City of Phoenix
New Markets Tax Credit Program
Implications for Arizona Technology Companies

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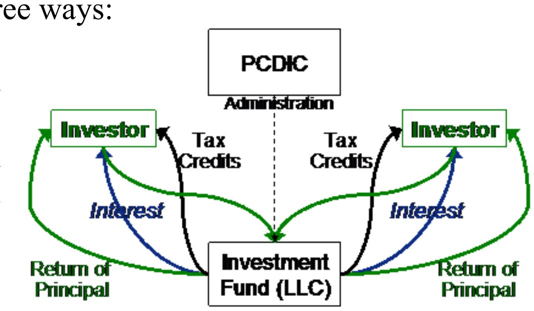
In March 2003 the City of Phoenix won $66.3 million in "New Markets Tax Credits" (NMTC) from the Community Development Financial Institutions Fund (www.cdfifund.gov), a branch of the U.S. Treasury. The Phoenix tax credits will support $170 million in total investments. The Phoenix award was the largest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

Potential: NMTC will help finance Phoenix' ongoing development as a high-tech and biotech center: it can help finance new wet labs for biotech research, grow specialty services businesses that support high-tech firms and invest venture capital in pharma startups. NMTC provides a way for the area's high-income winter residents—and others—to earn a good return while investing in the Valley's future. It adds another venture capital source, which may attract even more funds.

Management: The new Phoenix Community Development & Investment Corporation (PCDIC) will run the program through a 5-member Board of Directors made up of representatives Greater Phoenix Urban League, Chicanos Por La Causa, Phoenix Community Alliance and others. This Board will verify that projects meet program guidelines to improve under-served communities. Administrative fees will fund PCDIC.

Investors: Funds for PCDIC projects will come from investors with high taxable income, such as financial institutions, corporations and high-income individuals, subject to a minimum investment level. Funds are pooled and reinvested (loans and/or equity) in development projects and businesses. Funds typically flow back to investors in three ways:

- A modest, fixed rate of interest, to be determined (say 5%), plus
- Federal income tax credits totaling 39% of invested funds, spread over seven years: 5% each of the first three years, then 6% each of the next four years.
- Repayment of principal after seven years.



Investors will receive a Schedule K-1 each year to file with their tax returns. Investors may select among fund pools for commercial real estate, small businesses or startup businesses; each pool has a unique risk/reward profile. Special pools may also be created for special purposes or needs.

More about tax credits:

- Income tax credits are earned in the year the investment was made, regardless when during the year it was made. A December 31, 2003 investment earns a full 5% tax credit for 2003.
- Investors must have taxable income against which to apply the credits. Within limits, tax credits may be carried backward or forward to years with higher applicable taxes.

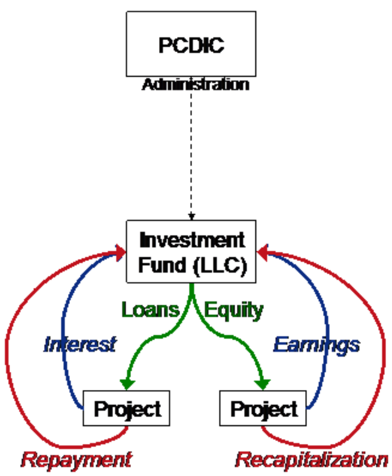
- Tax credits may not be applied to reduce taxes below the Alternative Minimum Tax (AMT) level. Investors who pay only the AMT will not benefit from this program.
- The tax credits are not separable from the underlying investment. Investors may sell their investment in the fund—and the tax credits that go with it—to a third party.

Investment projects must be in poor census tracts; qualifying areas are generally bounded by Baseline Rd., Camelback Rd., 75th Ave. and 48th St., plus tracts along Black Canyon Highway (I-17) to Cactus Rd. and a few other locations (see map). Projects may be retail, commercial development or businesses, but may *not* be rental housing (other programs may support rental housing) or selected adult-oriented businesses. Projects may combine NMTCs with other programs, such as enterprise zone credits, property tax abatements, SBA loans, etc.

Type of Project	Loans	Equity
Commercial Real Estate	✓	✓
Small Businesses	✓	
Startup Businesses		✓

Limited Liability Corporations (fund pools), administered by PCDIC, invest the funds either through loans or equity, depending on the type of project. For startup businesses, the City's "core area of focus" is on new biotechnology and technology startups and expansions. Life sciences projects may also benefit from commercial real estate investments.

Projects must meet underwriting criteria (in development), including debt service cash flow, loan asset coverage and recovery of principal after seven years. Interest will typically be about 100 basis points below market, and terms may allow interest-only payments. Loan origination fees will recover underwriting costs.



Projects are expected to create jobs, enhance commercial, retail and industrial development and help finance small and startup businesses, all in under-served areas. Projects will demonstrate how they will affect community development measures.

NMTC is adaptable to special situations. If a group of investors wants to invest in one specific project; a separate investment fund may be created to serve just that one project. If an investor wants to leverage tax credits with borrowed funds, a special IRS Revenue Ruling shows how.

Future development: City officials are eager to start funding deals in 2003. The City expects to compete for more tax credits for next year, and wants to show that it has moved quickly to raise investment capital, allocate its tax credits, and invest in projects that will improve quality of life in low-income areas.

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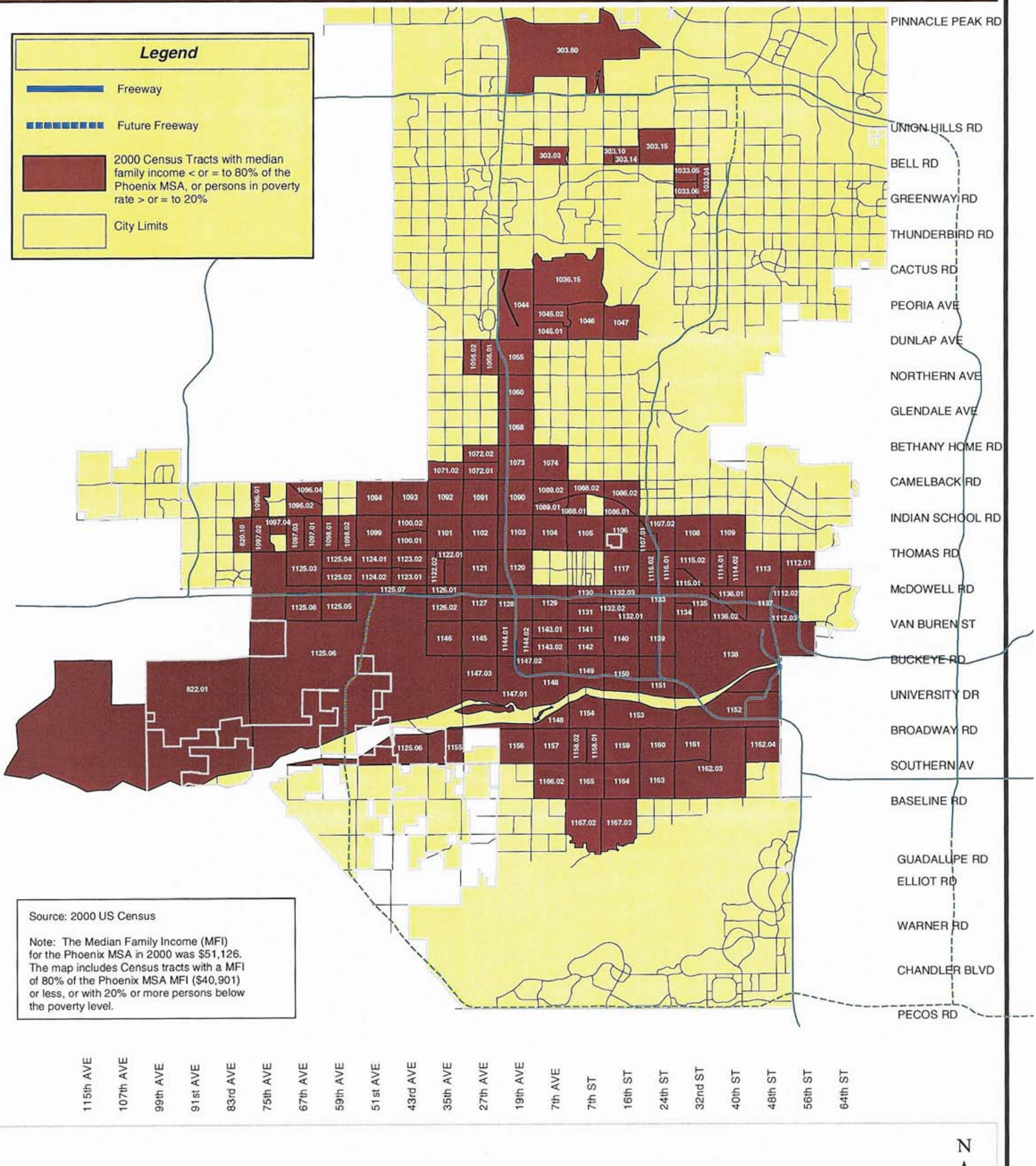
City of Phoenix 2000 Census Tracts
Low-Income Communities



Phoenix Community Development and Investment Corporation