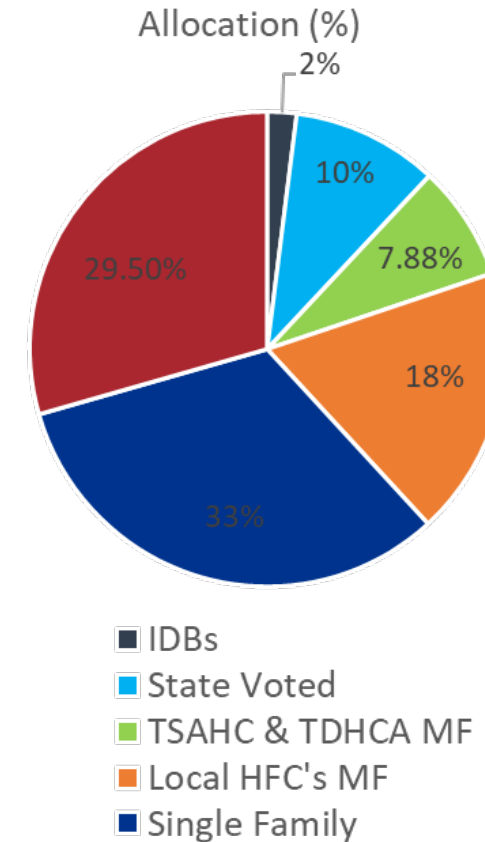
- Tax-exempt multifamily bonds must receive an allocation of private activity volume cap. Using volume cap allows PAB issuers to issue tax-exempt bonds to fund projects.
- The IRS sets the volume cap limits annually, and each state receives an allocation of volume cap from the federal government based on the state's population (i.e., \$125 per capita with a minimum of \$378,230,00 for 2024).
- The State of Texas received \$3,812,912,625 in PAB allocation in 2024.
- Volume cap in the State of Texas is administered by the Texas Bond Review Board.
- Once a multifamily deal receives its volume cap, through a reservation, the bonds must close within 180 days from receipt.
- ***Region 7 allocation was \$57,862,114 for 2024***

# Private Activity Bond Volume Cap



- The State of Texas received \$3,812,912,625 in PAB allocation in 2024. This PAB allocation is divided into 5 different Sub-Ceilings.
  - **SC 1 Single Family** 32.25% - \$1,229,664,322
  - **SC 2 State Voted** 10% - \$381,291,263
  - **SC 3 IDBs** 2% - \$76,258,253
  - **SC 4 TDHCA & TSAHC MF** 7.875%- \$300,266,869
  - **SC 4 Local HFC's MF** 18.375% - \$700,622,694
  - **SC 5 Other** 29.5% - \$1,124,809,224

2024 Private Activity Bond Allocation – Texas

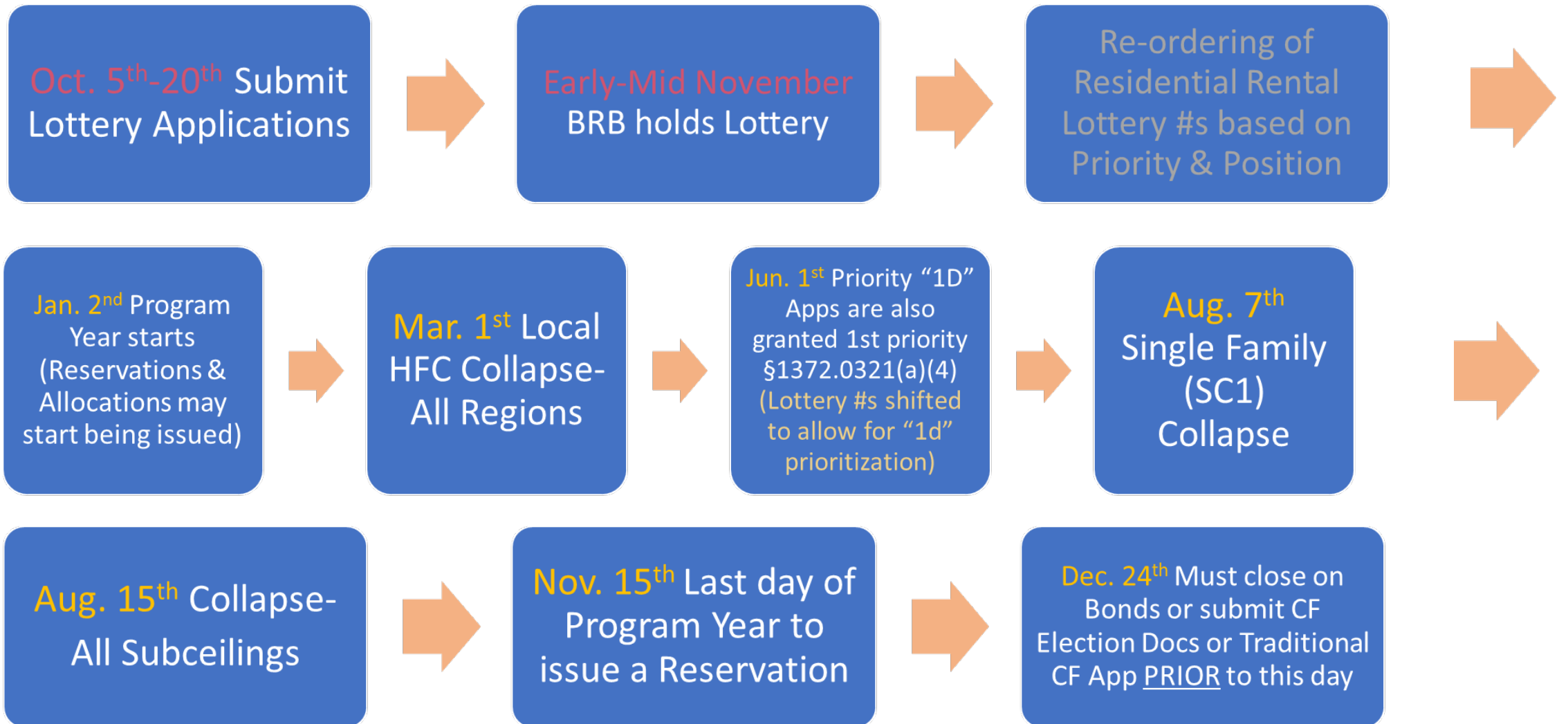




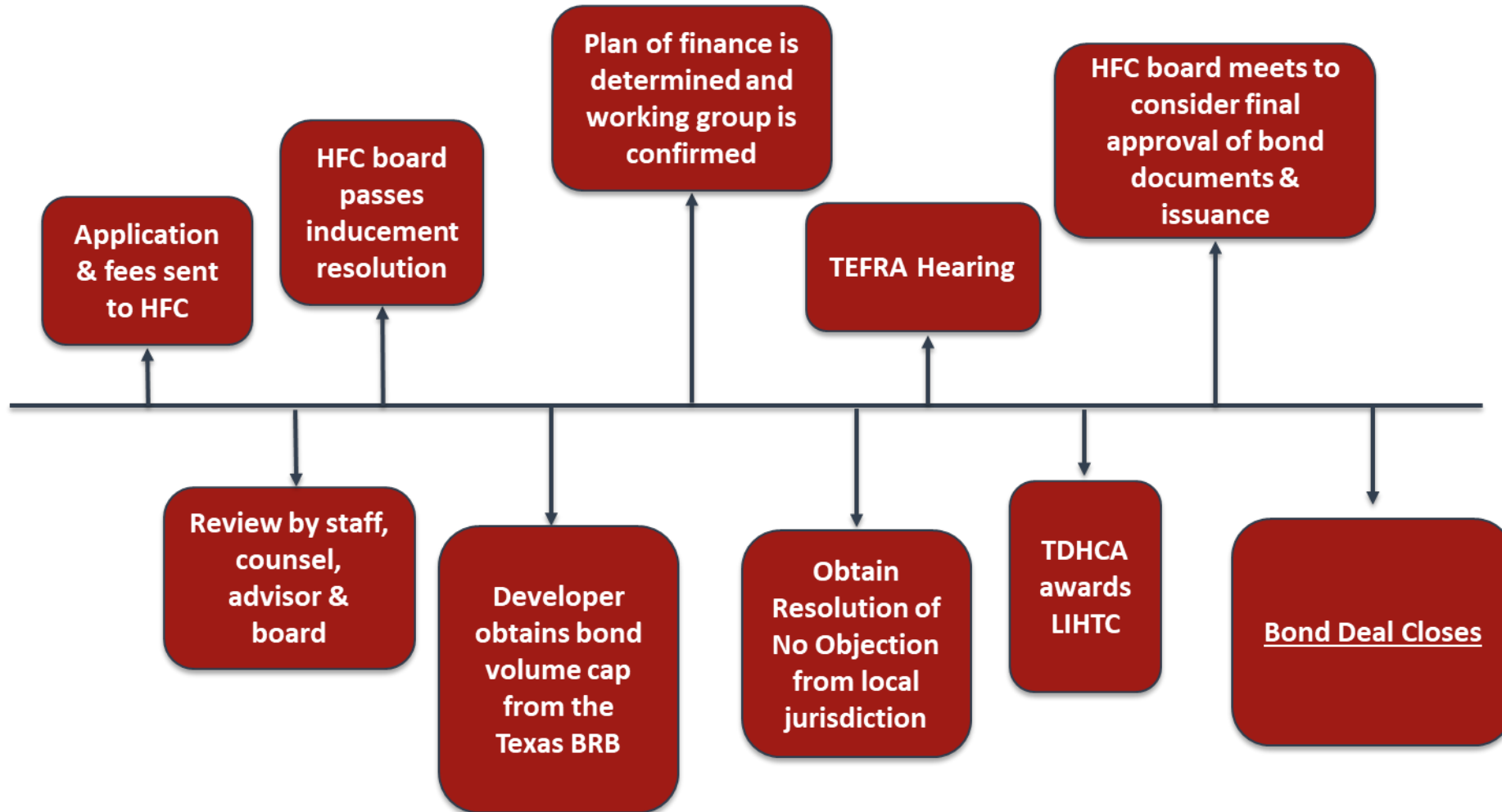


- Priority 0 - Must have filed a LIHTC app with TDHCA and closed a PAB reservation within the last 4 years; the project requires additional bonds to maintain the 50 percent test; and can only be used once
- Priority 1A - Set aside 50% of units - Cap rents at 30% of 50% AMFI  
Set aside 50% of units - Cap rents at 30% of 60% AMFI
- Priority 1B - Set aside 15% of units - Cap rents at 30% of 30% AMFI  
Set aside 85% of units - Cap rents at 30% of 60% AMFI
- Priority 1C - Set aside 100% of units - Cap rents at 30% of 60% AMFI  
For projects located in a census tract with median income that is greater than the median income of the county MSA, or PMSA that the QCT is located
- Priority 1D - projects located in counties, MSAs, or PMSAs with AMFI at or below the statewide median family income receive a priority boost on or after June 1
- Priority 2 - MUST receive 4% LIHTC - Set aside 80% of units - Cap rents at 30% of 60% AMFI
- Priority 3 - No AMFI Limits

# General Timeline of the PAB Program Year

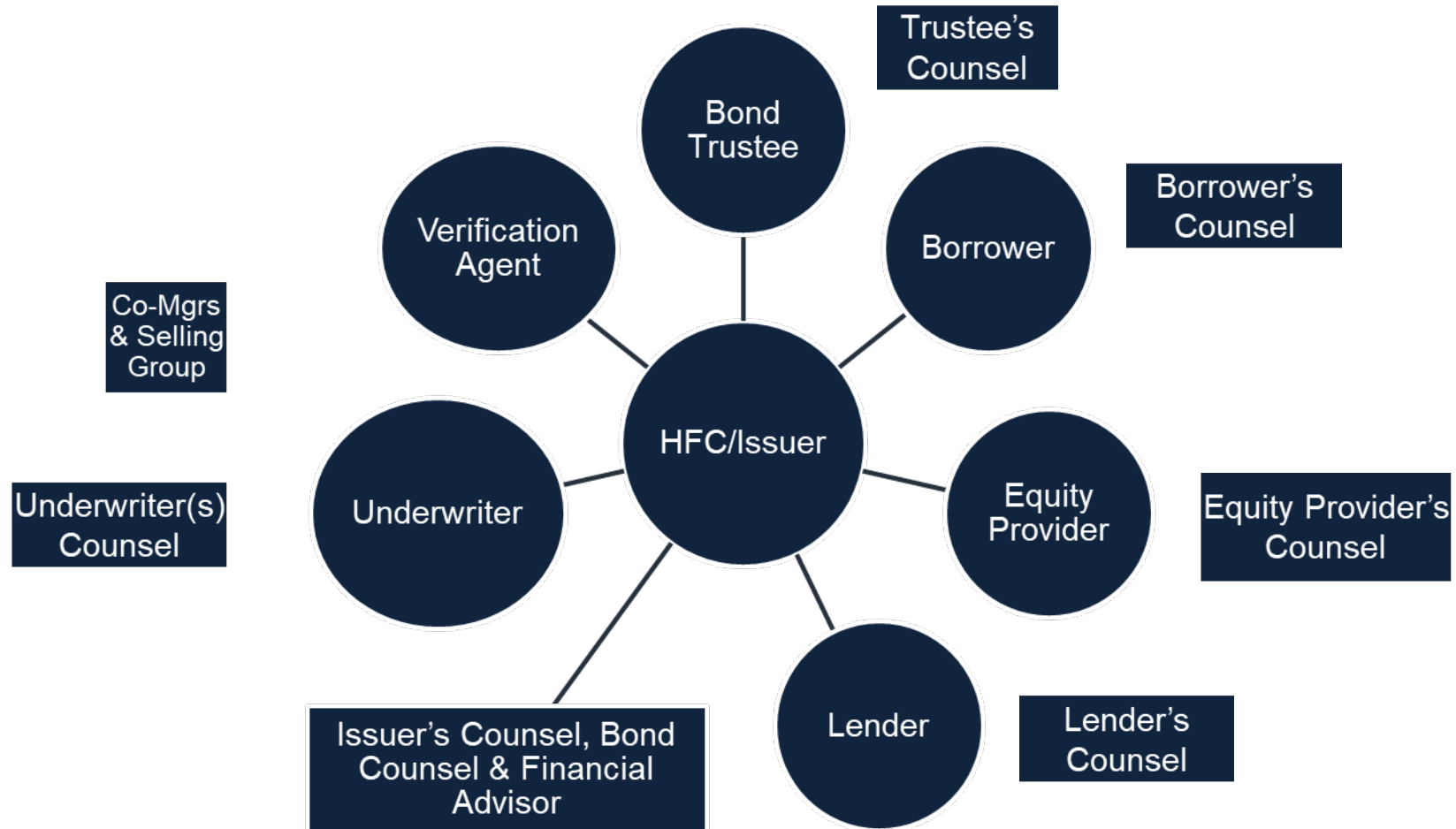


# Multifamily Bond Transaction Timeline



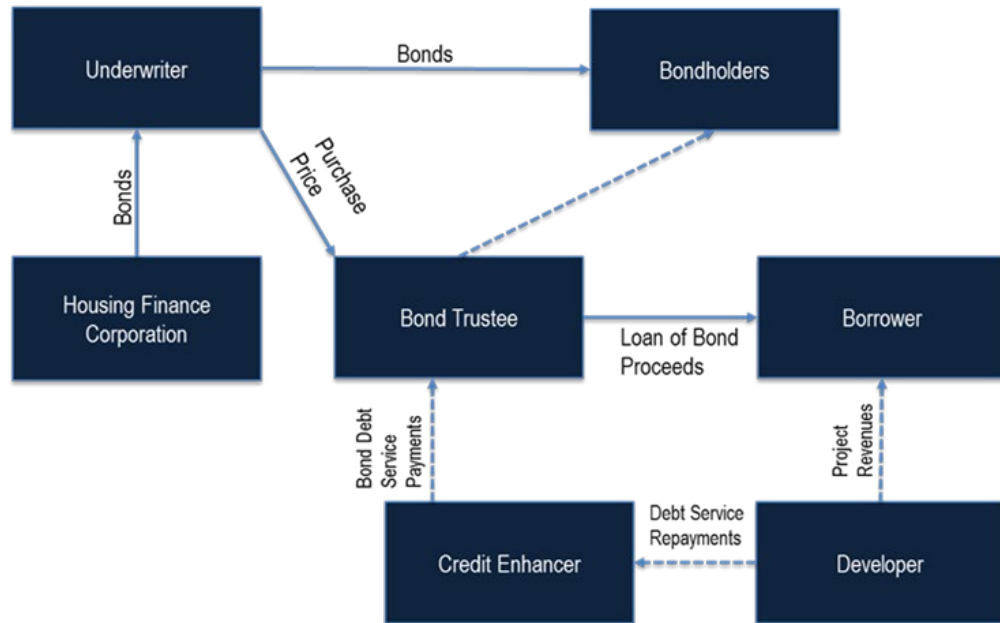


- Texas Bond Review Board
  - Volume cap in the State of Texas is administered by the Texas Bond Review Board.
  - The rules for volume cap allocation are based in statute and are not awarded on a discretionary manner.
- Attorney General
  - Before the issuance of a public security, bond counsel, on 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.





# Negotiated Sale Financing Team

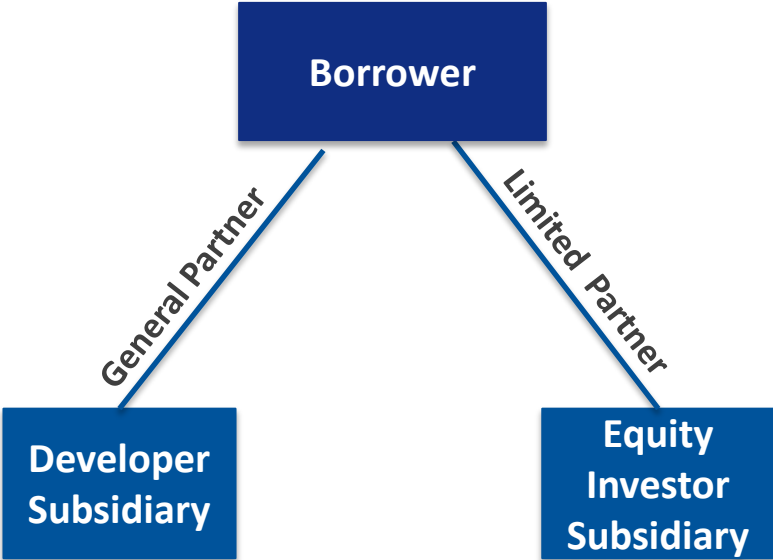


- Bonds are sold by the Issuer to the Underwriter pursuant to the bond purchase agreement.
- The Underwriter immediately resells the bonds to investors using the Issuer's official statement.
  - Institutional investors (investment funds, commercial banks and other accredited investors)
  - Retail (individuals)
- 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.<sup>19</sup>

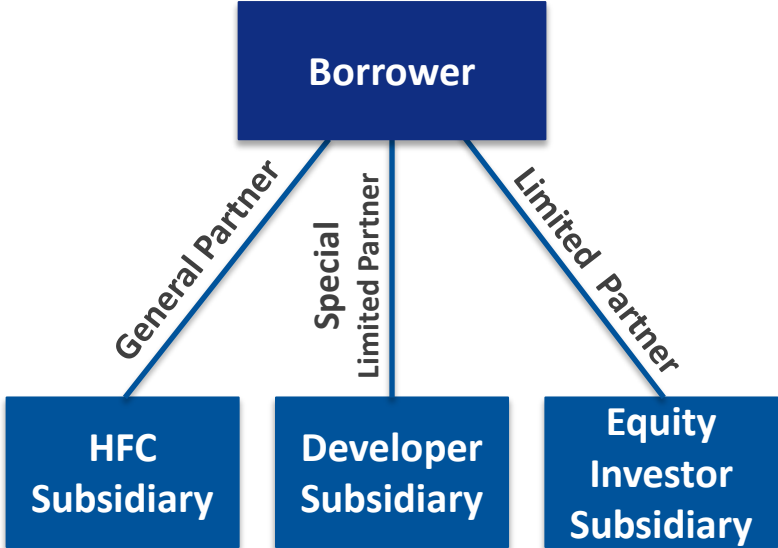




## Conduit Structure



## “Partnership” Structure



- Typically, the “borrower” in a multifamily housing financing consists of entities formed by the developer and the equity 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 to receive the tax abatement benefit.



- 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.
  - In order to secure the property tax exemption, the land must be titled in an HFC-owned entity and the HFC must have the right to compel title at any time (i.e. purchase option, ROFR)
- 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.



- Due to the competitiveness of tax credits and Private Activity Bond Volume Cap, developers have moved towards the workforce housing model to accommodate the “missing middle” (typically 60% of AMI – 140% of AMI), rehabilitate existing properties and preserve affordable housing.
- No federal tax law income restrictions, but state law Area Median Income (AMI) restrictions do apply.
  - 90% moderate income requirement (as defined by the Housing Finance Corporation, typically up to 140% AMI)  
**4 Person 140% AMI Collin County - \$154,420**
  - 50% at 80% area median income “safe harbor”  
**4 Person 80% AMI Collin County - \$88,240**
  - Additional HFC-imposed income may apply
- Generally, the developer will finance construction with conventional financing.
- Value of the property tax exemption should weight against the extent of income restrictions and rehabilitation to ensure tax savings are being used to generate affordable housing and increased opportunity for low- and moderate-income tenants.



- 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/or net cash flow generated from the project and/or an annual lease payment based off the percent of taxes abated. These funds are generally received for a minimum affordability period (to be negotiated, typically 10 - 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 through a joint venture contract to a sub-contractor to perform the actual duties of the general contractor, but the HFC would receive a fee for their role as general contractor.
- 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.



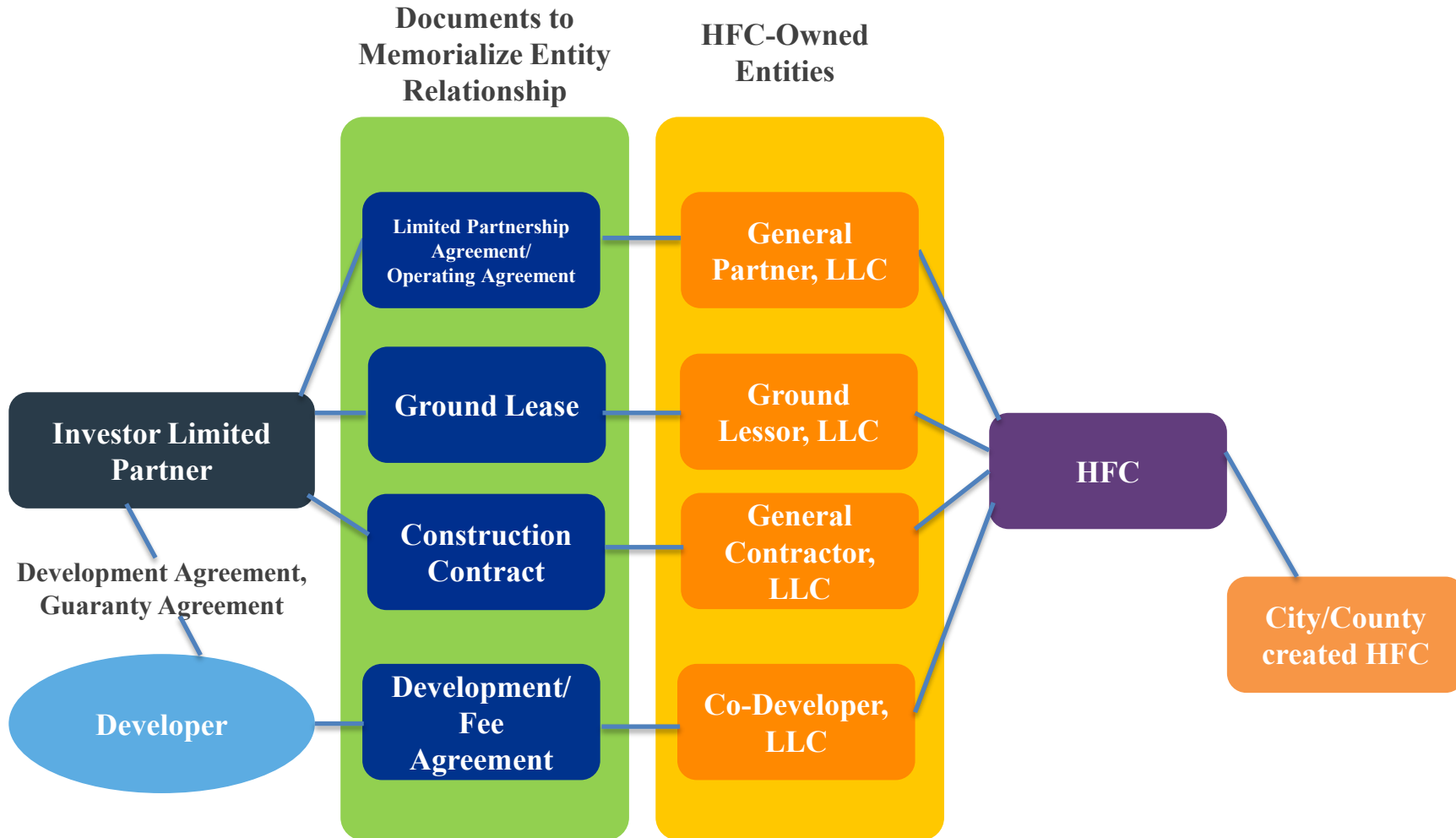
- The HFC could take on business risk of investing time and resources into projects that may not provide a substantial return for a long period of time.
  - If the project does not appreciate and does not cash flow, there is no liability to the HFC.
- The separate limited liability companies require administrative oversight.
- Liability risk from “slip and fall” type cases, but that is limited and minimized to the separate subsidiary entities.
- Political risk



- 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 equity 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% OR annual lease payment (subject to cash flow) and upon sale or refinance a 1.5% gross sale proceeds fee.
    - Fee to HFC: Partnership Management Fee of \$10,000, paid annually increasing by 3%, 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% - 40% OR upfront fee of 0.50% - 0.75% of the total cost of the project
  - **General Contractor**
    - Enters 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% or 1.5% of the hard construction costs.



## Disclaimer

- This communication is intended for issuers for educational and informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product or service. Financial transactions may be dependent upon many factors such as, but not limited to, interest rate trends, tax rates, supply, change in laws, rules and regulations, as well as changes in credit quality and rating agency considerations. The effect of such changes in such assumptions may be material and could affect the projected results. Any outcome or result HilltopSecurities, or any of its employees, may have achieved on behalf of our clients in previous matters does not necessarily indicate similar results can be obtained in the future for current or potential clients. HilltopSecurities makes no claim the use of this communication will assure a successful outcome. This communication is intended for institutional use only. For additional information, comments or questions, please contact Hilltop Securities Inc.