# HFC Bootcamp

## Annual Conference of the Texas Association of Local Housing Finance Agencies

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# Outline

# I. Chapter 394 and Other State Law Considerations

# Texas Housing Finance Corporations Act

- Local housing finance corporations are formed and operate under the provisions of the Texas Housing Finance Corporations Act, Chapter 394, Texas Local Government Code (the *"Act"* or *"Chapter 394"*).

- **Purpose.** Pursuant to the Act, the purpose of a local housing finance corporation is to "provide a means to finance the cost of residential ownership and development that will provide decent, safe, and sanitary housing for residents of local governments." *Section 394.002.*

- **Legal Status.** Housing finance corporations constitute public instrumentalities and nonprofit corporations and are not considered municipalities, counties or other political corporations or subdivisions of the State of Texas. *Section 394.015(d).*

# Texas Housing Finance Corporations Act

- **Board of Directors.** All powers of the housing finance corporation are vested in a board of directors. All directors must be residents of a local government sponsoring the housing finance corporation and *may* be a member of the governing body, an officer or an employee of the local government. *Section 394.021(a).*

- **Powers.** “A housing finance corporation may exercise any powers incidental to or necessary for the performance of the powers prescribed [in the Act] and may exercise other powers necessary or appropriate to carry out the purpose for which the corporation is organized.” *Section 394.031.*

# Texas Housing Finance Corporations Act

- **Powers (cont.).** Powers enumerated under the Act include the power to: (i) make contracts necessary or convenient to the exercise of its powers, (ii) incur liabilities, (iii) borrow money, (iv) issue notes, bonds and other obligations and (v) secure such obligations by mortgage of the corporation's assets. *Section 394.032(a).*

- A housing finance corporation may also (i) plan, research, study, develop and promote the establishment of residential development *Section 394.032(b)* and (ii) make donations for the public welfare or for charitable, scientific or educational purposes. *Section 394.032(c).*

- **Exemption from Taxation.** A housing finance corporation 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. *Section 394.905.* Exemption includes sales and ad valorem property taxes.

# HFC Board of Directors

- Members of an HFC Board of Director have duty to the HFC
  - Responsible for adhering to HFC mission
  - Must act in good faith with reasonable degree of care
  - Avoid conflicts of interest
- HFCs should obtain appropriate level of directors and officers' insurance for its officers and bylaws should provide for indemnification

# Other State Law Considerations

- **Open Meetings Act.** Housing finance corporations do not fit within the definition of "Governmental Body" under the Texas Open Meetings Act. *See Section 551.001(3), Texas Government Code.* In other words, housing finance corporations are NOT subject to the requirements of the Texas Open Meetings Act.

- **Open Records Act.** Pursuant to a decision of the Texas Attorney General, the Texas Open Records Act does apply to housing finance corporations. *See Open Records Decision No. 601.*

- **Public Funds Investment Act.** The funds of a housing finance corporation must be invested in accordance with the Texas Public Funds Investment Act. Housing finance corporations must enact an investment policy and appoint an investment officer pursuant to such act.

# II. Texas Bond Review Board and Private Activity Bond Volume Cap

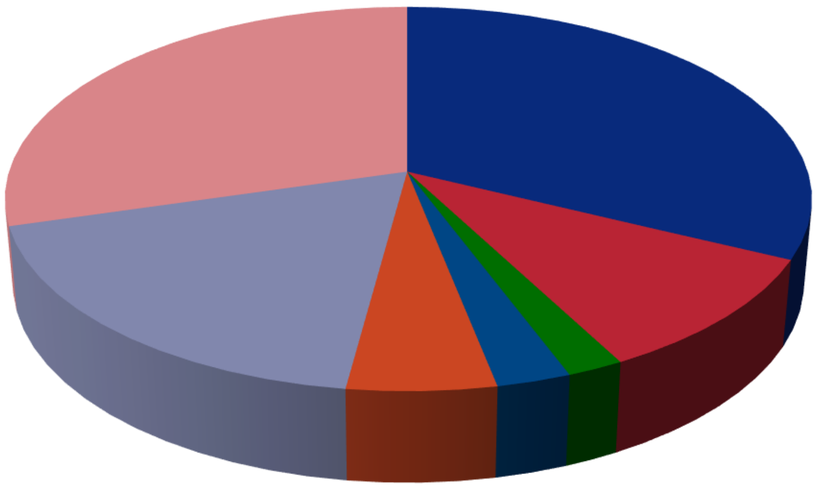
# Private Activity Volume Cap Basics

- Tax-exempt single family and multifamily housing bonds must receive an allocation of private activity volume cap.
- Each state receives an allocation of volume cap from the federal government based on the state’s population (i.e. $110 per capita with minimum of $324,995,000 for 2021).
- Texas was awarded $3,044,567,505 for 2020.
- Private activity volume cap must be obtained for a variety of private activity bond issuances including but not limited to student loans, solid waste, airport, water and sewage financings in addition to single and multifamily housing financings.
- An award of private activity volume cap can be carried forward for use in the following three calendar years.

# 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. *See Chapter 1372, Texas Government Code.*
- Volume cap is reserved in certain amounts for certain purposes under Chapter 1372.

# Volume Cap Use-Based Set Asides



## 2020 Texas BAB Set-Aside

| | | |
|---|---|---|
| MRB | 32.25% | $981,873,021 |
| State Voted | 10.00% | $304,456,751 |
| IDB | 2.00% | $60,891,350 |
| TSAHC-MF | 2.625% | $79,919,897 |
| TDHCA-MF | 5.25% | $159,839,794 |
| Local-MF | 18.375% | $559,439,279 |
| All Other | 29.50% | $898,147,413 |
| Total for the State | | $3,044,567,505 |

# Texas Private Activity Volume Cap

- Use-based allocations in place until August 15 of each year.
- **Single Family**: Local housing finance corporations may receive a maximum of $50 million in volume cap prior to August 15 (subject to reduction based on population). Reductions are also made for low utilization on last volume cap reservation used for single family purposes until July 15 of each year.
- **Multifamily**: Local housing finance corporations may receive a maximum of $50 million in volume cap prior to August 15.
- Lottery applications accepted from October 5 through October 20.
- Regional set-asides in place for multifamily until March 1.
- All set-asides collapse on August 15 and no maximum allocation applies.

# Texas Private Activity Volume Cap

- Must close within 180 days of receipt of allocation unless traditional carryforward volume cap is obtained.
- Traditional carryforward is available as of November 15 of each year; removes 180-day or 150-day closing deadline.

# III. Multifamily Housing 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 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 25-50% split)
  c) Sales tax savings (typically 20-25%)
- Typically are granted purchase option and right of first refusal if developer seeks to sell the project
- Increased oversight of management of project

**Burdens**

- Liability risk
- Administration of subsidiary entities and project ownership

# Partnering on “Workforce” Transactions

- Becoming increasingly common
- Typically, 50% of units reserved at 80% AMI and 90% at HFC “moderate” income threshold.
  - Additional HFC-imposed income restrictions?
- Conventionally financed (i.e. no tax-exempt bonds or LIHTC equity)
- Some HFCs have adopted workforce housing policies outlining requirements for these financings.

# HFC Takeaways

- HFCs bring significant value to deal with property tax and sales tax exemptions and should be compensated for providing these benefits.
- HFCs are entering into long term business relationship with a developer and need to conduct proper due diligence.
- Partnership transactions are complicated; HFCs need team of experienced advisors.
- HFC risk should be limited to fullest extent possible through use of subsidiary entities.
- HFCs should give careful consideration to the terms which it will enter into a workforce housing transaction.

# IV. Mortgage Credit Certificate Programs

# Mortgage Credit Certificate Programs

- Mortgage Credit Certificates (*"MCCs"*) are certificates issued to eligible borrowers which provide the borrower a dollar for dollar credit for a portion of mortgage interest paid each year.
- The benefit is limited to $2,000 per year if the MCC rate set by the housing finance corporation exceeds 20%.
- Borrower eligibility requirements are essentially the same as with a single family mortgage revenue bond program.
- Private activity volume cap must be obtained and exchanged for MCC authority (25% exchange rate).
- TEFRA approval is not required, but housing finance corporation must publish notice of program at least 90 days prior to issuing an MCC.

# Example of MCC Benefit to Borrowers

| | |
|---|---|
| Mortgage Amount: | $150,000 |
| Interest Rate: | 4.5% |
| Monthly Payment: | $562.50 |
| Total Interest Paid Per Year: | $6,750 |
| MCC Rate: | 30% |
| | $2,025 |
| Net Benefit: | **$2,000** |

Borrower can carry benefit forward for up to three tax years if there is insufficient tax liability in current year to fully utilize the benefit.

# Parties to MCC Program

**Housing Finance Corporation**

- Sponsors the MCC program; MCCs issued in name of housing finance corporation. May provide down payment assistance.

**Lenders**

- Lenders participating in the MCC program market product to potential borrowers and coordinate MCC issuance with program administrator.

**Program Administrator**

- Administers the program on behalf of the housing finance corporation.

**Bond Counsel**

- Drafts MCC documents; analyzes program to ensure compliance with state and federal law.

# V. Continuing Disclosure Compliance

# SEC Municipal Enforcement Actions

**Overview**

- Since early 2013 alone, apart from the MCDC Initiative, there have been enforcement actions brought against 18 state or local governmental entities and against 16 issuer officials.  In contrast, in the 14 years from the beginning of 1999 through 2012, the SEC resolved disclosure actions against only 11 state or local entities and 10 officials.
- Since the beginning of 2013, the SEC also levied $180,000 in civil penalties on eight officials.  In contrast, five officials (in only two actions) paid $85,000—less than half as much—in civil penalties in the 15 years from 1998 through 2012.  In pending actions, the SEC is seeking to levy civil penalties on five additional governmental entities and an additional six officials.
- Municipal securities enforcement has experienced a number of significant firsts in the 3-1/2 years since early 2013.  Most, if not all, of those measures follow the SEC's expansion of the role of its Public Finance Abuse Unit (formerly, Municipal Securities and Public Pensions Unit).

# SEC Municipal Enforcement Actions

**Beaumont Financing Authority (August 2017)**

- Charged with material misstatements and omissions in the sale of municipal securities.
- BFA routinely failed to comply with continuing disclosure requirements by filing information late and filing incomplete information.
- Executive Director of BFA fined $37,500 and is barred from participating in future municipal bond offerings.
- BFA required to take remedial action for previous misstatements, hire independent consultant and *implement written disclosure compliance policies.*
- SEC Order: “Despite seeking and receiving hundreds of billions of dollars in financing from municipal securities investors . . . the BFA did not have any formal written policies or procedures for the preparation of accurate, complete and timely official statements or post-issuance continuing disclosures.”

# Written Disclosure Compliance Policies

- Designate a compliance officer responsible for reviewing and monitoring housing finance corporation compliance with disclosure obligations
- Compliance officer conducts annual review of compliance and submits a report to the housing finance corporation's board of directors
- Compliance officer will review any official statements and other disclosure documents for compliance with securities laws and written compliance procedures

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Ryan Bowen is a partner in Chapman's National Public and Health & Education Finance Department. Ryan has experience serving as bond and underwriter's counsel in connection with a variety of bond financings and as investor's counsel with respect to the purchase of various state and local government obligations.

Ryan has experience serving as bond counsel and underwriter's counsel on private activity bond financings, including single family and multifamily housing bond transactions. His housing finance experience includes serving as partnership counsel in connection with multifamily financings involving the use of tax credits.

Ryan routinely advises banks and other institutional investors in connection with the structuring, purchase, placement and securitization of state and local government obligations structured as municipal bonds, loans and leases. He also has experience structuring trust vehicles to enable the securitization of tax-exempt assets.

Ryan has significant experience as counsel to providers of municipal reinvestment products, including representation of investment banks and special purpose entities providing fixed and floating rate investment agreements, repurchase agreements and forward delivery agreements to bond issuers in the public finance market.

Ryan routinely provides counsel on various securities law matters, including SEC and MSRB rules and regulations governing the municipal securities market and disclosure practices.

Prior to attending law school, Ryan worked as a consultant for PwC Consulting (formerly the consulting division of PricewaterhouseCoopers LLP) in Washington, DC.

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