

## RESOLUTION NO. 84-2011

*Adopted June 21, 2011 as Amended*

### **AUTHORIZING AN INDEMNIFICATION AGREEMENT WITH U.S. BANCORP COMMUNITY DEVELOPMENT CORPORATION, A MINNESOTA CORPORATION, IN AN AMOUNT NOT TO EXCEED \$4,725,200 AS PART OF THE NEW MARKETS TAX CREDIT FINANCING FOR THE COLLEGE TRACK CAMPUS RENOVATIONS AT 4301 THIRD STREET; BAYVIEW HUNTERS POINT REDEVELOPMENT PROJECT**

#### **BASIS FOR RESOLUTION**

1. The Redevelopment Agency of the City and County of San Francisco (“Agency”) is authorized under California Community Redevelopment Law (Health and Safety Code Section 33300 et seq.) to provide assistance and advance funds from its tax increment monies for the purpose of making improvements necessary for the redevelopment of blighted areas and the implementation of project area redevelopment plans.
2. On February 2, 2010, by Resolution No. 10-2010, the Agency’s Commission authorized the Executive Director to incorporate the San Francisco Community Investment Fund (“SFCIF”) for the purpose of participating in the New Markets Tax Credits (“NMTC”) Program.
3. The NMTC Program is administered by the Community Development Finance Institutions Fund, a division of the United States Internal Revenue Service. It provides for a tax credit taken over a seven-year period equal to 39% of the equity investment in an eligible project. The purpose of the NMTC Program is to provide a modest federal tax credit to stimulate private investment and economic growth in low-income communities that are often overlooked by conventional investors. These economically distressed communities lack access to the investment capital necessary to support business and economic development.
4. Per the authority granted by the Agency Commission, the SFCIF was created and a NMTC allocation application was submitted to the U.S. Department of the Treasury. The application was successful and the SFCIF was awarded a \$35 million NMTC allocation. The SFCIF plans to use this new capital source to fund New Markets Tax Credits eligible projects in San Francisco. The SFCIF has identified the College Track rehabilitation as its first project for the deployment of \$8.7 million in new market tax credits allocation.
5. U.S. Bancorp Community Development Corporation (“USB CDC”), the NMTC investor, requires an indemnification agreement (“Indemnification Agreement”)

to be executed by the Agency, the SFCIF and the SFCIF Sub-CDE<sup>1</sup>. Indemnification means the Agency would have to pay the losses suffered by USBCDC under certain circumstances.

6. The Indemnification Agreement is a standard NMTC investor requirement for entities like the SFCIF which do not yet have a track record. In the future, after the SFCIF has established a successful track record, this requirement may be waived. However, USBCDC was unwilling to waive the requirement for this first transaction.
7. The Indemnity Agreement protects the investor in the event of a recapture. A recapture is when the United States Internal Revenue Service (“IRS”) determines (during the seven (7) year compliance period) that a project is no longer eligible for the tax credits. Thus the investor is forced to pay additional taxes, interest and penalties for those years that it claimed the credits that the IRS has now disavowed.
8. The Indemnity Agreement is narrowly tailored and requires the Agency, SFCIF and SFCIF Sub-CDE to indemnify USBCDC in only four (4) limited circumstances: Failure to Maintain CDE Status, Failure of Substantially-All Test, Impermissible Redemption and Bad Boy Acts.
9. The accounting firm of Novogradac has calculated the amount of USBCDC’s loss (and thus the Agency’s exposure under the Indemnity Agreement) on a year over year basis, in the unlikely event of a recapture. The maximum exposure to the Agency under the Indemnification Agreement ranges from \$2,643,966 in the first year to \$4,725,200 in the seventh or last year of the NMTC compliance period. However, USBCDC agreed to a \$3 million cap but only for recaptures which occur as a result of failure of the Substantially-All Test and Redemptions, described below.
10. The four scenarios covered by the Indemnification Agreement are as follows:

*Failure to maintain CDE eligible status:* This can occur if the SFCIF fails to remain in good standing in accordance with the NMTC Program and applicable IRS regulations. Generally, the SFCIF is required to maintain an Advisory Board comprised of citizens from low-income communities within San Francisco. The SFCIF has to file reports to the IRS regarding the status of its projects including the College Track Project and file tax returns, etc. Under the Indemnity Agreement, there is no cap if there is a recapture due to this cause. However, the estimated maximum loss is approximately \$4.7 million.

*Failure of the Substantially-All Test:* The SFCIF is required to place at least 85% of the funds it receives from the sale of its tax credit allocation into an eligible project. A failure to do that will trigger a recapture event. In the case of College Track, the SFCIF is putting in 90%. The remainder of the funds will cover

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<sup>1</sup> The SFCIF Sub-CDE is a subsidiary of the SFCIF created to act as the leveraged lender to College Track. The SFCIF will assign a new single purpose Sub-CDE for each NMTC transaction.

permissible fees and expenses. Under the Indemnity Agreement, there is a \$3 million cap if there is a recapture due to this cause.

*Impermissible Redemptions:* The funds invested into the project are supposed to stay in the project for the entire compliance period. Thus, the IRS prohibits certain distributions from flowing out of the project and back up to the investor or the CDE. Under the Indemnity Agreement, there is a \$3 million cap if there is a recapture due to this cause.


*Bad Boy Acts:* Just as the name implies, these are intentional criminal acts like fraud, dishonesty etc., done either intentionally or through gross negligence. Under the Indemnity Agreement, there is no cap if there is a recapture due to this cause. However, the estimated maximum loss is approximately \$4.7 million.

11. Prior to declaring a recapture event, the IRS will provide notice and a twelve month cure period (except for Bad Boy Acts). If the defect is corrected during the cure period then there is no recapture and the obligations under the Indemnity Agreement are not triggered.
12. The New Markets Tax Credit Indemnification Agreement is associated with the funding of the College Track project. Approval of the Indemnification Agreement is a fiscal activity that will not independently result in a physical change in the environment and is not a "Project" as defined by CEQA Guidelines Section 15378(b)(4).

## RESOLUTION

**ACCORDINGLY, IT IS RESOLVED** by the Redevelopment Agency of the City and County of San Francisco that the Executive Director is authorized to: (a) enter into an Indemnification Agreement with U.S. Bancorp Community Development Corporation, a Minnesota corporation, in an amount not to exceed \$4,725,200 as part of the New Markets Tax Credit financing for the College Track campus renovations at 4301 Third Street in the Bayview Hunters Point Redevelopment Project Area, substantially in the form lodged with the Agency General Counsel; and (b) to execute any and all ancillary documents necessary to consummate the transaction.

**APPROVED AS TO FORM:**

  
James B. Morales 6/22/11  
Agency General Counsel