



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Kerrie Romanow

**SUBJECT:** SEE BELOW

**DATE:** October 16, 2018

Approved

Date

10/18/18

**COUNCIL DISTRICT: 3**

**SUBJECT: ACTIONS TO UNWIND NEW MARKETS TAX CREDIT TRANSACTIONS  
THAT FINANCED THE CONSTRUCTION OF THE ENVIRONMENTAL  
INNOVATION CENTER**

## RECOMMENDATION

1. Approve the unwinding of the New Markets Tax Credit transactions by: adopting a resolution to authorize the City Manager to (i) acquire the respective membership interests of Chase Community Equity, LLC, a Delaware limited liability company ("Chase Investor") and Community Development Properties New Markets MM, INC., a Delaware corporation ("Chase Manager") and, collectively with Chase Investor, the ("Fund Investors") in Chase New Markets Tax Credit SJEIC Investment Fund, LLC ("Investment Fund") for a purchase price of \$1,010 and, in connection therewith, to negotiate and execute the New Markets Tax Credit Exit Agreement and the Fund Purchase Agreement with Fund Investors; (ii) cancel the leverage loan made by the City to Investment Fund; and (iii) negotiate and execute other related documents as necessary in connection with the unwinding of the New Markets Tax Credit transactions.
2. Adopt a resolution consenting to the redemption of Investment Fund's membership interests in the (i) NDC New Markets Investments LXV, LLC (holder of QLICI Notes A and B), (ii) Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC (holder of QLICI Notes C and D), and Brownfield Revitalization XV, LLC (holder of QLICI Notes E and F) in exchange for assignments of QLICI Notes (A-F) (collectively, the "QLICI Notes") and the QLICI Loan Documents securing the QLICI Notes to the Investment Fund.
3. Adopt a resolution to authorize the City Manager to negotiate and execute all necessary documents to (i) cause Investment Fund to forgive the QLICI Loan and reconvey the QLICI Deed of Trust; (ii) dissolve the Investment Fund; (iii) terminate the Ground Lease and the Master Lease between the City and the EIC QALICB, Inc.; and (iv) enable the EIC QALICB, Inc. to dissolve as a California nonprofit public benefit corporation and transfer all of its assets to the City.

## **OUTCOME**

Approval of the recommendation would enable the investor and community development entities to exit the transaction; and the City to have full possessory interest in the Property and the improvements.

## **BACKGROUND**

The San José Environmental Innovation Center (“EIC”) was completed in March 2014 and is located on a 4.2-acre site at 1608 Las Plumas Avenue (“Property”). The EIC showcases a variety of innovative environmental features and leases space to three tenants that support the City’s sustainability efforts, the County of Santa Clara Household Hazardous Waste Program, Habitat for Humanity ReStore, and Prospect Silicon Valley. (See attachment 1)

The EIC was developed in several phases involving multiple sources of funding. (See attachment 2). In 2011, the City agreed to participate in a transaction utilizing New Markets Tax Credits to finance a funding gap for the construction of the EIC. (See attachment 3) Several entities were created including: EIC QALICB Inc., a California nonprofit public benefit corporation, which acquired a ground lease in the Property and developed the EIC, the Investment Fund, which acted as the vehicle for raising investment equity and loan funds to invest in the community development entities that had access to New Markets Tax Credits. The community development entities, NDC New Markets Investments LXV, LLC (“NDC”), Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, and Brownfield Revitalization XV, LLC, were created to provide the New Markets Tax Credits benefits (in form of a below-market loan) to EIC QALICB as financing for the EIC.

As part of the New Markets Tax Credit financing structure, the City entered into a master lease agreement with the EIC QALICB, Inc., to ensure the EIC’s programming and use is not impacted or changed due to the New Markets Tax Credit financing. As the master tenant, the City was required to make rent payments in consideration for having possession and beneficial use of the facility. Starting FY 2013-2014, the annual rent payments were approximately \$400,000, and increased 2.5% each year thereafter through the term of the master lease or unwind. The City was able to apply an additional \$4.31 million from the New Markets Tax Credit financing toward the cost of construction.

## **ANALYSIS**

The New Markets Tax Credit compliance period ends on November 8, 2018. The Investment Fund, and community development entities (NDC New Markets Investments LXV, LLC, Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, Brownfield Revitalization XV, LLC) have fulfilled their respective roles, and wish to exit the

transaction. The process to effectuate the exit was agreed to by all participants as part of the 2011 financing to require the Fund Investors to sell their respective membership interests in the Investment Fund to the City pursuant to Fund Interest Purchase Agreement for \$1,010—making the City the sole owner and member of Investment Fund. By purchasing both Members' interest in the Investment Fund, the City will become the sole member and manager of the Investment Fund.

NDC New Markets Investments LXV, LLC, Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, Brownfield Revitalization XV, LLC will subsequently redeem the Investment Fund's interest in their respective entities by assigning Notes (A-F) for the QLICI Loan and a Leasehold Deed of Trust securing such Notes encumbering the Ground Lease to the Investment Fund in exchange for the Investment Fund's interest. As a lender that has a collateral interest in the Investment Fund's interest in NDC New Markets Investments LXV, LLC, Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, and Brownfield Revitalization XV, LLC, the City must consent to the redemption of the Investment Fund's interest.

Following redemption of the Investment Fund's membership interest, the Investment Fund will be the holder of the QLICI Notes and successor beneficiary of a Leasehold Deed of Trust securing the QLICI Notes encumbering the ground leasehold estate in the Property of EIC QALICB, Inc.

At the City's election, the Investment Fund may satisfy its obligations under the leverage loan to the City by assigning the QLICI Loan Notes and the Leasehold Deed of Trust to the City, giving the City the right as a secured lender to EIC QALICB's leasehold interest in the Property under the QLICI Loan. Following the satisfaction of the leverage loan, the City may dissolve the Investment Fund.

Once Chase and the community development entities have exited the transaction, the City must still negotiate and execute all necessary documents to (i) terminate the Ground Lease and the Master Lease between the City and the EIC QALICB, Inc.; and (ii) enable the EIC QALICB, Inc. to dissolve as a California nonprofit public benefit corporation and transfer all assets to the City.

Upon completion of the unwind and dissolution of the EIC QALICB, Inc., as included in the 2018-2019 Adopted Budget on page X-51, the City should receive a transfer of all the assets including the EIC, and \$1,163,822 in estimated revenue from rent collected from the HHW Facility and account interest. This amount reflects \$80,500 retained by the EIC QALICB, Inc. for potential costs associated with the dissolution of EIC QALICB, Inc. such as extended directors and officer insurance, financial accounting, third party audits and tax preparation, and potential legal fees. The estimated \$1,163,822 will be deposited in the Integrated Waste Management Fund to reimburse the programs that contributed towards the purchase and construction of the EIC, and ongoing maintenance of the facility during the compliance period.

### **Alternatives Analysis**

The process to effectuate Chase and the community development entities' exit was agreed to by all participants as part of the 2011 financing. During the compliance period, the QLICI Loan payments were interest only payments satisfied by the City's rent payment to the QALICB received from the HHW Facility. If the City does not complete the unwind by dissolving the Investment Fund, and forgive the QLICI Loan to the EIC QALICB, the EIC QALICB will be required to repay principle and interest beginning November 2019 in the amount of \$598,939 through 2053. The current tenant and City master lease payments are not adequate to meet this obligation. Staff does not recommend this approach because it would not be in the City's interest to cycle the funds and incur the additional cost to support the current structure.

### **EVALUATION AND FOLLOW-UP**

Staff will provide updates on the EIC through the regular ESD reporting.

The effort to structure the financing for this project, and maintain compliance during these last seven (7) years required significant staff resources. Should the City wish to pursue financing using the New Markets Tax Credit Program for another project in the future, an analysis should be prepared to evaluate the cost and benefit on a case by case basis.

### **PUBLIC OUTREACH**

This recommendation will be posted on the City's website for the October 30, 2018 City Council meeting agenda.

### **COORDINATION**

This memorandum has been coordinated with the City Attorney's Office and the City Manager's Office.

### **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

HONORABLE MAYOR AND CITY COUNCIL

October 16, 2018

**Subject: Unwind New Markets Tax Credit Transactions**

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**CEQA**

Negative Declaration for Environmental Innovation Center, File No. PP09-138.

/s/

KERRIE ROMANOW

Director, Environmental Services

For questions please contact Shikha Gupta, Interim Deputy Director, Environmental Services Department, at 408-975-2520.

## Attachment 1 **Environmental Innovation Center Tenants**

*County of Santa Clara, Household Hazardous Waste ("HHW") Program* is one of two permanent HHW collection facilities within the County, where residents can schedule an HHW drop off appointment for the County's drive-through drop off program. In fiscal year (FY) 2017-2018, 24,790 residential hazardous waste drop off appointments were completed at the EIC HHW facility, which is 72% of all appointments countywide. San Jose residents made 66% of all HHW drop off appointments at the EIC. The Santa Clara County lease expires at the end of FY 21-22.

*Habitat for Humanity, ReStore* is a home improvement store and donation center with more than 800 locations nationwide. ReStore sells new and gently used furniture, appliances, and home improvement materials at a fraction of retail prices. The San José ReStore is managed by Habitat for Humanity East Bay/Silicon Valley, and the proceeds fund affordable housing in Santa Clara, Alameda, and Contra Costa counties. By promoting material reuse, ReStore reduce the volume of landfilled construction materials and home goods. In calendar year 2017, the San José ReStore diverted an estimated 1,260 tons of material from landfill. The City's lease with Habitat for Humanity expires at the end of FY 18-19.

*Prospect Silicon Valley ("PSV")* is a technology demonstration center that provides space and equipment to innovators to test and exhibit emerging energy, building and transportation technologies. Launched in partnership with the City of San José in October 2013, PSV help innovators attract investors, customers, talent, and grants to better promote emerging clean technologies and green jobs. The City's lease with PSV expires at the end of FY 18-19.

The EIC includes shared conference areas used by the tenants and various City departments, work space for eight Environmental Services Department field staff, and storage of City vehicles and equipment used by staff.

### **Operation Cost**

During FY 2015-2016 through 2017-2018, the EIC was operating at a deficit of approximately \$1.13 million relative to its rental income. The EIC incurred higher than expected operations & maintenance costs due to additional staff to support building operations. Funds to cover this cost was advanced through Integrated Waste Management Fund (423). Fund 423 will be reimbursed from the transfer of the assets from the QALICB to the City on the completion of the dissolution and unwind of the New Markets Tax Credit transactions. The City also anticipates that there will be less staff required to support site operations beginning FY 2019-2020 after the unwind and discussions to transfer the maintenance to the Public Works Department. Increased rental revenue will be required to support ongoing facility operations, build a facility operating reserve, fund ratepayer services, and mitigate future ratepayer service rate increases.

**Attachment 2 EIC Development Phases and Sources of Project Funding**

<b>EIC Development Phases and Sources of Project Funding</b>				
<b>Phase</b>	<b>Date End</b>	<b>Description</b>	<b>Cost Million (\$)</b>	<b>Funding Notes/Approval Memorandum References</b>
Land Purchase	2006	Property purchase from Housing Department	4.50	AB 939 fee revenues, Integrated Waste Management Funds (423), PG&E eminent domain deposit, and excess bond revenue. Memo 1
Phase I	2010	Conceptual design, exterior environmental features and improvements	3.56	Integrated Waste Management Funds (423) and CalRecycle grant. Memos 2,3,4
Phase II	2014	Site design, renovation of existing warehouse for retail and demonstration space, addition of a new pre-engineered 10,000 square foot permanent HHW facility, environmental features, delivery costs	18.68	Integrated Waste Management Funds (423), storm sewer operating funds (446), sewer service & usage charge fund (541), landfill AB 939 fee revenue, and unrestricted funds (CDDD ineligible deposits, and New Markets Tax Credit Proceeds). Memos 5,6,7
Hazardous Materials Additional Costs/ Construction Contract Settlement	2014	Contingency increase for unexpected hazardous material removal, and associated delivery costs, settlement of construction contract	2.07	Landfill AB 939 fee revenues, Integrated Waste Management Funds (423), non-restricted funds (CDDD ineligible deposits). Memos 8 and 9
Phase III	2015	Photovoltaic system and supporting car shelters	1.97	EDA grant and Integrated Waste Management Funds (423) and unrestricted City Building Energy Projects Funds. Memo 10
<b>Total</b>	<b>2018</b>	<b>Total Project</b>	<b>30.78</b>	

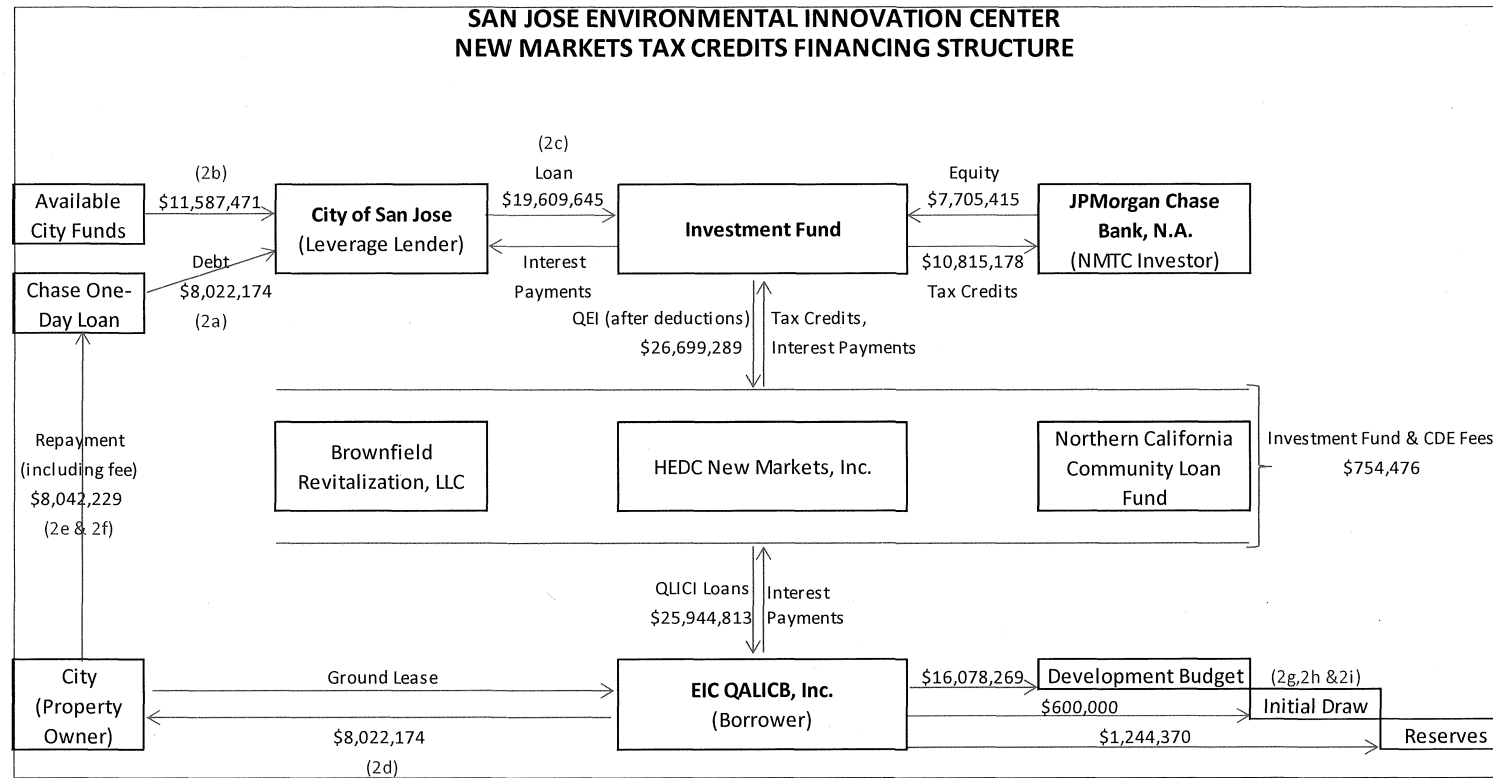
1. [http://www3.sanjoseca.gov/clerk/Agenda/060606/060606\\_07.01.pdf](http://www3.sanjoseca.gov/clerk/Agenda/060606/060606_07.01.pdf)
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7. [http://www3.sanjoseca.gov/clerk/Agenda/20111025/20111025\\_0701.pdf](http://www3.sanjoseca.gov/clerk/Agenda/20111025/20111025_0701.pdf)
8. <http://sanjoseca.gov/DocumentCenter/View/15180>
9. <http://sanjoseca.gov/DocumentCenter/View/21439>
10. [http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=734&meta\\_id=521056](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=734&meta_id=521056)

Sources of Project Funding	Amount (\$ Millions)
Utility Rate Payer Funds	11.05
<ul style="list-style-type: none"> <li>Integrated Waste Management Fund (423)</li> </ul>	9.31
<ul style="list-style-type: none"> <li>Storm Sewer Operating Fund (446)</li> </ul>	0.20
<ul style="list-style-type: none"> <li>Sewer Service &amp; Usage Charge Fund (541)</li> </ul>	1.54
Landfill AB 939 Fee Revenue	3.12
Unrestricted funds (e.g. CDDD ineligible deposits, grants, etc.)	12.30
<b>Total City Sources of Funding</b>	<b>26.47</b>
New Markets Tax Credit net proceeds	4.31
<b>Total Sources of Funding</b>	<b>30.78</b>



### Attachment 3 NEW MARKETS TAX CREDIT FINANCING STRUCTURE

See below for a diagram of the New Markets Tax Credit financing structure.



To leverage the tax credits available to the Investment Fund, the City loaned the Investment Fund \$19.61 million and raised \$7.71 million from Chase Community Equity, LLC (“Investor Member”). The Investor Member maintained 99.99% interest in the Investment Fund, and 0.01% membership interest was held by the Community Development Properties New Markets MM, Inc. (“Managing Member”). The Investment Fund used the proceeds of the loan and equity investment to purchase equity interests in NDC New Markets Investments LXV, LLC, Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, and Brownfield Revitalization XV, LLC. In turn, NDC New Markets Investments LXV, LLC, Northern California Community Loan Fund New Markets Tax Credit Sub-CDE III, LLC, Brownfield Revitalization XV, LLC used \$25.94 million of the equity investment to make a loan to EIC QALICB (“QICI Loan”) to purchase a ground lease and construct the EIC. The City agreed to master lease the EIC from EIC QALICB with the City’s lease payments made by the City used to make payments on the QICI Loan. The City’s lease payments came from the rent payments of its subtenants, Project Silicon Valley, Habitat for Humanity ReStore, and Santa Clara County HHW. The EIC QALICB used and managed the property in accordance with the New Markets Tax Credit rules for the seven (7) year New Markets Tax Credit compliance period, which expires on November 8, 2018.