CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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October 3, 2011

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: File 11-1034, Item 22 of the October 4, 2011 Board of Supervisors Calendar

The proposed resolution would (a) approve a New Market Tax Credit indemnification agreement between the City, the San Francisco Community Investment Fund and U. S. Bancorp Community Development Corporation (U.S. Bancorp).

Item 22 File 11-1034	Department(s): San Francisco Redevelopment Agency (SFRA) Office of Economic and Workforce Development (OEWD)

EXECUTIVE SUMMARY

Legislative Objective

- The proposed resolution would (a) approve a New Market Tax Credit indemnification agreement between the City, the San Francisco Community Investment Fund and U. S. Bancorp Community Development Corporation (U.S. Bancorp) in connection with the investment by U.S. Bancorp of $11,104,275 for the new SF Jazz Building at 205 Franklin Street, and (b) make findings under the California Environmental Quality Act (CEQA).

Fiscal Impact

- The San Francisco Community Investment Fund (SFCIF), a nonprofit organization created by the SFRA and OEWD, was allocated $15,000,000 of 2010 New Market Tax Credits for the SF Jazz Center project, which is part of an overall $40,675,000 New Market Tax Credits allocated to the SF Jazz Center project. The overall $40,675,000 of New Market Tax Credits includes (a) $7,625,000 from the Northern California Community Loan Fund (NCCLF), (b) $5,000,000 from the Nonprofit Facilities Fund (NFF), (c) $13,050,000 from Clearinghouse CDFI, and (d) the subject $15,000,000 from the SFCIF.
- Because (a) every $1 of Federal tax credit allocation equals approximately $.39 in actual tax credits on a potential investor's annual Federal Income Tax Return, and (b) the tax credits are further discounted to present value because the credit is over a seven-year period, the total $40,675,000 New Market Tax Credits is discounted to approximately $11,104,275 for the SF Jazz Center project.
- Under the proposed subject indemnification agreement, the City and the San Francisco Community Investment Fund would indemnify U. S. Bancorp as a result of the City's and SFCIF's actions in four circumstances: (1) failure of SFCIF to maintain specified requirements, which has a negotiated $5 million liability cap, (2) failure to commit at least 85 percent of tax credit funds to the project, (3) failure to maintain funds in the project, which also has a negotiated $5 million liability cap, and (4) fraud or gross negligence, which is estimated have a maximum $7.2 million liability for the City.

Policy Considerations

- Mr. Stephen Maduli-Williams of the SFRA advises that the proposed indemnification agreement's risk to the City and the San Francisco Community Investment Fund is small because (a) since the creation of the New Market Tax Credit Program approximately 11 years ago, there has never been a recapture of New Market Tax Credits for any reason, (b) the City would not be liable for any reason other than the four specific circumstances identified above, and (c) all of these four specific circumstances are within the reasonable control of the SFCIF to prevent or remedy.

Recommendations

- Amend the proposed resolution by adding on page 5, line 6: "Further Resolved, that the proposed Indemnification Agreement is limited to U. S. Bancorp Community Development Corporation's purchase of $15,000,000 of New Market Tax Credits from SFCIF and not from the purchase of New Market Tax Credits from other community development entities; and be it".

- Approval of the proposed resolution, as amended, is a policy decision for the Board of Supervisors.

MANDATE STATEMENT & BACKGROUND

Mandate Statement

According to San Francisco Charter Section 9.118, any agreement with a term of over ten years or expenditures of over $10,000,000 is subject to approval by the Board of Supervisors.

Background

On November 29, 1999, the SF Jazz Organization was created, as a nonprofit organization, to promote jazz concerts, programs and education in the Bay Area. The SF Jazz Organization is currently endeavoring to construct a new $55,818,375 SF Jazz Center. The $55,818,375 Sources and Uses of Funds for the SF Jazz Center project are summarized in the Attachment provided by Mr. Stephen Maduli-Williams, the Deputy Executive Director of Community and Economic Development for the San Francisco Redevelopment Agency (SFRA). The new SF Jazz Center, to be located at 205 Franklin Street, on the corner of Franklin and Fell Streets, would include an approximately 50,000 square foot state-of-the-art facility for holding jazz concerts, and education and other support events, with the provision of multiple stages, seating areas, classrooms and administrative offices. The SF Jazz Organization has already obtained all required City permits, and demolished the previous auto repair and smog inspection shop at 205 Franklin Street, graded the site, and driven in supporting piles. Construction of the new SF Jazz Center is anticipated to commence upon approval of the proposed indemnification agreement and separate related financing agreements, and be completed in approximately one year, or by October of 2012.

On February 2, 2010, the SFRA began working with the City's Office of Economic and Workforce Development (OEWD) to form a nonprofit organization, to apply for and disburse New Market Tax Credits[1] to eligible community development projects in San Francisco. On February 18, 2010, pursuant to the laws of the State of California, the SFRA Director created the San Francisco Community Investment Fund (SFCIF), a nonprofit organization[2], to apply for San Francisco's New Market Tax Credits from the U. S. Treasury. The San Francisco Community Investment Fund's purpose is to provide investment funds for projects in low-income communities, such that the San Francisco Community Investment Fund will transfer the capital funds it receives from selling the

[1] New Market Tax Credits (NMTC) are administered by the Community Development Financial Institutions Fund, which is a branch of the United States Department of the Treasury. The NMTC Program is designed to attract private investors by granting tax credits against Federal Income taxes due, in order to provide private capital investment for community development projects that would not otherwise be completed.

[2] The San Francisco Community Investment Fund is administered by a five-member Board of Directors, with staff support provided by the SFRA. The five-member Board of Directors is comprised of Mr. Fred Blackwell, the SFRA's Executive Director, Ms. Amy Brown, the Acting City Administrator, Ms. Jennifer Matz, the Director of the OEWD, Mr. Brian Strong, the Director of Capital Planning and Ms. Nadia Sesay, the City's Public Finance Director.

New Market Tax Credits and then loan those capital investment funds to qualified projects in low-income communities.

In February of 2011, the SFCIF was awarded $35,000,000 of 2010 New Market Tax Credits by the Community Development Financial Institution Fund of the U.S. Treasury. Such tax credits must be fully used on eligible projects by no later than September 30, 2013. Of the $35,000,000 total New Market Tax Credits awarded, $15,000,000 was reserved for the SF Jazz Project, with the balance of $20,000,000 of New Market Tax Credits allocated to (a) a June, 2011 $8,700,000 US Bancorp transaction related to an existing 13,000 square foot building project for a College Track tutoring facility in the Bayview District; and (b) a potential $11,300,000 application for a Mission Bay project related to Family House, a nonprofit organization, for families of children at UC-San Francisco Hospital.

U.S. Bancorp Community Development Corporation (U.S. Bancorp) is the entity that purchased New Market Tax Credits for the College Track transaction and is proposed to purchase the entire $35,000,000 of New Market Tax Credits allocated from the SFCIF. These New Market Tax Credits can then be applied as a credit against the U.S. Bancorp's corporate income taxes which would otherwise be owed to the Federal Internal Revenue Service (IRS). In order to purchase these New Market Tax Credits, U.S. Bancorp is requiring that the City and the San Francisco Community Investment Fund[3] enter into an indemnification agreement to cover specified losses that could be suffered by U.S. Bancorp as a result of purchasing these tax credits, based on four potential negative actions by the City and/or the SFCIF.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (a) approve a New Market Tax Credit indemnification agreement between the City, the San Francisco Community Investment Fund (SFCIF) and U. S. Bancorp Community Development Corporation in connection with U.S. Bancorp's investment of $11,104,275 for the new SF Jazz Building at 205 Franklin Street, and (b) make findings under the California Environmental Quality Act (CEQA). A final mitigated negative declaration was certified by the Planning Commission on July 15, 2010, in compliance with CEQA, and the proposed resolution incorporates those CEQA findings.

According to Mr. Maduli-Williams, the proposed New Market Tax Credit indemnification agreement would indemnify U.S. Bancorp for its purchase from the SFCIF of the $15,000,000 of SF Jazz Center project tax credits, in the event that the U.S. Internal Revenue Service (IRS) were to determine in the future that the SF Jazz Center project is not eligible for these tax credits, such that U.S. Bancorp would be required to pay additional Federal Income taxes, interest and penalties. According to Mr. Charles Sullivan of the City Attorney's Office, the proposed indemnification agreement

[3] Both the SFCIF as well as the subsidiary of the SFCIF that is assigned to this specific transaction for the SF Jazz project, namely SFCIF Sub-CDE 2, will be parties to the proposed indemnification agreement.

indemnifies U.S. Bancorp against specific negative actions by the City and/or SFCIF. The proposed indemnification agreement would extend for at least seven years, from October 11, 2011 through October 10, 2018 and will terminate when the IRS can no longer assess tax liability against U.S. Bancorp for the use of the New Market Tax Credits.

Mr. Maduli-Williams advises that the proposed indemnification agreement must be approved by the Board of Supervisors, prior to the October 11, 2011 closing date because the tax credits secured by two of the other parties[4] involved in the overall SF Jazz Center transaction will otherwise expire. Mr. Maduli-Williams advises that if these other tax credits expire, the overall financing for the SF Jazz Center would be significantly delayed and potentially jeopardized.

On September 28, 2011, the Budget and Finance Committee considered the proposed resolution and sent it to the full Board of Supervisors, without recommendation. The proposed resolution will be considered by the full Board of Supervisors on October 4, 2011.

FISCAL IMPACTS

As noted above, the SFCIF was allocated $15,000,000 of New Market Tax Credits by the Community Development Financial Institution Fund of the U.S. Treasury for the SF Jazz Project. As shown in the Attachment, the $15,000,000 of New Market Tax Credits from the San Francisco Community Investment Fund (SFCIF) is part of an overall total of $40,675,000 of New Market Tax Credits allocated to the SF Jazz Center project by four Community Development Entities. The four Community Development Entities total $40,675,000 allocation of New Market Tax Credits includes (a) $7,625,000 from the Northern California Community Loan Fund (NCCLF), (b) $5,000,000 from the Nonprofit Facilities Fund (NFF), (c) $13,050,000 from the Community Development Financial Institutions (CDFI) Clearinghouse, and (d) the subject $15,000,000 from the SFCIF.

However, because (a) every $1 of Federal tax credit allocation equals approximately $.39 in actual tax credits on a potential investor's annual Federal tax return, and (b) the tax credits are further discounted to present value because the credit is spread over a seven-year period, Mr. Maduli-Williams advises that the total $40,675,000 of New Market Tax Credits is discounted to approximately $11,104,000 of cash for the project, as also shown in the Attachment.

Similarly, the $15,000,000 of New Market Tax Credits, which are the subject of the proposed indemnification agreement, are discounted to equal approximately $4,095,000.

[4] There are a total of four Community Development Entities involved in this SF Jazz Center project that are providing New Market Tax Credits totaling $40,675,000. The two other parties that are in jeopardy of losing their tax credits allocated to the SF Jazz Center project are the Community Development Financial Institutions (CDFI) Clearinghouse, which has $13,050,000 of tax credits, and the Nonprofit Facilities Fund, which has $5,000,000 of tax credits.

According to Mr. Maduli-Williams, each of the other three entities involved in these tax credits are entering into their own indemnification agreements with U.S. Bancorp. However, the Budget and Legislative Analyst notes that the proposed resolution does not specifically limit the indemnification agreement to either the $15,000,000 of New Market Tax Credits, or the discounted amount of approximately $4,095,000. Rather, as noted in the title of the proposed resolution, the proposed indemnification agreement is in connection with U.S. Bancorp's total discounted investment of $11,104,275 for the new SF Jazz Building at 205 Franklin Street, which reflects the amount contributed by all four Community Development Entities.

Therefore, the Budget and Legislative Analyst recommends that the proposed resolution be amended to clarify that the proposed agreement to indemnify U.S. Bancorp is limited to the $15,000,000 of New Market Tax Credits allocated by the SFCIF by adding the following new text on page 5, line 6:

> "Further Resolved, that the proposed Indemnification Agreement is limited to U.S. Bancorp Community Development Corporation's purchase of $15,000,000 of New Market Tax Credits from SFCIF and not from the purchase of New Market Tax Credits from other community development entities; and be it"

Under the proposed subject indemnification agreement, the City and the San Francisco Community Investment Fund would indemnify U. S. Bancorp if the IRS recaptured the New Market Tax Credits purchased by U.S. Bancorp from the SFCIF as a result of one of the four circumstances, which are identified below, including a brief summary of each of the estimated financial exposures for the City:

1. Failure to Maintain Requirements – this could occur if the SFCIF fails to remain in good standing with the New Market Tax Credits Program and applicable IRS requirements, in accordance with the San Francisco Community Investment Fund's (Community Development Entity) operating agreement. Mr. Maduli-Williams advises that the San Francisco Community Investment Fund negotiated a maximum $5,000,000 financial limitation on the City's liability to cover this provision under the proposed indemnification agreement.

2. Failure to Commit At Least 85 Percent of Funds – according to specified Federal Internal Revenue Service rules, the San Francisco Community Investment Fund is currently required to place 85 percent of the New Market Tax Credit funds that it receives into the SF Jazz Center project. According to the financial forecasts for the SF Jazz Center project, the SFCIF is currently proposing to put $14,625,000 of the total estimated $15,000,000, or 97.5 percent of the New Market Tax Credit funds into the SF Jazz Center project, with the remaining $375,000 ($15,000,000 less $14,625,000) proposed to fund permissible fees and related expenses.

3. Failure to Maintain Funds in Project – according to Federal Internal Revenue Service rules, all of the required New Market Tax Credit funds must remain in the

project, or other eligible project, for the entire seven-year compliance period, or through October 10, 2018. Therefore, no distributions of New Market Tax Credit funds that are committed to the SF Jazz Center project may be made to either U.S. Bancorp or to the SFCIF for the duration of the seven-year period. Mr. Maduli-Williams confirms that the SFCIF also negotiated a maximum $5,000,000 financial limitation on the City's liability to cover this Failure to Maintain Funds in Project provision under the proposed indemnification agreement.

4. Fraud or Gross Negligence – This pertains to any criminal acts, such as fraud, malfeasance, material misrepresentation, willful misconduct, which are committed intentionally or through gross negligence by the SFCIF. Under the proposed indemnification agreement, there would be no financial limitation on the City's liability to cover this provision. However, based on tax liability estimates conducted by the accounting firm of Novogradac and Company, retained by the SFRA, the estimated maximum loss to the City would be $7.2 million. Mr. Sullivan concurs with this maximum potential loss to the City.

Mr. Maduli-Williams advises that other than for the Fraud or Gross Negligence circumstance, the IRS will provide notice and allow up to 12 months to cure or correct any specified deficiency. If there is no timely cure or correction within the 12-month period, Mr. Maduli-Williams advises that the San Francisco Community Investment Fund is currently negotiating with US Bancorp to first seek recovery from the SF Jazz Organization, before seeking recovery from the San Francisco Community Investment Fund or lastly, from the City. Such negotiations have not yet been completed as of the writing of this report.

Given that the SFCIF currently receives a two percent transaction fee from each New Market Tax Credit allocation, the SFCIF received $700,000 from the $35,000,000 2010 allocation. In addition, future annual New Market Tax Credit allocations will result in further transaction fees being received to the SFCIF. If necessary, these SFCIF transaction fees would potentially be available for funding a potential financial recovery from U.S. Bancorp.

POLICY CONSIDERATIONS

As noted above, in June of 2011, the SFCIF completed a transaction with U.S. Bancorp investing approximately $8,700,000 of New Market Tax Credits for the rehabilitation of an existing 13,000 square foot facility at 3rd Street at Jerrold Avenue in the Bayview District for use as a College Track tutoring facility for inner-City youth. As part of that transaction, the SFRA, without the City's required participation, entered into an indemnification agreement with U.S. Bancorp that is similar to the proposed indemnification agreement, between the SFCIF and U.S. Bancorp, which now does require the City's participation. Therefore, the previous indemnification agreement, which did not require the City's participation, was not subject to Board of Supervisors approval.

However, in the FY 2011-2012 State budget, Governor Brown proposed to terminate Redevelopment Agencies Statewide. Currently, the California Redevelopment Agency Association is pursuing litigation to stop Governor Brown's proposal, such that the courts recently issued a stay of that proposal until January of 2012. However, as a result of that termination proposal, the SFRA is currently prohibited from entering into any contracts or financial commitments, such that the SFRA cannot be a party to the proposed indemnification agreement.

According to Mr. Maduli-Williams, the risk to the City and the SFCIF is remote under the proposed indemnification agreement because since the creation of the New Market Tax Credits Program approximately 11 years ago, there has never been a recapture of New Market Tax Credits for any reason. Furthermore, Mr. Maduli-Williams advises that if a problem were to arise for any reason other than the four specific provisions explained above to indemnify U.S. Bancorp, the City would not be liable under the proposed indemnification agreement. In addition, Mr. Maduli-Williams advises that all of the four indemnification provisions listed above are within the reasonable control of the SFCIF to prevent, which provides additional security to the City, that the SFCIF could remedy these circumstances. With respect to the risk to the City and to the SFCIF, Mr. Sullivan defers to the opinion of Mr. Maduli-Williams.

The proposed resolution states that the SFCIF, together with the three other Community Development Entities that are providing New Market Tax Credits, have entered into a separate Community Benefits Agreement with the San Francisco Jazz Organization to provide additional community benefits. For example, in accordance with this Community Benefits Agreement, (a) construction of the new SF Jazz Center project is specified to generate 95 new prevailing wage construction jobs, (b) when completed, the SF Jazz Center would generate an additional 25 permanent prevailing wage jobs, and (c) the SF Jazz Center will provide free and low-cost performances, create middle school programs, conduct additional outreach and create business linkages to the community. In addition, based on negotiations completed within the last week, Mr. Maduli-Williams advises that the separate Community Benefits Agreement includes (a) hiring goals of 50 percent of all new construction jobs initially targeted to residents of the Fillmore (Zip Code 94115), then to other San Francisco low-income communities and then to the overall City of San Francisco, and (b) the SF Jazz Organization has agreed to place $420,000 in a separate reserve account to guarantee the commitments included in the separate Community Benefits Agreement.

RECOMMENDATIONS

1. Amend the proposed resolution to clarify that the proposed indemnification agreement is limited to the $15,000,000 of New Market Tax Credits allocated to the SF Jazz Center project by the San Francisco Community Investment Fund by adding on page 5, line 6:

"Further Resolved, that the proposed Indemnification Agreement is limited to U. S. Bancorp Community Development Corporation's purchase of $15,000,000 of New Market Tax Credits from SFCIF and not from the purchase of New Market Tax Credits from other community development entities; and be it"

2. Approval of the proposed resolution, as amended, is a policy decision for the Board of Supervisors.

Harvey M. Rose

cc: Supervisor Chu
Supervisor Mirkarimi
Supervisor Kim
President Chiu
Supervisor Avalos
Supervisor Campos
Supervisor Cohen
Supervisor Elsbernd
Supervisor Farrell
Supervisor Mar
Supervisor Wiener
Clerk of the Board
Cheryl Adams
Controller
Rick Wilson

SFJAZZ CENTER

SOURCES AND USES OF FUNDS

LAND/BUILDING COST			**6,514,744**
HARD COSTS (including contingency)			**32,771,985**
General Construction			
HDDCO Construction Contract		31,059,115	
Preconstruction Services		65,841	
Construction Contingency	5.3%	1,647,029	
SOFT COSTS (including contingency)			**12,050,271**
FINANCING COSTS			**198,000**
TOTAL PROJECT COST BEFORE NMTC FINANCING COSTS			**51,535,000**

				CDE FEE STRUCTURE		
				Up Front	**Annual**	**Exit**
NMTC FINANCING COSTS			**4,283,375**			
NMTC Allocation/QEI	**40,675,000**					
SFCIF	15,000,000			2.5%	0.5%	0.0%
NCCLF	7,625,000			3.0%	0.5%	0.0%
NFF	5,000,000			2.5%	0.4%	2.0%
Clearinghouse CDFI	13,050,000			2.0%	0.5%	0.2%

	NMTC Legal/Consultant Costs Paid by QALICB	2.9%	**1,180,000**	
	Legal Fees	400,000		
	Accountant Fee for Model	25,000		
3.00%	SFCIF Consultant Fees	450,000		
0.75%	NMTC Consulting Fees	305,000		
	NMTC Fees to CDEs and Investor		**3,103,375**	
2.43%	Up Front CDE Fees - Percent of QEI	989,750		
0.49%	Asset Management Fees - Percent of QEI	1,388,625		
	CDE Tax and Audit - 4 CDEs, Fund, QALICB	600,000		
	Exit Fees	125,000		
	TOTAL PROJECT COST INCLUDING NMTC COSTS			**55,818,375**

TOTAL FINANCING SOURCES			
SFJAZZ Costs Incurred to Date and Cash at Closing			**29,571,000**
Land/Building Acquisition Cost Incurred		6,514,744	
Soft Costs Incurred		8,030,208	
USBCDC Contribution to Legal Fees		75,000	
Cash/Campaign Funds Available at Closing		15,026,048	
New Market Tax Credit Equity			**11,104,000**
Total NMTC Equity Investment	27.30%	11,104,000	
NMTC Equity Pricing	$0.70		
Total NMTC Financing (QEI)			40,675,000
Funding Required Outside of NMTC Financing			**15,143,375**
TOTAL SOURCES OF FUNDS			**55,818,375**
Funding Required Outside of NMTC Financing			**15,068,375**
Balance of Cash Available from Capital Campaign			4,522,221
Construction/Bridge Loan on Balance of Capital Campaign			10,546,154