How to Structure a TIF Deal

Simplifying and De-Mystifying Tax Increment Financing

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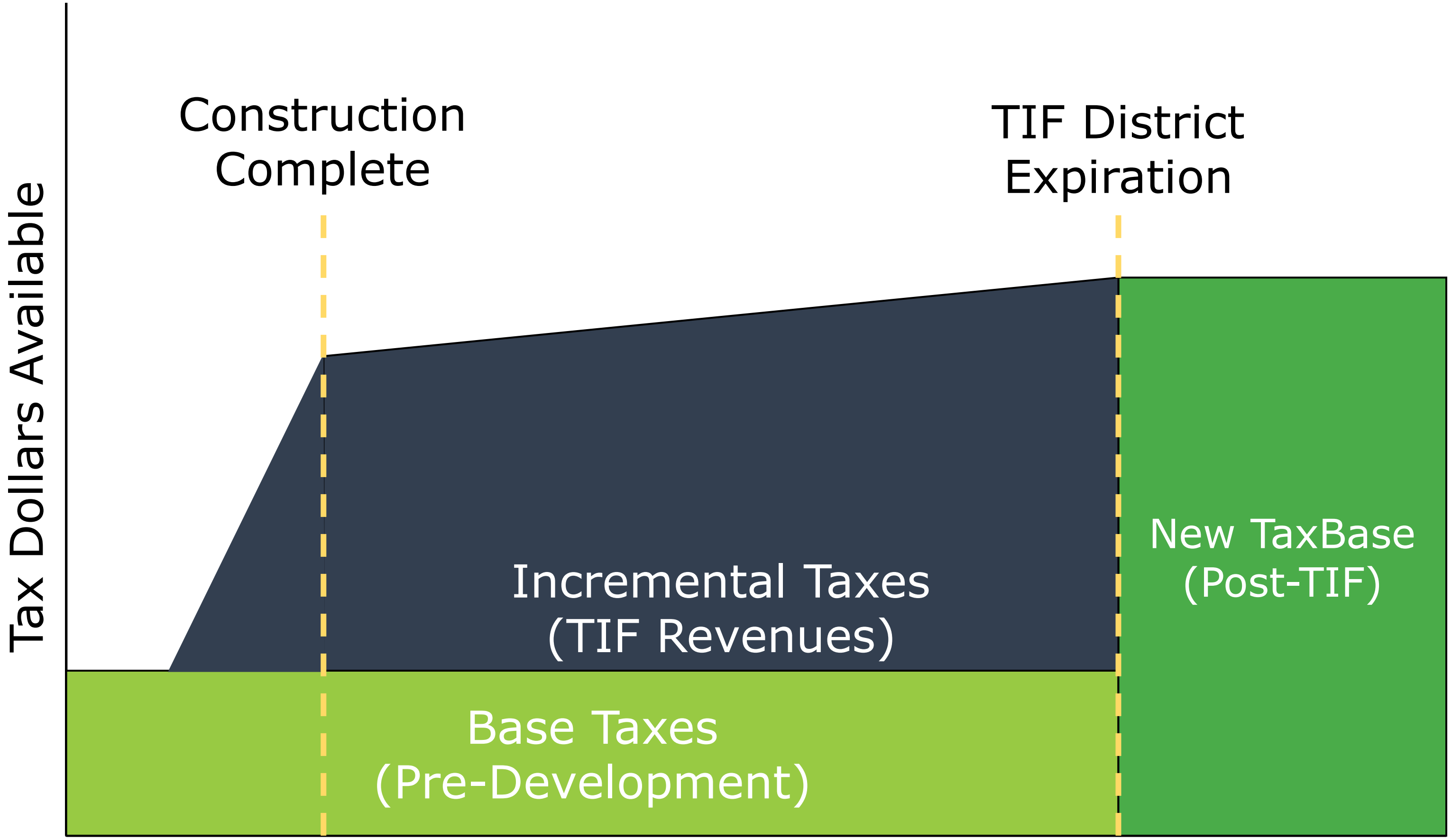
How does Tax Increment Financing Work?

- Financing a project with increased value of future tax revenues
- TIF districts split taxes:
  - Base
  - Incremental



How to Maximize TIF Benefits Using Deal Structure

- First, what is deal structure?
- How do I design my deal structure?

Three Typical TIF Objectives

- Up-front financing utilizing loans or public bonds
- Long-term investment in infrastructure/fund-building
- Increasing the ROI for a specific project
- Combination of the above

Basic Structural Features

- Timing
  - Base vs Term
  - Is the term rolling?
- Area
  - Often overlooked

How to Maximize TIF Benefits Using Deal Structure (cont'd)

- Identify the type(s) of TIF revenue and the specific TIF tools (details matter)
- Address key factors impacting the revenue stream (e.g., abatements, school portion, buildout schedule)
- Consider risks and risk mitigation strategies, especially regarding construction and valuation
- Determine how to optimally monetize

How Much is My TIF Worth?

- Based on the type(s) of TIF and the structure of the TIF(s), what is the estimated value?
- How can I effectively predict what my revenue stream will look like?
- Is there any flexibility to extend my TIF?
- Who gets the “excess” TIF revenue?

What Will this TIF Fund?

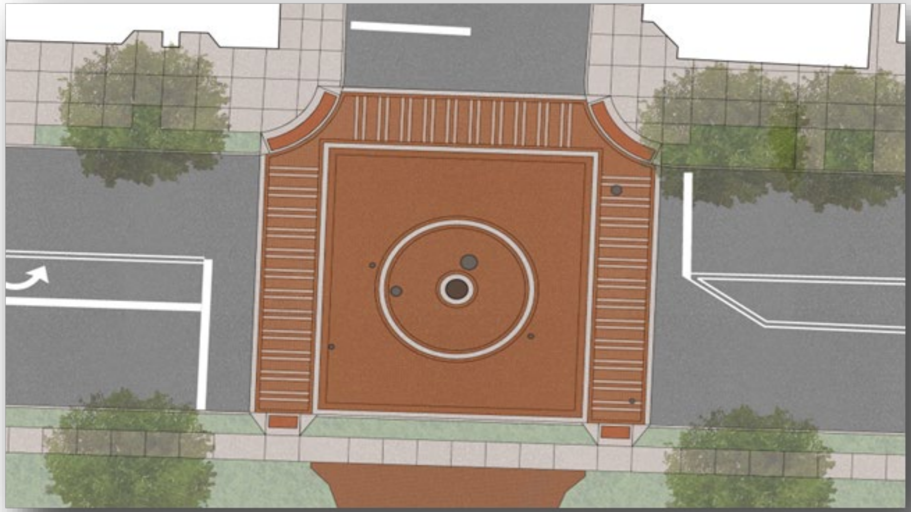
- Public infrastructure related to a specific project
- In many jurisdictions, it can be used for private improvements
- Support ongoing infrastructure
- Reimburse qualified costs that have been incurred
- Some other arrangement?

Up- Front Financing Approach Overview

- A public bond or note issuance
- Bonds may be issued by a municipal entity; different security types and depending on level of direct issuance or credit support – the bonds may be rated at the level of the municipality
- Privately placed debt
- Loan programs
- Ex. Public Garage for a Mixed-Use project

Long - Term Investment/Fund - Building Overview

- Community -led TIFs
- Sometimes gradual growth
- Example: Main Street development



Increased Project ROI Overview

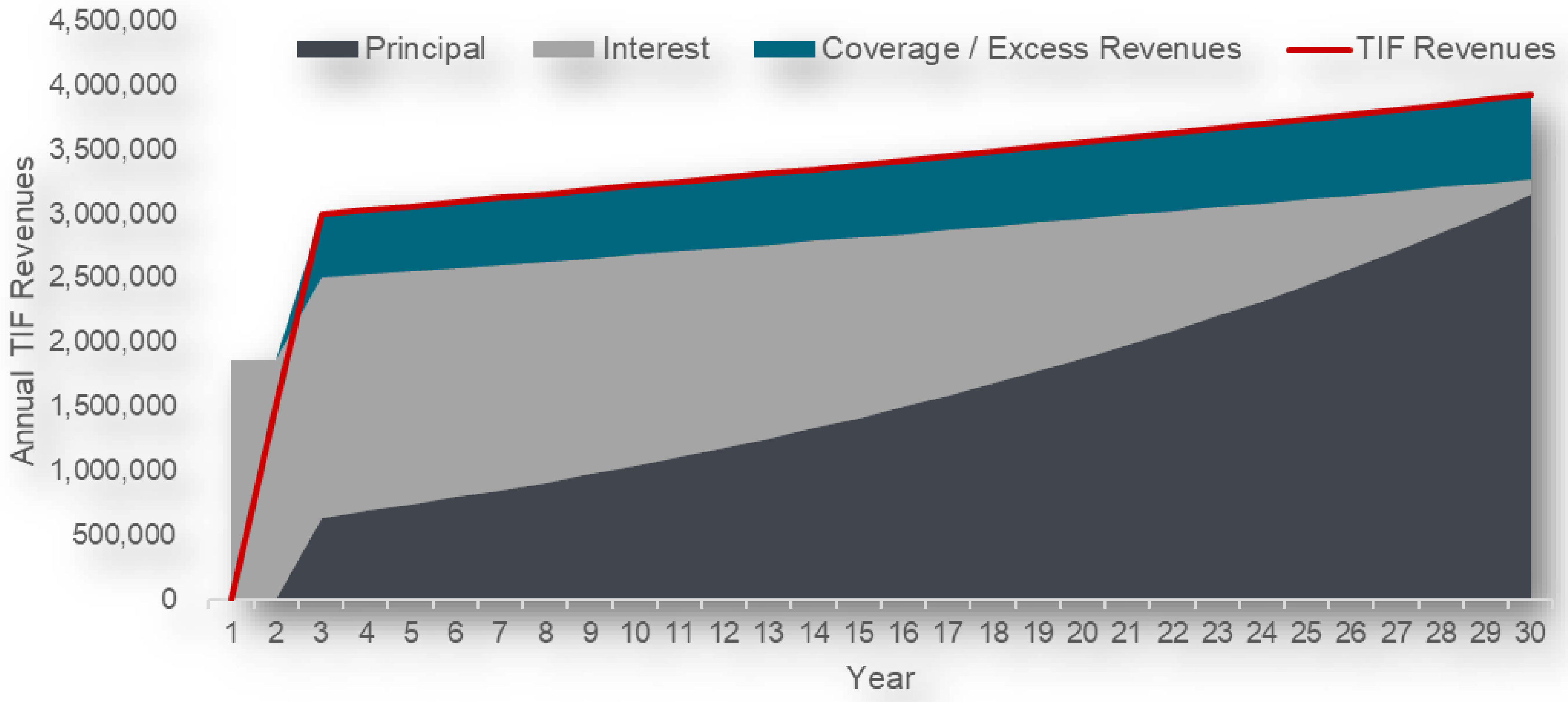
- No lack of equity or financing
- Privately -placed bonds to developer principals or affiliates
- Reimbursement agreements

Up- Front Financing Approach: Covering a Funding Gap

- Cash flows are monetized and used to fund public infrastructure improvements
- Bonds/notes are issued as revenue bonds with a direct pledge of TIF revenue
  - All TIF payments are pledged to the bond trustee for debt service payments

Sizing TIF Revenue Bonds

- The size of a TIF bond issuance is largely determined by the projected TIF revenues available, as determined by the projected assessed value above the base value.



Sizing TIF Revenue Bonds (cont'd)

Senior Debt

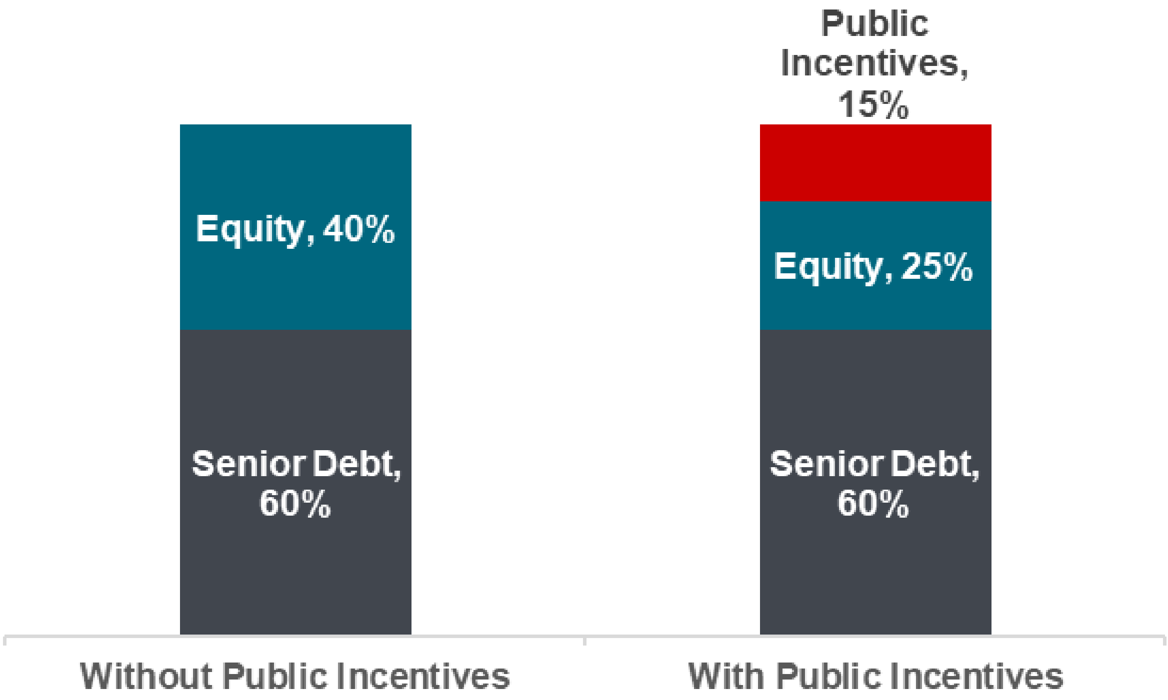
- 50-65% of a typical capital stack
- Often requires a minimum 1.20x debt service coverage

Equity

- 25-40% of a typical capital stack

Public Incentives (e.g., TIF)

- Proportion of capital stack is variable – often 10-20%
- Lenders often view it as "quasi-equity", as TIF debt can and should be structured as non-recourse to the Developer



Features of TIF Revenue Bonds

- Non-Recourse
- Pre- or Post-Construction
- Upfront Cash Injection
- Long-Term Financing
- Fixed Interest Rate
- Additional Upside Over the Term
- Prepayable After 5-10 Years

Bond Security Features

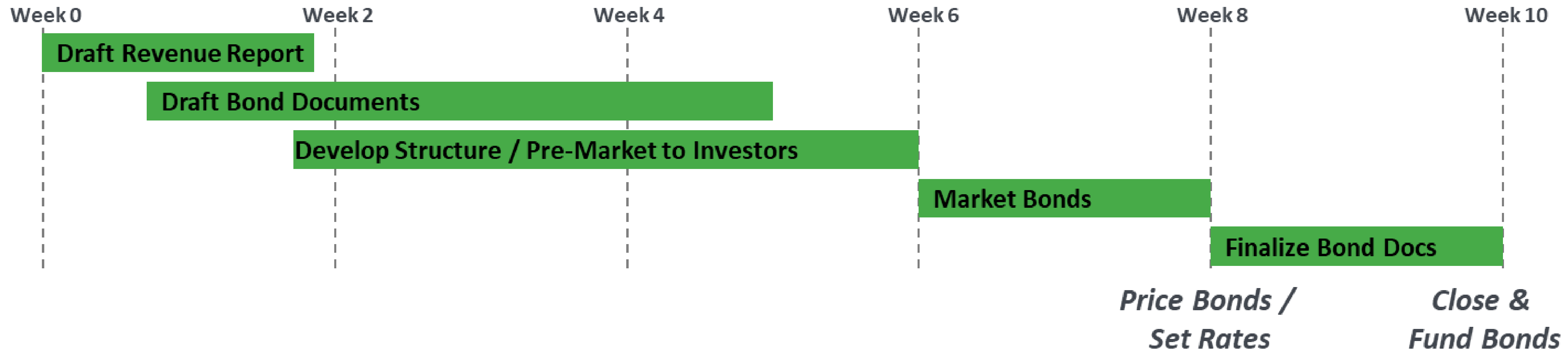
- Secured solely by first lien on incentive revenues
- Revenue enhancements?

Sample Calculation of Debt Service Coverage Ratio							**Typical Debt Service Coverage Ratio**	
Projected Revenues (any given year)		**Debt Service** (same year)		**Excess Revenues**		**Debt Service Coverage Ratio**	**Property Tax Incentives**	**Sales Tax Incentives**
$1,000,000	÷	$800,000	=	$200,000		1.25x	1.15x-1.25x	1.25x-1.35x

Bond Security Features (cont'd)

- TIF proceeds are typically considered quasi-equity from a senior lender's perspective
- A debt service reserve fund is required for all revenue bonds
- There are no personal guaranties required
  - A completion guaranty or performance bond may be required during construction or until stabilization

Transaction Timeline



What is a Tax - Exempt Bond?

- If federal tax requirements are met, bondholders don’t pay income tax on the interest on the bonds.
- The interest is also exempt from state and local taxes.
- This translates into lower costs of borrowing.

Sounds Awesome, I'll have two! Oh, there's a catch?

General rule of thumb, the federal government subsidizes:

- Governmental activity;
- Charitable activity (501(c)(3) Education and Healthcare; and
- Certain "exempt facilities."

So how do we determine whether something is "governmental activity"

- Can't have both:
  - More than 10% Private Use; and
  - More than 10% Private Payment or Security
- Can't be a private loan

Are my PILOTS Private or Public

- Usually PILOTS are considered “generally applicable taxes” and are NOT private payments
- Unless you make an “impermissible agreement” such as:
  - Minimum service payments;
  - Agreement to be personally liable for a tax if the tax doesn’t have personal liability;
  - A guaranty of the tax or to provide additional credit if there is a shortfall; and
  - Minimum valuation agreements or agreements not to challenge value.

What is private use?

- Special legal right with respect to the bond financed property in a trade or business;
- Can be created by ownership, lease, management contract or otherwise;
- Use by the general public is not private business use.

Parking Garages

- Can be public or private;
- First test is to determine whether trades or businesses have a right (in the aggregate) to use more than 10% of the available spaces;
- Second is to look to the management and operation.
- A publicly owned garage that is managed by a private entity needs to be managed pursuant to a "qualified management" agreement. Quick test: look to see who profits, who has risk. If it is a private entity, there is probably private business use.

Case Study: Flats East Bank (Cleveland, OH)

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- Purpose: Refunding four bond series and other public loans
- Total Bond Size: $52mm
- Project Type: Mixed-Use
- Tax Structuring / Optimization
  - Split into two series so both tax-exempt
  - Subordinate series has MSP
- Rating Considerations
  - Senior Series Rated “BB” (S&P)

Case Study: Flats East Bank (Cleveland, OH)

- Interest Rate
  - Senior: 3.98%
  - Subordinate: 4.62%
- Proceeds: $50,954,393
  - Refunding Public Loans: $17,026,001
  - Refunding Public Bonds: $33,928,392
- Security – *Non-Recourse*
  - Senior: TIF Revenues Only
  - Subordinate: TIF Revenues and Minimum Service Payments

Case Study: Santa Fe Square (Tulsa, OK)

- Purpose: New construction (private and public improvements)
- Total Bond Size: $20mm
- Project Type: Mixed-Use (Office, hotel, retail and multi-family)
- Multiple revenue streams (Property and sales tax TIF)
- Incentive Structuring: Worked with City to optimize agreements
- Phasing Considerations
  - Office needed to open quickly for tenant
  - Multi-family reliant on HUD financing
  - "Tranche" structure implemented

Case Study: Santa Fe Square (Tulsa, OK)

- Interest Rate: 4.62%
- Proceeds: $16,155,833
- Security - *Non-Recourse*
  - Property Tax TIF Revenues
  - Sales Tax TIF Revenues

Project Capital Stack / Sources of Funds

Sources of Funds:		
Construction Loan	$93,930,891	72%
Developer Equity	$19,904,123	15%
Bond Proceeds	$16,155,833	13%
Total Project Costs	**$129,990,847**	**100%**

What other tax issues should I be aware of?

- If there is an “accession to wealth” there could be taxable income:
  - Typically, only occurs where financed items are to be owned or operated by a private party
  - However, if all funds are “circular” good argument that no accession to wealth exists

Increase ROI: Reimbursement

- If borrowing isn't attractive, the developer (or maybe an assignee) can be reimbursed for prior costs as TIF revenues are received
- You can get interest (rate is negotiable)
- Interest might be able to be tax-exempt

Reimbursement (cont'd)

Advantages

- Less costs and paperwork
- Interest rates are negotiable
- When TIF revenue is steady, can be more easily monetized in the future

Disadvantages

- Interest is negotiable
- Lack of upfront cash
- Need to be diligent in pursuing reimbursement and collections over a long period of time

Reimbursement (cont'd)

- Can the interest paid to me under a reimbursement agreement be tax-exempt?
- Maybe
  - No opinion of counsel
  - Issuer should file a form 8038
  - Not all issuers may take this approach

Bank It?

- What happens as TIF revenue grows?
- Additional improvements?
- Remote TIF?
- Expand the TIF?
- Remember, funds can only be used for statutory purposes and there may be limits in the authorizing ordinance.
- Plan ahead!

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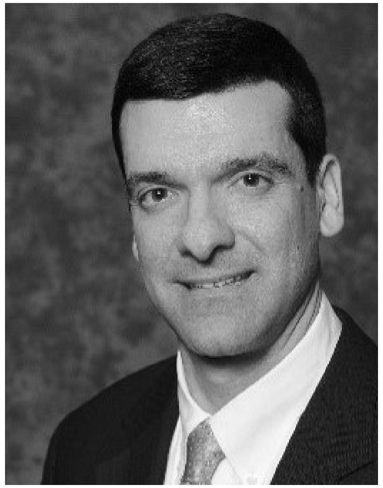

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