UTAH SYSTEM OF
HIGHER EDUCATION
Building a Stronger State of Minds℠

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January 15, 2014

MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

SUBJECT: Southern Utah University – New Markets Tax Credit Financing for the Shakespeare Festival Project

Issue

At the November 2013 Board of Regents meeting, Southern Utah University (SUU) officials updated the Board on a New Market Tax Credit (NMTC) financing option that SUU intends to use to procure approximately $3.4 million of capital funding for the Shakespeare Festival Project. This project is a component of the Board approved Southern Utah Center for the Arts Project. SUU is now seeking approval to proceed with this previously introduced financial proposal.

Background

The specific opportunity available to SUU for the new Shakespeare Festival facility involves a $4,850,500 investment by U.S. Bancorp (USB), which combined with $10,149,500 of SUU project funds, creates a $15 million "Qualified Equity Investment (QEI)" on which USB qualifies for the NMTC.

The $4,850,500 USB equity contribution will cover the following estimated costs:

CDFA Placement Fee	$375,000
Audit, Compliance, and Asset management Fees	600,000
Legal and Accounting Fees	495,000
Total Fees	$1,470,000

The estimated remaining balance of $3,380,500 and the SUU contribution of $10,149,500 are then available to the Utah Shakespeare Theatre Foundation for construction of the project.

The primary elements and documents included in the proposal are:

- The IRS regulations that are specific to NMTC programs require that the facility be built and owned by a private foundation that is not controlled by SUU. That foundation is the Utah Shakespeare Festival Foundation (USFF) whose membership includes two members appointed by SUU and three members who are independent community members. The facility will be built under the direct supervision of DFCM and under the terms specified in the Development Services Agreement to be executed.

- A **ground lease** with USFF for 60 years at $1.00 per year for the ground on which the facility is to be built. Upon any termination date of the lease the unencumbered title to all improvements, furnishings, fixtures, and equipment shall transfer to the University.

- A **building lease** wherein USFF leases the facility to SUU for 20 years with 8 five-year renewals at the amounts specified in the contract. Upon termination of the lease the unencumbered title to all improvements, furnishings, fixtures, and equipment transfer to SUU.

- The key document in the arrangement is the **Investment Put and Call Agreement** under which at the end of seven years, at which time U.S. Bancorp will have received all of the applicable tax credits, will exercise the "Put" provision. SUU will then pay the "Put" price, estimated to be approximately $1,000, that will terminate the notes and leases and the complete and unencumbered title of the facility will revert to SUU. If, for any reason, the "Put" is not executed, SUU, by exercise of the "Call" provision, can purchase from the lender all of its remaining interest and ownership in the QEI fund for an amount equal to the fair market value at the time, which is anticipated to be negligible.

The attached letter from SUU provides additional information about the multiple contractual agreements that are required to complete this rather complex arrangement. They involve a combination of leases and contractual agreements among multiple entities, all of which are under review by attorneys from the Office of the Attorney General for compliance with state law and by the law firm of Jones Waldo, appointed by the Attorney General's Office to provide legal counsel to the State of Utah, with regard to federal tax matters related to this transaction. This work continues and, presuming clearance from the Attorney General's Office prior to the Regent meeting, letters from both the Office of the Attorney General and Jones Waldo will be provided to Regents at the meeting. Should work not yet be completed by the January Board meeting, this agenda item will be pulled until a later date.

Officials from SUU will be in attendance at the meeting to present this proposal and respond to questions.

Commissioner's Recommendation

Presuming appropriate legal assurances are in hand, the Commissioner recommends that the Board authorize SUU to execute the final documents of the NMTC funding proposal for the new Shakespeare Festival Facility and to report back to the Board the final details of the transaction.

David L. Buhler
Commissioner of Higher Education

DLB/GLS/WRH
Attachment

SUU SOUTHERN UTAH UNIVERSITY

VICE PRESIDENT FOR FINANCE & ADMINISTRATION
351 WEST UNIVERSITY BOULEVARD
CEDAR CITY, UTAH 84720 (435) 586-7721 FAX: (435) 865-8479

January 2, 2014

David L. Buhler, Commissioner
Utah System of Higher Education
Board of Regents Building, The Gateway
60 South 400 West
Salt Lake City, UT 84101-1284

Dear Commissioner Buhler:

Southern Utah University received Regents' approval to pursue a financing method that would net the Shakespeare Theater Project approximately $3.5 million in funding through the use of New Market Tax Credits (NMTCs) that are allocated by the United States Treasury Department. The program is administered by the Internal Revenue Service. This letter outlines the specific documents that involve SUU, the Utah Shakespearean Festival Foundation, the Utah Shakespeare Festival and DFCM to effect this receipt of funds. Each document will be executed in order to complete the various transactions that will result in that amount of funding for the construction of the new Utah Shakespeare Festival theatre and related structures. The following is a list of those documents with short descriptions of terms that are significant to the Regents' approval. Each item makes reference to an exhibit that contains the full document (attachments to this letter). These documents are all in DRAFT mode and will be revised by review and final data at the time of closing. Please note that while there is agreement on the terms of these documents and no substantive changes are anticipated, final financial numbers may vary slightly by the closing date.

Southern Utah University
New Market Tax Credits Funding Document Summaries

Ground Lease Summary (Exhibit A)

Landlord: Southern Utah University

Tenant: Utah Shakespeare Festival Foundation

Rent Amount: $1.00 per Lease Year

Term: 60 Year Lease; commencing on January 1, 2014

Summary: The University, as owner of the land where the Center for the Arts project (more specifically the Shakespeare Theater and Administration Building) will be constructed, agrees to lease the real property upon which the facilities will be constructed to the Utah Shakespeare Festival Foundation for the period of 60 years. Upon any termination date of the lease, unencumbered title to all improvements, furnishings, fixtures, and equipment shall transfer to the Southern Utah University.

Note: For the purpose of this financing, the Foundation's articles are being amended to provide for a five member board, two of whom are affiliated with SUU (the President and the Finance VP), and three who are community members. This is to comply with the requirements of the Counsel to the U.S. Bancorp Community Development Corporation, the NMTC investor.

Building Lease Summary (Exhibit B)

Lessor: Utah Shakespearean Festival Foundation (the owner).

Lessee: The Utah Shakespeare Festival (the tenant) which is a division of Southern Utah University.

Rent Amount: $147,714 per year through year 7 then $719,713 per year through year 25.

Term: 20 Year Lease; commencing on January 1, 2016; plus 8 five-year renewals at fair market rental rates. These terms are consistent with the 60 year term of the ground lease.

Summary: The Utah Shakespearean Festival Foundation, as owner of the building, (more specifically the Shakespeare Theater and Administration/Production building) agrees to lease the land and building to the Utah Shakespeare Festival (a department of the University) for the purposes of performing Shakespeare productions and other plays, and housing Shakespeare Festival personnel, for a period of 60 years. This lease shall constitute a "triple net" lease, where the lessee is responsible for all expenses (taxes, utilities, operating costs, O&M, etc.) related to the property for the term of the lease.

Leverage Loan Agreement (Exhibit C)

Leverage Loan Borrower: USFF Investment Fund, LLC is an entity owned by U.S. Bancorp Community Development Corporation, the NMTC Investor. USFF Investment Fund is also referred to as the CDE in some instances.

Leverage Loan Lender: Southern Utah University.

Loan Amount: $10,149,500. On the closing date, the entire loan amount will be disbursed into a restricted account, which will be used to make a portion of the QLICI loan that will go to the Utah Shakespeare Festival Foundation (see below). The QLICI loan is comprised of the funds from SUU and the investor.

Term: 30 Year Loan; commencing on March 20, 2014

Interest Rate: 1.39155% annual rate (imputed)

Maturity Date: February 29, 2044

Payments: Quarterly interest only for installments in the amount of $35,308.84 through the initial loan period (March 20, 2021). Quarterly interest and principal payments would occur after that through the maturity date to fully amortize the loan. Payments are not anticipated beyond the initial seven years of the project.

Fund Pledged Collateral: Pursuant to the Pledge Agreement, Fund Borrower pledges as Fund Loan Collateral its 99.99% membership interest in Alliance Finance Fund 4, LLC .

QLICI Loan Agreement (Exhibit D)

Borrower: Utah Shakespearean Festival Foundation

Lender: Alliance Finance 4, LLC (The CDE)

Loan Amount: $14,625,000 ($15M less fees). $4,855,500 comes from the investor, and $10,149,500 comes from the leverage loan lender.

Term: 30 Year Loan; commencing on March 20, 2014

Interest Rate: 1% annual rate

Maturity Date: February 29, 2044

Payments: Quarterly interest only installments in the amount of $36,562.50 for the first seven years. Quarterly principal and interest payments commencing on March 20, 2021 through maturity date to fully amortize the loan. The project will close after the initial seven years.

Covenants: Besides being subject to the normal construction loan type agreements, the borrower must comply with certain covenants that are part of the NMTC program, which are found in Section 7.32 of the QLICI Loan Agreement. Generally, these pertain to activities that are required or prohibited, such as converting the project from a theater to a tattoo or massage parlor, and which are under the control of SUU, because SUU has exclusive rights to use the project pursuant to the building lease.

Pledge Agreement (Exhibit E)

This agreement between Southern Utah University (SUU) and USFF Investment Fund, LLC (Investment Fund) creates a first position security interest in all assets (collateral) of the Investment Fund for SUU (the lender). This agreement, the Land Lease and the Building Lease provide security for SUU issuing the leverage loan to the project.

Development Services Agreement (Exhibit F)

This is an agreement between Southern Utah University (referred to as the developer for the purposes of this agreement) and the Utah Shakespearean Festival Foundation (the owner). It establishes a relationship between the developer and the owner for the oversight and construction of the project using the same processes as would exist with any state agency. The developer will execute an agreement with DFCM to provide the same services as with any other facility construction on the SUU campus.

Investment Fund Put and Call Agreement (Exhibit G)

The "PUT" and "CALL" agreement between the U.S. Bancorp Community Development Corporation (investor) and Southern Utah University (leverage lender) stipulates conditions and timing of a "PUT" provision and a "CALL" provision. The "PUT" provision requires the leverage lender to purchase the investor's interest in the investment fund for the sum of $1,000. Upon the completion of the "PUT" option the investor transfers all rights and titles in the investment fund to the leverage lender. In the event that the investor does not exercise its "PUT" option, the "CALL" provision provides the leverage lender the option to purchase (the CALL) from the investor all of its interest and ownership in the investment fund for an amount equal to the fair market value of the Investor's interest in the fund at the "CALL" date. The Investor's interest will be valued by an independent appraiser who will estimate the net present value of the assets minus the liabilities, calculated at the "CALL" date. In either case the leverage lender must also pay the amount of damages, if any, to the NMTC investor that are owed to the NMTC investor under the Guarantee Agreement (described below).

Unconditional Guaranty of New Markets Tax Credits, Put Price and Environmental Indemnification (Exhibit H)

This document details an agreement between the Utah Shakespearean Festival Foundation, (QALICB) and U.S. Bancorp Community Development Corporation (Investor) wherein the QALICB guarantees compliance with the provisions of the United States Treasury and IRS rules and regulations that qualify the Investor's investment for the New Market Tax Credits. It stipulates conditions that would require the QALICB to indemnify the Investor for any disqualified Tax Credits, the "PUT" price if not paid by the Lender, and any damages due to environmental issues.

The conditions that would result in a recapture of the Tax Credits for which the QALICB would be liable are specified in the covenants in the QLICI Loan Agreement (as described above) and pertain to activities that are prohibited; for example, converting the project from a theater to a tattoo or massage parlor. This is easily guaranteed.

The Put Price Guarantee covers an event wherein SUU (the lender) does not pay to the Investor the "PUT" price, estimated to be approximately $1,000, that will terminate the notes and leases; restoring complete unfettered title to the land and buildings to the Lender. There is no foreseeable condition where SUU would not pay the "PUT" price.

Summary

The expectation and plan is that, at the end of seven years, the investor will have received the NMTCs in full and will exercise the "PUT" provision, and all documents, notes, leases and titles will transfer back to SUU and the structure will be closed. If, for any reason, the "PUT" is not executed, SUU can exercise the "CALL" provision that will have the same effect.

SUU requests authorization to enter into the various contracts, leases and other agreements to effectuate the issuance and awarding of NMTCs as outlined. Final documents and closing is anticipated to take place in April 2014.

Thank you for the enormous effort by you and your staff in reviewing and evaluating the merits of this financing opportunity for the Shakespeare Theater Project and for Southern Utah University.

Sincerely,

Dorian G. Page, CPA

Vice President Finance & Administration

Cc: President Rich Kendell
Dr. Gregory L. Stauffer, Associate Commissioner
for Planning, Finance & Facilities
Ralph Hardy, Assistant Commissioner for Facilities Planning
Tom Berggren, Jones Waldo
Mike Carter, Assistant Attorney General
Kevin Olsen, Assistant Attorney General

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Questions and Responses Regarding SUU NMTC Financing Proposal

1. Why couldn't SUU simply raise the funds through private gifts to build the facility?

   This non-state funded project is really remarkable especially given the size and scope of Southern Utah University. The fund raising effort has been without precedent. Approximately $ 30.0 million (exclusive of the NMTC funding) has been raised from private and public sources. If there were another $3.5 million from donors readily available to us, we certainly would have secured such funding. We will continue our fund raising efforts, but time is of the essence and further delays in launching this project will harm the project and our ongoing fund raising efforts.

2. What is the **estimated** composition of the US Bank $5 million "investment?"
   a. Project Investment $3.5 million
   b. Transaction Costs $1.5 million

3. Why are the "transaction" costs so high (30% of US Bank investment)?

   a. Placement Fee $375,000
   This is a "finders fee" for the CDFA (Allocator) of the NMTCs in the state of Utah. They spend a great deal of time and effort to qualify to receive tax credit authorizations and then oversee the allocation of credits for the term of the project (estimated at seven years). They have completed several successful projects in the State. This fee is not negotiable.
   b. Audit/Compliance/Asset Management $ 600,000
   This covers all the required compliance issues for the term of the NMTCs, including an annual audit and tax return. It also covers the cost of managing the financial structure for the seven year period. This is an estimated budget based on the experience of other projects. Compliance is an important aspect of dealing with the IRS which oversees these projects.
   c. Legal and Accounting $ 495,000
   This is the estimated cost of Legal and Accounting services related to setting up the financing structure to comply with IRS regulations related to the NMTCs. We have been required to appoint specialized attorneys and accountants that have expertise in the field of NMTCs. The actual process for securing and managing NMTCs is complicated and all parties want to have competent legal counsel.

   Total <u>$1,470,000 (estimated)</u>

4. Why does SUU have to put $10 million into the deal?

The total project (Theater) is equal in cost to the approved NMTC investment ($15M). The total project will be constructed through the financing structure required by the NMTC's regulations. The project requires at least two parties—a private sector investor (US Bank) and a leveraged lender (SUU) which adds funding to the total project. The two investments, approximately $15.0 million, equal the costs of the project and the processing fees.

5. Why is the SUU contribution called a "leverage loan"?

The investor's investment is "leveraged" through use of a loan to construct a facility that will qualify as a NMTC business. In most financing arrangements, this would be a bank loan. Where SUU has raised the needed funding, SUU will be the "leverage lender" and put cash into the investment fund. The term " leverage lender" is simply language that is commonly used in NMTC transactions.

6. Why and how does US Bank get the tax credit benefit on SUU's $10 million?

The investor is eligible by regulations to receive tax credits for the entire project for their investment, together with the leverage loan. US Bank receives a 39% tax break (of the total project) spread over seven years.

7. Why does the ground lease run 60 years and the building lease only 35 years?

The land lease must be for 60 years to establish "ownership" by the QALICB, (Utah Shakespeare Festival Foundation), complying with NMTC's regulations. The 35-year building lease term was from an earlier version of the documents. The current building lease is now set at a fixed 20-year period and eight 5-year renewal periods to agree with the land lease. There is now general agreement between the two documents.

8. Why are the ground and building leases longer than the seven year tax credit period?

The leases have to be for a term that approximates the useful life of the project, so that it represents a true business transaction. Many times, the "leverage loan" would last longer that the seven year NMTC earnings period. While the financial forecasts anticipate a longer project term, the project will end after seven years. As noted above the term of the land lease must be at least 60 years to establish "ownership" of the project. The building lease was designed to provide SUU with controls and influence over the project, and matches the term of the ground lease. Notwithstanding that, the PUT/CALL option entitles SUU to take the investor out of the transaction when the investor has received the NMTC benefits (seven years).

9. How do the “PUT” and “CALL” provisions terminate SUU’s obligation at the end of the seven year period?

The Investor will own 99.9% of the investment fund that owns the entity serving as the construction lender to the project . The Community Development Finance Alliance (, CDFA) which has the NMTC allocation, will own the other 0.01 %). At the end of seven years, the investor will have received their investment and a required internal rate of return. While for tax reasons it cannot be contractually bound to transfer its interest in the investment fund after seven years, that is the present intent. Following the exercise of the “PUT” option, SUU will own 100% of the investment fund and can arrange for the unwinding of the transaction, resulting in SUU’s 100% of the ownership in the project. The “CALL” provision is also an option (see below).

10. What would deter US Bank from exercising the “PUT” option?

To-date US Bank has closed approximately 185 NMTC projects with 100% being closed with the” PUT” option. There is pressure on the bank to complete the deal as outlined. The non-profit and economic development market place would not look favorably on the Bank if it did not exercise the “PUT”. If they were in some kind of financial crisis and they figured that the “CALL” option would generate more revenue than the” PUT”, they might decide to not exercise the” PUT”. This is a VERY unlikely scenario.

11. What is the estimated cost to SUU when the “PUT” is exercised?

$1,000.00, primarily for processing closing documents.

12. What enables SUU to exercise the “CALL” provision in the event US Bank does not exercise the “PUT ?”

The “Investment PUT and CALL Agreement” authorizes SUU to exercise the “CALL” option if the” PUT” is not exercised by the Investor.

13. What is the cost to SUU if the “CALL” provision is exercised?

The cost will be the fair market value of the investment fund at the date of the” CALL.” This is determined by agreement between the Investor and SUU; or by an independent appraiser. The value of the investment fund is the net present value of the projected cash flows of the fund. That amount will depend on the remaining cash flows and the discount rate used. We estimate that it would be between $100 K and $200 K. At closing we will reserve the estimated amount even though it is VERY doubtful that the ” PUT” would not be exercised. But, the “CALL” provision does give SUU an exit if we desire it.

14. What potential liabilities, financial or otherwise, does SUU incur in this deal?

The risks associated with this transaction are that we default on our obligations to build the project, or we change the use of the facility to a "prohibited" business (e.g. massage or tattoo parlor). These risks are remote and controlled to a great extent by us. We have the funds to build the project and all the necessary approvals. We will not convert the property to a prohibited use. Our potential liability for either of these risks would be the return of the investor's investment.

15. What is the overriding value of this [Center for the Arts] project?

The NMTCs are designed to leverage private funds for investment in economic development. This project is recognized by the State, the County and the City as a significant economic development project, as each entity has provided multiple millions of dollars toward its completion. The Utah Shakespeare Festival has benefitted SUU, Cedar City and the State for over 50 years. A recent economic impact study was completed in January of 2011, authored by Neil N. Abercrombie and Kelly K. Matthews, indicating that the economic impact of the Festival on the local economy is $35.0 million annually. The new Center for the Arts project will expand this economic impact in significant ways.