Preston Hollow Capital, LLC

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Executive Summary

On December 14th, 2021, Kroll Bond Rating Agency LLC (KBRA) assigned a BBB issuer rating to Preston Hollow Capital, LLC ("PHC" or the Company), a private investment company founded in 2014 and headquartered in Dallas Texas, specializing in direct and secondary market investments in municipal securities. The rating Outlook is Stable. The rating is based on KBRA's Global Finance Company Rating Methodology published on November 28, 2017 and ESG Global Rating Methodology published on June 16, 2021.

Ratings				
Entity	**Type**	**Rating**	**Outlook**	**Action**
Preston Hollow Capital, LLC	Issuer	BBB	Stable	Assign

Key Credit Considerations

The rating reflects PHC's deep and experienced management team with decades of municipal finance and real estate lending experience, primarily senior secured, well-collateralized and covenant-heavy debt investments diversified by region and sector, low leverage with a target of approximately 1x Recourse Debt-to-Equity (excluding non-recourse term-matched trusts and including a contemplated preferred equity issuance as debt), strong underwriting and risk management, strong earnings metrics, permanent equity capital from established institutional investors and PHC's management team including the President/CEO and an adequate funding/liquidity profile with significant unencumbered assets.

PHC's funding strategy is focused primarily on non-recourse term matched trusts (TMTs) which provides a more stable source of borrowing compared to short-term recourse facilities. KBRA views PHC's TMT funding as relatively stable given maturities are long-term and generally matched with the maturities of assets collateralizing the TMT, there is no mark-to-market collateral posting required, and TMTs are fully non-recourse to PHC. In addition, the rating considers PHC's demonstrated strong underwriting with low losses and successful workouts of distressed credits through the Covid-19 pandemic. These strengths are counterbalanced by the risks related to the business of investing in illiquid non-investment grade or unrated municipal debt, relatively high single credit concentration (top 5 credits comprise 31% of portfolio), high dividend payouts and a focus on secured debt financing with fewer sources compared to higher-rated finance companies.

The Stable Outlook reflects the Company's low leverage, low non-accruals and losses through the Covid-19 pandemic to-date and adequate liquidity with significant unencumbered assets.

Credit Strengths
▪ Low leverage: Recourse Debt-to-Equity <1x currently and expected to increase to 1x over time
▪ Strong management expertise in bespoke municipal debt investments
▪ Portfolio of well-collateralized and covenant heavy debt investments diversified by region and sector
▪ Strong and stable earnings and asset quality metrics since inception including through COVID
▪ Permanent equity capital from two prominent private equity firms and the Company's CEO/President
▪ Borrowing primarily focused on non-recourse term-matched trust which provide stable funding
▪ Good level of unencumbered assets given low leverage
Credit Constraints
▪ Single credit exposure greater than higher-rated finance companies (top 5 positions represent 31% of portfolio)
▪ Reliance on secured funding with limited sources; partially mitigated by stable long-term TMT funding
▪ Potential Net Asset Value (NAV) decline due to quarterly fair value calculations of investments
▪ Investment in primarily non-rated illiquid municipal debt
▪ High dividend payout ($92m in 2020 representing 73% of revenues)

Rating Sensitivities

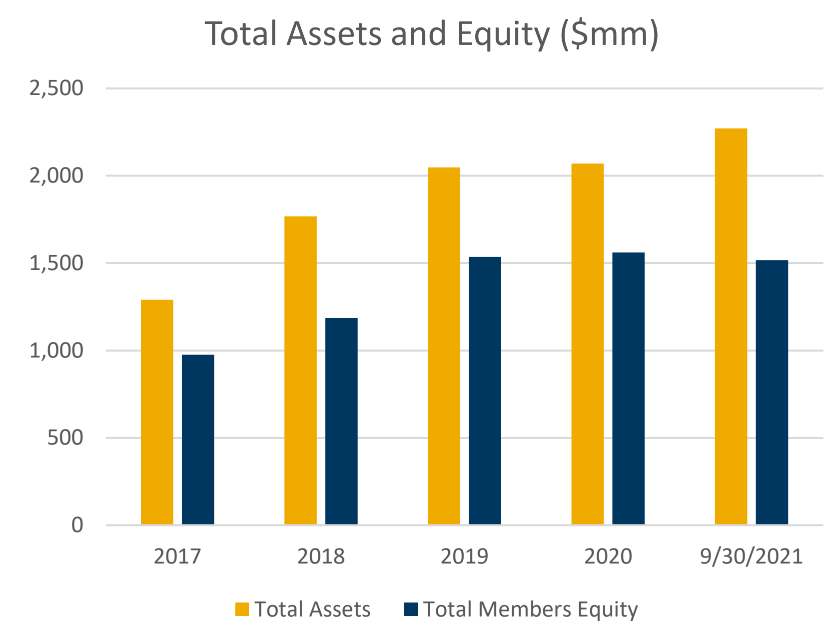
The rating Outlook is Stable, therefore, a rating upgrade is not expected in the near-term. Over time, significant market share and portfolio growth, significant improvement in single credit diversification, increased portfolio exposure to higher-rated credits and increased diversity of funding sources while maintaining Recourse Debt-to-Equity leverage below 1x and stable asset quality metrics could lead to consideration for an upgrade.

The Outlook could be revised to Negative or the rating could be downgraded if a significant downturn in the U.S. economy or changes in U.S. tax policy have material negative impacts on PHC's portfolio, credit losses and/or portfolio concentrations increase materially, or leverage increases above 1x Recourse Debt-to-Equity or 2x Total Debt-to-Equity which could cause performance volatility; KBRA notes that higher leverage would increase the sensitivity of the rating to a deterioration in asset quality. A material weakening in the stability of funding, including weakening of term-matched trust terms that increases refinancing and liquidity risk for PHC or a change in management coupled with a shift in investment strategy, investment process and/or risk management could also lead to a downgrade.

Key Business Factors Rating Determinants

Market Share, Branding and Viability

Preston Hollow Capital, LLC (PHC) is a private investment company founded in 2014, headquartered in Dallas Texas, specializing in direct and secondary market investments in municipal securities. The Company is a leading provider of bespoke municipal finance with a diversified investment portfolio having closed over $3.7 billion in transactions across a variety of sectors of the municipal bond market including real estate, senior living, K-12 and higher education, healthcare, infrastructure, hospitality, general government, and economic development. As of Sept. 30, 2021 (3Q21), the firm had $2.3Bn of total assets and permanent equity capital of $1.5Bn. The Company has 34 employees between its headquarters in Dallas and a satellite office in San Francisco where it maintains capital markets and secondary trading staff. PHC's largest investors include two well-established private equity sponsors – HarbourVest and Stone Point – along with Jim Thompson, Chairman and CEO. The remaining investor base is diversified across other institutional investors and high net worth individuals.



PHC provides capital solutions to local governments, higher education institutions, not-for-profit entities, and other borrowers. The Company focuses on bespoke municipal transactions that are heavily covenanted and well collateralized. The need for specialized underwriting and structuring further plays to PHC's expertise in this niche business. As of 3Q21, the Company had total asset of $2.3Bn, including $2.0Bn of total investments (up from $334 million in 2015) comprised of 87 investments with a weighted average yield of 6.5%.

The municipal market is highly fragmented and retail investor focused. PHC focuses on the inefficiencies and less competitive environment in the highly negotiated specialized transactions, which are mostly non-rated or non-investment grade. According to PHC, this market segment represents roughly 10% of the municipal market share and is not easily financed through the traditional channels. PHC focuses on non-rated transactions and special situations for non-investment grade borrowers that do not have ready access to the capital markets. In many situations, PHC differentiates itself by guiding the borrower through the financing process, assisting with strategy, structure and economics of a transaction. The Company focuses on investments in real estate, healthcare, education, infrastructure, hospitality, general government and economic development with sizes typically ranging from $10-$100 million.

REPRESENTATIVE CREDIT TYPES

Real Estate
Special assessments / special tax transactions with proven developers

Healthcare
Single site & multi-site system healthcare facilities; start-up healthcare facilities; off balance sheet joint ventures

Economic Development
Tax increment, tax credit and other economic development incentive financings for developing and completed projects

Infrastructure
Primarily debt investments in infrastructure related projects including transportation, safety, social and other projects

Higher Education & K-12
Education related projects including student housing, public and private education institutions and charter schools

Senior Living
Construction and rehabilitation needs for independent living, assisted living, and memory care facilities

General Government
General obligation, lease appropriation or other needs

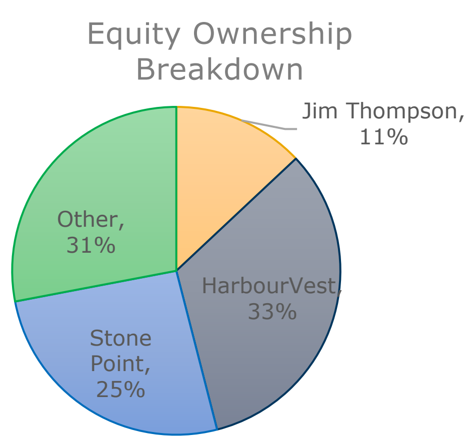
Hospitality
Providing entire capital stack for development of hospitality related projects, including limited and full service hotels

The Company employs a rigorous value investment approach and its industry expertise to targets investments with tax-exempt yields of 5% to 7%. Approximately 90% of PHC's portfolio is either directly originated or purchased in a primary transaction, while roughly 10% is purchased in the secondary market. Secondary trading plays a role in PHC's business strategy both for risk management and profit realization. However, management stated they intend to primarily focus on their core originate-and-hold strategy. The Company's large capital base allows it to be opportunistic when liquidity is scarce and municipal bonds are attractively priced.

Business Risk Management

Ownership

PHC was founded in 2014 by Jim Thompson, the former CEO of ORIX USA for 22 years. Thompson initially capitalized the Company with $100 million of his own wealth and subsequently raised additional equity from leading private equity investors, Stone Point Capital and HarbourVest Partners, in addition to Dallas-based family wealth organizations.



Stone Point Capital, founded in 2005 and headquartered in Greenwich CT with 50 investment professionals, has raised and managed seven private equity funds – the Trident Funds – with aggregate committed capital of over $26 billion. Stone Point owns 25% of the equity.

HarbourVest Partners, LLC is a registered investment advisor under the Investment Advisors Act of 1940 and was founded by Brooks Zug and Ed Kane in 1994. The firm has over $71 billion of assets under management. HarbourVest owns 33% of the equity.

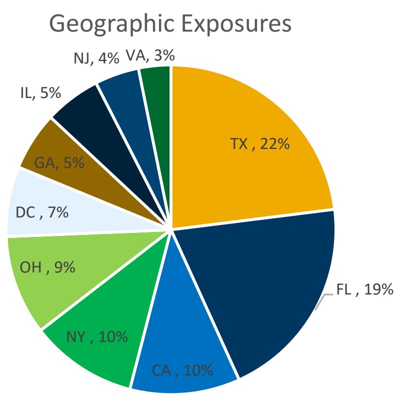
Management Team and Corporate Governance

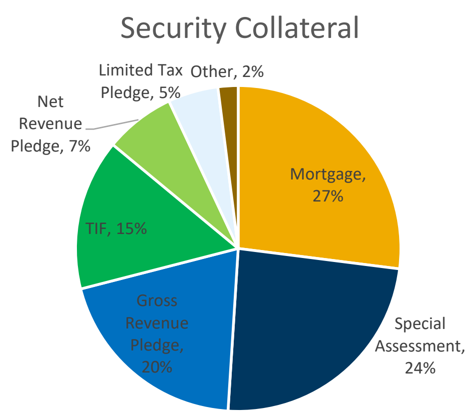
Corporate governance is considered adequate for the size and scope of PHC's business. In addition to Jim Thompson, the Board of Directors has two other voting members - Chris Doody, Managing Director of Stone Point, and Alex Rogers, Managing Director of HarbourVest. PHC's anchor private-equity investors Stone Point Capital and HarbourVest are well-established investment firms managing funds with large capital bases.

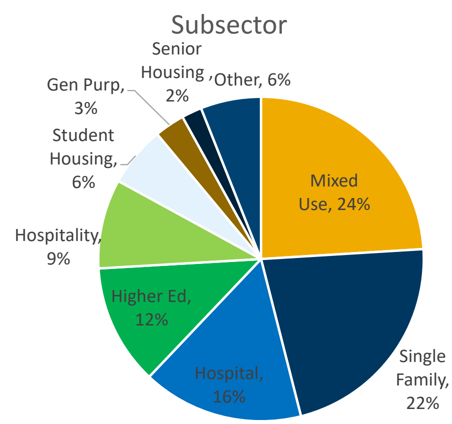
PHC's management team has a long and successful track record in municipal finance, several of whom previously worked together at ORIX USA, the U.S. subsidiary of a publicly traded ORIX, the Tokyo-based international financial services company founded in 1964. Jim Thompson, the Chairman, CEO and founder of PHC brings 42 years of experience in the financial services business. He was previously CEO of ORIX USA for 11 years. Cliff Weiner, the head of fixed income also joined PHC from ORIX USA where he was CEO and president of ORIX Municipal Finance. Paige Deskin, the CFO, was previously with SWK holdings, a specialized finance company and prior to that was Controller of ORIX USA for eight years. John Bills, PHC's Co-CCO, previously served as CCO and Director of CMBS Surveillance for ORIX USA for eleven years. Ramiro Albarran, Co-head of Originations, joined PHC in 2015 and previously led the Municipal and Infrastructure Finance Group at Guggenheim Securities. Joe James joined PHC in 2017 and was named Co-COO. He was previously a partner and head of Asset Management at Frontier Equity. In 2018, PHC hired Charlie Visconsi as Co-Head of Originations He was previously Co-Head of Public Finance at Morgan Stanley from 2012 through 2017.

Portfolio

At 3Q21, PHC's $2.0Bn investment portfolio included 87 credits and was invested in primarily tax-exempt municipal debt with an average yield of 6.5%. The portfolio was diversified by geography with top exposures to Texas (22%), Florida (19%) and California (10%) and no other state accounting for more than 10%. The portfolio is diversified by subsector with the largest collateral exposures to mixed use and single family comprising 24% and 22% of the portfolio, respectively. In recent years, PHC diversified away from real estate exposures by targeting originations in subsectors such as Hospital (16%) and Higher Education (12%). The portfolio has some single credit exposure greater than higher-rated finance companies with the top 5 positions representing 31% of portfolio. These investments include exposures to real estate, hospital and education sectors are well collateralized at moderate loan-to-values and have strict financial covenants. The largest position, Landstar Homes/Avenir, is a residential real estate development in Florida. PHC's exposure to this credit is expected to decrease over the next year by actively selling bonds and by homebuilder lot paydowns. The other top exposures include investments in hospitals and higher education. PHC's overall diversified portfolio and acceptable leverage strategy further mitigates issuer specific risk.

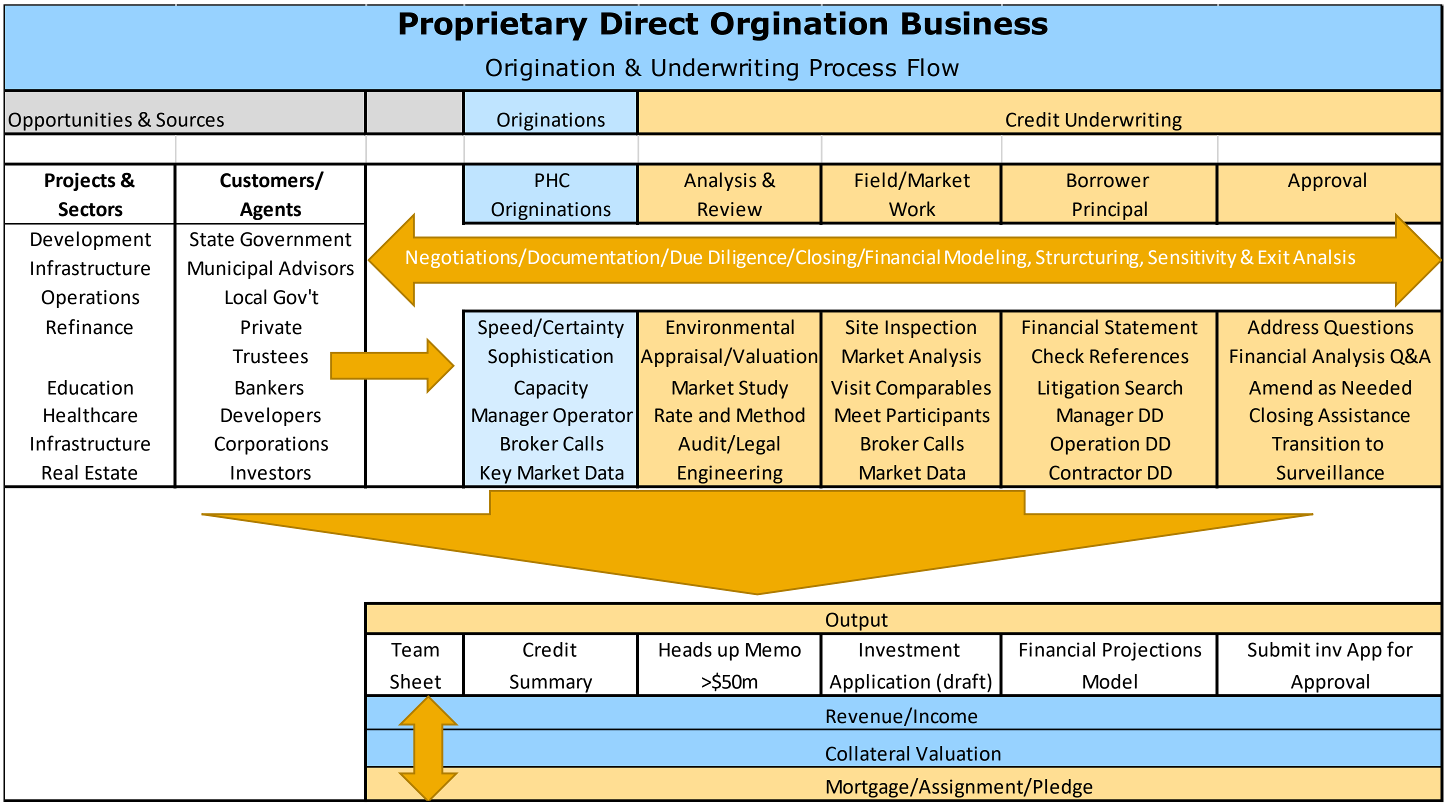






Risk Management

The Company maintains strong underwriting guidelines to support optimal recovery outcomes in cases of default. In most cases, PHC has first lien positions with multiple levels of collateral including real estate, future revenue, contractually pledged senior tax receivables, and reserve funds. The Company has strong surveillance and portfolio risk management systems in place. Individual credits are managed from the origination phase throughout their lifecycle and the portfolio is monitored by sector, subsector, sponsor and geographic region. Credit quality is monitored through financial performance analysis, communications with credit participants, credit migration monitoring and communication between PHC Management. Portfolio valuations are derived from bids from broker-dealers, independent third-party pricing services including ICE and internally developed market valuations when observable pricing is unavailable.



Funding

Recourse Funding - The Company maintains recourse secured financing with two banks – a margin lending facility with MUFG and a securitization TOB trust facility with Deutsche Bank. In a TOB structure, PHC deposits tax-exempt municipal bonds into a trust that then issues senior and subordinated trust certificates. The senior trust A certificates are typically issued in an amount of 60-70% of the bond fair value (LTV) to third party banks or other institutional Qualified Purchaser (defined under the 1940 Act) and Preston Hollow retains the B certificate. The trusts collapse upon maturity or upon exercise of call option embedded in the B certificate held by PHC. In 2020, the company entered into a TOB securitization facility with Deutsche which is a 3-year term facility which is considered more stable than previous short-term TOB financing. The Company also entered into a $13mn total return swap, maturing in November 2021, to attain leverage on a position.

Non-Recourse Funding **-** The Company also securitizes certain municipal bonds in long-term term match trusts (TMTs) with institutional investors providing financing with the purchase of a senior A certificate. TMT borrowings typically match the maturity of the underlying bonds (which typically feature principal amortization) and are non-recourse to PHC. The Company's funding strategy is to use the MUFG and Deutsche facilities as near-term financing and then seek longer term financing through TMTs. The Company has had success expanding its TMT funding, having issued 11 TMTs to multiple investors totaling $819 million par amount ($558 million A Certificate borrowing) as of 3Q21.

TMTs are structured as partnerships to pass through tax-exempt income to a lender. The Trust issues A Certificates to a lender and B Certificates to PHC, with the A Certificates having both payment priority and liquidation priority, but A certificates are non-recourse to PHC. A Certificates feature fixed rates and B Certificates receive residual interest payments. Initial coupons for the A Certificates generally have been fixed for approximately 10 years, with higher coupons thereafter if a refinancing does not occur on/before the coupon step-up date. After step-up dates, if A Certificates are not refinanced, all cash flow is typically used to pay down the A Certificates. Proceeds from bond redemptions or bond sales are used to redeem the A Certificates and B Certificates on a pro rata basis, with the A Certificates maintaining payment priority.

Preston Hollow Funding Sources							
3Q 2021 $mm	Deutsche Bank	MUFG	NA	Various	Unused Available Borrowing*	Outstanding	Term
DB Secured Term Facility (A/B Notes)	400	—	—	—	**250**	**150**	3 years; Oct 2023
Total Return Swap	—	—	13	—	**—**	**13**	Nov-21
Margin Facility (MUFG)	—	150	—	—	**150**	**—**	Matures 2022 but can be terminated annually at option of bank
Term Matched Trusts** (Non-recourse to PHC)	—	—	—	558	**—**	**558**	Various; aligned with underlying bond maturity

**subject to asset eligibility. **Borrowed amount represents A Certificates*

ESG Management

KBRA typically analyzes Environmental, Social, and Governance (ESG) factors through the lens of how issuers plan for and manage relevant ESG risks and opportunities. More information on KBRA's approach to ESG risk management can be found here. Over the medium-term, issuers will need to prioritize ESG risk management and disclosure with the likelihood of expansions in ESG-related regulation and rising investor focus on ESG issues.

Environmental Factors

Environmental factors including climate-related risks are part of the Company's investment considerations. In addition, portfolio diversification by sector and region helps to mitigate the Company's exposure to physical climate risk, such as earthquakes, wildfires, and hurricanes.

Social Factors

The Company is committed to stakeholders with consideration of ESG factors as it relates to its employees and communities in which it invests. The Company focuses on financing projects with the potential to create measurable social impact by addressing local needs and opportunities for community development. It works with prospective borrowers to ensure its financing projects address one or more of the United Nations Sustainable Development Goals: reduced inequalities, sustainable cities and communities, clean water and sanitation, quality education and good health and well being. The Company also uses its proprietary Social Impact Finance Framework to ensure its investments comply with its social impact finance guiding principles, which focus on these United Nations goals and other such goals at the community level, including affordable basic infrastructure and housing, access to essential services, and employment generation, among others.

Governance Factors

KBRA focuses on the impact of the risk management framework and corporate governance on the company and notes that PHC has adequate risk governance with respect to ESG management. The governance framework is supported by an experienced and deep management team, comprehensive underwriting and risk management process and a track record of meaningful improvements in the communities and developments in which the company invests. An inter-departmental committee of senior managers oversees selection, evaluation and monitoring of all projects and the investment portfolio is reviewed regularly by the Committee for compliance.

Economic and Operational Risk

The company is exposed to a US economic recession and regulatory changes that effect the municipal market. A dramatic change in the tax-exempt status of municipal debt could have a materially negative effect on PHC's investments, however KBRA views this risk as unlikely, particularly since tax-exempt status for municipal bonds has existed since 1917 and was unchanged under the U.S. Tax Cuts and Jobs Act passed in December 2017.

A portion of PHC's investments are exposed to the real estate market and bear the risk of local economic downturns. In addition, the Company faces potential declines in portfolio net asset value due to quarterly fair valuation of investments which could be driven by single issuer, sector and regionally specific economic challenges in addition to interest rate fluctuations. These risks are mitigated by geographic, sector and credit diversification, priority liens, strong covenants, ongoing risk management and low leverage use. PHC hedges a portion of its interest rate risks using treasury shorts, caps, and swaps.

The Company's surveillance and portfolio risk management processes are considered robust. The portfolio is monitored by sector, subsector and sponsor as well as geographically. Individual credits are managed from the origination phase throughout their lifecycle. Credit quality is monitored through financial metrics, communication with credit participants, credit migration monitoring, communication with PHC management and the capital markets team.

Effects of U.S. Tax Cuts and Jobs Act

While many tax exemptions were eliminated or capped, the municipal bond-interest tax exemption remained unchanged. One change effected by the Act was the elimination of advanced-refunding bonds, meaning that muni issuers are no longer able to refinance outstanding bonds at lower interest rates prior to a bond's actual call date. Since advanced refunding will not be an option, some issuers may want shorter calls, such as five years, instead of the current standard of 10 years, because they might want flexibility if yields move lower. KBRA does not view this change as having a material impact on the quality of PHC's portfolio.

Key Quantitative Rating Determinants

Profitability

Net interest income has comprised the majority of PHC's revenue and is expected to remain the largest contributor, providing a good indicator of core earnings. Net interest income steadily increased as the firm grew its portfolio and net interest income-to-average assets been relatively stable. The Company has also realized strong gains on sale since inception which drives a material portion of revenues. In 2020, revenue from net gains on sales including securities and real estate represented 28% of total revenue driven by profitable gains on certain positions. PHC has kept operating expenses relatively low; Operating expense as percentage of average assets was 1.13% in 2020. KBRA notes that the majority of PHC's investments are fair valued quarterly which could cause fluctuations in earnings, however, annual unrealized gains have generally been positive since inception.

Profitability Metrics

($mm)	2017	2018	2019	2020	YTD 9/30/21
Net Interest Income	64.1	86.3	101.6	101.1	68.9
Interest Expense	8.5	14.7	23.2	19.2	15.7
Net gains on sales	25.0	39.8	45.2	28.8	56.6
Total Revenue	95.3	129.9	140.4	121.4	131.4
EBIT	88.2	122.8	137.3	107.7	122.7
Net Income	79.7	108.1	114.1	88.4	107.0
Average Assets	1,079.4	1,528.4	1,907.2	2,057.9	2,169.4
Average Total Equity	800.0	1,081.1	1,361.6	1,548.8	1,561.0
Net Income / Average Assets	7.4%	7.2%	6.0%	4.3%	6.6%
EBIT/Average Assets	8.2%	8.0%	7.2%	5.2%	7.5%
EBITDA/Interest Expense	10.3x	8.4x	5.9x	5.6x	7.8x
NII/Total Revenue	67%	66%	72%	83%	52%
NII/Avg. Assets	5.9%	5.6%	5.3%	4.9%	4.2%
NII/Avg. Equity	10.5%	9.2%	8.3%	6.9%	5.9%
Pre-tax ROAE	10.0%	10.2%	8.4%	5.7%	9.1%

YTD ratios annualized. Source: PHC Audited Financials

Liquidity

Liquidity is considered adequate at $480 million as of 9/30/21 comprised of $400 million undrawn available borrowing (subject to asset availability) and $172 million in cash. In addition, the Company had $1.4Bn of unencumbered investment assets as of 9/30/21 including $324 million TMT B certificates. The Company intends to moderately increase leverage through secured TMT borrowing so available liquidity and unencumbered assets may decline but are expected to remain adequate given low overall leverage use. The Company has no outstanding TMT debt maturing in the next two years; the DB facility matures in 2023 and the MUFG facility matures in 2022. PHC is focused on borrowing primarily through long-term TMTs which is considered a stable source of funding with limited refinancing risk given it is non-recourse to PHC and collateral maturities are typically matched with TMT maturities.

Capital Adequacy

The capital base is considered strong with total equity capital of $1.52Bn at 9/30/21, comprised of $1.0Bn in contributed investor capital as well as investment income and reinvested dividends. Recourse Debt-to-Equity (which excludes non-recourse TMTs) was 0.11x as of 9/30/21. As PHC's committed capital has been deployed, the firm plans to use borrowing to grow the portfolio, increasing Recourse Debt-to-Equity to a 1.0x target, while Total Debt-to-Equity is not expected to exceed 2x. KBRA views this leverage level as appropriate for PHC's asset quality. The Board of Directors determine the annual dividend payout annually. While unit holders may elect to take full distribution in cash, the majority of holders have reinvested their dividends in years past. There are no agreements in place that permit investors to redeem capital at will. Dividend reinvestment was minimal in 2020 compared to 50% in prior years and the Company distributed relatively high dividends of $92 million in 2020 (73% of revenues).

Capital Adequacy

($mm)	2017	2018	2019	2020	YTD 9/30/21
Recourse Borrowings	301.7	467.0	157.1	163.0	163.1
Non-recourse Borrowings (TMT A certificates)	-	95.5	333.2	330.8	554.6
Total Debt	301.7	562.5	490.4	493.8	717.7
TMT B Certificates	-	40.8	170.9	157.8	264.6
Total Equity	975.0	1,186.0	1,536.0	1,559.7	1,517.3
Total Debt/Equity (x)	0.31x	0.47x	0.32x	0.32x	0.47x
Recourse Debt/Equity* (x)	0.31x	0.41x	0.12x	0.12x	0.13x
Total Debt/EBITDA (x)	3.42x	4.58x	3.57x	4.59x	4.39x
Recourse Debt/EBITDA* (x)	3.42x	3.80x	1.14x	1.51x	1.00x
Secured Debt/Total Assets	23.4%	31.8%	24.0%	23.9%	31.6%

*excludes TMTs. EBITDA reflects year-to-date annualized.

Asset Quality

PHC has demonstrated strong underwriting with low non-accruals, low impairments and successful workouts of distressed credits since inception and through the Covid-19 pandemic. The COVID impact on PHC's portfolio has been modest. During 2020, three assets were put on non-accrual status representing 3.6% of total portfolio market value and non-accruals declined to 1% as of 3Q21. PHC places a loan or bond on non-accrual status when the full and timely collection of interest or principal becomes uncertain. The Company has had one impairment since inception, recognized in 2020, representing 0.5% of the portfolio. Given the strong level of capital (low leverage) it is expected that a modest level of additional impairments would be manageable. In addition, PHC has generated significant gains on sale of positions since inception and unrealized portfolio gains have grown from $36 million at 2017 to $156 million at 3Q21. Stable asset quality metrics are underpinned by a diversified portfolio in primarily senior secured investments and strong underwriting standards.

Portfolio Performance (% of Portfolio)	2017	2018	2019	2020	1Q 2021	2Q 2021	3Q 2021
Non-accrual	1%	2%	2%	2%	2%	1%	1%
Real Estate Owned (REO)	0%	0%	0%	2%	4%	5%	1%
Non-accrual + REO	1%	2%	2%	5%	6%	6%	2%
Impairment	0.0%	0.0%	0.0%	0.5%	0.0%	0.0%	0.0%

Source: PHC