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BUSINESS X-FORM

SPECIAL ISSUE: NEW MARKETS TAX CREDITS

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NMTC: VENTURE CAPITAL FOR PHOENIX HIGH-TECH START-UPS

High-tech and biotech start-ups may find attracting venture capital (VC) can be easier when they locate in key Phoenix areas, due to New Markets Tax Credits.

VC funds may use tax credits for seed money, early stage or later stage investments. Target industries are: bioengineering, bioinformatics, biotechnology, genomics research, health care, information systems technology pharmaceuticals and semiconductors.

TAX CREDITS GUARANTEE INVESTORS A MODEST RETURN, SO THE OVERALL RISK/REWARD PROFILE IS MORE ATTRACTIVE.

Tax credits can make *fund-raising* easier for VC funds that invest in Phoenix high tech start-ups. Tax credits guarantee investors a modest return over seven years so the overall risk/reward profile is more attractive.

Tax credits can make *syndication* easier for VC funds. If a fund is too small to meet all of a start-up's capital needs, or it does not want to bear all the risk by itself, it may bring in other VC funds to assemble the needed capital. With a base amount in place—raised with NMTC help—other VC funds may be more likely to participate.

Tax credits may help *attract out-of-state capital* to Phoenix. VC funds typically invest locally, where they can oversee and counsel managers in whom they have invested. An out-of-state VC fund may be more comfortable joining a syndicate where a local lead investor, supported by tax credits, will watch over its investment.

Tax credits support *patient* investments. During the first seven years, a VC fund may harvest earnings and gains, but it must preserve its original investment. After seven years, a VC fund may restructure its investment entity to maintain stock ownership in financed companies without recapitalizing its investment.

VCs should require invested companies to remain in the qualified area. If the start-up moves out of the low-income area during the first seven years, and a VC fund using NMTC owns more than ⅓ of the company, it must pay back its tax credits. NMTC-supported investments can never own more than half of a start-up company.

NEW MARKETS TAX CREDITS WILL FINANCE BUSINESSES IN PHOENIX CORE COMMUNITIES

The NMTCs that the City of Phoenix recently won will help finance business development in low-income neighborhoods in three ways:

- Loans for real estate revitalization or development.
- Loans to small businesses.
- Equity investments in high-tech start-ups.

The City hopes to start investing in late August 2003.

To qualify, businesses or projects must be in "low income" census tracts, the dark areas on the attached map. In these areas, median income is 80% or less of the metro area income, or the poverty rate is 20% or higher. Depending on the type of project, applicants must meet other qualifications, too.

Purposes of the NMTC programs, within the low-income, underserved community, are:

- Create new jobs
- Enhance commercial, retail & industrial development
- Help finance small and start-up businesses

Businesses can combine NMTC resources with other City programs. Parts of the NMTC low-income community overlap the Phoenix Enterprise Zone and the Rio Salado Habitat Restoration Project. Depending on location, businesses may also benefit from EXPAND collateral enhancement, tax abatements, workforce development, and management and technical assistance.

BACKGROUND

In March 2003, the City of Phoenix won $66.3 million in "New Markets Tax Credits" (NMTC) from the Community Development Financial Institutions Fund (www.cdfifund.gov), a branch of the U.S. Treasury. Phoenix won the largest award in this first round. Its tax credits will support investments up to $170 million. Nationally, CDFI awarded a total $975 million in tax credits, supporting up to $2.5 billion in investments, to 66 winners out of 345 applicants. Congress authorized these credits in the December 2000 Community Renewal Tax Relief Act.

NMTC Loans to Small Business

Small businesses can borrow from $35,000 to more than $1 million for major equipment purchases, working capital or to buy or expand a business, on very favorable terms. The loans can finance up to 90% of the cost.

Expected interest rates will be 100 to 150 basis points below current market rates for the first seven years, after which the interest rate will reset to the then-current market rate. The rate depends on the borrower's financial strength, security and location.

Amortizations may be from seven to 25 years, longer than most bank loans, lowering monthly payments. Borrowers may not pay off a loan during the first seven years, but may pay off any time afterward.

To qualify for these loans, a business must:

- Be substantially located in Phoenix low-income communities (dark areas on map)
- Show how the business will create quality jobs for or provide services to low-income community residents
- Demonstrate ability to make payments, comparing projected free cash flow to debt service
- Document business experience, profitability, positive net worth and liquidity and working capital ratios within industry norms
- Provide a first or second mortgage or equipment lien, and owners' personal and other loan guarantees
- Pay normal loan fees and closing costs

Investors and NMTC

Investors in NMTC earn tax credits totaling 39% of their investment, spread over seven years: 5% per year for the first three years, then 6% per year for four years.

These credits can *not* reduce taxes below the Alternative Minimum Tax, so very few individuals can benefit.

Most investors will therefore be public corporations, who will access the credits through financial services houses. Local venture capital firms will also access the credits on behalf of their capital sources, mostly banks.

The City anticipates competitive Request for Proposal processes to distribute the tax credits.

Dividing Phoenix's $66.3 million in awarded tax credits by 39% yields $170 million in potential investment capital. Because the credits are spread over seven years, their present value may be less than their face value, and they may yield less than $170 million.

NMTC Real Estate Financing

Real estate development and revitalization projects can get below-market-rate loans with very favorable terms. Two types of loans are anticipated: senior debt is secured by a first mortgage; mezzanine debt is secured by partnership interests or a second lien. The following table compares these loan types:

Terms	Senior	Mezzanine
Loan amounts	$1-$35 million	$1-$35 million
Amortization	10, 25, 30 yrs.	10-yrs. minimum; may be int. only
Loan-to-Value/Cost	Up to 75%	Up to 90%
Min. Debt Service Coverage Ratio	1.20:1	1.10:1
Target interest rate	10-yr. Treasury Note rate floor	9% plus cash flow participation

For both types of loans:

- Target interest rates are expected to be at least 100 basis points below current market rates.
- No prepayments are allowed in the first seven years.
- Normal closing costs (fees and negotiable points) will be paid by borrower.
- Recourse during construction and lease-up; non-recourse after stabilized occupancy (negotiable term).

Target types of developments include:

- Community-serving retail
- Commercial/industrial development
- Transit-oriented development
- Office or research lab for downtown biotech campus
- Corporate and regional business headquarters

Applicants for NMTC loans must demonstrate how the projects will meet community investment objectives:

- Create quality jobs for low-income area residents
- Attract higher-income residents to the urban core
- Provide services to the low-income community
- Raise local property values

City Creates NMTC Web Site

The City of Phoenix is creating a special web site to educate the business and investment communities about its NMTC programs: www.PhoenixNMTC.org.

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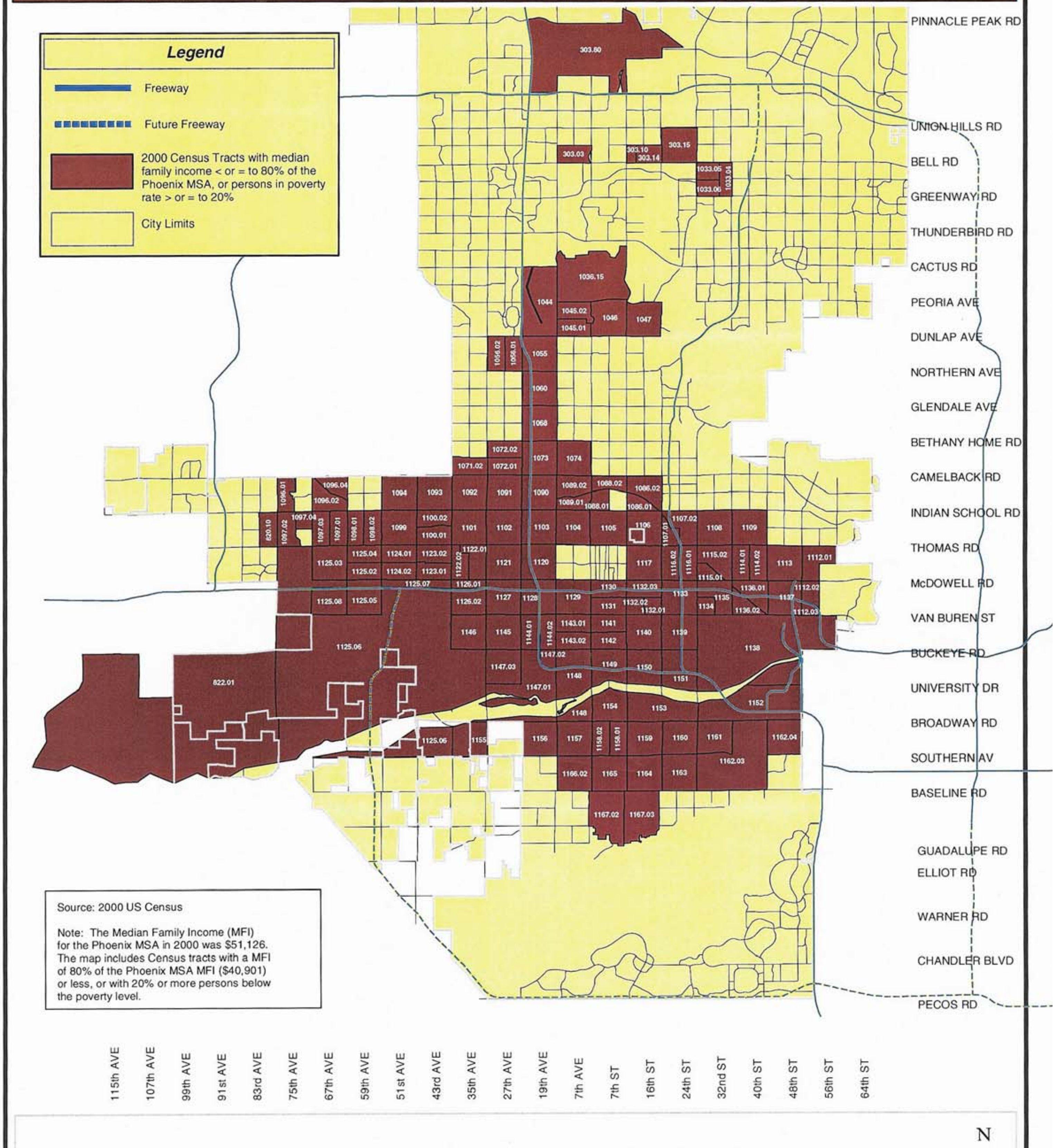
City of Phoenix 2000 Census Tracts
Low-Income Communities



Phoenix Community Development and Investment Corporation