

HB

120

<TARGET><BILL>HB 120</BILL><SUBJECT>HB
120</SUBJECT><COMM>HFIN27</COMM></TARGET>

FISCAL NOTE

STATE OF ALASKA
2011 LEGISLATIVE SESSION

Fiscal Note Number 1
 Bill Version HB 120
 (H) Publish Date 1/24/11

Identifier (file name) 1747-CED-AIDEA-01-10-11
 Title AIDEA New Markets Tax Credit Assistance Guarantee
 Sponsor Rules Committee
 Requester Request of the Governor
 Dept. Affected DCCED
 Appropriation AIDEA
 Allocation AIDEA Operations
 OMB Component Number 1234

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2012	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING		0.0	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES								
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CHANGE IN REVENUES								
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF								
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other Interagency Receipts								
TOTAL		0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2011) cost _____

POSITIONS

Full-time								
Part-time								
Temporary								

Why this fiscal note differs from previous version

Prepared by Sara Fisher-Goad, Deputy Director - Operations
 Division Alaska Industrial Development & Export Authority
 Approved by Susan K. Bell, Commissioner
Commerce, Community & Economic Development

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 Date/Time 1/21/11 12:30 PM
 Date 1/21/2011

FISCAL NOTE #1

STATE OF ALASKA
2011 LEGISLATIVE SESSION

BILL NO. HB 120

Analysis

This bill establishes a new market tax credit assistance program within AIDEA and enables AIDEA to use money in its enterprise development account to fund guarantees and loans AIDEA would make under this program.

This legislation has no operational fiscal impact to AIDEA.

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Governor Sean Parnell
STATE OF ALASKA

January 21, 2011

The Honorable Mike Chenault
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Chenault,

Under the authority of Article III, Section 18, of the Alaska Constitution, I am transmitting a bill creating a new markets tax credit assistance guarantee and loan program within the Alaska Industrial Development and Export Authority (AIDEA).

This legislation will enable AIDEA to foster more economic development in Alaska, especially in areas with great need for new investment. Under this legislation, AIDEA could issue guarantees and make loans to help finance projects funded through a federal new markets tax credit program. This federal program offers a competitive process by which federal new markets tax credits are allocated to support the nationwide financing of projects located in low income areas or otherwise serving low income populations. The federal program arises under Section 45D of the Internal Revenue Code, and provides for the allocation of new markets tax credits equal to 39 percent of total qualifying investments, payable over seven years. The tax credits provide a present value investment return of approximately 30 percent of the amount of the qualifying investment, and can substantially reduce the financing costs for a project.

Investments made under the federal new markets tax credit program generally would fund only a portion of total project costs. The balance of the funding must come from other loans or financing. There is a scarcity of capital available and this legislation would enable AIDEA to issue guarantees and make loans to assist in funding amounts not covered by investments made under the federal program.

The proposed legislation requires AIDEA to evaluate the commercial reasonableness of the underlying loan AIDEA would guarantee to determine that the project will promote economic development and requires the financial institution to service the guaranteed loan.

I urge your prompt and favorable action on this measure.

Sincerely,

A handwritten signature in black ink that reads "Sean Parnell".

Sean Parnell
Governor

Enclosure

SB 66 and HB 120

An Act creating a new markets tax credit assistance guarantee and loan program within the Alaska Industrial Development and Export Authority; and providing for an effective date.

Sectional Analysis

Section	Analysis
1	Amends AS 44.88.155(c) to allow assets of the enterprise development account to be used to fund a new markets tax credit assistance guarantee or loan
2	<p>Amends AS 44.88 by adding a new article – New Markets Tax Credit Assistance Program.</p> <p>44.88.700 allows AIDEA to issue guarantees and make loans to help finance projects funded through a federal new markets tax credit program. The assistance is limited to projects within Alaska for which tax credits are allocated by a qualified community development entity; the authority shall determine that the project will promote economic development; the authority may agree to certain restrictions and guidelines arising from the federal program.</p> <p>44.88.710 provides that a guarantee does not create a debt or liability of the state; a guarantee may not be canceled except under its terms</p> <p>44.88.715 establishes applicant qualifications</p> <p>44.88.720 requires an applicant to provide certain information required by AIDEA in regulation including the potential submission of an economic benefit analysis prepared by a person acceptable to the authority.</p> <p>44.88.730 establishes condition of a loan guarantee</p> <p>44.88.740 requires financial institution holding a guarantee shall service the loan</p> <p>44.88.750 allows AIDEA to make leverage loans if AIDEA determines an applicant is not able to obtain a leveraged loan from a financial institution</p> <p>44.88.760 sets a cumulative \$50 million limit under this program</p> <p>44.88.770 provide AIDEA the authority to adopt regulations, establish terms and conditions, execute contracts, charge fees and interest rates, acquire property through purchase, transfer or foreclosure</p> <p>44.88.799 defines terms used in the new article</p>
3	Immediate effective date



Bill Hearing Information Sheet
Prepared by AIDEA
February 4, 2011
House Bill 120

“An Act creating a new markets tax credit assistance guarantee and loan program within the Alaska Industrial Development and Export Authority; and providing for an effective date.”

This legislation will enable AIDEA to foster more economic development in Alaska, especially in areas with great need for new investment. This program requires both equity and debt financing and there is a scarcity of debt capital available. This legislation provides the mechanism for AIDEA to issue guarantees and make loans to assist in financing projects in these underserved and underdeveloped areas.

The federal New Markets Tax Credit (NMTC) Program permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs). Essentially, the program provides substantial tax credits to equity investors to projects, which also borrow funds from what is termed a leveraged lender. By combining tax credits on the equity side with favorable loan conditions on the debt side, the cost of financing a qualifying project can be reduced by between 20-30%.

The program offers these benefits to support investment in economically disadvantaged areas. Substantially all of the qualified equity investment must be used by the CDE to provide investments in low-income communities. The credit provided to the equity investor totals 39 percent of the cost of the investment and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is six percent annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

The program was reauthorized by Congress in December 2010 for an additional two years and has tax credits allocations worth \$3.5 billion for each year. To date, the Fund has made 495 awards totaling \$26 billion in allocation authority.

The program uses census tracts as the geographic unit and only projects in Qualified Census Tracts (QCT) are eligible for the NMTC tax credits. QCTs are those that meet at least one of the following requirements:

- Poverty rate greater than 20%, and/or
- Median income less than 80% of the state/metropolitan median.

There are two portions to financing through the NMTC program.

- The equity portion as described above; and

- The second is a loan usually from a bank that is called a leveraged lender under the program. It is this debt portion of the program that has suffered from the economic downturn because banks have been unwilling to lend and as a result there is a shortage of debt to complete many NMTC deals. While the NMTC program has been a success its current usage is limited by a lack of credit. The leveraged lender is limited to interest only payments for the seven years of the tax credit period. At the end of the seven years the loan is retired through a balloon payment or refinanced.

In order to work, NMTC funding, therefore, must have equity investors seeking tax credits and a willing leveraged lender. SB66 seeks to facilitate adequate participation by debt lenders to support the equity portions of this program.

HB120 will vitalize the NMTC program in Alaska by allowing AIDEA to provide loan guarantees to the leveraged lender in an NMTC deal. This AIDEA guarantee would incentivize participation by financial institutions. Before issuing a NMTC guarantee or a loan, the Authority will determine that the project will promote economic development in the state. In cases where the applicant can show that they have been unable to obtain a leveraged loan, under commercially reasonable terms, from two financial institutions then AIDEA may make a direct leveraged loan to the project.

The combined outstanding principal balance of AIDEA's loan guarantees and loans may not exceed \$50 million.



To: Ted Leonard; Michael Catsi; Mark Davis
From: Vincent Ravaschiere *VR*
Date: October 11, 2010
Re: Enhancing the Value of the Federal New Markets Tax Credit Program in Alaska

Introduction

Some weeks ago, you asked me for my thoughts, initially in draft form, on how the Alaska Industrial Development and Export Authority ("AIDEA" or the "Agency") could help stimulate and facilitate New Markets Tax Credit ("NMTC") transactions in the State of Alaska. In this regard, we had preliminary discussions regarding the possibility that AIDEA might act as the leveraged lender in NMTC transactions. You asked me to help determine how such a program might work, consider how AIDEA might protect itself from exposure in acting as a leveraged lender, and suggest other ways in which AIDEA might assist in making the NMTC program work in Alaska. Finally, you asked me to address several specific questions that relate to AIDEA acting as a NMTC leveraged lender.

In response, I submitted a draft memo to AIDEA on October 4, 2010 and attended a meeting to discuss these topics with you at AIDEA's offices on October 6, 2010. As part of that meeting, we met with representatives of Alaska Growth Capital, the only Alaska based NMTC allocatee, to hear and understand their views on how AIDEA could be helpful in promoting NMTC transactions in Alaska. Following that meeting, you asked me to revise my draft memo in light of our discussions and submit this final version to you.

Background

In December 2000, Congress enacted the New Markets Tax Credit Program as part of the Community Renewal Tax Relief Act of that same year. Intended to address the lack of investment capital available for business and other economic development activities in low income communities, the Program operates by providing a federal subsidy to many different project types developed in eligible areas. The Program is codified at Sec. 45D of the Internal Revenue Code and is administered by the Community Development Financial Institutions ("CDFI") Fund in the Department of the Treasury.

Once a year, through a highly competitive process, the credits are awarded to financial institutions that are certified by the CDFI Fund as Community Development Entities ("CDEs"). The CDEs then offer the credits to investors in exchange for equity capital, which is then used to subsidize below market financing for eligible projects. Except for rental housing, NMTCs can be used to subsidize almost any type of business or real estate project, including community facilities and other nonprofit uses such as schools, health clinics and cultural institutions. In addition, and under certain circumstances, even residential rental units can qualify for the subsidy if they are part of a mixed-use development.

Under the NMTC Program, it is possible for a project to obtain a loan at a below market rate of interest, or to obtain the equivalent of an equity subsidy of approximately 15% of total project cost. However, there is no guarantee as to either the type or level of subsidy available to a particular project. Both will depend upon the outcome of negotiations among and between the project developer, the CDE and the tax credit investor.

AIDEA Acting as a NMTC Leveraged Lender

The NMTC subsidy is delivered to specific projects via discrete transactions that generally require the participation of a lender to provide debt as a portion of the financing. (See attached Structure Chart.) Every dollar of debt provided to a NMTC transaction attracts approximately \$.35 in federal equity subsidy, though the actual amount will vary from transaction to transaction. Recently, due to the financial crisis and the resulting lack of available credit, it has become increasingly difficult to find commercial lenders to participate in these transactions, thereby diminishing the use of the federal subsidy in Alaska and elsewhere.

The lack of leveraged lenders currently participating in the Program creates a need for AIDEA or some other source to fulfill that role. By creating a loan fund, or otherwise directing loans to NMTC transactions, AIDEA could stimulate the delivery of federal dollars to projects within Alaska, and do so in such a way as to exert its influence over which types of projects receive the subsidy. It is anticipated that this initiative would be at little or no cost to the State because the NMTC Program permits the leveraged lender to be paid a market rate of interest on the loan and then allows the repayment of the principal in full at the end of the seven year NMTC compliance period.

Specific Questions Regarding AIDEA's Possible Role as a NMTC Leveraged Lender

You have asked me to address the following specific questions regarding AIDEA's possible role as a NMTC leveraged lender:

1. What, if any, are the federal requirements for being a leveraged lender?

There are no federal requirements of which I am aware for acting as a leveraged lender.

2. Are there any exemptions from federal requirements for public entities?

N/A. See No. 1 above.

3. What are the benefits for AIDEA in being the leveraged lender?

The benefits of AIDEA in being a NMTC leveraged lender are that AIDEA could stimulate the delivery of federal dollars to projects in Alaska while exercising its

influence on the types of projects that receive the federal subsidy. AIDEA could also earn a reasonable rate of return by making leveraged loans.

4. What are the disadvantages?

The disadvantages are that such loans would entail credit risk, and that that risk would be compounded by the fact that the loans are nonrecourse over the seven year NMTC compliance period. In addition, as a leveraged lender, AIDEA would have only an indirect security interest in the underlying project asset. Also to be considered are the opportunity costs of utilizing AIDEA funds in NMTC projects rather than for other programs and purposes.

5. How can a leveraged lender minimize its risk when it has no recourse to the assets of the QALICB for seven years?

Leveraged lenders can attempt to minimize their risk in a number of ways, including: (1) implementing appropriate underwriting standards and procedures; (2) acting as the servicing agent for the CDE loans; (3) obtaining a letter of credit to mitigate construction risk; (4) obtaining a priority interest in cash flow distributions and other proceeds that may be received; (5) obtaining additional collateral and guarantees, so long as they are not derived from the underlying project; (6) establishing the right to assume management control of the investment fund in the event problems arise. It is important to note, however, that most of these rights would have to be negotiated with the other parties to the transaction, including the equity investor and the CDE, who might not agree to them.

6. Are there other state development finance authorities that play the role of leveraged lender? If so, please provide a list.

I have not done a 50 state review of the practices of state development finance authorities with regard to making leveraged loans. However, I understand that in connection with its own NMTC allocation, the New Jersey Economic Development Authority provides a subordinated leveraged loan product to facilitate its NMTC transactions.

Other Ways in Which AIDEA Might Help Facilitate the NMTC Program in Alaska

The following are several other ideas about how AIDEA might help facilitate NMTC transactions within the State. First, AIDEA could examine its existing grant and loan programs to determine whether these programs can be modified in some way so as to facilitate their use in conjunction with the NMTC structure. Second, AIDEA could consider being the guarantor of all or a portion of independent leveraged loans, similar to the SBA loan guaranty program. Third, AIDEA might consider being a guarantor on the compliance indemnity, particularly with regard to targeted population transactions. Fourth, AIDEA might consider acting as the tax credit investor and then syndicating the tax credits to corporate taxpayers. Finally, it would be helpful if there were a procedure for the

expeditious designation of State economic incentive zones so as to help certain projects qualify for the Program.

The October 6, 2010 Meeting at AIDEA

We met at AIDEA's offices on October 6, 2010 to review the draft memo and further discuss how AIDEA could help stimulate and facilitate NMTC transactions in the State of Alaska. As part of that meeting, we met with representatives of Alaska Growth Capital to share our ideas with them and to hear their views on how AIDEA could help in promoting NMTC transactions. The meeting concluded with the understanding that AIDEA should stimulate and facilitate NMTC transactions by participating as both a guarantor of NMTC leveraged loans and as a lender of last resort to NMTC transactions if and when the existence of the AIDEA guarantee proves insufficient to cause a private financial institution to make the particular leveraged loan.

This conclusion was reached for two basic reasons. First, due in part to the lack of available credit in general, it is exceedingly difficult at the present time for NMTC projects to obtain leveraged loans from private financial institutions. Guaranteeing or providing leveraged loans should help alleviate a serious bottleneck that has developed and is preventing many eligible NMTC transactions from moving forward.

Second, of the various roles considered for AIDEA, acting as a guarantor or provider of leveraged loans was deemed to be the one most consistent with AIDEA's historic role in promoting economic development. One of AIDEA's three major program initiatives has been its loan participation program, in which the Agency works closely with the private sector to provide loans to economic development projects. Acting as a leveraged loan guarantor or provider, therefore, is closely related to AIDEA's experience in debt financing, and is consistent with the principle that AIDEA's approach should be to assist private financial institutions in providing that financing, stepping in directly only when the private sector does not respond.

In concluding, there was also discussion at the meeting of other ways in which AIDEA might help facilitate NMTC use in Alaska, specifically in the rural hubs. For example, there was some consideration given to AIDEA serving as a guarantor on the tax credit compliance indemnity, particularly with regard to targeted population transactions, where projects not located in NMTC qualified areas are nonetheless eligible for the credits because of the characteristics of the project's customers, employees or owners. Because obtaining the tax credit equity investment in these transactions has been problematic, this is an area in which in the future AIDEA may wish to consider playing a role.

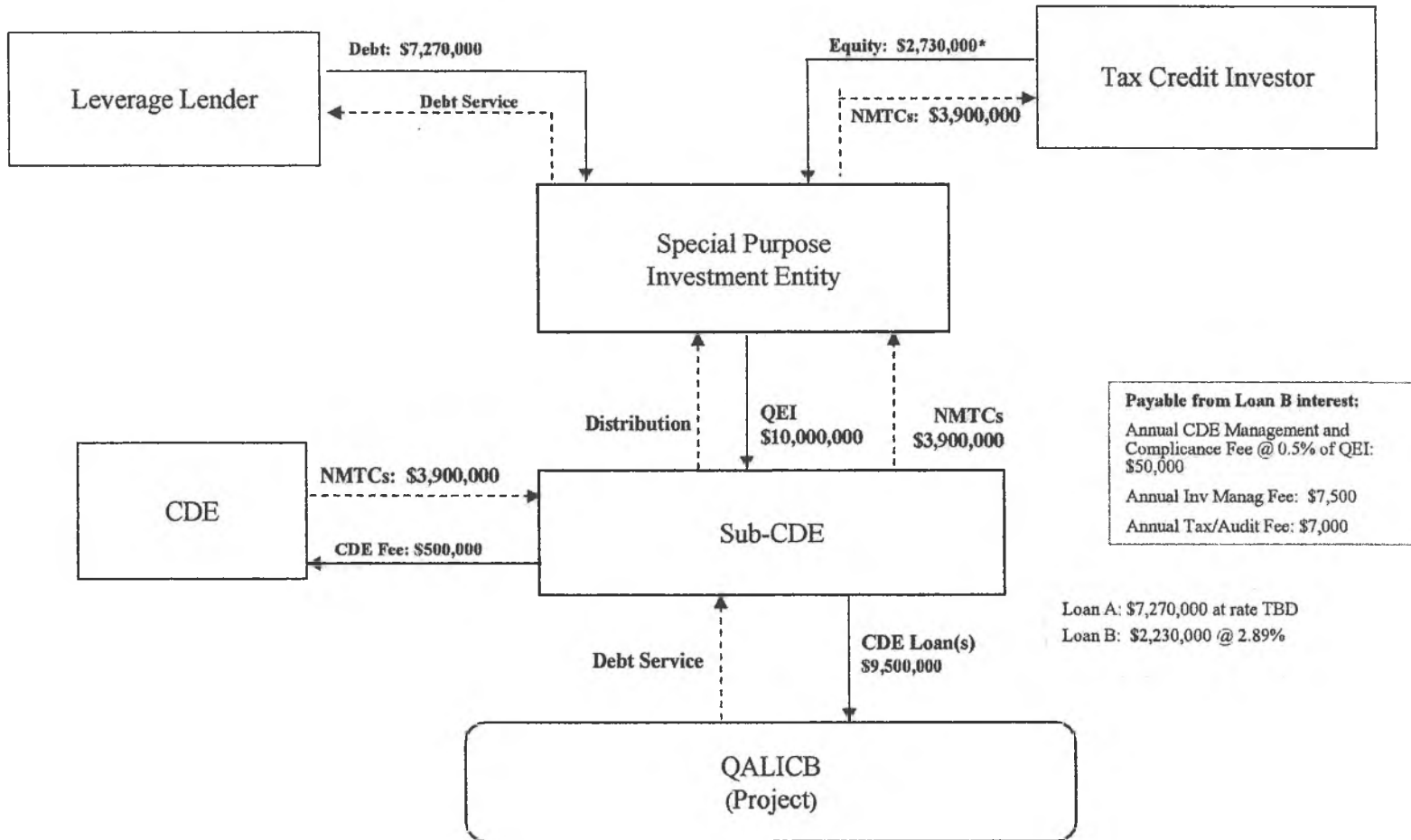
Disclaimer

Please note that this memorandum is not intended to constitute legal, accounting or tax advice.

Sample NMTC Structure Chart

\$10,000,000 QEI

10/11/10



- Transaction costs not reflected.
- Numbers are approximate.

*Credits priced at \$.70 for illustrative purposes only.