



presents

Public-Private Partnerships for Real Estate Development: Contract Negotiation Strategies

Allocating and Mitigating Developer and Contractor Risks in PPP Deals

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Wednesday, April 7, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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Public Private Partnerships

Allocating and Mitigating Developer and Contractor Risks in PPP Deals

Wednesday, April 7, 2010
1:00 p.m. Right Coast
10:00 a.m. Left Coast

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> Antitrust > Global Litigation > Intellectual Property

Introduction

- The demand for public facilities and infrastructure has increased as the nation's population has increased.
- However, the ability of government to pay for these facilities and infrastructure has not kept pace.
- Accordingly, cash-strapped state and local governments turn to the private sector for financing, design, construction, maintenance and operation of new facilities and infrastructure projects.

Public-Private-Partnerships

- These arrangements between governmental entities and private entities are currently referred to as “public-private-partnerships” (PPPs or P3s) or sometimes “private finance initiatives” (PFIs).
- While the nomenclature is new, the concept is not.

Lease and Lease-Back

- California local governments have used lease and lease-back transactions for at least half a century.
- In the typical lease and lease-back transaction, the government entity owns a parcel of land that it leases to a private entity.
- The private entity then builds a facility on that land and leases the land (improved with the facility) back to the governmental entity.
- A notable example is the Dorothy Chandler Pavilion in Los Angeles. (*See County of Los Angeles v. Nesvig* (1965) 231 Cal.App.2d 603.)

The Canadian Experience

- Many successful PPPs have been done in Europe.
- The Canadian province of British Columbia has embraced the concept, creating a new organization “Partnerships British Columbia” (PBC) to advance PPPs.
- (PBC purports to be a private company, but it is wholly owned by the British Columbia Ministry of Finance.)
- Several states are attempting to emulate the British Columbia experience.

Recent California Legislation

- From the Infrastructure Advisory Commission Website:

“After decades of underinvestment, traditional funding and delivery methods cannot keep pace with California’s growing demand. Effective May 21, 2009, California law allows public agencies to partner with the private sector in creating innovative solutions to California’s vast transportation infrastructure needs.

Recent California Legislation

- Senate Bill X2 4 authorizes the California Department of Transportation (Caltrans) and regional transportation agencies to enter into public-private partnership (P3) arrangements that may include private sector finance, design, construction, maintenance, and operation of transportation facilities.

Recent California Legislation

- The Public Infrastructure Advisory Commission is a new auxiliary unit of the Business, Transportation and Housing Agency. In addition to reviewing proposed P3 agreements, the Commission will assist transportation agencies by: helping to identify suitable P3 opportunities, researching and analyzing P3 projects around the world, assembling a library of best practices and lessons learned, and providing advice and procurement-related services upon request.”

Recent California Legislation

- This “library of best practices and lessons learned” can be found at:

www.publicinfrastructure.ca.gov

Potential Benefits of PPPs

- The principal benefit to the governmental entity is that it obtains use of the facility or infrastructure without having to make a large initial capital outlay or incur additional bonded indebtedness.
- However, credit-rating agencies have begun to view some PPP projects as off-book financing (a la Enron) and treat the PPP debt as government debt. This could result in lowering the governmental entity's credit rating, which could lead to higher interest costs – on all of the entity's debt.

Potential Benefits of PPPs

- Another potential benefit is that the PPP will often be more efficient than the traditional method of acquiring and operating facilities or infrastructure.

Risks of PPPs

- Higher Costs
- While PPPs may make it possible to bring an infrastructure project on line years earlier than under conventional government bond-funded approaches, a PPP in the United States may cost more in the long run.
- Tax-Free Government Bonds vs Taxable Private Bonds:
 - The interest paid on most state and local government bonds is exempt from federal income taxes and often from state personal income taxes as well.
- On the other hand, private entity debt usually is fully taxable, so the private entity typically must pay a higher interest rate than would a public entity. For the deal to make sense, the public entity (or the users) eventually must reimburse the private entity for this higher cost of debt through higher user fees.

Risks of PPPs

- Higher Costs

- The cost comparison between tax-free government debt and taxable private debt may be impacted by the American Resource and Recovery Act of 2009 (aka ARRA or “Stimulus”) which authorizes state and local governments to issue new financial instruments called “Build America Bonds.” (ARRA, Division B, Section 1531(a).)

The Void Contract Rule

- The basic capacity of a governmental entity to enter into a contract is limited by the mode of contracting prescribed by applicable law.
- Contracts not made in accordance with the prescribed mode are void *ab initio* (from the beginning). They cannot be ratified.
- Further, there is ordinarily no recovery in *quasi* contract or quantum meruit for work performed under a void contract.
- *Los Angeles Dredging Co. v. City of Long Beach*, 210 Cal.348, 353 (1930).

The Void Contract Rule (continued)

- A void contract is problematic.
- The governmental entity is left with an uncompleted project.
- The contractor will not recover its out-of-pocket expenses.

First Street Plaza Partners (a PPP Horror Story)

- Tom Bradley served as mayor of Los Angeles from 1973 to 1993. In 1986, the city decided that it needed additional office space for city employees. In 1987, the city's Chief Administrative Officer issued an RFP to developers for a project to be called "First Street North," consisting of an office tower for the city's use plus commercial, residential, community and retail space to be built on 11 acres of city-owned land between the Civic Center and Little Tokyo. In 1988, the city council entertained proposals from three developers and authorized the CAO to enter into exclusive negotiations with First Street Plaza Partners for development of the site.

First Street Plaza Partners

- Over the next several years, the developers expended more than \$12 million on environmental impact reports and other land use and environmental review procedures.
- On July 31, 1993, Tom Bradley was succeeded by Richard Riordan, and in 1994 the city decided not to go forward with the project and terminated negotiations with FSPP.

First Street Plaza Partners

- FSPP sued to recover out-of-pocket expenditures of \$12 million.
- The trial court granted summary judgment in favor of the city on the grounds that the contract formation requirements of the city's charter had not been satisfied.
- The Court of Appeal affirmed.
- *First Street Plaza Partners v. City of Los Angeles*, 65 Cal.App.4th 650 (1998).

First Street Plaza Partners

- The appellate court made some suggestions:

“The instant case seems largely the product of size and complexity coupled with the modern phenomenon of ‘**public-private partnerships.**’ Given the current terms of the charter, it may be that “public-private” projects of this magnitude can only be safely undertaken by a sequence of contracts, with each successive contract protecting a party in plaintiff’s position, or by a contract containing conditions subsequent or dispute resolution methods by which undecided issues will later be decided. These approaches might be cumbersome, but the alternative is the course followed here: extensive expenditure before contract resulting in exposure to significant loss in the event of ultimate failure of the contract negotiations.”

First Street Plaza Partners

- The court makes some good points:
- In the typical PPP, the private entity (or its lenders) shell out money up front, and then recoup this investment over the life of the project in the form of user fees, tolls, rent, etc.
- But what happens if the project is terminated before the private entity has recouped its investment?

First Street Plaza Partners

- The first point is to **get it in writing**.
- The second point is that the writing should incorporate a remedy for early termination, i.e., the private entity is reimbursed for its out-of-pocket expenses plus a reasonable profit. (Something similar to the federal termination for convenience clause, FAR 52.249-2.)

The Void Contract Rule Sources of Challenges

- In *First Street Plaza Partners*, the challenge to the contract came from the governmental entity.
- Other sources of challenge are:
 - Taxpayers. *Graydon v. Pasadena Redevelopment Agency*, 104 Cal.App.3d 631 (1980); *Concerned Citizens of Stockton v. City of Stockton*, 128 Cal.App.4th 70 (2005).

The Void Contract Rule

Sources of Challenges

- Unions. *Professional Engineers in California Government v. Department of Transportation*, 13 Cal.App.4th 585 (1993).
- Environmentalists.
- The competition.
- NIMBYs.

The Void Contract Rule

- Even if there is no successful challenge to the validity of PPP agreement, the spectre of such a challenge can result in a higher interest rate to cover a perceived risk premium:

The fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds...the possibility of future litigation is very likely to have a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit.

Walters v. County of Plumas, 61 Cal.App.3d 460, 468 (1976).

Ways to Mitigate The Void Contract Rule Risk

- The traditional approach is to obtain opinion letters from counsel that:
 - (a) the governmental entity has the legal capacity to enter into the PPP transaction, and
 - (b) the the governmental entity has followed all required procedures.
- Another approach is to bring a **validation action**.

Validation

- Fortunately, there is a way (in California, at least) to mitigate the risk that an agreement will be found void or that the threat of litigation will result in higher interest rates. California Code of Civil Procedure §§860, *et seq.*, provides that a public agency may bring an action to determine the validity of certain transactions.

Validation

- There are pros and cons to validation.

Pro:

If a court accepts a validation action and rules that the PPP agreement is valid, then there is little risk of a subsequent successful legal challenge.

Also, if the public entity commits to a validation action early in the negotiation process, this may give comfort to the lenders and reduce the interest rate that the private entity will have to pay.

Con:

Filing a validation action may smoke out opposition. Someone with an inclination to challenge the project may be prodded to file an opposition in the validation action. There also is the possibility that the court will find the transaction is not valid.



PRESENTATION TO CLE APRIL 7, 2010

“Public-Private Partnerships for Real Estate
Development/Sustainability & Infrastructure”

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Stimulus Impact on General Services Administration's Real Estate Portfolio

- **Impact of H.R. 1 – ARRA (Economic Stimulus) on Federal Buildings Fund**
 - **\$5.55 billion**
 - **\$750 million** for Federal Buildings and courthouses
 - **\$450 million** for a new headquarters for the Department of Homeland Security
 - **\$300 million** for border stations and land ports of entry
 - Not less than **\$4.5 billion** to convert GSA facilities to High-Performance Green buildings
 - **\$4 million** for the Office of Federal High-Performance Green Buildings
 - **\$3 million** for a training and apprenticeship program for construction, repair and alteration of Federal buildings

Stimulus Impact on Federal Green Buildings

- **Federal Buildings Fund**
 - **Federal Green Buildings**
 - H.R. 1 required that the General Services Administration (GSA) submit a detailed plan, by project, to the Committees on Appropriations of the House of Representatives and the Senate describing the planned use of the Stimulus funds within 45 days of enactment of this Act
 - On March 31, 2009, GSA issued a report to Congress detailing the federal building renovation/energy retrofiting which they plan to fund through Stimulus funds

Federal Real Estate Impacts on Market

- Background
 - GSA's Public Buildings Service is the workplace provider for the civilian federal government
 - GSA manages 347 million square feet of space in 8,500 buildings split between federally owned and leased space
 - Federal agencies look to GSA to procure utilities that are both cost-effective and environmentally responsible

Federal Real Estate & Sustainability

- Background
 - Industry recognizes that buildings consume about 40 percent of the total energy used in the United States and as much as 70 percent of the electricity. GSA's Public Buildings Service has a challenge to lead by example, and to demonstrate how they can reduce energy consumption by intelligently integrating energy efficiency in building design and leasing space (190 million square feet) in energy star and lead certified buildings.

Federal Real Estate & Sustainability

- Federal Government and Green Buildings
 - Federal goals for high performance and sustainable buildings are to:
 - Reduce the total ownership cost of facilities
 - Improve energy efficiency and water conservation
 - Provide safe, healthy, and productive built environments
 - Promote sustainable environmental stewardship

Federal Real Estate & Sustainability

- Federal Government and Green Buildings
 - The Energy Policy Act of 2005 requires agencies to apply sustainable design principles to the siting, design and construction of all new buildings, where life-cycle cost effective.
 - Executive Order 13423, signed January 24, 2007, requires agencies to ensure that new construction and major renovation projects comply with the Guiding Principles for Federal Leadership in High Performance and Sustainable Buildings.

Federal Real Estate & Sustainability

- Federal Government and Green Buildings
 - The Guiding Principles for Federal Leadership in High Performance and Sustainable Buildings were first developed for a Memorandum of Understanding signed by 19 Federal agencies on January 24, 2006. The principles are:
 - Employ Integrated Design Principles
 - Optimize Energy Performance
 - Protect and Conserve Water
 - Enhance Indoor Environmental Quality
 - Reduce Environmental Impact of Materials

Federal Green Buildings

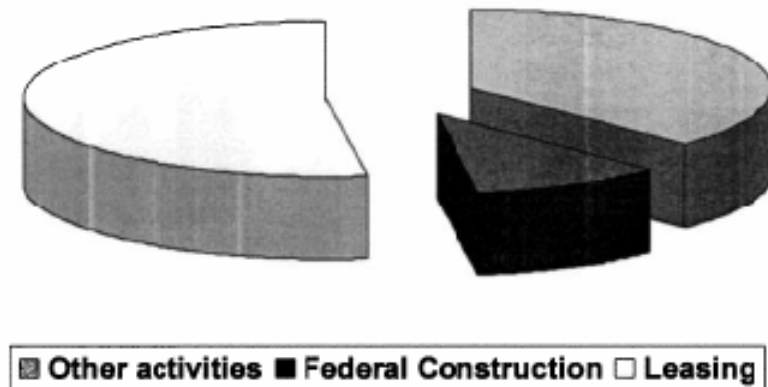
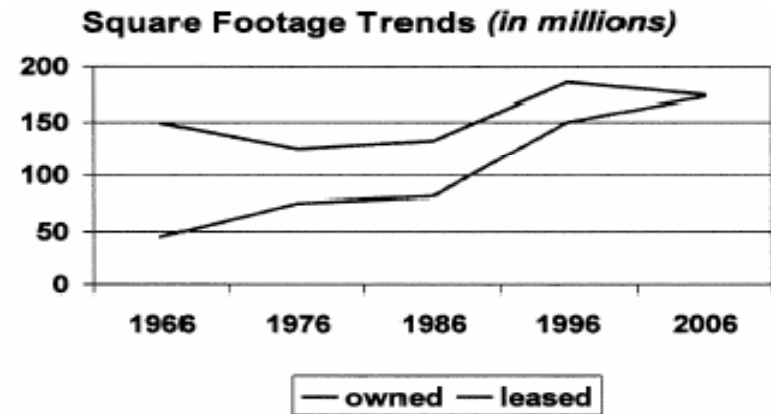
- Examples of Federal Green Buildings
 - NOAA Satellite Operations Center, Suitland, MD - This building has the largest green roof on the Eastern seaboard. The green roof merges with the landscape and saved first costs by eliminating the need for increased stormwater piping.
 - Federal Building, San Francisco, CA - This building is the first naturally ventilated high rise building in the U.S. It features an 18 story tower that is only 65 feet wide to allow access to daylight and views for all building tenants. The building is designed to perform 20% better than California's Title 24 energy code.

Current Issues Facing Federal Real Property Management and Public-Private Partnerships

- Federal real estate portfolio
- Current GSA Authorities
- Issues GSA faces
- Impact of scoring
- Infusion of \$5.55 billion from Recovery Act for construction, renovation, and green building initiatives

Portfolio Trends on Federal Level

- Government-owned space has remained relatively stable over the last 40 years while leased space has more than tripled
- Since 1990:
 - The rental of space budget has grown from \$1.5 billion to 4.3 billion - over 50% of the FBF budge obligations
 - Discretionary funds available for new construction and repair and alterations obligations have shrunk from 40% to 16%



Federal Real Estate Authorities

- Real estate is an appreciating asset for which the Government often has a long-term need.
- The self-insured status of FBF allows GSA to enter into operating leases requiring only the budget authority needed to cover annual lease payments.
- GSA's multi-year leasing authority allows contracts with lease terms of up to 20 years.
- GSA has responsibly funded and managed large scale programs, as well as significant individual projects, for which Congress authorized leveraged financing (not requiring up-front scoring of the full budgetary commitment).

Section 412 of the FY05 Appropriations Act – Opportunities for Public-Private Partnerships

Grants GSA two new authorities

1. Retention of proceeds
 - FBF proceeds in FY'07 – FY'09 of approximately \$200m
2. Real property disposition
 - New vehicles of disposition, e.g. leaseback arrangements
 - Outlease/leaseback applications never approved for use

40 U.S.C. § 585(c)

- Authority to outlease unimproved property to private sector developer and leaseback buildings constructed on land owned by GSA
 - At the end of the term, improvements would revert to GSA
- Outlease restriction of 30 years is of concern to development community

ESPCs

- Authority to time-finance renovations that result in energy-savings
- \$200m in investment financed – more to come
- Administratively burdensome but growing potential – given 2030 goal of carbon-neutral buildings

Other Real Estate Authorities – Opportunities for Public-Private Partnerships

- Adaptive Use Authority
 - Authority to outlease or exchange unused portions of historic properties
 - Proceeds retained for use in historic properties
- Acquisitions-by-Exchange
 - Allows GSA to leverage equity in its assets
 - Must be used to acquire an existing building
- Cooperative Use Act Outleasing
 - Limited to certain activities and areas of buildings and adjacent land
 - Commercial rates can be charged
 - Proceeds can be retained for operational expenses

Examples of “Off-Budget” Financing

- Congress has periodically approved “off-budget” financing, allowing GSA to acquire real property assets through annual payments without requiring substantial, up-front budget authority.
 - In the mid-1950s, GSA received authority to privately finance construction of 23 buildings.
 - In the early 1970s, GSA received purchase contract authority to finance the construction of 68 projects worth \$1.4 billion adding 11m square feet of inventory.
 - In the late 1980’s Congress authorized a total of 10 lease purchase projects in annual Appropriations Acts.
- By all real estate metrics these alternately financed projects undertaken by GSA have been successful.

Criteria Used in OMB's Evaluation of an Operating Lease and Impacts on Public-Private Partnerships:

Seven criteria defining an operating lease:

1. Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term.
2. The lease cannot contain a bargain-price purchase option.
3. The lease term does not exceed 75% of the estimated economic life of the asset.
4. The present value of the minimum lease payments over the life of lease does not exceed 90% of the fair market value of the asset at the inception of the lease.
5. The asset is a general purpose asset rather than being for a special purpose of the government and is not built to unique specification for the government as lessee.
6. There is a private sector market for the asset.
7. The risks of ownership remain with the lessor (the project should not be on federal land).

Impact of Budget Scoring on Public-Private Partnerships

- Financial constraints and the budgetary treatment of capital investment influence the method of acquisition
- Limits the use of public-private partnership (P³) for GSA real estate opportunities
- Leasing where Federal construction is preferred
- Fewer 20 year leases
- Fewer opportunities for ownership
- Higher cost with shorter terms
- More complex leasing process / more transactions

Solutions Being Advocated

- P³ options (for example: Exchanges, Section 412 Projects, ESPCs) relieve scarce Federal Building Fund resources to provide capital for investment and reinvestment in real property assets
- Government-owned assets which constitute the income-producing base of the FBF generate \$7/square foot versus leased-properties
- GSA's role in the acquisition and stewardship of federal real property requires a balanced approach as described below:
 - Provide additional resources through direct appropriations into the FBF for national priorities and opportunity purchases
 - Reinterpret scorekeeping guidelines under current authorities (with the agreement of congressional and administration stakeholders) to allow GSA to engage in P3 projects and leveraged acquisition of assets to meet long-term needs (e.g., sale/leaseback and lease/leaseback)

Challenges to Public-Private Infrastructure Opportunities

- GAO Study (2007)
 - Federal funding usually targeted at single mode of transportation.
 - Governments are generally organized by transportation modes. Not always cooperation between modes or with private sector.
 - Some benefits are tough to quantify [reduced congestion, better air]
- Financing Issues
 - Large Capital Needs
 - May be Long Lead Times (permits)
 - Revenue Source/Security for Debt
 - Instability in Financial Markets

Financing Tools for P³ Infrastructure

- Tax-Exempt Bonds: Can be issued to finance intermodal facilities
 - Plain vanilla general obligation bonds or simple revenue bonds
 - Public use/public ownership needed for plain vanilla bonds
- Private Activity Tax-Exempt Bonds: For certain types of facilities, some of which may be privately owned
 - Airports (public ownership needed)
 - Docks & Wharves (public ownership needed)
 - Mass Commuting Facilities (public ownership needed)
 - High-speed intercity rail facilities [not rolling stock]
 - Limits on dollar volume of issues per state per year for mass commuting and rail

Financing Tools for P³ Infrastructure

- TIFIA Loans/Loan Guaranties
 - Subordinated loan/loan guarantee program available to public and private entities.
 - Highway, transit, rail, some port and freight facilities
 - Limit – TIFIA assistance may not exceed 33% of estimated costs
 - Applicant's senior debt must be investment grade
 - Currently, ARRA authorizes \$200 million
 - May include design, etc. costs
 - Maturity within 35 years of completion of construction. Interest rate tied to US Treasuries.
 - Lines of Credit. Supplement to Project Revenues during first 10 years of operations. Pays O&M, debt service on senior debt

Financing Tools for P³ Infrastructure

- Commercial Taxable Loans to Private Concessionaire
 - Banks or Capital Market
 - Security is assets/revenues of project
 - Lenders – rightfully want seat at table if there is a default
- Equity
 - When contributed? Who guarantees?
- Multiple Sources in the Same Project. Not uncommon
 - Government Appropriations or Government-backed Debt
 - Private Activity Bonds
 - TIFIA
 - Bank Loans
 - Equity

P³ Contract Issues

- Structure – Complex project agreements between government and single purpose private entity, with parent guarantees
 - Lenders will be heavily involved. Project could be 75-80% debt financed
- Government Team – Public officials, financial advisors, lawyers, engineering advisors, others (traffic consultants).
 - KEY: Need a public person as dedicated leader/key person on government team.
 - KEY: Need clear, fair procurement process.
 - Process may be lengthy.

P³ Contract Issues

- Some Key P3 Contract Considerations
 - Length of Term – Tax issues, economics for private concessionaire.
 - Government Oversight/Accountability. Technical requirements should be clear, detailed. CC must meet ongoing maintenance, must return project to government in specified good condition. Audit, inspection rights.
 - Non-compete clauses. When are they really needed? Limits on government policy options.
 - Construction. Importance of price certainty and setting a completion date. Issues: change orders, delays. Performance guarantees.
 - Operations. Maintenance. Closure, monitoring, force majeure. New capital projects: proposed by CC; proposed by Government; required by change in law. Commercial development rights.

P³ Contract Issues

- Some Key P3 Contract Considerations (cont'd)
 - Payment. Upfront v. over term of agreement v. hybrid. Use of payment. “Profit Sharing.”
 - Revenues. If tolls or user fees, who controls increases. Is there profit sharing? Government makes availability payments. What about low revenues?
 - Uncontrollable Circumstances: Use limited list. Force majeure, change in law, etc. Relief: delay, financial adjustments, terminations. Compare with: Discriminatory legislation.
 - Defaults: Rights of lenders? Payments? Arbitration? Termination?
 - Termination: By government for convenience. Termination payments.

Legal Considerations in P³ Agreements

- State Constitution and Laws. Do existing laws provide authority to do a P3 infrastructure project?
 - Governments do not have implicit powers.
 - Legislation enacted upfront or after selection.
- State Law Considerations
 - Procurement laws
 - Enforcing a P3 agreement against the government. Appropriations risk.
 - Sovereign Immunity
 - State/local taxes. Real estate tax
 - Policy Objectives. Prevailing wage. Consequences of failure.
 - Labor Unions/Benefits/Retirement.
 - Environmental issues.

Other Incentives: New Markets Tax Credit Expansion

- New Market Tax Credit (NMTC) authorizations of \$3.5 billion for 2009 was increased to \$5 billion.
 - Additional authorizations for future years must be allocated to qualified community development entity (CDE) that submitted an allocation application in the past and either did not receive an allocation or received less than requested
- To qualify for NMTC, a qualified equity investment must be made into qualified CDE, which must make equity investment or lend funds to a qualifying low-income business (QALICB)

Build America Bonds

- Governmental bonds issued as taxable bonds
- Bondholder receives federal income tax credit equal to 35% of interest payable each year for life of bonds
- May only be issued through 2010
- A special version of Build America bonds, the Recovery Zone Bonds, can be deployed as Private Activity Bonds

Overview of NMTC Program

- Enacted on December 21, 2000
- Part of the Community Renewal Tax Relief Act of 2000
- Creates a tax credit for equity investments in Community Development Entities (CDEs)

What is a CDE?

- A domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments or financial counseling in Low-Income Communities Creates a tax credit for equity investments in Community Development Entities (CDEs)
- CDEs are required to demonstrate that they:
 - Have a **primary mission** of serving, or providing investment capital for, Low-Income Communities (LICs) or Low-Income Persons
 - Are **accountable** to residents of the LICs that they serve

What is “Low-Income?”

Generally, Low Income Communities are:

- Census tracts with **at least 20%** poverty, or
- Census tracts where the median family income is **below 80%** of the area median family income

CDFI Fund gives preference to applications for projects or services in exceptionally distressed areas

Credit Amount

- Credit taken over a 7-year period
- Credit rate:
 - 5% in each of the first 3 years
 - 6% in each of the final 4 years
- Equals 39% of amount of original investment
- NPV about 30%

Amount of NMTC Investment Authority Available

| | |
|-------------|--------------------|
| 2002 | \$2.5 billion |
| 2003 | \$1.5 billion |
| 2004 | \$2 billion |
| 2005 | \$2 billion |
| 2006 | \$3.5 billion |
| 2007 | \$3.5 billion |
| 2008 | \$3.5 billion |
| 2009 | \$5 billion |
| 2010 | \$5 billion |

Unallocated investment authority may be carried over from year to year until 2014. *additional special allocations were allowed for hurricane relief

Responsibilities of IRS and CDFI Fund

- CDFI Fund:
 - Certifies CDEs
 - Allocates the NMTCs
 - Monitors CDEs for compliance
- Main Treasury / IRS:
 - Interprets tax code and when investors can claim tax credits
 - Determines if investors are subject to recapture

Process Overview

- Step 1:** Entities apply to the Fund for CDE certification
- Step 2:** Entities apply to the Fund for a NMTC allocation
- Step 3:** The Fund competitively selects CDEs to receive NMTC allocations
- Step 4:** CDEs use allocations to offer NMTCs to investors for cash
- Step 5:** CDEs use proceeds to make “Qualifying Low-Income Community Investments” (QLICIs)

Claiming NMTCs

- CDEs offer NMTCs to investors for “Qualified Equity Investments” (QEIs) in the CDE
- QEI is any purchase of stock or capital interest in a for-profit corporation or partnership
- QEIs must stay in the CDE for a 7-year period
- CDEs must offer NMTCs to investors within 5 years after entering into an Allocation Agreement with the Fund
- Investors may claim credits as of the date it initially makes the QEI

CDE Use of NMTC Proceeds

“Substantially all” of an investor’s cash must be made in QLICIs **within 12 months**

Years 1-6:

Substantially All = 85% of amount paid by investor at original issue

Year 7:

Substantially All = 75%

The CDE’s contract with the CDFI Fund will likely require that 97% of investor’s cash be deployed when an original QLICI is made.

CDE Use of NMTC Proceeds

(Cont'd)

- Proceeds must be invested in QLICIs throughout the **7-year** credit period
- CDE reinvestment requirement
 - Years 1-6:
 - Generally, returns to the CDE of capital must be reinvested within **12 months**
 - Periodic loan repayments may be aggregated for up to 24 months before reinvestment is required

Qualified Low-Income Community Investments

- Any capital or equipment investment in, or loan to, any “Qualified Active Low-Income Community Business” (QALICB)
- Any equity investment in, or loan to, any CDE
- Purchase of a loan from another CDE if the loan is a QLICI
- “Financial counseling and other services” (FCOS) to business located in, and residents of, LICs

QALICB Criteria

- 1) At least 50% of the total gross income is from the active conduct of a qualified business in Low-Income Communities (LICs); and
- 2) At least 40% of the use of the tangible property of the business is located in LICs; and
- 3) At least 40% of the services provided by the business' employees are performed in LICs; and

The gross income test is deemed to be met if either the tangible property or the services test is at 50% or higher

QALICB Criteria

(Cont'd)

- 4) Less than 5% of the average of the aggregate unadjusted bases of the property is attributable to collectibles (e.g., art and antiques), other than those held for sale in the ordinary course of business (e.g., inventory); and
- 5) Less than 5% of the average of the aggregate unadjusted bases of the property is attributable to nonqualified financial property (e.g., debt instruments with a term in excess of 18 months).

Ineligible Business Activity

- Operation of residential rental property:
 - Buildings which derive 80% or more of income from residential dwelling units; and
- Properties where no substantial improvements are made
- Development or holding of intangibles
- Operation of other ineligible businesses – e.g.
 - Golf courses
 - Race Tracks
 - Gambling facilities
 - Certain farming businesses
 - Stores where the principle business is the sale of alcoholic beverages

Recapture

NMTCs may be recaptured from investors during the 7-year credit period of:

- 1) The QEI fails the substantially all requirement
- 2) The CDE ceases to qualify as a CDE
- 3) The CDE redeems the investment

If a CDE files for bankruptcy, this is not a recapture event.

Why Become a CDE?

- For-profit CDEs may raise capital by offering tax credits to investors
- All CDEs (including non-profits) are eligible to:
 - Receive loans and investments from; or
 - Sell loans to for-profit CDEs that have been issued tax credit allocation by the Fund

CDE Certification Requirements

- Must be a duly organized domestic corporation or partnership
- Must have a valid Employer Identification Number (EIN) issued by the IRS for each entity (including subsidiaries)
- Must meet the 2 certification tests:
 - Primary mission; and
 - Accountability

How the deals work

Lender(s)

Tax Credit
Investor

Investment Fund, LLC

CDE

Project