COUNCIL AGENDA: 10-25-11
ITEM: 7.1

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Kerrie Romanow
Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: October 11, 2011

Approved

Date 10/11/11

COUNCIL DISTRICT: 3

SUBJECT: NEW MARKETS TAX CREDIT FINANCING FOR THE CONSTRUCTION OF THE ENVIRONMENTAL INNOVATION CENTER

RECOMMENDATION

1. Adopt a resolution to authorize the City Manager to execute a Ground Lease, Master Lease, Development Agreement, One-Day Loan Agreement, Investment Fund Leverage Loan Agreement, Put/Call Agreement, Environmental Indemnification in the form proposed, and to authorize the City Manager to execute and deliver these documents and other related documents as necessary in connection with the closing of the New Markets Tax Credit (NMTC) financing transaction for the Environmental Innovation Center project.
2. Adopt the following 2011-2012 Appropriation Ordinance and Funding Source Resolution amendments in the Integrated Waste Management Fund:
    a. Increase the estimate for Earned Revenue by $8,022,174 to recognize revenue from a one-day loan;
    b. Decrease the appropriation to the Environmental Services Department for Household Hazardous Waste Las Plumas Facility by $11,587,471;
    c. Establish an appropriation to the Finance Department for a NMTC Transaction Leverage Loan in the amount of $19,609,645;
    d. Increase the estimate for Earned Revenue by $8,022,174 to recognize ground lease revenue;
    e. Decrease the appropriation to the Environmental Services Department for Non-Personal/Equipment by $20,055;
    f. Establish an appropriation to the Finance Department for the NMTC Transaction One-Day Loan Repayment in the amount of $8,042,229;
    g. Increase the estimate for Earned Revenue by $10,630,285 to recognize revenue from an initial draw and the fiscal year 2011-2012 portion of development budget;
    h. Increase the appropriation for Household Hazardous Waste Las Plumas Facility by $10,441,785;
    i. Establish an appropriation to the Office of Economic Development for the Environmental Innovation Center's Public Art in the amount of $188,500.

OUTCOME

Approval of this recommendation will enable the City to close the proposed NMTC financing transaction to pay for the remaining construction-associated costs for the San José Environmental Innovation Center (EIC) project, netting approximately $4,500,000 in additional construction funds for the EIC after deducting all transaction fees and compliance period expenses. Timely action on this transaction will secure the project's financing, which is recommended given the increasing demand for NMTCs despite the reduction in NMTC allocations from the Federal Government.

EXECUTIVE SUMMARY

Staff first presented Council with the proposed NMTC transaction as a means of leveraging private investment with City funds for the EIC on May 17, 2011. Subsequently on June 21, 2011, Council authorized the execution of a term sheet with JPMorgan Chase Bank, N.A. (Chase) and three Community Development Entities (CDEs). Proceeds from the transaction would be used to complete the EIC project which currently has a funding gap of approximately $4,350,000. Initially, staff estimated there would be $6,000,000 in net proceeds from the NMTC transaction; however, a lower than anticipated appraisal and exclusion of certain staff costs from the valuation of property resulted in a reduction of the net NMTC proceeds to $4,500,000. After modifying the scope of the EIC's furniture, fixtures, and equipment (FF&E) budget, eliminating the FF&E contingency, and reducing the construction contingency from 15% to 12%, the revised net NMTC proceeds are sufficient to cover the EIC's funding gap, and the reduced budget will not impact the functionality of the project.

To close the NMTC transaction, the City will need to execute several agreements, including: a Ground Lease Agreement to convey the City's interest in the property and its improvements to the EIC QALICB, Inc.; an Environmental Indemnification whereby the City holds Chase, the CDEs, and the EIC QALICB, Inc. harmless from any claims related to environmental contamination on the property; a One-Day Loan Agreement with Chase in an amount equal to certain City third party project expenses; a Leverage Loan Agreement with the Investment Fund equivalent to the sum of the One-Day Loan amount and City funds previously appropriated for the EIC; a Development Agreement between the City and the EIC QALICB, Inc. to oversee the construction of the EIC; a Master Lease Agreement between the City and EIC QALICB, Inc. so the City may continue to operate the facility after construction and ensure the EIC is used in a manner consistent with the NMTC program and funding sources; and a Put/Call Agreement between the City and Investment Fund's members to allow for the purchase of the Investment Fund's indirect interest in the EIC project and the unwinding of the NMTC structure.

BACKGROUND

Environmental Innovation Center

The EIC is located at 1608 Las Plumas Avenue on a 4.2 acre lot. The City completed an initial phase of improvements (Phase I) in June 2010 which included the installation of several sustainable technologies such as an advanced stormwater mitigation system, pervious sidewalk pavements, and light-emitting diode (LED) streetlights. The second phase of the project (Phase II) has been designed to attain a minimum of Leadership in Energy and Environmental Design (LEED) Silver certification by the U.S. Green Building Council. With the NMTC proceeds and a grant from the U.S. Department of Commerce's Economic Development Administration, staff anticipates that the EIC could achieve LEED Platinum certification for New Construction (a first for a City building) and be near net zero energy usage. Phase II will renovate the existing warehouse to include: a Clean Technology Demonstration Center (CTDC) where innovators will test and develop alternative energy, green fleet commercial vehicles, and emerging energy efficient technologies; conference space for environmental workshops and job trainings; and a Habitat for Humanity ReStore to sell discounted new, like new, and surplus construction materials. Phase II will also include the addition of a 10,000 square foot permanent Household Hazardous Waste (HHW) drop-off facility for the convenient and safe disposal of hazardous household items.

The City has expensed approximately $12,256,600 on the EIC through August 2011. Table 1 below outlines $4,777,174 which was spent on third party services and products. An additional $4,500,000 was spent by the Environmental Services Department (ESD) to purchase the property, and the remainder, $2,979,426, was primarily expensed on ESD and Department of Public Works (DPW) staffing costs. Staff estimates there are $15,693,435 of remaining costs, yet the City currently only has $11,587,471 available. Thus, there is an estimated funding gap of $4,105,964. The remaining costs consist of: a $11,094,935 construction contract for Phase II with a minimum $1,330,000 (12%) contingency awarded by Council on May 31, 2011; $188,500 for public art; approximately $980,000 for Group4 Architecture Research + Planning, Inc. (Group4) to assist with construction administration, LEED certification, coordinate with the general contractor and public artist, and prepare a signage package; and $2,100,000 for FF&E to provide a turn-key space and to more likely yield a higher lease rate to offset any operating and maintenance costs. As discussed in the Phase II supplemental construction award memorandum presented to Council on May 31, 2011, the approximately $240,000 needed to fund DPW personal services personnel services for construction administration in 2011-2012 would be funded from ESD's existing 2011-2012 appropriations in the Integrated Waste Management Fund if these costs are not funded from NMTC proceeds. The source of funding for these ESD appropriations would be a combination of ratepayer revenue, AB939 fees, and late fees.

Table 1

Third Party Expenses Through August 2011	**Amount**
Site Preparation/Improvements (Phase I)	$1,821,277
Utility Connections	$186,667
Permits, Reports & Studies	$33,579
Lead Testing & Asbestos Remediation	$57,587
Groundwater Monitoring	$155,627
CEQA Review & Compliance	$235,915
CTDC Consultants	$57,750
Architects & Engineers	$2,228,772
Total	**$4,777,174**

New Markets Tax Credit Program

The NMTC program, enacted by Congress and administered by the U.S. Department of the Treasury, was created to promote economic development in distressed areas. Each year, the Treasury's Community Development Financial Institution Fund competitively allocates tax credits to eligible organizations referred to as CDEs. CDEs then solicit private equity investments in exchange for federal income tax credits over a seven-year compliance period totaling 39% of the qualified equity investment made into a QALICB that sponsors a project benefiting its community.

As initially reported to Council on May 17, 2011, staff proposes to finance the remaining EIC project costs by structuring a NMTC financing transaction that will generate the funding necessary to complete the project. In the proposed transaction, the City will be involved in several key capacities as the leverage lender, developer, ground lessor, and master tenant (refer to page 1 of the Attachment). Staff last updated Council on the proposed transaction on June 21, 2011, when Council authorized staff to negotiate and execute a term sheet with Chase as the investor and Brownfield Revitalization, LLC, HEDC New Markets, Inc., and the Northern California Community Loan Fund as the CDEs.

Staff had anticipated closing the NMTC transaction in August 2011. The delay in closing was due to efforts by all parties to reconcile a low appraisal of the property with the scope of the financing. This NMTC transaction required an appraisal of the proposed project to ensure that there is adequate security to support the qualified low-income community investment (QLICI) loans to the qualified low-income community business (QALICB). The current economic climate continues to negatively impact land and building values across the country, and the appraisal for the EIC property came in lower than a 2005 appraisal. The valuation of the "as is" market value of the property was $8,022,174, significantly less than the expenses the City had incurred through August 2011 and had proposed as the ground lease payment amount. The discrepancy between the valuation and ground lease payment led to a reevaluation of the loan amounts for which tax opinions must be issued. The transaction is now estimated to net nearly $4,500,000 for the construction of the EIC after all transaction-related expenses, fees, and reserves. This amount remains sufficient to complete the EIC's construction with a reduced

FF&E budget and contingency amount than initially anticipated. No major impacts to the constructability of the project are expected.

EIC QALICB, Inc.

On May 17, 2011, Council authorized the City Manager to establish an independent QALICB for the purpose of participating in the proposed NMTC transaction and to appoint the initial five members for the QALICB's Board of Directors. Subsequently on June 20, 2011, the EIC QALICB, Inc. was formed as a California nonprofit public benefit corporation. An application is in the process of being submitted to the Internal Revenue Service for the EIC QALICB, Inc.'s tax exemption status. The first official meeting was held on July 15, 2011, to review the filed Articles of Incorporation, ratify the Board's composition, elect officers, and discuss the organization's Bylaws. Weekly board meetings have been scheduled, for the most part, through the anticipated closing period of the NMTC transaction.

ANALYSIS

Conditions of Closing

The closing of the NMTC financing transaction is still subject to several conditions of Chase and the CDEs, such as: receipt and approval of due diligence items, receipt and approval of all necessary NMTC documentation, and receipt and approval of tax and authority opinions. To satisfy such requirements, staff has been diligently working to prepare and compile the necessary information and reports. The items that have been requested from the City to date include: a detailed project budget and disbursement schedule, documentation of project expenses to date, information from Applegate Johnston, Inc. and Group 4, an appraisal, a probable maximum loss study, environmental reports on the existing groundwater contamination, an American Land Title Association (ALTA) survey, and a title insurance policy.

Ground Lease Agreement

The proposed NMTC structure requires the City to enter into a long term ground lease for the parcel on which the EIC is sited, at 1608 Las Plumas Avenue. The City will maintain a fee interest in the property but will convey a long term 99-year ground lease interest to the EIC QALICB, Inc. which includes development rights. The EIC QALICB, Inc. will pay the City an estimated $8,022,174 upfront in consideration for the ground lease. This payment amount is equivalent to the sum of the appraised "as is" value and costs the City incurred for the benefit of the EIC QALICB, Inc. related to third party services and the development of the project. This payment for the ground lease cycles through the financing structure as the One-Day Loan discussed below.

The ground lease would be subject to use restrictions consistent with the special funding sources used to pay for the HHW facility and Habitat for Humanity Restore portions of this project, or other services consistent with the source of funds used to build the facility. All improvements to the property would need to be in compliance with all applicable laws and ordinances such as the General Plan, Zoning Ordinance, and Municipal Code imposed by the City. These improvements would remain and be surrendered with the property upon termination or expiration of the ground lease. Furthermore, to ensure compliance with the NMTC program, the EIC QALICB, Inc. or any subsequent lessee would not be allowed to use the property for any of the following uses: (i) any trade or business consisting predominantly of the development or holding of intangibles for sale or license; (ii) any trade or business the principal activity of which is farming; (iii) any other trade, business or activity prohibited by any amendment to Section 45D of the Internal Revenue Code; (iv) private or commercial golf course; country club; massage parlor; hot tub facility; suntan facility; race track or other facility used for gambling; any store the principal business of which is the sale of alcoholic beverages for consumption off premises; shooting gallery; adult bookstore or facility selling or displaying pornographic books, literature, or videotapes; bingo or similar games of chance; or video game or amusement arcade. The property also could not be used to provide dwelling units, or other areas with sleeping accommodations, other than on a transitory basis.

Environmental Indemnification

In 1986, five underground storage tanks were removed from the property, four 2,000 gallon tanks and one 10,000-gallon tank located in the southeastern portion of the site. In April 1999, the Regional Water Quality Control Board (RWQCB) requested that the City investigate a potential fuel leak related to the 10,000-gallon tank. Between January 2000 and June 2001, the City performed two soil and groundwater contamination investigations. The data and results of these investigations showed the soil and groundwater were contaminated with petroleum hydrocarbons and chlorinated volatile organic compounds, localized to the above referenced southeastern portion of the site. Following those investigations, the City installed six permanent groundwater monitoring wells between 2003 and 2005 to assess the extent of groundwater contamination. Beginning in 2010, the RWQCB approved a reduction of monitoring frequency to a semi-annual basis. The groundwater contamination results in the wells have remained stable since the data was first collected, and the groundwater plume remains on-site.

In 2009, the City's consultant conducted additional testing and sampling of the groundwater beneath the building to further define the contamination. The consultant's report concluded that the contamination began at 15 feet below ground surface with the higher concentrations at least 20 feet below ground surface. Due to this finding and the thick concrete slab beneath the warehouse, the report also concluded that vapor intrusion was not a likely concern for the proposed site use. More recently, the City has continued to contact the RWQCB to discuss the contamination at the site and next steps. Both agencies agreed that a Conceptual Site Model and Soil Gas Work Plan would be prepared. Such plan with a summary of the historic data and investigations to date was submitted in April 2011 for which the City is awaiting feedback from the RWQCB. The City has continued to do additional investigations, such as soil gas sampling, whose results have led to the conclusions that vapor intrusion into the warehouse is unlikely, the plume is both stable and defined, and that the contamination should not hinder the project.

Chase and the CDEs have requested that the City unconditionally indemnify them from any potential future claims related to environmental contamination on the property. An indemnification agreement would require the City to, at its own cost and expense, take all actions which are either legally required to take to eliminate, clean up, contain, remediate, or address any contamination that impact to the property. An indemnity would also defend and hold Chase and the CDEs harmless from and against any and all claims, demands, damages, losses, liens, liabilities, penalties, fines, lawsuits and other proceedings and costs and expenses, which may arise directly or indirectly from or out of, or in connection with the property's contamination and any clean-up/remediation actions. Furthermore, as requested by Chase and the CDEs, the City's current environmental consultant will provide a reliance letter stating that the parties can rely on the consultant's reports previously prepared for the City.

One-Day Loan Agreement

The City will borrow an estimated $8,022,174 in the form of a one-day loan from Chase to capitalize on the current value of the property and certain development costs that the City has expensed to date. The City would be able to repay the one-day loan upon receipt of the upfront ground lease payment from the EIC QALICB, Inc. The EIC QALICB, Inc. will receive the funds to pay for the ground lease from the QLICI loans from the CDEs. A fee equivalent to 0.25% of the loan amount, estimated at $20,055, will be assessed and due at the time of the City's repayment of the loan. Staff proposes to fund with late fee revenue in Integrated Waste Management Fund's Non-Personal/Equipment appropriation. The cycling of the bridge loan proceeds typically occurs within a 24-hour period at the time of the NMTC transaction closing.

Leverage Loan Agreement

The City's leverage loan to the Investment Fund, estimated to be $19,609,645, combines the estimated $8,022,174 one-day loan amount with $11,587,471 of City funds previously appropriated for the project. The leverage loan will be for a term of 42 years. The City will not have a direct security interest in the project. However, the security for the leverage loan will be the Investment Fund's interest in the CDEs who in turn will have a security interest in the project through the QLICI loan to the EIC QALICB, Inc. The leverage loan will accrue approximately 0.50% interest per year for the first seven years. There will be no prepayment of the loan during the seven-year NMTC compliance period. Thereafter, full principal repayment is allowed without penalty. The leverage loan amount will amortize for the remaining 35 years of the term and will be due in full at the end of the term. The leverage loan agreement with the Investment Fund will also incorporate a seven-year standstill agreement under which the City will agree to forbear from exercising its rights, such as: accelerating the payment in full of all or part of the loan; filing or participating in the filing of any involuntary bankruptcy proceeding of the Investment Fund; exercising any voting rights or management and control rights of the collateral; and instituting a lien or taking any other action to enforce its rights and remedies.

Development Agreement

The City will enter into a development agreement with the EIC QALICB, Inc. to oversee the construction of the EIC. The expectation of the City will be to complete and deliver the project to the EIC QALICB, Inc. in a prompt and expeditious manner, consistent with good workmanship and in compliance will all applicable federal, state and local laws, rules, regulations, and ordinances. The City will also be responsible for the general administration and supervision of the project, keeping of account and cost records for the project, coordinating with the consulting architect, and regularly monitoring the construction progress schedule.
As consideration for assuming the responsibility for the development of the EIC, the City will have access to the development budget of the EIC QALICB, Inc. to fund the completion of Phase II construction and pay the remaining project costs. The development budget will be funded by QLICI loans between the EIC QALICB, Inc. and three CDEs, and will be held in a pledged and controlled construction disbursement account. Chase, acting on behalf of the lenders, will administer and authorize withdrawals of the QLICI loan proceeds. Releases of proceeds from the account will be limited to one draw per month and requests to withdraw from the construction disbursement account will need to be accompanied by supporting documentation compiled by the City, including progress reports, mechanic lien waivers, and inspection reports. In accordance with the DPW's standard retainage practices, the development agreement will require the City to withhold 10% of the cost of the work and materials in place for the project. Upon completion of the project's construction, the City may be eligible to receive a developer fee equivalent to the remaining amount in the development budget of the EIC QALICB, Inc., assuming there are savings and undisbursed amounts.

In addition to the development agreement, Chase and the CDEs have requested the City provide a Completion Assurance Agreement whereby the City would commit to complete the EIC within the development budget (see Table 2 below and page 2 of Attachment). In the event that the City identifies a difference between the actual budgeted or estimated costs, it will be required to advise the EIC QALICB, Inc. on how to modify the project to complete it within the available funds. The City, in consultation with Group 4 and Applegate Johnston, Inc., shall determine whether such item may be omitted or if the plans and specification for such item may be changed for cost savings without materially changing the functionality of the EIC, or if any other construction item may be omitted or modified for a savings in cost without materially changing the functionality of the EIC. If the City finds that cost savings are possible, the City would proceed with negotiating an appropriate change order to implement such cost savings. In the event there are cost overruns, staff anticipates utilizing the 12% construction contingency amount that has been set aside in the development budget. If additional funding is necessary, the City may consider revising the FF&E scope.

Table 2

Development Budget	FY 11-12	FY 12-13	Amount
Phase II Construction	$7,924,954	$3,169,981	$11,094,935
Construction Contingency (12%)	$953,498	$381,399	$1,334,897
Public Art	$188,500		$188,500
Furniture, Fixtures & Equipment (FF&E)	$787,500	$1,312,500	$2,100,000
Architectural Services (Group 4)	$653,333	$326,667	$980,000
Developer Fee		$250,000	$250,000
Total	**$10,507,785**	**$5,440,547**	**$15,948,332**

Master Lease Agreement

The City will enter into a 42-year master lease agreement with the EIC QALICB, Inc., to ensure the EIC's programming and use is not impacted or changed due to the NMTC financing. As the master tenant, the City will be required to make rent payments in consideration for having possession and beneficial use of the facility. Staff anticipates construction will be completed in December 2012, and occupancy of the facility should begin soon thereafter. Accordingly, the annual rent payments would be approximately $400,000 beginning fiscal year 2013-2014, and are projected to increase 2.5% each year thereafter through the term of the master lease. The City proposes to satisfy this rent obligation and operating expenses through the revenue from subleases for ReStore, the CTDC, and HHW facility. Staff anticipates the revenue from the ReStore and HHW operations will be sufficient to meet the rent obligation for the first seven years. Staff is working to secure funding sources for the CTDC; however, the structure of the existing revenues associated with the existing anchors at the EIC allows the CTDC to be vacant with no impact to the General Fund. Staff has received requests from outside organizations wishing to be located at the CTDC. If the CTDC does not proceed as anticipated, for whatever reason, staff will proceed with securing job and revenue generating uses associated with clean technology to occupy the CTDC space. The alternative use will also align with the project's funding sources. Furthermore, the City's rent payment would be returned to the City in the form of a payment on the City's leverage loan to the Investment Fund.

As discussed in the May 17, 2011 Council report, the City's rent payment to the EIC QALICB, Inc. ensures that the financing structure is maintained to prevent a potential redeployment of funds and foreclosure of the ground lease. Because the City will be serving in every key capacity in the project—including as a leverage lender, developer and master tenant—the likelihood of an event of default and redeployment of funds occurring is extremely low. The events that could cause a redeployment of funds will correspond to the events of default in the QLICI loan agreements between the EIC QALICB, Inc. and the CDEs. Any defaults that occur beyond a reasonable cure period could trigger foreclosure proceedings by the CDEs acting as lenders, which in turn, would require the redeployment of funds into another qualified NMTC project. Events which would trigger a default under the QLICI loan agreements and potentially cause a redeployment of funds are:

- failure by the EIC QALICB, Inc. to make its debt services payments in a timely manner;
- failure to complete the construction of the project as proposed; and

- bankruptcy by the EIC QALICB, Inc.

An occurrence of default and corresponding remedy actions, in and of themselves, will not cause a recapture of tax credits. For example, in the event of default, the CDEs may exercise the right to accelerate the payment on the QLICI loan made to the EIC QALICB, Inc., initiate foreclosure proceedings, or assume the EIC QALICB, Inc.'s role to complete the project. If the CDEs call their loans and force repayment, the QALICB must pay the outstanding loan amount in full. If the QALICB fails to do so, the CDE may exercise its foreclosure rights and sell the leasehold security interest in the EIC project to another party, but the City would retain its ownership of the site. Any repayments received by the CDEs, whether from the acceleration of debt or sale of the leasehold interest, must be redeployed into another QALICB and eligible project within 12 months of receiving those proceeds. If the CDEs succeed in doing so, a recapture of tax credits will be avoided. If a recapture event did occur and the City was found liable, the City would be responsible to Chase for the total value of the tax credits in addition to any legal fees and penalties imposed by the U.S. Department of Treasury and Internal Revenue Service. However, the City could also step in at any time to remedy an event of default or purchase the leasehold interest from the CDEs. In short, the City has substantial control over the circumstances which would trigger a default.

The master lease will also require the City to pay for other operational expenses for the property expenses, such as insurance, maintenance, repairs, and utilities. For example the City would be responsible for providing general liability and excess/umbrella liability protection, and for obtaining property insurance with special cause of loss/all risk hazard, boiler and machinery, and business interruption/loss of rents coverage. The City is self-insured for commercial general liability claims and has a property insurance policy for the other aforementioned coverage. In lieu of requiring the EIC QALICB, Inc. to obtain separate commercial general liability and property insurance, the City has proposed to indemnify Chase and the CDEs in the master lease for claims arising out of the City's operation of the facility.

If neither of the options in the Put/Call Agreement are exercised after the seven-year compliance period (as described below), the City's annual rent obligation would continue through the term of the master lease. Important to note, however, is that these rent payments, minus an $8,000 due to one of the CDEs for the management of the Investment Fund, would be returned to the City in the form of a payment on its leverage loan. Because the City's rent payments as the master tenant is projected to be the largest source of income for the EIC QALICB, Inc., the City's rent payments have been scheduled in a manner that allows the EIC QALICB, Inc. to meet its QLICI loan debt obligation during the initial seven years where only loan payments are due and afterward, beginning in year eight, where amortization of the outstanding QLICI loan amounts commence and principal payments are due.

Subordination and Non-Disturbance Attornment Agreement

The City will also enter into a subordination, non-disturbance, and attornment agreement (SNDA) with the EIC QALICB, Inc. In the event of a foreclosure on the ground lease, the

SNDA will detail the rights of the EIC QALICB, Inc. and the City, and their relationships with the CDEs. The subordination part of the SNDA will ensure the City's rights under the master tenant agreement subordinate to the rights of the CDEs. The non-disturbance portion of the SNDA will ensure the City's master lease agreement is not terminated as a result of a foreclosure and as long as the City is in good standing on its master lease agreement. The attornment component of the SNDA will require the City to continue its obligations under the master lease agreement, recognize the lessor in the event of a ground lease foreclosure, and provide assurance to Chase and the CDEs that the project would continue to comply with NMTC requirements to further prevent a recapture event..

Put/Call Agreement

The City will also enter into a Put/Call Agreement with Chase (a 99.99% non-managing member of the Investment Fund) and an affiliate of HEDC New Markets, Inc. (the 0.01% managing member of the Investment Fund). This agreement enables Chase to exit the NMTC transaction after it has claimed approximately $10,410,000 in tax credits over the seven-year compliance period. Pursuant to the Put/Call Agreement, Chase will have the option during the 60 days after the seven-year compliance period to "put" its interest in the Investment Fund up for sale for the greater of either $1,000 plus all taxes, fees and costs attributable to exercising this option or any outstanding amounts still owed by the EIC QALICB, Inc. from its obligations to Chase and the CDEs. Concurrently, the 0.01% managing member of the Investment Fund may "put" its interest for sale at $100. The City would have 10 business days following a notice from the managing members to pay the "put" price.

Alternatively, if Chase does not exercise the "put," the City will have the option to "call" for the sale of Chase and the managing member's interest in the project anytime following the "put" period. The "call" price could be considerably higher than the "put" price as it would be equivalent to the fair market value of Chase's membership interest in the Investment Fund as determined by an independent appraiser mutually agreed upon by Chase and the City. However, the fair market value is anticipated to be significantly discounted by the outstanding QLICI loan amounts and is projected to be approximately $763,000. The City would need to identify additional funds before exercising the "call." Depending on their availability, ratepayer, AB 939 fees, and unrestricted funds (e.g. Recycle Plus late fees) may be eligible funding sources for this use. Exercise of the "call" would also be conditioned upon the good standing of the QLICI loans and NMTC program compliance.

The Investment Fund has a 99.99% interest in the CDEs who made the QLICI loans to the EIC QALICB, Inc. for the benefit of the project. By purchasing Chase's and the managing member's interest in the Investment Fund the City would become the holder of the promissory notes and be able to forgive the QLICI loans for which it was making rent payments to the EIC QALICB, Inc. to effectively dissolve the financial structure assuming the EIC QALICB, Inc. accordingly agreed to terminate the ground lease. If neither the "put" nor the "call" options are exercised, the City would need to continue to meet its rent obligation through the remaining 35 years of the master lease. These annual payments, minus $8,000 for the management of the Investment

Fund, would be returned to the City in the form of payments on its leverage loan.

Closing Process

Upon satisfaction of the closing conditions and execution of the necessary agreements, a series of wire transfers will occur, beginning with Chase and the City (refer to page 1 of the Attachment for a flow of funds diagram).

- Chase will wire the one-day loan amount, estimated to be $8,022,174, to the City. (Recommendation 2.a increases the estimate for Earned Revenue to account for this).
- The City will combine the one-day loan amount with $11,587,471 (Recommendation 2.b decreases the appropriation for Household Hazardous Waste Las Plumas Facility to provide this funding) to make an estimated $19,609,645 leverage loan to the Investment Fund. (Recommendation 2.c establishes this appropriation).
- Chase will wire an estimated $7,705,415 equity investment to the Investment Fund.
- The Investment Fund will combine the City's leverage loan and Chase's equity investment and deduct an estimated $615,771 for fees and reserves. The balance will then be wired to the CDEs as a qualified equity investment in the estimated amount of $26,699,289.
- The CDEs will deduct an estimated $754,476 for their upfront allocation fees and wire the remaining amount as QLICI loans to the EIC QALICB, Inc. in the total estimated amount of $25,944,813.
- The EIC QALICB, Inc. will wire an estimated $8,022,174 to the City in exchange for the ground lease and as reimbursement for the third party expenses the City incurred to date. (Recommendation 2.d increases the Earned Revenue estimate to recognize the ground lease revenue).
- The City will pay the estimated $8,022,174, plus a 0.25% one-day loan fee estimated to be $20,055, to Chase as repayment of the one-day loan. (Recommendation 2.e and 2.f provide this funding and establish the Loan Repayment).
- An initial draw of approximately $600,000 will be made on the day of closing. Of this amount, $122,500 will be to reimburse the City for NMTC-related costs (see Table 3 below), approximately $300,000 will be to pay Chase and the CDEs for their legal and accounting costs related to the closing of the transaction, and $177,500 will be used to pay for the City's NMTC consultants. (Recommendation 2.g increases the estimate for Earned Revenue to recognize the initial draw, shown in Table 3, as well as additional funds that are expected to be drawn down through the remainder of this fiscal year. Recommendation 2.h and 2.i show the use of those funds for the Household Hazardous Waste Las Plumas Facility).
- An estimated $1,244,370 will be set aside for the EIC QALICB, Inc.'s NMTC reserves and operating expenses during the seven-year compliance period. Any unspent monies at the end of the seven year compliance period will be deposited in the EIC QALICB, Inc.'s operating account.
- The remaining balance, estimated to be $16,078,269, will be the development budget and will be held in a pledged and controlled construction disbursement account in the name of the EIC QALICB, Inc. (refer to Table 2 for the City's portion of the development budget

and page 2 of the Attachment for a complete budget for the EIC QALICB, Inc).

Table 3

Initial Draw at Closing (City Reimbursement)	Amount
NMTC Deposits to Chase & CDEs	$70,000
Appraisal	$8,000
Constructability Review	$4,500
Land Survey and Title Insurance Policy	$40,000
Total	**$122,500**

EVALUATION AND FOLLOW-UP

Staff plans to provide an update on the EIC to the Community and Economic Development (CED) committee in Fall 2011. Staff may also provide NMTC financing updated through the regular Green Vision reporting.

PUBLIC OUTREACH/INTEREST

☒ **Criterion 1**: Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This recommendation meets Criterion 1. Therefore, this memorandum will be posted on the City's website for the October 25, 2011 Council Agenda.

COORDINATION

This memorandum has been coordinated with the Office of the City Attorney, the Finance Department, Department of Public Works, and the Office of Economic Development.

COST SUMMARY/IMPLICATIONS

The City executed a term sheet on September 14, 2011 whereby the City is liable for up $250,000 in costs if the NMTC transaction does not close. The costs the City would assume would be costs the other parties incurred during the negotiations, drafting of agreements, and other related-third party expenses. In addition to the $250,000, the City would not be refunded for the items totaling $122,500 as listed in Table 3 above, such as the appraisal and deposits. To date, a $40,000 deposit has been made to Chase for their engagement of legal counsel. Staff anticipates making a $30,000 deposit to the CDEs in consideration of the their third party costs incurred for legal and accounting reviews as part of their underwriting and closing of the proposed NMTC transaction. The funding source for both deposits is the Integrated Waste Management Fund's Non-Personal/Equipment appropriation from one-third rate payer revenues, one-third AB 939 fee revenue, and one-third Recycle Plus late fee revenue. Both deposits will be reimbursed to the Integrated Waste Management Fund upon closing of the NMTC transaction through the initial draw (see Table 3 above).

In addition to the deposit, an estimated $20,055 one-day loan fee payment will be made to Chase from the Integrated Waste Management Fund's Non-Personal/Equipment appropriation and also offset by fee and rate revenue. The City will not be refunded for this fee.

Operating Cost

There are no cost implications to the General Fund as a result of these appropriation actions. Operating expenses for the facility are estimated at $290,000 and include utilities, maintenance and operations, information technology, insurance, and a contingency reserve. Utility expenses cover a range of items including water, electricity and natural gas which are mitigated by energy efficient features of the EIC and, possibly, the installation of photovoltaic panels throughout the site. Staff anticipates the revenue from the ReStore and HHW operations will be sufficient to meet the master tenant rent obligation and operating expenses. Council approved the execution of a lease with Habitat for Humanity Silicon Valley for the operation of ReStore on June 21, 2011. The City is currently negotiating a lease and operating agreement with the County of Santa Clara for its use of the space for HHW operations which staff anticipates completing by the end of fiscal year 2011-2012. Updates on the CTDC will be provided through reports to the CED committee.

The EIC QALICB, Inc. will have on-going obligations due to NMTC compliance and reporting requirements; however, reserves will be set aside to cover these expenses. These expenses include: the cost for directors and officers liability insurance, annual filing of tax returns, audited financial statements, and asset management and audit fees while its QLICI loans remain outstanding. An estimated $1,244,370 from the total $25,944,813 QLICI loan amount that the EIC QALICB, Inc. will receive from the CDEs will be set aside to cover these costs throughout the seven-year compliance period (see Table 4 below). Unspent amounts at the end of the seven year compliance period will be transferred to the EIC QALICB, Inc.'s operating account.

Table 4

EIC QALICB, Inc. Reserves	Amount
Reserve for CDE Fees & Expenses	$813,625
Reserve for Exit Fees	$110,245
Investment Fund Fees & Expenses	$120,500
Operating Expenses	$200,000
Total	**$1,244,370**

BUDGET REFERENCE

Fund #	Appn #	Appn. Name	Total Appn	Amount for Project	2011-2012 Adopted Capital Budget Page*	Last Budget Action (Date, Ord. No.)
423	7275	Household Hazardous Waste Las Plumas Facility	$11,587,471	$11,587,471	V - 865	06/21/2011 28928
423	0762	ESD Non-Personal/Equipment	$3,840,697	$20,055	XI - 48	6/21/2011 28928

* The City Council adopted the 2011-2012 Proposed Operating Budget on June 21, 2011. The Adopted Budget will be published in Fall 2011.

CEQA

A CEQA Negative Declaration for the renovation of the EIC was adopted on December 1, 2009 (PP09-138).

/s/
KERRIE ROMANOW
Acting Director, Environmental Services

Jennifer A. Maguire
JENNIFER A. MAGUIRE
Budget Director

I hereby certify that there will be available for appropriation in the Integrated Waste Management Fund in the Fiscal Year 2011-2012 monies in excess of those heretofore appropriated therefrom, said excess being at least $26,674,633.

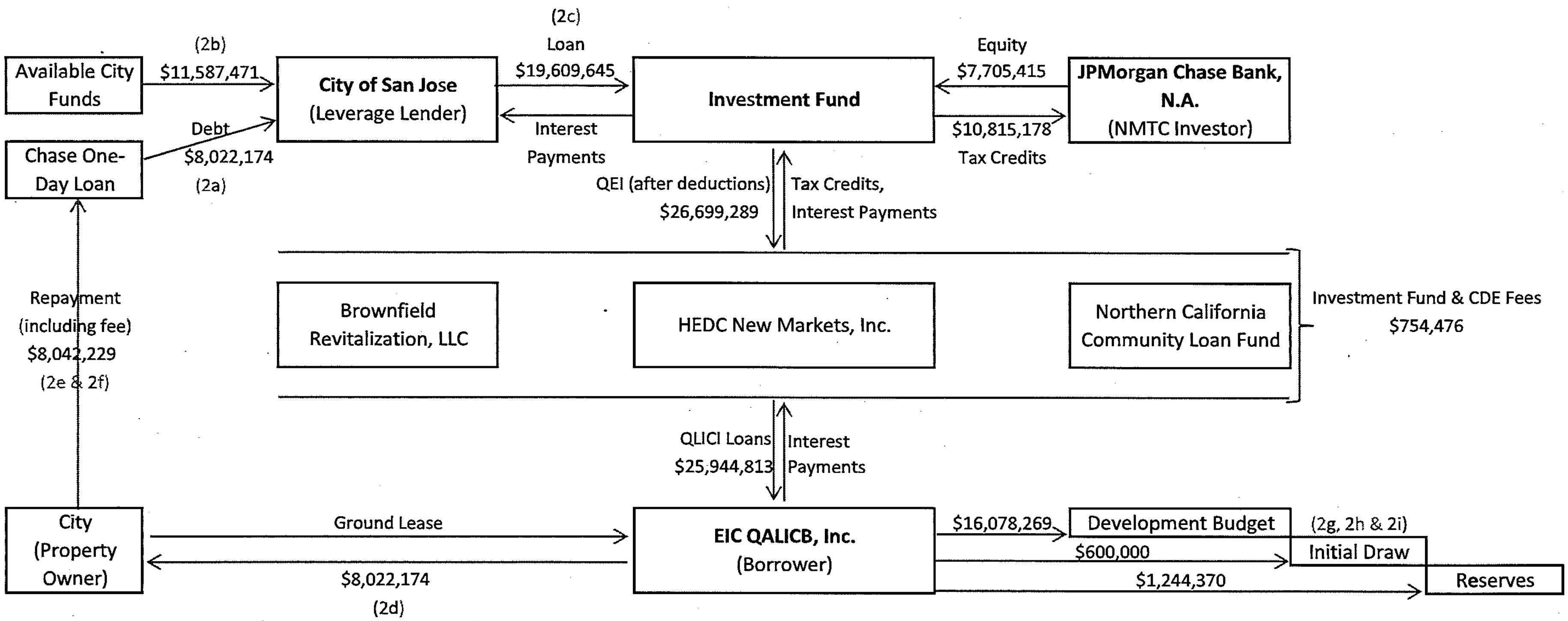
Jennifer A. Maguire
JENNIFER A. MAGUIRE
Director, Budget Office

Attachment

For questions please contact Jo Zientek, Acting Assistant Director, Environmental Services Department, at 408-535-8557.

ATTACHMENT

SAN JOSE ENVIRONMENTAL INNOVATION CENTER
NEW MARKETS TAX CREDITS FINANCING STRUCTURE



ATTACHMENT

SAN JOSÉ ENVIRONMENTAL INNOVATION CENTER
EIC QALICB, INC.'S SOURCE & USE BUDGET

SOURCES	
QLICI Loans	
Loan A (Leverage Loan)	**$19,609,645**
Loan B (NMTC Equity)	**$6,335,168**
TOTAL SOURCES	**$25,944,813**

USES	
Ground Lease	$8,022,174
Development Budget	
Third Party Construction Inspections	$22,500
Construction Period Interest	$107,437
City's Development Budget	
Phase II Construction	$11,094,935
Construction Contingency	$1,334,897
Public Art	$188,500
Furniture, Fixtures & Equipment	$2,100,000
Architectural & Engineering Services	$980,000
Developer Fee	$250,000
Initial Draw	
Appraisal	$8,000
Constructability Review	$4,500
Land Survey & Title Insurance Policy	$40,000
NMTC Deposits to Chase & CDEs	$70,000
NMTC Consultants	$177,500
NMTC Transaction Costs (Legal & Accounting)	$300,000
Reserves	
Operating Expenses	$200,000
CDE Fees & Expenses	$813,625
Exit Fee	$110,245
Investment Fund Fees & Expenses	$120,500
TOTAL USES	**$25,944,813**