CSG | advisors

MEMORANDUM

To: Tim Durose, CFO Minneapolis Public Housing Authority (MPHA)

From: Stacy Vincent, Vice President, CSG Advisors

RE: Self-Development Key Considerations

Date: July 21, 2017

Background

CSG Advisors is working with MPHA to present a variety of financial options, recommend projects based on feasibility and other key considerations, as well as provide implementation steps to move forward. As part of MPHA's portfolio analysis, CSG is evaluating the feasibility of: 9% Low-Income Housing Tax Credits (LIHTC); converting public housing units to the Rental Assistance Demonstration (RAD) program; leveraging rehabilitation projects that meet certain thresholds with 4% LIHTC/bonds; and securing other potential sources. CSG will present its preliminary analysis and findings to obtain input from MPHA in order to develop recommendations and an implementation strategy.

This summary memo provides MPHA with background information, opportunities, challenges and key considerations regarding the agency's roles and responsibilities for potentially self-developing sites in the future. CSG has assisted several Housing Authorities with successfully self-developing projects. Although self-development requires significant resources on the part of agencies and represents new challenges, there are a number of advantages. Included on the following pages, CSG provides the typical ownership structure and key considerations for MPHA's review and for further discussion.

Recommendations/Next Steps

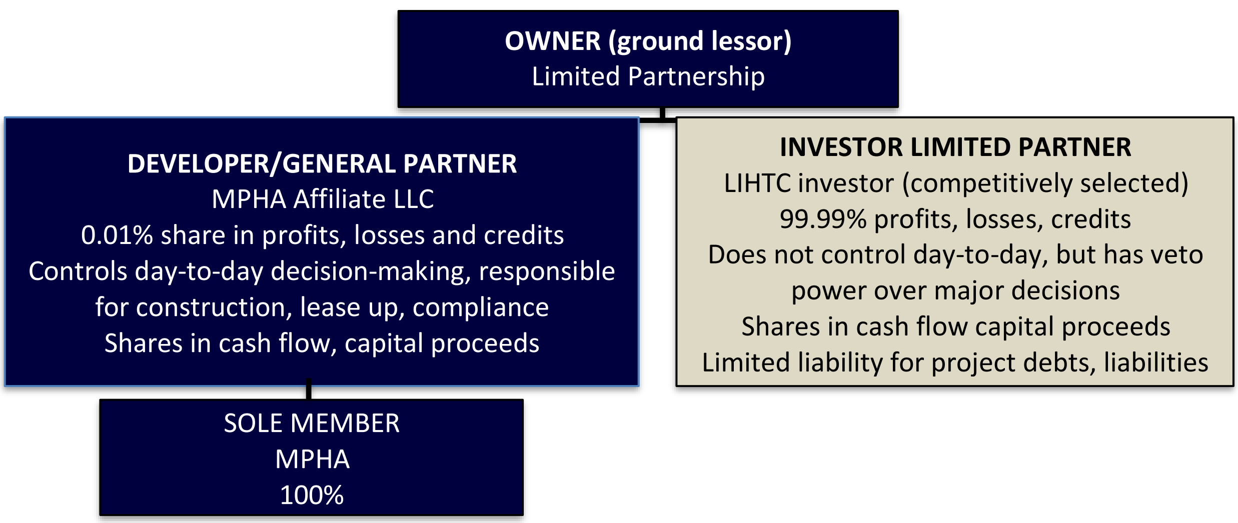
As MPHA further defines its role in the region and diversifies its income, self-developing rehabilitation projects that incorporate 4% LIHTC/bonds projects is recommended. With limited resources from HUD, self-development allows MPHA to realize the full benefits of setting up the transaction with MPHA's interest in mind and realizing the full financial benefits of undertaking the transaction. For new construction projects including 9% LIHTC, New Market Tax Credits, mixed-income and mixed-use projects, MPHA should consider co-developing with private developers, after undergoing a through and competitive procurement process that lays out MPHA's required key business terms in any solicitations. When procuring a co-developer, MPHA can establish, early in the process, its desired role and that of other parties in the day-to-day management structure. After completing a number of successful projects, where MPHA plays the role of co-developer, MPHA may want to consider self-developing new construction projects as well.

CSG has been successful at working with other Housing Authorities and their legal counsel in addressing some potential challenges associated with self-developing. Agency capacity and resources can be supplemented by a multi-disciplinary team of contractors and guarantees can be limited by negotiating with investors and then funding guarantees with proceeds from the transaction.

Self-Development Typical Ownership Structure

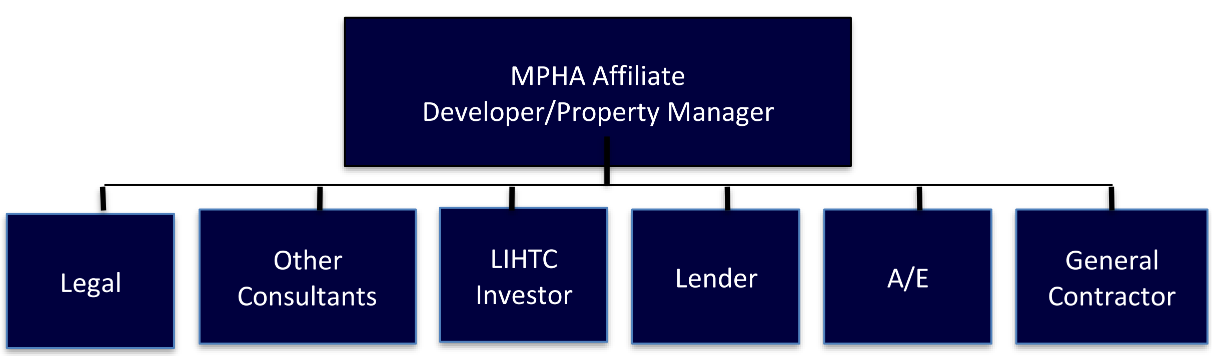
In order for MPHA's projects to raise tax credit equity, using either 4% and 9% LIHTC, a partnership structure must be utilized. MPHA should consult with legal counsel on the recommended legal structure, but often the ownership includes the parties, as outlined below and shown on the organizational chart.

- **Owner Entity**. MPHA would enter into a long-term ground lease with the limited partnership (as Owner) formed to admit the tax credit investor, once selected, as limited partner.
- **Limited Liability Company.** Is a single purpose LLC formed so that its sole member is MPHA, serving as general partner.
- **Investor Limited Partner.** After a competitive selection process, the selected investor forms a special purpose entity to undertake each project or phase.
- **Developer.** A separate single purpose limited liability company is also formed to serve as developer, for which MPHA would also serve as the sole member of the developer.



Self-Development Team Structure

MPHA, as developer, would be required to procure legal counsel, other consultants, the LIHTC investor/lender, design team and general contractor, complying with standard HUD procurement guidelines. MPHA would also either need to serve as property manager or procure a third party.



Key Considerations

Self-Development Items for Consideration

MPHA should consider the items listed below when determining its desired role in redevelopment activities, as well as the opportunities and challenges.

- **Examine authorizing law, resolutions and formation documents.** To determine MPHA's legal capacity to play various roles in public/private transactions and any related limitations in structuring the owner entity and financing the transaction. Work with legal counsel to revise the required documents so that MPHA has the greatest amount of flexibility possible.
- **Set up accurate accounting systems.** For receiving and using program income, consult with legal counsel to avoid conflicts of interest prohibited by its ACC, comply with federal and local procurement requirements, identify accessible sources of funds for guaranties and properly allocate costs and risks among the entities.
- **Affiliate controls.** If MPHA determines it is in the agency's best interest to set up an affiliate for development purposes, the agency should implement controls that differentiate the affiliate's existence as a distinct legal entity. These include accounting mechanisms and careful review of guaranty and other obligations to ensure that the work of the affiliate is properly authorized and does not expose MPHA to any inappropriate level of risk.
- **Rehabilitation as a first step.** If Housing Authorities decide to venture into self-development, setting up its first transactions to rehabilitate apartments is often advisable. Since MPHA has significant experience in modernizing its apartments, moving toward a leveraged tax credit transaction may be a natural transition. Housing Finance Authorities and Investors are typically most comfortable with Housing Authority experience and capacity in the rehabilitation realm. After building capacity and experience, Housing Authorities may consider new construction and mixed-income and mixed-use as logical future steps.

OPPORTUNITIES

- Control and flexibility. MPHA makes all decisions and can, with greater transparency, ensure MPHA's best interests are prioritized.
- Business model. Builds internal capacity so that future development activities can become part of MPHA's core business. Also, would allow MPHA to become an active and influential housing leader in the region.
- Timing. Accelerate timeframe with no developer procurement or negotiations.
- Developer/Asset Management Fees. MPHA retains 100% of the fees (after any necessary deferred fees) as opposed to sharing with a private developer. Fee proceeds may have certain requirements, but typically have some flexibility under HUD regulations.
- Cash flow. MPHA will have greater control over cash flow and will benefit from a well-run property.

CHALLENGES

- Guarantees. MPHA must provide all guarantees (construction completion, stabilization, operating deficits and tax credit compliance) based on negotiations with the investor.
- Staff capacity/resources. Mixed-finance/ RAD transactions are complex and require that staff learn the intricate details of different program requirements. Devoting full-time staff to these projects is often necessary.
- Risk/compliance obligations. The housing authority is taking on additional risk and must fulfill all compliance obligations.
- Local perception. MPHA must change the perspective of local leaders about the housing authority's role in the community.