SALT LAKE CITY COUNCIL STAFF REPORT

DATE: November 14, 2006

SUBJECT: Briefing on the use of New Markets Tax Credits to aid in the construction of the Sorenson Unity Center Project – Resolution accepting the Public Benefit Study required by Utah Code Section 10.8.2

STAFF REPORT BY: Jennifer Bruno, Policy Analyst

AFFECTED COUNCIL DISTRICTS: District 2

ADMINISTRATIVE DEPT: AND CONTACT PERSON: Public Services, Rick Graham, Director

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POTENTIAL MOTIONS:

1. **["I move that the Council"]** Adopt a resolution accepting the Public Benefit Study regarding construction of the Sorenson Unity Center, to maintain compliance with Utah Code Section 10.8.2.

2. **["I move that the Council"]** Not adopt a resolution accepting the Public Benefit Study regarding construction of the Sorenson Unity Center, to maintain compliance with Utah Code Section 10.8.2.

The following information was provided previously for the Council Work Session on November 7, 2006. It is provided again for your reference.

KEY ELEMENTS:

A. The Administration will brief the Council on an initiative to benefit from New Markets Tax Credit Financing (a financial tool authorized by Congress in 2000) in order to cover a funding shortfall in the construction of the Sorenson Unity Center.

B. Construction bids came in at $700,000 over budget (bids *included* classroom space for the computer clubhouse). The Council could choose to appropriate an additional $700,000 from the general fund balance to cover this difference, or the Council could choose to pursue New Markets Tax Credits.

C. The advantage to pursuing New Markets Tax Credit Financing, is that because the City already has approximately $4.7 million to contribute towards the project, the financial institution that would be the City's investor in the project ("The Bank"), is willing to contribute approximately $1.99 million. Proceeds above and beyond construction costs could be used towards the first few years of operations and maintenance expenses at the Center, reducing the burden on the general fund during that time. The net benefit to the City is as follows:
   - Pays the $700,000 cost overrun
   - Reimburses the approximately $550,000 the City has already spent on design of the Center

- Leaves approximately $399,000 for the City to use in operations and maintenance of the Center, above and beyond what the City receives in rent payments from tenants (the sum of the developer fee, interest payments made, and interest accrued). Given that the administration estimated it would cost approximately $150,000 above rental income to operate and maintain the Center, this money would operate the Center for just over 2.5 years. It is important to note that this sum could increase as contingencies of the development are or are not used. Any "extra" money not used in development will be paid to the City as a part of this "developer fee."

See chart below for a detailed breakdown:

Net Benefit Analysis		
Financial Instituations Contribution	$	1,990,382
Associated Costs of Deal:		
Land rent ($1 per year, 7 years)	$	7
"Reimbursment" of the City for expenses incurred (the City will fund rent out of this payment - In turn, rent will pay for the interest costs of the loan)	$	566,157
Reserves for closing the deal after 7 years ("Put" and "Call") - may be as low as $1,000	$	100,000
Other Fees/Contingency	$	225,000
Total Associated Costs	*$*	*891,164*
Net Benefits:		
Payment of cost overrun	$	700,000
"Developer Fee" (for City to use for O&M) - less rent paid	$	179,968
Interest on City's $4.7 million	$	167,237
Interest on Funds remaining with the City	$	52,013
Total Net Benefit to the City	**$**	**1,099,218**

Note: The developer fee is a balancing number and may increase if all contingencies are not needed

D. The Administration has indicated that in order for the New Markets Tax Credit approach to move forward, the Council would need to express its support on or before the November 14th City Council meeting.

E. The following outlines the proposed structure of the deal that the City would agree to in order to benefit from these New Markets Tax Credit Financing (for a brief explanation of the basics of New Markets Tax Credits, see the section on page 4). This deal can also be seen graphically in the attached flow chart:

   1. In order for the investor to receive the benefits of these tax credits, the investor's money must be loaned to a non-governmental entity. Because the City already has a Foundation formed ("The Salt Lake City Foundation", formed in 1997), this Foundation will act as the conduit for the receipt of these tax credits. The Bank requires the creation of a separate entity from the Foundation to actually receive and have control of the money. As such, the Salt Lake City Foundation will create the "**New Utah Entity**," (a non-profit corporation) to receive all of the money to

construct the project. (See Matters at Issue for issues relating to the Salt Lake City Foundation/Budgeting issues)

2. **The total amount transferred to the "New Utah Entity" from the Bank is approximately $6.7 million. The "New Utah Entity" is only responsible for interest payments on this "loan." The cost of these interest payments is <u>included</u> in this $6.7 million.**
    - Process - The City will loan approximately $4.7 million to the Bank's Investment Fund, a subsidiary of which is the arm that actually gives out the tax credit-based funding (a CDE).
    - The Investment Fund will pay interest on this loan, at .5% for a period of 8 years. The total amount paid to <u>the City</u> in the form of interest is $167,237. The terms of this loan will stipulate that the Bank (through the CDE arm) will contribute $1.99 million into the Center, through the New Utah Entity.
    - Because of the tax benefits that the Bank receives as a result of their involvement in the federal New Markets Tax Credit program, during the "compliance period" (7 years), the New Utah Entity is only responsible for the interest on these loans, which has been included in the total $6.7 million.
    - Therefore, the City will be responsible for no additional funds in order to achieve this deal. While the documents make reference to payments beyond the 7 years, a separate agreement with the Bank will enable both the Bank and the City to terminate the deal after 7 years. It is important to note that the Bank will be required to give notice to the City if they decide to terminate or not to terminate. If they decide not to terminate, this would give the City notice, and would serve as an impetus for City action to terminate the agreement.
3. The City will enter into a **ground lease** with the New Utah Entity for a term of 60 years (Markets standard timeframe), for the entity to construct the building. During the period of their agreement, the New Utah Entity will own the building, and will secure the $4.7 million portion of the loan with the deed. At the end of the 60 year term, the City will become the sole owner of the project (the highly likely scenario is that the City will terminate the agreement with the New Utah Entity when they terminate the agreement with the Bank, after 7 years).
4. The City will also enter into a **master lease** whereby it will act as an agent and developer for the New Entity in order to construct the building. This lease would include a developer fee (see above), and will reimburse the City for design expenses already incurred ($550,000). The lease would also specify that for a term of 20 years (Markets standard), the City will be responsible for sub-leasing, operations, and maintenance of the building, and will also retain all rent and fees paid by users. The rent that the City will pay will be $55,000 per year for the first year, with a 1% escalator in each of the following 9 years (the source of the City's payment for this rent is the reimbursed design money, the interest on the initial loan to the Bank, and the Developer Fee. This money will be held by the City and then paid out to the New Entity). The total amount for 7 years of rent is approximately $397,000.
5. The rent that the New Entity receives from the City will be used to pay for the interest due on the loans from the CDE (approximately $385,000 <u>total</u> over the 7 years).
6. The New Entity, governed by the Board of Trustees of the Salt Lake City Foundation, will control, but will not be able to disperse any funds until the applicable confirmed

documents relating to the specific part of the project have been demonstrated (confirmed construction documents, inspection certificates, etc).

7. After 7 years the City has the ability to terminate the agreement with the Bank (cost of termination is covered in reserves that are factored into the $6.7million loan). No additional funding is required at that time. At that time the SLC Foundation may choose to also terminate the "New Utah Entity" and have the City assume all ownership.

F. The complexity of this arrangement is due to the fact that federal laws prohibit a qualified CDE (in this case, an arm of "the Bank") from entering into an agreement with a governmental agency. The structure the City is pursuing is very similar to a non-profit housing corporation forming an LLC for a specific project to take advantage of residential low-income housing tax credits.

G. Contingency – the City will not release any funds to the Bank until there is a binding agreement between the CDE and the New Entity, stating that the CDE cannot use the funds for any other purpose other than loans to the New Entity for the purpose of constructing the Sorenson Unity Center. If for any reason the City's loan could not be used (for example, the block were accidentally contaminated with hazardous materials that could not be mitigated), the funds would be returned to the City. The Bank will pledge its Investment Fund's 99.9% ownership interest in the CDE as security for the performance of its loans to the New Entity.

NEW MARKETS TAX CREDIT BASICS

A. The New Markets Tax Credits Program was enacted by Congress in December 2000 as part of the bipartisan Community Renewal Tax Relief Act.

B. The purpose is to spur private investment in target low-income, urban and rural communities by attracting investors with tax incentives.

C. The federal program is similar to the CDBG program, in that there is a cap on the number of dollars that the federal government allows for tax credits. Each funding cycle, a number of Community Development Entities (CDEs) compete for and are allocated a specific amount of New Markets Tax Credit. Not all CDEs who apply are awarded tax credits. In this case, the Bank that the City is in negotiations with is the CDE.

D. The CDE must then find a Qualified Equity Investment (QEI – In this case, the non-profit corporation created by the Salt Lake City Foundation) to partner with in order to expend the Tax Credits that it has been allocated.

E. The project must be located in a qualified low-income community (the Sorenson Unity Center is in a qualified community).

F. Tax credits can only be used in target areas, for a limited number of purposes. New Markets Tax Credits are not allowed for solely-residential projects. Mixed-use projects are allowed as long as more than 20 percent of the gross income comes from commercial rents.

MATTERS AT ISSUE:

A. The Salt Lake City Foundation is a 501(c)(3) corporation, and was created in 1997 for the purpose of accepting small grants and donations. The articles of incorporation state that the board of trustees consist of the Mayor of Salt Lake City, and two trustees appointed by the Mayor (currently the CAO and Director of Finance). As such, once the authority is given for the Foundation to pursue this process, the Council currently would have no oversight over the actions of the Foundation or the "New Utah Entity." However, because this project involves development of City property, which may directly or indirectly impact future City budgets and/or policy, the Administration is actively pursuing changing the articles of incorporation to include the Council Chair on the Board of Trustees. This will guarantee a certain amount of oversight and interest on the part of the Council. Altering the articles of formation is an administrative process. The current intent is to specify that the third member of the Board of Trustees would be appointed jointly by the Mayor and the Council Chair.

B. The City Attorneys Office looked into the matter of the City's liability exposure at the facility. Because the "landlord" of the property is the Foundation, and is technically not a governmental entity, they would not have the City's situation of governmental immunity. After consulting with the City's Risk Manager, the Attorneys Office recommends that we purchase liability insurance. The City's Risk Manager has indicated that this is a good solution in terms of protecting the City's interest in the property and would be fairly inexpensive (approximately $10,000 - $20,000).

C. The details of this deal can be somewhat confusing upon first review. Council Staff will continue to analyze the deal points in order to more fully explain the program. Tom Berggren, the City's consulting attorney for this matter, will be available at the Council Meeting to more completely answer any questions the Council may have. Staff can then work with Mr. Berggren and the Administration to follow-up on Council questions prior to the November 14th meeting. Please consider this staff memo a summary of key issues, rather than a completely comprehensive staff analysis.

BUDGET RELATED FACTS:

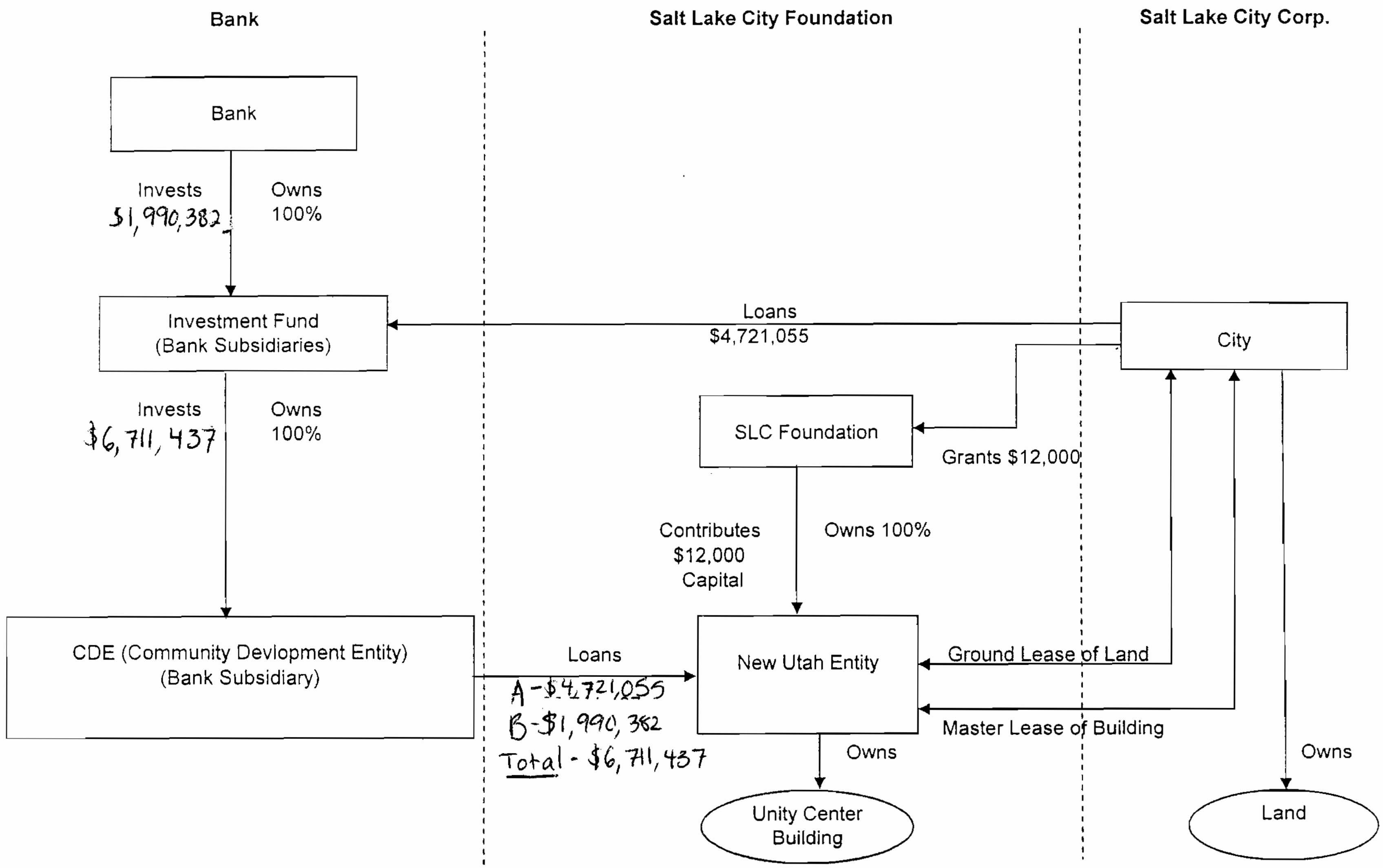
A. The net cash-in-hand gain to the City is approximately $399,000 in developer fees, interest paid to the City, and interest accrued. This money can be used to operate and maintain the Unity Center. Given that the administration estimated it would cost approximately $150,000 above rental income to operate and maintain the Center, this money would operate the Center for just over 2.5 years. It is important to note that this sum could increase as contingencies of the development are or are not used. Any "extra" money not used in development will be paid to the City as a part of this "developer fee."

B. The $700,000 cost overrun will also be covered, with no additional responsibility to the City.

C. The total net benefit is effectively $1.1 million.

cc: Rocky Fluhart, Sam Guevara, DJ Baxter, Kay Christensen, Rick Graham, LeRoy Hooton, Tim Harpst, Kevin Young, Max Peterson, Boyd Ferguson, Louis Zunguze, Doug Wheelwright, Doug Dansie, Kurt Larson, Barry Esham, Marge Harvey, Janice Jardine, Valda Tarbet

FLOW OF FUNDS



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By: Email

M E M O R A N D U M

TO: **Rick Graham**

CC: **Kay Christensen**
Boyd Ferguson

FROM: **Tom Berggren**

DATE: **October 31, 2006**

RE: **Sorenson Unity Center**

Executive Summary:

The City currently has available approximately $5.3 million from grants to construct the Sorenson Unity Center (the "Project"). The Administration has learned that the Project is a type of development that is eligible for investment by an entity that wants federal tax credits under the New Markets Tax Credits Program (the "Tax Credits Program"). A financial institution (the "Bank") has expressed its interest in supporting the Project by contributing approximately $1.99 million in cash to the Project in accordance with the Tax Credits Program, which would result in a net benefit to the Project of in excess of $1.1 million. This additional funding is critical to making the Project a success. You have requested that I (1) explain how this contribution could be made, (2) highlight the key provisions of the agreements that would implement the financing of the construction costs and initial operational funding for the Project, and (3) review the benefits and the risks that may be involved. This memo responds to your request.

In essence, because of the benefits the Bank would receive under the Tax Credits Program over the first seven years after construction of the Project, the Bank's contribution can remain with the Project with no repayment or any other remaining obligations on the part of the City. While there are certain potential problems with the proposal, they are probably quite unlikely to occur and in any event there are ways to mitigate any such problems.

Proposed Structure:

Attached is a chart that shows how the funds would flow. The following is a description of the main terms of the necessary agreements:

(a) A new Utah nonprofit corporation (the "New Entity") will be formed by the existing Salt Lake City Foundation (the "SLC Foundation"), and an Operating Agreement will be signed by the trustees of the SLC Foundation containing, among other things, the following provisions:

(i) The City will make a grant to the SLC Foundation in the amount of approximately $12,000. The SLC Foundation will use this amount of money to capitalize the New Entity, which in turn will use these funds for incidental costs incurred in connection with starting up the Project.

(ii) The SLC Foundation will be the sole member/owner of the New Entity.

(iii) The New Entity should apply for 501(c)(3) status. Given the nature of the Project and that the New Entity will be 100% owned by the SLC Foundation, which is already a 501(c)(3) entity, tax-exempt status should not be difficult to obtain.

(iv) It should be noted that the current Articles of Incorporation of the SLC Foundation provide that the Mayor is one of the three trustees, and the Mayor appoints the other two trustees. As you have instructed, we will amend the Articles of Incorporation to provide that the Chair of the City Council will be one of the three trustees, the Mayor will be one of the trustees and those two will appoint the third trustee.

(v) The Articles of Incorporation for the New Entity will provide that the three directors of the New Entity will be the same as the trustees for the SLC Foundation. The New Entity would need a President and a Secretary. As we have discussed, the directors could appoint Gordon Hoskins as President and Dan Mule' as Secretary.

(b) At the closing, the New Entity will enter into a Ground Lease with the City, pursuant to which the parties agree as follows:

(i) The City agrees to ground lease approximately 2.2 acres along 900 West to the New Entity.

(ii) The Ground Lease is for a term that will expire 60 years following the date on which the Project is placed in service.

(iii) The rent is $1 per year.

(iv) The parties acknowledge they are simultaneously entering into the Master Lease Agreement (see below).

(v) At the end of the term, the City becomes the owner of the Project.

(c) At the closing, the City and the New Entity will enter into a Master Lease Agreement, pursuant to which the parties agree as follows:

(i) The New Entity agrees to cause the construction of the Project at its expense. The City agrees to act as the agent of the New Entity for the purpose of constructing the Project. The New Entity will agree to pay the City a developer fee of at least $210,000. The City can use that money to fund reserves to pay for the costs of operation and maintenance.

(ii) Following substantial completion of the Project, the City agrees to use its best efforts to lease the space to permitted users and lessees, such as educational institutions and non-profit organizations, and to use the facility as the site for public programming that is currently funded by the City or may be desired by the community to meet specific community needs.

(iii) The Master Lease will be a "net lease" (under which the City is responsible for all costs of operation of the Project).

(iv) The City will retain all rent and fees paid by sublessees and users.

(v) The term of the Master Lease will be 20 years.

(vi) The rent to be paid by the City will be \$55,000 per year for the first year, with a 1% increase each of the next nine years. In year 11, the rent increases to \$85,750 per year, with a 5% increase in the next nine years. This amount allows the New Entity to pay debt service owing on the CDE Loans (described below). Also, part of the proceeds of the CDE Loans (discussed below) that the New Entity receives can be used by the New Entity to reimburse the City for previously incurred costs, which money will then be used by the City to establish a reserve that will pay the full amount of this rent during the first seven years. In order to prevent the City's rent obligation from constituting unconstitutional debt, there will be a "subject to appropriation" clause, pursuant to which the New Entity acknowledges that the payment of rent each year is subject to an annual appropriation by the City Council. There would also be a clause that provides that the subleases and the rental payments thereunder will be assigned as security for the City's Master Lease obligations, so that if the City ever fails to pay rent (including but not limited to by reason of the City's failure to appropriate the necessary funds), the rent payable by sublessees will be paid to the New Entity (up to the amount owed by the City from time to time).

(vii) The parties will acknowledge that the City will initially hold reserves in the amount of at least \$210,000 to use for operational costs that are not covered by income from the Project during the term of the Master Lease. (This money will come from the developer fee earned by the City discussed above).

(d) At the closing, the City will enter into a loan agreement with a newly formed subsidiary of the Bank (the "Investment Fund"), pursuant to which the parties agree as follows:

(i) The City agrees to make a loan (the "City's Investment Loan") in the amount of \$4,721,055 to the Investment Fund. The terms are as follows:

1. It will have a term of 8 years.

2. The City will agree to accept from the Investment Fund, in satisfaction of its obligation to repay the City's Investment Loan, an assignment to the City of the larger CDE Loan (discussed below), should the Investment Fund elect to cause the CDE (defined

below) to distribute the same in kind to the Investment Fund.

3. The maturity date of the City's Investment Loan may be extended in the event there is an unexpected delay in the full funding of the Investment Fund's investment in the CDE to account for the resulting increase in the length of the compliance period under the New Markets Tax Credits Program (i.e. seven years after last investment is made (the "NMTC Compliance Period"), plus a reasonable time thereafter is allowed to enable the SLC Foundation to acquire the Bank's membership interests in the Investment Fund, pursuant to either the "Put" or "Call" rights described below).

4. It will bear interest at the rate of 0.50% per annum.

5. No principal payments are required, only monthly payments of accrued interest until maturity.

6. The City agrees that, notwithstanding any default under the loan by the Investment Fund to the CDE, the City will forebear from exercising any of its remedies prior to the maturity date of the City's Investment Loan.

7. The Investment Fund will pledge its partnership interest in the CDE as the sole security for the City's Investment Loan.

(ii) The Bank agrees to make a capital contribution (the "Investor's Contribution") to the Investment Fund in the net amount of $1.99 million.

(iii) The Investment Fund agrees to use the proceeds of the City's Investment Loan and the Investor's Contribution to make a capital contribution to a newly formed, special-purpose limited liability company (the "CDE") controlled by the Bank.

(iv) The Investment Fund agrees to cause the CDE to make two loans to the New Entity on the following terms:

1. One loan will be in the amount of approximately $4,721,055 and one loan will be in the amount of $1,990,382 (the "CDE Loans"). Each loan will bear interest at the rate of 0.82% per annum and have a term of 36 years. Each will be interest only during the

NMTC Compliance Period, and then it will begin paying principal with a balloon payment due in the last year. The larger loan will be secured by a deed of trust on the New Entity's ownership interest in the building and its leasehold interest in the land created by the Ground Lease. The smaller loan may or may not be secured.

2. The New Entity will agree to use the Project only for the specified purposes that are in compliance with the Tax Credits Program.

(e) At the closing, the SLC Foundation will sign an indemnification agreement pursuant to which it agrees that it will indemnify the Bank for any losses incurred by the Bank as a result of the violation of the New Entity's representations and covenants that the New Entity will comply with the requirements of the Tax Credits Program.

(f) At the closing, the Bank will enter into an Option Agreement with the SLC Foundation, pursuant to which the parties agree as follows:

(i) The SLC Foundation grants the Bank the option to sell its membership interest in the Investment Fund to the SLC Foundation for a purchase price of $1,000 at the end of the NMTC Compliance Period (the "Put").

(ii) If the Put is not exercised by the Bank, the Bank grants the SLC Foundation the option to purchase its membership interest in the Investment Fund for a purchase price equal to the fair market value of the membership interest, which will be determined in accordance with an agreed upon formula (the "Call"). The actual amount of the fair market value of the membership interest at the time the Call is exercised will end up to be a number that is less than $100,000. This is because the Investment Fund will have a liability to pay the City's Investment Loan of $4,696,508, which will be satisfied by assigning the larger CDE Loan to the City, and then the only other asset of the Investment Fund will be the smaller CDE Loan. The fair market value of that approximately $2 million loan, given its long maturity and its low interest rate and principal repayment requirements, and given that it is subordinate to the larger CDE Loan (which will be secured by a deed of trust on the building), will be very modest; prior to the closing, financial projections will be made, using reasonable future market assumptions, that will demonstrate that the loan will be worth less than $100,000. The New Entity can establish/build up reserves to make sure this sum is available if the SLC Foundation needs to exercise the Call in the event the Put is not exercised.

The Bank's Exit:

If the Put is exercised, the SLC Foundation will control the CDE and can then exercise the rights of the Investment Fund under the operating agreement of the CDE, which will include (i) the right to require a distribution in kind of the CDE Loans to the Investment Fund, (ii) the right to remove and replace the managing member of the CDE, and (iii) the right to elect to dissolve the CDE. The SLC Foundation would then be able to determine the disposition of the CDE Loans (including the right to cause them to be assigned in satisfaction of the City's Investment Loan as described above). While this may be a taxable event, there are no tax consequences because the SLC Foundation is a 501(c)(3). There would be no remaining obligations of the City or the SLC Foundation (other than pursuant to the indemnification agreement discussed below). If the Project is subsequently transferred to the SLC Foundation or the City, there could possibly be tax consequences, but it is likely that the transfer could be structured to eliminate those issues, and assuming that the New Entity is a 501(c)(3), there will definitely be no liability at that point.

If for any reason the Put is not exercised, then SLC will exercise its Call, which results in the same scenario as described in the previous paragraph.

Risks:

(1) Under the indemnification agreement by the SLC Foundation referred to above, if the New Entity were to use the Project for the purposes of operating (1) an apartment complex, (2) a bank, credit union or other financial institution, or (3) a country club, massage parlor, hot tub facility, suntan facility or racetrack, the Bank would have its tax credits recaptured and the SLC Foundation would be responsible for paying the Bank an amount equal to its anticipated federal tax credits. By managing the Project to avoid those prohibited uses, the City, as the master lessee under the Master Lease, can prevent the SLC Foundation from being liable for such amounts.

I understand that the Department of Public Services has created pro formas for the revenues and costs in operating the Project over the next seven years. I also understand that, based on prior discussions with the Council (1) City appropriations for funds for the operation of the Project will be required in a few years, once the initial operational reserves have been depleted, and (2) to the extent that it turns out to be more difficult than projected to locate users of the Project willing to pay rent and/or a share of the operating costs of the Project, these operational subsidies may be more than the current pro formas provide.

Please call me if you have any questions regarding the foregoing.

Thank you.

RICHARD GRAHAM
PUBLIC SERVICES DIRECTOR

SALT LAKE CITY CORPORATION
DEPARTMENT OF PUBLIC SERVICES

ROSS C. "ROCKY" ANDERSON
MAYOR

COUNCIL TRANSMITTAL

TO: Rocky Fluhart, Chief Administration Officer

DATE: October 31, 2006

FROM: Rick Graham, Director
Public Services Department

SUBJECT: New Market Tax Credit Initiative - Sorenson Unity Center Project

STAFF CONTACT: Rick Graham 535-7774
Tom Berggren, Legal Counsel 534-7449
Jones, Waldo, Holbrook & McDonough, P.C.

DOCUMENT TYPE: Briefing

RECOMMENDATION: That the City Council support the Administration's effort to bring New Market Tax Credit investment funding into the Sorenson Unity Center funding program.

BUDGET IMPACT: The New Market Tax Credit funding initiative will bring approximately $2,050,000 in cash to the project, to support the full build-out of the project including the construction of two (2) classroom spaces to house the computer club house program.

DISCUSSION: The City currently has available approximately $5.3 million from grants and earned interest to construct the Sorenson Unity Center. The Sorenson Unity Center project is a type of public development that is eligible for investment by an entity that wants federal tax credits under the New Market Tax Credit Program. The City is close to finalizing an investment contribution of approximately $2,050,000 in cash with a financial institution. This additional funding is critical to making the project a success. It will allow the City to construct a 25,000 square foot building that includes space for the City's current computer clubhouse program and the other fitness, education, health and cultural arts programs desired by the community.

Attached, is a Memorandum prepared by Tom Berggren, the City's outside legal counsel hired to provide legal support and technical expertise, and to represent the City's interest

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throughout the negotiation process. Tom's memorandum highlights the key provisions of the funding agreement; and reviews the benefits and risks involved.

Construction bids have been received and contract negotiations are currently underway with the low bidder. Construction will begin in early December with completion anticipated in late summer 2007.

PUBLIC PROCESS: Not Needed

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By: Email

M E M O R A N D U M

TO: **Rick Graham**

CC: **Kay Christensen**
Boyd Ferguson

FROM: **Tom Berggren**

DATE: **October 31, 2006**

RE: **Sorenson Unity Center**

Executive Summary:

The City currently has available approximately $5.3 million from grants to construct the Sorenson Unity Center (the "Project"). The Administration has learned that the Project is a type of development that is eligible for investment by an entity that wants federal tax credits under the New Markets Tax Credits Program (the "Tax Credits Program"). A financial institution (the "Bank") has expressed its interest in supporting the Project by contributing approximately $2,050,000 in cash to the Project in accordance with the Tax Credits Program. This additional funding is critical to making the Project a success. You have requested that I (1) explain how this contribution could be made, (2) highlight the key provisions of the agreements that would implement the financing of the construction costs and initial operational funding for the Project, and (3) review the benefits and the risks that may be involved. This memo responds to your request.

In essence, because of the benefits the Bank would receive under the Tax Credits Program over the first seven years after construction of the Project, the Bank's $2,050,000 contribution can remain with the Project with no repayment or any other remaining obligations on the part of the City. While there are certain potential problems with the proposal, they are probably quite unlikely to occur and in any event there are ways to mitigate any such problems.

Proposed Structure:

Attached is a chart that shows how the funds would flow. The following is a description of the main terms of the necessary agreements:

(a) A new Utah nonprofit corporation (the "New Entity") will be formed by the existing Salt Lake City Foundation (the "SLC Foundation"), and an Operating Agreement will be signed by the trustees of the SLC Foundation containing, among other things, the following provisions:

(i) The City will make a grant to the SLC Foundation in the amount of approximately $12,000. The SLC Foundation will use this amount of money to capitalize the New Entity, which in turn will use these funds for incidental costs incurred in connection with starting up the Project.

(ii) The SLC Foundation will be the sole member/owner of the New Entity.

(iii) The New Entity should apply for 501(c)(3) status. Given the nature of the Project and that the New Entity will be 100% owned by the SLC Foundation, which is already a 501(c)(3) entity, tax-exempt status should not be difficult to obtain.

(b) At the closing, the New Entity will enter into a Ground Lease with the City, pursuant to which the parties agree as follows:

(i) The City agrees to ground lease approximately 2.2 acres along 900 West to the New Entity.

(ii) The Ground Lease is for a term that will expire 39 years following the date on which the Project is placed in service.

(iii) The rent is $1 per year.

(iv) The parties acknowledge they are simultaneously entering into the Master Lease Agreement (see below).

(v) At the end of the term, the City becomes the owner of the Project.

(c) At the closing, the City and the New Entity will enter into a Master Lease Agreement, pursuant to which the parties agree as follows:

(i) The New Entity agrees to cause the construction of the Project at its expense. The City agrees to act as the agent of the New Entity for the purpose of constructing the Project. The New Entity will agree to pay the City a developer fee of about $210,000. The City can use that money to fund reserves to pay for the costs of operation and maintenance.

(ii) Following substantial completion of the Project, the City agrees to use its best efforts to lease the space to permitted users and lessees, such as educational institutions and non-profit organizations, and to use the facility as the site for public programming that is currently funded by the City or may be desired by the community to meet specific community needs.

(iii) The Master Lease will be a "net lease" (under which the City is responsible for all costs of operation of the Project).

(iv) The City will retain all rent and fees paid by sublessees and users.

(v) The term of the Master Lease will be 20 years.

(vi) The rent to be paid by the City will be $55,000 per year for the first year, with a 1% increase each of the next nine years. In year 11, the rent increases to $85,750 per year, with a 5% increase in the next nine years. This amount allows the New Entity to pay debt service owing on the CDE Loans (described below). At the closing, reserves will be funded that will pay the full amount of this rent during the first seven years. In order to prevent the City's rent obligation from constituting unconstitutional debt, there will be a "subject to appropriation" clause, pursuant to which the New Entity acknowledges that the payment of rent each year is subject to an annual appropriation by the City Council. There would also be a clause that provides that the subleases and the rental payments thereunder will be assigned as security for the City's Master Lease obligations, so that if the City ever fails to pay rent (including but not limited to by reason of the City's failure to appropriate the necessary funds), the rent payable by sublessees will be paid to the New Entity (up to the amount owed by the City from time to time).

(vii) The parties will acknowledge that the City will initially hold reserves in the amount of $210,000 to use for operational costs that are not covered by income from the Project during the term of the Master Lease. (This money will come from the developer fee earned by the City discussed above).

(d) At the closing, the City will enter into a loan agreement with a newly formed subsidiary of the Bank (the "Investment Fund"), pursuant to which the parties agree as follows:

(i) The City agrees to make a loan (the "City's Investment Loan") in the amount of $4,721,055 to the Investment Fund. The terms are as follows:

1. It will have a term of 8 years.

2. The City will agree to accept from the Investment Fund, in satisfaction of its obligation to repay the City's Investment Loan, an assignment to the City of the larger CDE Loan (discussed below), should the Investment Fund elect to cause the CDE (defined below) to distribute the same in kind to the Investment Fund.

3. The maturity date of the City's Investment Loan may be extended in the event there is an unexpected delay in the full funding of the Investment Fund's investment in the CDE to account for the resulting increase in the length of the compliance period under the New Markets Tax Credits Program (i.e. seven years after last investment is made (the "NMTC Compliance Period"), plus a reasonable time thereafter is allowed to enable the SLC Foundation to acquire the Bank's membership interests in the Investment Fund, pursuant to either the "Put" or "Call" rights described below).

4. It will bear interest at the rate of 0.50% per annum.

5. No principal payments are required, only monthly payments of accrued interest until maturity.

6. The City agrees that, notwithstanding any default under the loan by the Investment Fund to the CDE, the City

will forebear from exercising any of its remedies prior to the maturity date of the City's Investment Loan.

7. The Investment Fund will pledge its partnership interest in the CDE as the sole security for the City's Investment Loan.

(ii) The Bank agrees to make a capital contribution (the "Investor's Contribution") to the Investment Fund in the amount of $2,058,174.

(iii) The Investment Fund agrees to use the proceeds of the City's Investment Loan and the Investor's Contribution to make a capital contribution to a newly formed, special-purpose limited liability company (the "CDE") controlled by the Bank.

(iv) The Investment Fund agrees to cause the CDE to make two loans to the New Entity on the following terms:

1. One loan will be in the amount of approximately $4,721,055 and one loan will be in the amount of $1,990,382 (the "CDE Loans"). Each loan will bear interest at the rate of 0.82% per annum and have a term of 36 years. Each will be interest only during the NMTC Compliance Period, and then it will begin paying principal with a balloon payment due in the last year. The larger loan will be secured by a deed of trust on the New Entity's ownership interest in the building and its leasehold interest in the land created by the Ground Lease. The smaller loan may or may not be secured.

2. The New Entity will agree to use the Project only for the specified purposes that are in compliance with the Tax Credits Program.

(e) At the closing, the SLC Foundation will sign an indemnification agreement pursuant to which it agrees that it will indemnify the Bank for any losses incurred by the Bank as a result of the violation of the New Entity's representations and covenants that the New Entity will comply with the requirements of the Tax Credits Program.

(f) At the closing, the Bank will enter into an Option Agreement with the SLC Foundation, pursuant to which the parties agree as follows:

(i) The SLC Foundation grants the Bank the option to sell its membership interest in the Investment Fund to the SLC Foundation for a purchase price of $1,000 at the end of the NMTC Compliance Period (the "Put").

(ii) If the Put is not exercised by the Bank, the Bank grants the SLC Foundation the option to purchase its membership interest in the Investment Fund for a purchase price equal to the fair market value of the membership interest, which will be determined in accordance with an agreed upon formula (the "Call"). The actual amount of the fair market value of the membership interest at the time the Call is exercised will end up to be a number that is less than $100,000. This is because the Investment Fund will have a liability to pay the City's Investment Loan of $4,696,508, which will be satisfied by assigning the larger CDE Loan to the City, and then the only other asset of the Investment Fund will be the smaller CDE Loan. The fair market value of that approximately $2 million loan, given its long maturity and its low interest rate and principal repayment requirements, and given that it is subordinate to the larger CDE Loan (which will be secured by a deed of trust on the building), will be very modest; prior to the closing, financial projections will be made, using reasonable future market assumptions, that will demonstrate that the loan will be worth less than $100,000. The New Entity can establish/build up reserves to make sure this sum is available if the SLC Foundation needs to exercise the Call in the event the Put is not exercised.

The Bank's Exit:

If the Put is exercised, the SLC Foundation will control the CDE and can then exercise the rights of the Investment Fund under the operating agreement of the CDE, which will include (i) the right to require a distribution in kind of the CDE Loans to the Investment Fund, (ii) the right to remove and replace the managing member of the CDE, and (iii) the right to elect to dissolve the CDE. The SLC Foundation would then be able to determine the disposition of the CDE Loans (including the right to cause them to be assigned in satisfaction of the City's Investment Loan as described above). While this may be a taxable event, there are no tax consequences because the SLC Foundation is a 501(c)(3). There would be no remaining obligations of the City or the SLC Foundation (other than pursuant to the indemnification agreement discussed below). If the Project is subsequently transferred to the SLC Foundation or the City, there could possibly be tax consequences, but it is likely that the transfer could be structured to eliminate those issues, and assuming that the New Entity is a 501(c)(3), there will definitely be no liability at that point.

If for any reason the Put is not exercised, then SLC will exercise its Call, which results in the same scenario as described in the previous paragraph.

Risks:

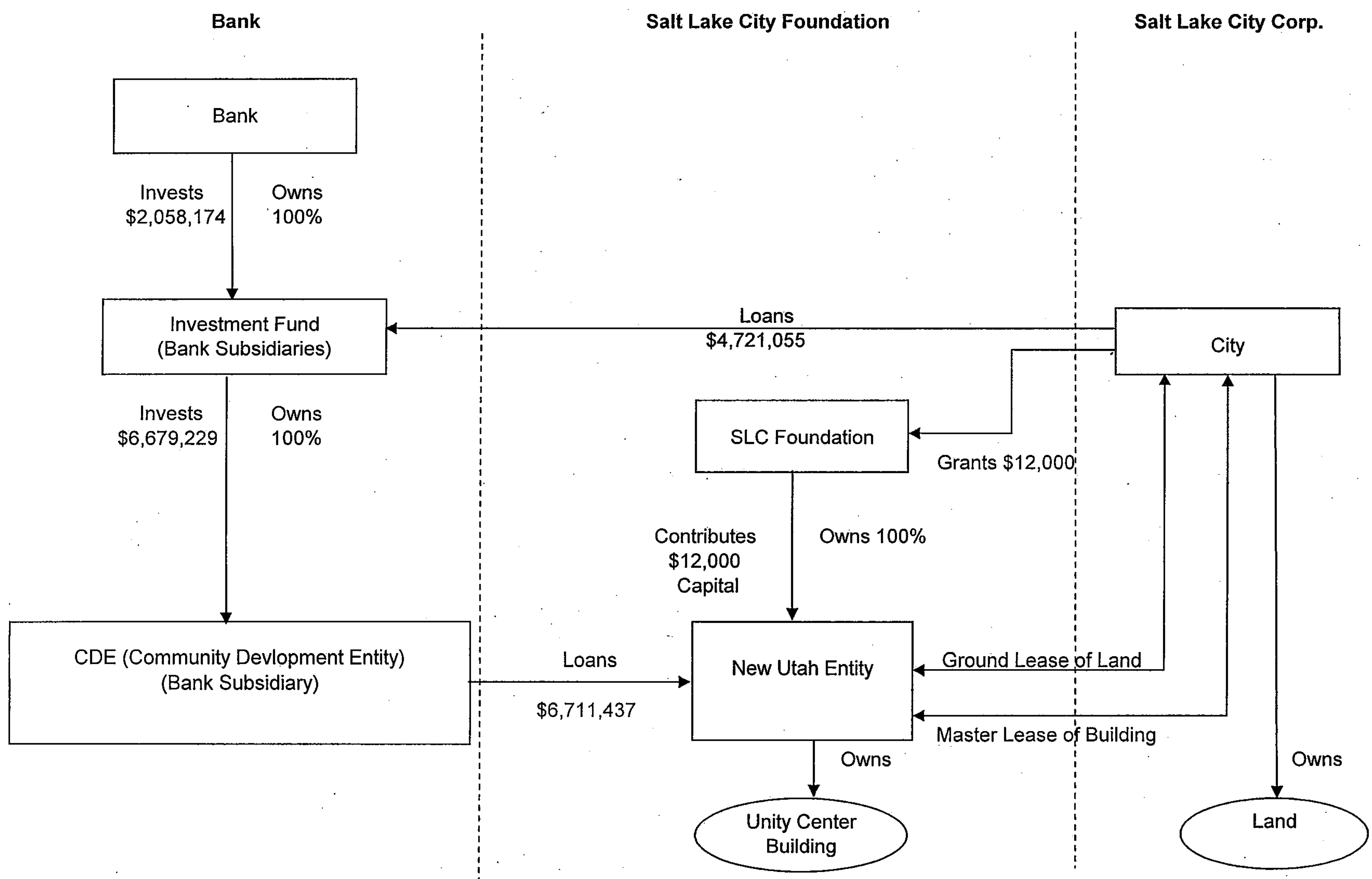
(1) Under the indemnification agreement by the SLC Foundation referred to above, if the New Entity were to use the Project for the purposes of operating (1) an apartment complex, (2) a bank, credit union or other financial institution, or (3) a country club, massage parlor, hot tub facility, suntan facility or racetrack, the Bank would have its tax credits recaptured and the SLC Foundation would be responsible for paying the Bank an amount equal to its anticipated federal tax credits. By managing the Project to avoid those prohibited uses, the City, as the master lessee under the Master Lease, can prevent the SLC Foundation from being liable for such amounts.

I understand that the Department of Public Services has created pro formas for the revenues and costs in operating the Project over the next seven years. I also understand that, based on prior discussions with the Council (1) City appropriations for funds for the operation of the Project will be required in a few years, once the initial operational reserves have been depleted, and (2) to the extent that it turns out to be more difficult than projected to locate users of the Project willing to pay rent and/or a share of the operating costs of the Project, these operational subsidies may be more than the current pro formas provide.

Please call me if you have any questions regarding the foregoing.

Thank you.

FLOW OF FUNDS



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COUNCIL TRANSMITTAL

OK Steve Fawcett

TO: Steve Fawcett
Deputy Director, Management Services Department

FROM: Kay Christensen

SUBJECT: Approval of Transfer of Municipal Assets under Utah Code Annotated Section 10-8-2

STAFF CONTACT: Kay Christensen
535-7677

DOCUMENT TYPE: Study required by UCA Section 10-8-2 and request for Public Inspection and Public Hearing as required by UCA Section 10-8-2

BACKGROUND/DISCUSSION: This information is being provided in compliance with UCA Section 10-8-2, which states the purposes for which a municipal body may appropriate funds. The Statute sets forth a specified process which must be followed to determine if a charitable contribution can be made. The process has three steps:

1. A study must be performed that identifies the net equivalent value received by the City in exchange for any City asset contributed. The benefit may be intangible. The study must consider the following factors:

a. The specific benefits to be received by the City;

b. The City's purpose in making the appropriation, including an analysis of how the safety, health, prosperity, moral well-being, peace, order, comfort or convenience of the residents of Salt Lake City will be enhanced; and

c. Whether the appropriation is "necessary and appropriate" to accomplish the City's goals.

2. Notice of a public hearing must be published in a newspaper of general circulation at least 14 days prior to the date of the hearing, and the notice must include the availability of the completed study for public inspection.

3. A public hearing must be held by the City Council and the Council must make a determination that the appropriation will provide for the safety, health, prosperity, moral well-being, peace, order, comfort or convenience of the residents of the City, and that the net value received by the City will constitute adequate consideration or equivalent value for the benefit being provided by the appropriation.

Attached is a study regarding Salt Lake City Corporation's intention to enter into a financial arrangement in order to reap the benefits of the federal New Market Tax Credit program for the construction and operation of the Sorenson Unity Center. The arrangement requires the City to enter into a ground lease and a master lease.

MEMORANDUM

TO: Steve Fawcett

FROM: Kay Christensen

DATE: October 30, 2006

SUBJECT: New Market Tax Credit Financial Agreement Regarding the Sorenson Unity Center: Study to Comply with Utah Code Annotated Section 10-8-2

UCA 10-8-2 states the purposes for which a municipal body may appropriate public funds and the factors that must be considered in determining the propriety of such an appropriation.

Salt Lake City Corporation intends to enter into a financial arrangement in order to reap the benefits of the federal New Market Tax Credits Program for the construction and operation of the Sorenson Unity Center. The arrangement requires the City to enter into a ground lease and a master lease.

To ensure that the financial arrangement is in compliance with UCA 10-8-2, the following study has been performed. This study will consider the following factors:

(1) The specific benefits to be received by the City;

(2) The City's purpose in making the appropriation, including an analysis of how the safety, health, prosperity, moral well-being, peace, order, comfort or convenience of the residents of Salt Lake City will be enhanced; and

(3) Whether the appropriation is "necessary and appropriate" to accomplish the City's goals.

Benefits and Costs to Salt Lake City: The New Market Tax Credits Program was enacted by Congress in December 2000 as part of the bipartisan

Community Renewal Tax Relief Act. The purpose of the NMTC is to spur private investment in low-income urban and rural communities. The program is based on the idea that there are viable business opportunities in low-income communities and that a federal tax credit would provide an attractive incentive to increase the flow of investment capital to such areas. Tax credits will make the cost of capital 2 or 3 percentage points below the cost it would have been without the credits. The program offers a credit against federal income taxes for qualified organizations, called "community development entities (CDE's)." CDE's qualify for the program and are allocated an amount of New Market Tax Credits. The CDE must then seek a "qualified equity investment (QEI)."

When Salt Lake City learned of the New Market Tax Credits Program, the City began to seek a CDE that would be interested in helping to finance the Sorenson Unity Center. While the City owns the property on which the Center will be constructed and substantial donated funds for construction, recent increases in construction costs have raised the price of construction beyond the funds on hand. Low bid on the project came in at over $700,000 more than expected. Fortunately, the City had been in negotiation with a well-respected financial institution (the "Bank") with New Market Tax Credits that is willing to consider the Sorenson Unity Center a candidate for support as a qualified equity investment. Certain terms and conditions are necessary to achieve the status of qualified equity investment and it is those terms and conditions that require analysis under the provisions of UCA 10-8-2.

Because the New Market Tax Credits cannot go directly to a government entity, the following structure has been created to allow the City to reap the benefits of the program:

The City has available approximately $4.7 million in donations and interest to construct the Sorenson Unity Center. The Bank has been allocated federal New Market Tax Credits and is willing to contribute approximately $2,050,000 into the Center through the Tax Credits program.

The City will make a loan of the $4.7 million to the Bank's Investment Fund (CDE) for a term of 8 years. The CDE will then make a capital contribution, generated from the Tax Credit program, to the Investment Fund of approximately $2,050,000.

In essence, because of the benefits the Bank would receive under the Tax Credits Program over the first seven years after construction of the Project, the Bank's $2,050,000 contribution can remain with the Project with no repayment or any other remaining obligations on the part of the City.

The CDE will then lend approximately $6.7 to the entity that will facilitate the construction and operation of the Sorenson Unity Center. That entity is a new Utah nonprofit corporation (the "New Entity") formed by the existing Salt Lake City Foundation (the "SLC Foundation"). This structure is necessary to meet the requirement of the federal NMTC program. The SLC Foundation will be the sole member/owner of the New Entity.

The New Entity will build the Center, pay interest on the loans and keep reserves for closing out the investment after approximately 8 years.

The City will ground lease (for a term of 39 years) the 2.2 acres of land for the Sorenson Unity Center to the New Entity. The New Entity will own the building. The City's approximately $4.7 million loan will be secured by a deed of trust on the leasehold interest in the building secured by the ground lease. Rent will be $1 a year and at the end of the term the City will become the sole owner of the project.

At the same time the City and the New Entity will enter into a master lease agreement in which the New Corporation agrees to cause the construction of the Sorenson Unity Center at its expense and the City agrees to act as the agent of the New Entity for purposes of constructing the project. The New Entity will agree to pay the City a developer fee of approximately $210,000. The City can use that money as a reserve to pay for the cost of operation and maintenance of the facility.

The City will not make its loan until there is a binding loan agreement between the CDE and the New Entity stating that the CDE is obligated to make the loans to the New Entity for the purpose of financing the construction of the Sorenson Unity Center. The CDE could not use the funds for any other purpose. If for any reason the City's loan could not be used (for example, if the block were accidentally contaminated with hazardous materials that could not be cleaned up), the CDE would be obligated to immediately return the money to the City.

The Investment Fund will pledge its 99.99% partnership interest in the CDE as security for the performance of the Investment Fund's obligations to the City.

When the building is completed, the City will lease the space to educational institutions, non-profit organizations and others as possible, and use the facility as the site for public programming that is currently funded by the City or may be desired by the community to meet specific community needs. Under the terms of the master lease, a "net lease," the City will be responsible for all costs of operation of the Center and will retain all rent and fees. The term of the master lease is 20 years.

Meeting Salt Lake City's Purpose and Enhancing the Quality of Life for Residents: As a result of the New Market Tax Credits Program, Salt Lake City will gain approximately $2 million in additional funds to construct and operate the Sorenson Unity Center. Because the low bid on construction of the Center was $700,000 above expectations, it would not be possible to construct the Center as planned without an infusion of funds from the City or from the New Market Tax Credits Program. While the City will incur costs related to the New Market Tax Credits Project, and will loan funds to the CDE and enter into a lease agreement with the New Entity, the approximately $2 million in funds flowing into the project will be adequate to cover all costs of construction, legal and other fees associated with the project, and may even provide some residual funds for operation and maintenance.

In order for the Bank to be eligible to receive new market tax credits, the Sorenson Unity Center must remain an eligible project. If the New Entity were to use the project for the purposes of operating (1) an apartment complex, (2) a bank, credit union or other financial institution, or (3) a country club, massage parlor, hot tub facility, suntan facility or racetrack, the Bank would have its tax credits recaptured and the SLC Foundation would be responsible for paying the Bank an amount equal to its anticipated tax credits. By managing the Sorenson Unity Center to avoid those prohibited uses, the City can prevent the SLC Foundation from being liable for such amounts.

The new Sorenson Unity Center will serve the area from 1300 South to 2100 South and Redwood Road east to 700 East. While the proposed facility will be an asset for the whole City, the target area is this underserved segment of the City. The Glendale, Poplar Grove area is one of the City's most diverse communities.

To determine the demographics of this target area, the City examined census statistics in Census Tracts 1028.02, 1029 (which goes north to 9th South west of 1-15), 1031, and 1032; four Census Tracts.

The Salt Lake City School District reports that there are at least 28 languages spoken in this geographic area, and that there are over 1,700 children who are not currently served by any early childhood education program.

With regard to general population, race and ethnicity, age, household status (whether single head of household or married), income level, education level, rental or ownership of residence, and primary language, the following statistics apply:

Population- 17,053

Race

White-	12,093
African American-	486
American Indian-	471
Asian-	618
Pacific Islander-	711
Some other race-	1,801

Ethnicity

Hispanic- 3,978 (23%)

On the census form "Hispanic" is not listed as a race, so the majority of the category "some other race" are Hispanics also.

Median Age

The median age in the area is 30.

Housing

There are 6,773 housing units in the target area. 3,160 of those units are owner occupied (49.5%) and 3, 221 (50.5%) are renter occupied.

Language
There are 4,646 people who speak English as their primary language, 979 who speak Spanish, 357 who speak other Indo-European languages, 283 who speak Asian and Pacific Islander languages (mostly Tongan), and 137 who speak other languages. Those are very broad categories that encompass the 28 languages mentioned by the School District.

Place of Birth
3,671 residents of the target area are foreign born. 72% of those people are not citizens and 28% are naturalized citizens.

Family Type
Female Head of household with children under 18. 543
Male head of household with no wife present and children under 18. 183

Income
Median Family Income $36,000.

The Sorenson Unity Center project is not an expansion of the existing recreation center. Its mission is to, "Provide a public space that appeals to, welcomes and values the culture of all people. The Center will offer multi-generational programs and services that are unique to the needs of the community, bridge cultural difference, and allow people to work, play and learn from each other. Programs and services will be designed to be broad in their appeal, sustainable, and cost effective so all participants experience equal and fair treatment. The Center will be a safe place for all to enjoy."

It is expected that the Center will serve at least 325 people per day in the full range of services and programs offered. There is no facility offering the same services anywhere in the Glendale/Poplar Grove area.

Accomplishing Salt Lake City's Goals: The mission of Salt Lake City Corporation is "to make Salt Lake City the best place to live, work, play, visit and to do business." The Sorenson Unity Center is an asset to the City in achieving each of those goals, and the New Market Tax Credits agreement will make construction of the Center as planned a reality.

In conclusion, the City is fortunate to have found a financial institution willing to invest in the future of Salt Lake City's west side, and the New Market Tax Credits project is necessary and appropriate to accomplish the City's goal.

RESOLUTION NO. _____ OF 2006
(ACCEPTING THE STUDY PERFORMED
IN COMPLIANCE WITH *UTAH CODE* SECTION 10-8-2
AND APPROVING A GROUND LEASE AND MASTER LEASE
AND AN APPROPRIATION OF MONEY
RELATING TO THE PROPOSED SORENSEN UNITY CENTER

WHEREAS, the City Administration has recommended that the City construct the Sorensen Unity Center (the "Unity Center"); and

WHEREAS, the City Administration has recommended that the City obtain approximately $2,000,000 through a financing involving new markets tax credits; and

WHEREAS, such new markets tax credit financing requires the City to ground lease the land on which the Unity Center will be located to a Utah nonprofit corporation (the "New Entity"), the sole member/owner of which will be the existing Salt Lake City Foundation, and thereafter to enter into a master lease with the New Entity pursuant to which the City will lease from the New Entity the Unity Center and the land on which it is located; and

WHEREAS, under the master lease the City will be obligated to perform certain ongoing services with respect to the Unity Center that will benefit the New Entity; and

WHEREAS, the City Council has received and reviewed a study (the "Study") regarding the proposed ground lease and master lease prepared by the City's Department of Management Services in compliance with the requirements of *Utah Code* Section 10-8-2, and public notice has been given at least 14 days prior hereto in a newspaper of general circulation within the City; and

WHEREAS, the Council has reviewed the Study, and has fully considered the analysis and conclusions set forth therein, and all comments made during the public hearing;

NOW, THEREFORE, BE IT RESOLVED by the City Council of Salt Lake City, Utah:

1. The City Council hereby adopts the conclusions set forth in the Study, and hereby finds and determines that, for all the reasons set forth in the Study, the net value to be received by the City from the new markets tax credits financing will constitute adequate consideration, or equivalent value, both tangible and intangible, for the benefit being provided by the proposed ground lease and master lease;

2. In the judgment of the City Council, the Unity Center, through the ground lease and the master lease, will provide for the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of Salt Lake City;

3. $4,733,843 is hereby appropriated from the City's Special Revenue Account for (a) a loan to the made from the City to an investment fund that owns a community development entity and (b) a grant to the Salt Lake City Foundation, each in connection with the new markets tax credits financing.

Passed by the City Council of Salt Lake City, Utah, this 14th day of November, 2006.

SALT LAKE CITY COUNCIL

By______________________________
CHAIRPERSON

ATTEST:

____
CHIEF DEPUTY CITY RECORDER

APPROVED AS TO FORM
Salt Lake City Attorney's Office
Date 10-2-06
By Boyd Ferguson

I:\RESOLUTI\Doug Short matters\Accepting 10-8-2 study re Unity Center 11-2-06.doc