




Office of  
City Attorney

MEMORANDUM

TO: MAYOR AND CITY COUNCIL

FROM: WILLIAM D. WELLS, CITY ATTORNEY 

DATE: NOVEMBER 2, 2009

RE: CONSIDERATION OF NEW MARKETS TAX CREDITS

At its Committee meetings on November 2, 2009, the Council will begin receiving detailed information on a potential source of additional funding for components of the Community Maritime Park – New Markets Tax Credits (NMTCs). If a decision to go forward and use this funding source is made, it will be, unquestionably, the most complex financial transaction the City of Pensacola has ever engaged in. The purpose of this memorandum is to provide a general description of the changes which will need to be made in the funding of the Park and to alert Council to the nature of the risks which may be encountered in the transaction over the next few years. The City Attorney's Office is not making any recommendations to Council on this issue, but we are attempting to focus upon the potential risks of the transaction so that Council will be in a position to satisfy itself that the risks will be responsibly managed and minimized if a decision to go forward with NMTCs is made.

While the City Attorney's Office claims no expertise in the field of finance and tax code compliance, the City is fortunate that our Disclosure counsel, the international law firm of Edwards Angell Palmer & Dodge, LLP, does have expertise and experience in the relatively new field of NMTCs. Dick Barker and I previously requested that Edwards Angell address a series of questions regarding the use of NMTCs in connection with bonds and the firm responded in a memorandum dated September 17, 2009, which is part of your agenda package. The firm will have two of its partners, Rick Miller and Steve Paul, present at the Committee of the Whole meeting, to describe the proposal and answer questions.

THE IMPACT OF NMTCs ON THE CURRENTLY PLANNED PARK PROJECT

1. NMTC funds will require the addition of a new component of the Community Maritime Park. Since the currently contemplated park and multiuse stadium are already planned to be funded with \$40 million from the sale of bonds, a new component must be included to be paid for by the sale of tax credits. The use originally proposed by Ed Gray, Executive

Director of the Capital Trust Agency Community Development Entity LLC (CTA-CDE) and others has been the Maritime Museum, but the latest version of the Official Statement of the bond sale states, "These additional proceeds would be used for construction of a museum for use by the University of West Florida or its not-for-profit subsidiary, or a conference center or other components of the 2009 Project." The issue here is that whatever the new component is going to be, whether a museum or conference center or something else, it must be planned and constructed with the entire park and stadium within 24 months of the date that the sale of tax credits occurs. The federal regulations governing the use of NMTCs requires that the project to be financed with the inclusion of those funds be completed within two 12 month periods of funding and expenditures, resulting in a total of 24 months. Therefore, Council must decide quickly (1) exactly what new feature will be built, and (2) assure itself that the new feature can actually be built in 24 months from whenever the tax credits are sold, if NMTCs are going to be used.

2. The use of NMTCs will require that the entire park and stadium construction project be expedited to be completed in 24 months of funding the NMTC transaction. This is a very substantial change from the current construction schedule which has been negotiated with the CMPA and its developer, the Maritime Park Development Partners, LLC. The current construction schedule provides a 36 month period and includes automatic extensions for such unavoidable delays as inclement weather and delay in the receipt of materials. The Development Agreement does have provisions for mutually agreed-to alterations in the construction schedule, but to compress the current 36 month schedule into a 24 month schedule will require a substantial amount of planning and renegotiation with the CMPA and its developer.
3. In order to utilize Build American Bonds (BABs) in conjunction with NMTCs, the City must alter its relationship with the CMPA so that the CMPA will become an instrumentality of the City. This would be done by altering the corporate charter of the CMPA in order to provide that the City will have the power of appointment and removal of a majority of the Board of the CMPA. See memorandum of Edwards Angell dated September 17, 2009.

We are informed that the use of BABs requires that there be a governmental purpose and a governmental body utilizing the proceeds of the bonds. BABs are likely to make up the majority of capital raised in the upcoming bond sale. In order to maximize the amount of money that can be raised through the sale of tax credits, those funds must become a common fund with the proceeds of BABs. With that leveraging, the \$43 million bond proceeds can be added to the \$13-20 million raised through the sale of \$70 million in tax credit allocations. However, the NMTC program is not regarded as a means of raising public funds for governmental entities – its purpose is generally to allow profitmaking or non-profit entities to stimulate the local economies of economically depressed neighborhoods. Therefore, to separate the entity that will be receiving and using NMTCs from the City, our consultants have advised that the CMPA, a Sec. 501 (c) 3 organization, can be used to mix the public funds of bond sales and the private funds derived from the sale of tax credits. The CMPA will be, therefore, a private entity controlled by a

government entity. Although this combination of funding and organizational arrangement has never been undertaken before, our advisors are prepared to render their written legal opinion to provide the City with comfort on this issue. In addition, the law firms representing Mr. Gray's CTA-CDE will be expected to provide the same type of opinion.

4. The use of NMTCs will require a change in the flow of funds for the upcoming bond sale so that tax increment revenues from the CRA can be first used to satisfy the NMTCs structure and loans, and, ultimately, to make payments to the City's bondholders. It is expected that tax increment revenues paid by the CRA will be sufficient to cover these obligations. However, since the tax increment revenues will now be subject to claims against CMPA and the community development entities providing the NMTCs, the Preliminary Official Statement informs bondholders as follows: "In the event that NMTCs are used in connection with the 2009 Project, the City's covenant to budget and appropriate Non-Ad Valorem Revenues should be viewed as the primary security for the Series 2009 Bonds."
5. In order to take the steps which will be necessary to utilize NMTCs, the City will be required to take a number of actions (i.e., revising Interlocal Agreements with the CRA, approving restructuring the CMPA, and amending approval of the Development Agreement) which would trigger a new 60-day petition/referendum period.
6. The City will be required to understand and formally waive the various conflicts of interest which our legal advisors would be engaged in, absent such waivers. This is necessitated by the circumstance that Lott and Associates (Richard and Pat Lott) will be representing the City, Mr. Gray's CTA-CDE, the Gulf Breeze Loan Pool (if that is to be the source of bridge financing between the sale of bonds and the sale of tax credits), and Pat Lott is counsel to the University of West Florida/museum project. In addition, our Disclosure Counsel, Edwards Angell, should become tax counsel to the CMPA as a prerequisite for the City placing its potential liability to repay \$28 million in tax credits into the hands of the CMPA.<sup>1</sup>

#### THE RISKS TO THE CITY POSED BY THE USE OF NEW MARKETS TAX CREDITS

Private entities, including Mr. Gray's CTA-CDE and others currently being solicited by Mr. Gray, have been authorized by an agency of the federal government to sell federal tax credits. Each of the two companies is expected to sell \$35 million of their federal allocations, thereby generating \$27,300,000 over seven years, netting \$13-20 million in funds to be added to the proceeds of the City's \$43 million bond proceeds. The proposal discussed to this point has

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<sup>1</sup> The current Official Statement in the bond issue states, "If a recapture were to occur for this or any other reason, CMPA may become liable for the recaptured amount as set forth in Section 45D of the Code. As a result, CMPA could be forced to find a source of funding for such liability, or could be forced to cease operations .... The agreements, representations and warranties to be undertaken with respect to NMTCs will expressly state that the City is not liable for and makes no such representations or warranties with respect to NMTCs."

been for these funds to be added to \$2 million in Florida tax credits and \$4-5 million already in the museum foundation's coffers to pay for the construction of the park, the multiuse stadium and the Maritime Museum. All of this must be accomplished in 24 months and the project and its participating entities must remain compliant with federal tax laws and regulations for the entire 7 years of the use of tax credits by the entities that will be purchasing them.

In the event that the IRS or another federal agency challenges the purchasers' use of tax credits (referred to as a "recapture event" in the IRS code) over the next 7 years plus the applicable statute of limitations period, costly and complicated litigation could occur, particularly if the "recapture event" were triggered by actions of the CMPA or the CDEs. Despite the express limitations of liability to the investors in NMTCs to be stated in the Preliminary Official Statement and provided in the related documents, it is possible that the City would be drawn into this litigation. The search for a deep pocket entity could lead to the only deep pocket in this transaction: The City of Pensacola and/or its CRA.

In my opinion, this is the scenario that the City Council must protect itself against. Therefore, as Council begins the process of receiving detailed information, it is urged that the Council focus closely upon the level of comfort it may achieve, and the minimization of risk.

1. The City's retained national law firm of Edwards Angell and Mr. Gray's retained national firm of Ballard Spahr LLP will provide written opinions that this structure complies with the requirements of law. The national firm retained by UWF, Squire Sanders & Dempsey LLP, has declined to give such an opinion, and Pat Lott, representing UWF and the museum foundation, has written to state that the University is unable and unwilling to provide indemnification for its use of funds in constructing the museum.

The City's retained counsel will be providing a number of suggestions that, if incorporated into the contracts to sell tax credits, will minimize the risks to the City. Council should insist that some or all of them be requirements or conditions upon the City's willingness to enter into this transaction. Negotiations will take place between the City and Ed Gray's firm, CTA-CDE, between the City and the other entities being recruited by Mr. Gray, and negotiations will take place between the City and UWF. The result of these discussions will establish the City's risk in this transaction.

2. Council must satisfy itself that the park, multiuse stadium and museum (or other component) can be completed in 24 months. This is the "safe harbor" provision provided by the IRS regulations. In any event, the purchasers of tax credits will be informed of the risk that this project may be delayed for numerous reasons, but they will be entitled to a good faith assurance that it can otherwise be completed on time. Since the City Attorney's Office claims no expertise in public construction, it is suggested that Council secure an opinion from a source knowledgeable in construction projects of this nature before giving such an assurance to the tax credit purchasers.

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If the City Council decides to go forward with the use of NMTCs as a source of funding for components of the Community Maritime Park, the City Attorney's Office will work closely with all retained counsel with the objective in mind of controlling and reducing the City's risk in this transaction as much as possible. If any member of Council requires further information, please do not hesitate to contact the City Attorney's Office.