

# Housing Finance Corporations: **The Good, the Bad and the Ugly**

# Agenda

- Housing Finance  
Corporation Basics
- Potential Ethics Issues
- Best Practices to Avoid  
Ethics Issues



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# What is an HFC?

- Housing Finance Corporation, aka. “HFC”
  - Governed by Chapter 394, Texas Local Government Code
  - “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.*
  - “constitute a public instrumentality and nonprofit corporation” and “does not constitute a municipality, county or other political corporation or subdivision” of the State of Texas. *Section 394.015(d).*
  - 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).*
  - “may exercise any powers incidental to or necessary for the performance of the powers prescribed [in this Chapter] and may exercise other powers necessary or appropriate to carry out the purpose for which the corporation is organized.” *Section 394.031.*

# The Good...

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- HFCs allow bond issuance without impacting the city or county bond caps and ratings
- HFCs have more flexibility, similar to a local government corporation
- HFCs run like corporations
- HFCs can be the non-profit partner or LLC member in development deals to provide property tax exemptions and other benefits in exchange for a long-term revenue stream and an active part in development projects

# The Good...about this presentation

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- PFCs are similar to HFCs, but are governed by Chapter 303 Texas Local Government Code
- These best practices may also apply to any local government corporation, such as EDCs, redevelopment agencies (when RDA's are created with an overlapping LGC), etc.

# The Bad...Why Should the City Attorney Care?

- HFC's often share staff with cities and counties without clear distinctions between roles or time
- HFCs can make contracts, incur liabilities, issue bonds, borrow money and secure such obligations by mortgage of the HFC's assets without needing the sponsor's approval. Section 394.032(a)
- Separation from the sponsor local government is not always clear to the developer, HFC or HFC's counsel
- Not subject to Open Meetings Act or Public Information Act\*\*
- Not subject to state procurement laws
- Subject to Public Funds Investment Act
- May or may not be clearly subject to other city or county policies

# Potential Legal Ethics Issues (the Ugly)

Ethics Rules Implicated by legal representation of HFC and sponsoring local government:

- Rule 1.01 Competent and Diligent Representation
- Rule 1.02 Scope and Objectives of Representation
- Rule 1.03 Communication
- Rule 1.05. Confidentiality of Information
- Rule 1.06. Conflict of Interest: General Rule
- Rule 1.12 Organization as a client
- Rule 2.02 Evaluation for use by third persons
- Rule 4.02. Communication with One Represented by Counsel

# Rule 1.01(a) Competent and Diligent Representation

A lawyer shall not accept or continue employment in a legal matter which the lawyer knows or should know is beyond the lawyer's competence, unless:

- (1) another lawyer who is competent to handle the matter is, with the prior informed consent of the client, associated in the matter; or
- (2) the advice or assistance of the lawyer is reasonably required in an emergency and the lawyer limits the advice and assistance to that which is reasonably necessary in the circumstances.

Comment 6. Having accepted employment, a lawyer should act with competence, commitment and dedication to the interest of the client and with zeal in advocacy upon the client's behalf. A lawyer should feel a moral or professional obligation to pursue a matter on behalf of a client with reasonable diligence and promptness despite opposition, obstruction or personal inconvenience to the lawyer. A lawyer's workload should be controlled so that each matter can be handled with diligence and competence. As provided in paragraph (a), an incompetent lawyer is subject to discipline.



# Rule 1.02 Scope and Object of Representation

(a) Subject to paragraphs (b), (c), (d), (e), and (f), a lawyer shall abide by a client's decisions...concerning the objectives and general methods of representation...

(f) When a lawyer knows that a client expects representation not permitted by the rules of professional conduct or other law, the lawyer shall consult with the client regarding the relevant limitations on the lawyer's conduct.

Comment 1: 1. Both lawyer and client have authority and responsibility in the objectives and means of representation. The client has ultimate authority to determine the objectives to be served by legal representation, within the limits imposed by law, the lawyer's professional obligations, and the agreed scope of representation. Within those limits, a client also has a right to consult with the lawyer about the general methods to be used in pursuing those objectives. The lawyer should assume responsibility for the means by which the client's objectives are best achieved. Thus, a lawyer has very broad discretion to determine technical and legal tactics, subject to the client's wishes regarding such matters as the expense to be incurred and concern for third persons who might be adversely affected.

# Best Practices

- Verify whether your local government sponsors an HFC, PFC, or other non-profit
- Clarify whether the city/county attorney represents the sponsored non-profits
- Discuss the scope of representation for HFC and other non-profits with your governing body
- Have outside/special counsel available when/if needed (Ex. Bonds, tax counsel, real estate/housing transactions)
- Talk to your departments about which staff are involved in the HFC
- Know the statutory authority of the sponsored non-profit and the applicable local laws and policies

# Rule 1.03 Communication

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(a) A lawyer shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Comment 1: The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued to the extent the client is willing and able to do so. For example, a lawyer negotiating on behalf of a client should provide the client with facts relevant to the matter, inform the client of communications from another party and take other reasonable steps to permit the client to make a decision regarding a serious offer from another party. A lawyer who receives from opposing counsel either an offer of settlement in a civil controversy or a proffered plea bargain in a criminal case should promptly inform the client of its substance unless prior discussions with the client have left it clear that the proposal will be unacceptable. See Comment 2 to Rule 1.02.

# Rule 1.05(b) Confidentiality of Information

Except as permitted by paragraphs (c) and (d), or as required by paragraphs (e) and (f), a lawyer shall not knowingly:

(1) Reveal confidential information of a client or a former client to:

(i) a person that the client has instructed is not to receive the information; or

(ii) anyone else, other than the client, the client's representatives, or the members, associates, or employees of the lawyer's law firm.

(2) Use confidential information of a client to the disadvantage of the client unless the client consents after consultation.

(3) Use confidential information of a former client to the disadvantage of the former client after the representation is concluded unless the former client consents after consultation or the confidential information has become generally known.

(4) Use privileged information of a client for the advantage of the lawyer or of a third person, unless the client consents after consultation.

# Rule 1.12 Organization as Client

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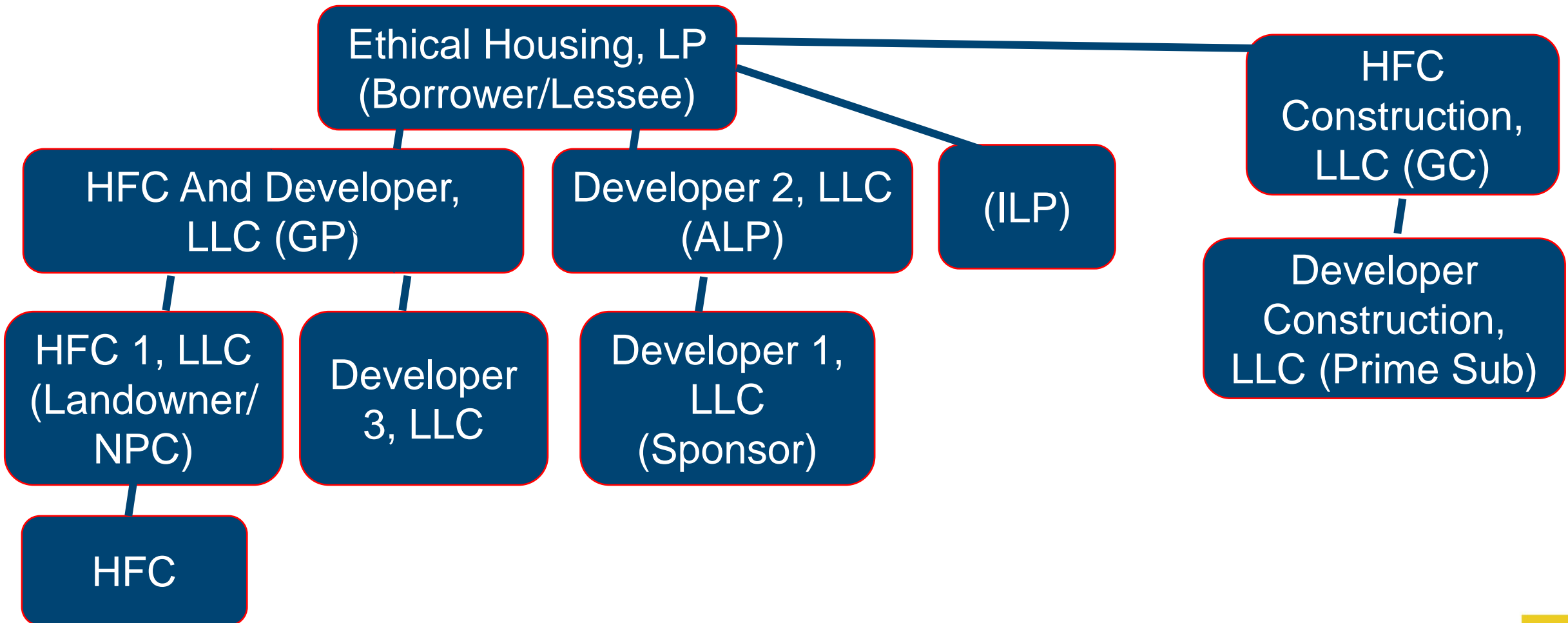
(a) A lawyer employed or retained by an organization represents the entity. While the lawyer in the ordinary course of working relationships may report to, and accept direction from, an entity's duly authorized constituents, in the situations described in paragraph (b) the lawyer shall proceed as reasonably necessary in the best interest of the organization without involving unreasonable risks of disrupting the organization and of revealing information relating to the representation to persons outside the organization.

(e) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing or when explanation appears reasonably necessary to avoid misunderstanding on their part.

# Best Practices

- Regardless of how the clients interact, treat each as a separate client and legal entity
- Communicate with the governing body of each client when appropriate
- Request a staff representative from each client to interact with the legal counsel for that client to provide clear direction to the attorneys
- Frequently remind staff, governing bodies and third-parties of your role and scope of representation
- Consider carefully what information is “confidential” and “privileged” for each client
- Remember that HFC information is not public information and may not be as easily accessible as local government information

# Potential Ethics Issues – Deal Structure



# Potential Ethics Issues – Who is the Client?

Ethical Housing, LP  
(Borrower/Lessee)

HFC And Developer,  
LLC (GP)

Developer 2, LLC  
(ALP)

(ILP)

HFC 1, LLC  
(Landowner/  
NPC)

Developer  
3, LLC

Developer 1,  
LLC  
(Sponsor)

HFC  
Construction,  
LLC (GC)

HFC

Developer  
Construction,  
LLC (Prime Sub)



# Rule 1.06(b)-(c) Conflict of Interest: General Rule

(b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

(1) involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyer's firm; or

(2) reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.

(c) A lawyer may represent a client in the circumstances described in (b) if:

(1) the lawyer reasonably believes the representation of each client will not be materially affected; and

(2) each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.

# Rule 1.06 – Meaning of “Directly Adverse”

Comment 6: Within the meaning of Rule 1.06(b), the representation of one client is “directly adverse” to the representation of another client if the lawyer's independent judgment on behalf of a client or the lawyer's ability or willingness to consider, recommend or carry out a course of action will be or is reasonably likely to be adversely affected by the lawyer's representation of, or responsibilities to, the other client. The dual representation also is directly adverse if the lawyer reasonably appears to be called upon to espouse adverse positions in the same matter or a related matter. On the other hand, simultaneous representation in unrelated matters of clients whose interests are only generally adverse, such as competing economic enterprises, does not constitute the representation of directly adverse interests. Even when neither paragraph (a) nor (b) is applicable, a lawyer should realize that a business rivalry or personal differences between two clients or potential clients may be so important to one or both that one or the other would consider it contrary to its interests to have the same lawyer as its rival even in unrelated matters; and in those situations a wise lawyer would forego the dual representation.

# Rule 4.02 (a) & (c) Communication with One Represented by Counsel

(a) In representing a client, a lawyer shall not communicate or cause or encourage another to communicate about the subject of the representation with a person, organization or entity of government the lawyer knows to be represented by another lawyer regarding that subject, unless the lawyer has the consent of the other lawyer or is authorized by law to do so.

(c) For the purpose of this rule, “organization or entity of government” includes: (1) those persons presently having a managerial responsibility with an organization or entity of government that relates to the subject of the representation, or (2) those persons presently employed by such organization or entity and whose act or omission in connection with the subject of representation may make the organization or entity of government vicariously liable for such act or omission.

# Rule 2.02 Evaluation for Use by Third Persons

A lawyer shall not undertake an evaluation of a matter affecting a client for the use of someone other than the client unless:

- (a) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and
- (b) the client consents after consultation.

Comment 1. An evaluation may be performed at the client's direction but for the primary purpose of establishing information for the benefit of third parties; for example, an opinion concerning the title of property rendered at the behest of a vendor for the information of a prospective purchaser, or at the behest of a borrower for the information of a prospective lender. In some situations, the evaluation may be required by a government agency; for example, an opinion concerning the legality of the securities registered for sale under the securities laws. In other instances, the evaluation may be required by a third person, such as a purchaser of a business.

# Best Practices

- Define the scope of representation for each client prior to working on any transaction
- Verify the scope of representation on each new transaction
- Identify each client's role in each new transaction
- Identify potential adverse scenarios between clients
- Obtain conflict waivers when necessary
- Carefully consider the impact to your client before granting a conflict waiver
- Even when a conflict is waived by the clients, avoid representation on matters that causes concern for you as an attorney
- Consider assigning each client separate counsel
- Keep in mind what matter is being communicated about and communicate appropriately with each client
- Do not draft legal opinions for use in a transaction without careful consideration

# More Good, Bad and Ugly...Federal Funds

- Federal money is often used in affordable housing transactions
- Providing federal money to an HFC as a subrecipient may allow more efficient compliance monitoring and administration of federal funds, while keeping the local government's audits more simplified
- Adding a lending relationship complicates the situation and increases the potential for conflicts of interest and potential legal ethics issues
- Consider what happens if there is a federal clawback or other compliance violation

# Best Practices

- Ensure nonprofits still have appropriate policies and procedures for the types of funding sources anticipated to be handled by the entity
- Consider different policies for hiring outside consultants and legal counsel based on the entity's potential needs
- Review policies, procedures and agreements from both the sponsor's perspective and the nonprofit's perspective to ensure the interests of both entities are zealously represented in each matter
- Modify the scope of representation when necessary, even after a matter has been initiated
- Consider the role of intermediary

# A Note about Dissolution

- Sec. 394.026. DISSOLUTION OF CORPORATION. (a) If the board of directors determines by resolution that the purposes for which the housing finance corporation was formed have been substantially met and that **all bonds issued by and all obligations incurred by the corporation have been fully paid**, the directors shall execute a certificate of dissolution stating those facts and declaring that the corporation is dissolved. The directors shall file the certificate for recording in the office of the secretary of state. The directors shall execute the certificate under the corporation's seal.
- (b) On the filing of the certificate of dissolution, the corporation is dissolved. **The title to all funds and property owned by the corporation at the time of dissolution vests in the local government to be used exclusively by the local government to provide for the housing needs of individuals and families of low and moderate incomes, including single-family units and mixed income multifamily projects found by the local government to serve the interests of low and moderate income individuals and families if the single-family and multifamily projects have as a major purpose the provision of safe, sanitary, and decent housing for individuals and families of low income.** The funds and property shall be promptly delivered to the local government.





# Questions?

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