

Dear Potential Applicant:

Enclosed is a loan application package for the City of Santa Ana's Empowerment Zone bond-financing program. Please read the application package carefully and provide the information requested. Two copies of the application, all supporting documentation, and a **\$1,250.00** application fee should be sent to the City of Santa Ana Community Redevelopment Agency. **A complete application package must be received by the City prior to consideration by the Santa Ana Empowerment Corporation for the issuance of tax-exempt bonds.**

We appreciate your interest in the City's Empowerment Zone bond-financing program and we hope that the use of tax-exempt bonds will meet your financing needs. We look forward to working with you throughout this process. If you have any questions, please contact Deborah Sanchez at (714) 647-6548 or Melissa Alva at (714) 647-5328.

Sincerely,

Patricia Whitaker
Executive Director
Community Development Agency

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1. City of Santa Ana Empowerment Zone Bond-Financing Application
2. City of Santa Ana Empowerment Zone Boundary Map

II. BACKGROUND OF THE EMPOWERMENT ZONE BOND FINANCING PROGRAM

In 1994, the Secretary of Housing and Urban Development (HUD) designated the first Empowerment Zone and Enterprise Communities (“EZ/EC”) to create jobs and business opportunities in the most economically distressed areas of the inner cities and the rural heartland. The EZ/EC effort provides tax incentives and performance grants to create jobs and expand business opportunities. It also focuses on activities to support people looking for work, such as job training, childcare and transportation.

On January 13, 1999, Vice President Gore announced that 15 cities and 5 rural communities were selected as Second Round Federal Empowerment Zones. The City of Santa Ana, California (the “City”) was the only urban area west of the Rockies to receive a Second Round Empowerment Zone designation. It was the commitment and diligence of City residents, community-based organizations, local businesses, and City staff that helped develop the strategic plan that earned the City its Empowerment Zone designation (the “Zone”). The City’s Empowerment Zone is approximately 4 square miles (see Attachment 2).

The Zone offers the potential for up to \$100 million in federal funds over a ten-year period. In addition, various incentives are provided for Second Round Empowerment Zones, including the issuance of a special category of tax-exempt private activity bonds (“industrial development bonds”) known as Empowerment Zone Facility Bonds (AKA, Enterprise Zone Facility Bonds) or EZ bonds.

EZ bonds can only be issued by municipalities to businesses in federally designated Empowerment Zones. Bond proceeds are used to make loans at tax-exempt interest rates to qualifying business borrowers. These loans may be used to finance the cost of qualifying industrial, commercial and retail projects. A potential borrower must qualify as an “empowerment zone business” (please refer to the attached map or contact the City of Santa Ana’s Community Development Department for address verification) and the property financed by the loan must be designated a “qualified zone property.” Projects funded with the proceeds from EZ bonds must generate substantial public benefits in return for the implicit public subsidy of tax exemption.

In order to qualify a potential bond applicant, an issuer (i.e. the City of Santa Ana) must comply with the federal program requirements for elected official approval. To this end, on July 19th, 1999, the City created the Santa Ana Empowerment Corporation (the “Corporation”).

A twenty-three member Board of Directors comprises the Corporation. Board members represent the residential, business, non-profit, education and government sectors of the Zone.

The overall goal of the Corporation is to attract and retain a prosperous business base, thereby enhancing the local tax and employment base while improving the

quality of life for residents in the Zone. The primary objective is to provide qualified business owners with low-cost sources of funds to finance capital expenditures, which will, in turn, increase employment or otherwise contribute to economic development within the Zone. To this end, the Corporation and its credit advisors will carefully review all applications for EZ bonds. The Corporation will assess the economic development benefits generated by each project, particularly in the area of job creation. The Corporation will also determine whether the financing of any proposed projects could in any way damage the City's public image with local competing businesses, as well as from a credit and/or environmental perspective. Once the Corporation has completed its project review, it will then make a final determination as to whether or not an applicant is eligible for an EZ bond allocation.

III. GENERAL ELIGIBILITY GUIDELINES

Both federal and local statutes govern the eligibility of projects for EZ bonds. However, EZ bonds issued for projects in Second Round Empowerment Zones are not governed by a state's bond statutes and are exempt from a state's private activity bond limit. Therefore, EZ bonds issued by the City are not governed by the State of California's industrial development financing guidelines. A public hearing, however, must still be held before the bonds are issued. In California, this is part of the local inducement process.

Each Second Round Empowerment Zone, however, is subject to its own volume ceiling. The City of Santa Ana's Empowerment Zone, for example, is limited to \$130 million of EZ bonds. This volume ceiling applies to the aggregate amount of EZ bonds that the City can issue during the life of the Zone, which is scheduled to end in January 2009.

Municipalities with Second Round Empowerment Zone designations are also free to allocate their EZ bond volume allocation according to local policy. At this time, the City has not chosen to limit its individual project dollar allocations beyond the federal designation volume limit of \$130 million.

Federal legislation and the federal tax code place the following general restrictions on the use of tax-exempt bond proceeds. Ninety-five percent (95%) of the proceeds must be used for the defined project and the cost of issuance cannot exceed two percent (2%) of the bond proceeds. No more than twenty-five percent (25%) of the proceeds can be used for land cost. To acquire an existing building, a maximum of fifteen percent (15%) of the bond proceeds must be used to renovate the facility. The weighted average life of the bond issue cannot exceed 120% of the weighted average of the estimated life of the assets being financed and the maximum bond term is 40 years.

IV. FEDERAL APPLICANT ELIGIBILITY REQUIREMENTS

Federal legislation places statutory restrictions upon what types of businesses and property are eligible for EZ bond financing. More specifically, the legislation defines an eligible property as a qualified zone property (“QZP”) and an eligible business as an empowerment zone business (“EZ business”). The definitions of each are summarized below:

Qualified Zone Property (QZP).

An EZ bond-financed project must add value to the capital base of the zone in order to be considered a QZP. A QZP may be either an original use property or a substantially renovated property. At least 85% of the use of the QZP must be in the active conduct of an EZ business (as defined below) and operated by the taxpayer in the zone that is applying for the bond financing.

An original use property is defined as a property that was acquired by a taxpayer/applicant (the “Applicant”) through an arms-length purchase that occurred after the date of empowerment zone designation. If the Applicant were the first person to use a property for an EZ business, then it would also be considered an original use property. Finally, if the property has been vacant for at least a one-year period including the date of zone designation, any use prior to that period is disregarded and it may still be considered an original use property.

A substantially renovated property is defined as a property which will require the Applicant, during any 24-month period after zone designation, to make improvements that will add an amount to the tax basis which is equal to 15% of the taxpayer’s property tax basis immediately before the 24-month period (provided the cost of improvements exceeds \$5,000 minimum).

The Applicant could also use EZ bonds to finance the purchase and subsequent renovation of a building. In this case the amount spent on the renovation must be at least equal to the purchase price of the building prior to the renovation. Finally, the Applicant could use EZ bonds to finance the renovation of a property that it already owns if the amount spent on the renovation is at least equal to the original cost of the property as reduced by depreciation.

No more than 5% of the QZP of the business can be “non-qualified financial property” which is generally defined as debt, stock, partnership interests, and various financial instruments. Specifically permitted are reasonable amounts of working capital held in cash or short-term debt instruments, and accounts receivable arising from sales of inventory. Finally, no more than 5% of the QZP can be works of art or other “collectibles,” unless they are specifically being held for sale to customers.

A QZP project can include land, existing buildings, machinery, equipment, or any other existing hard asset. The construction of new buildings or equipment also qualifies. EZ bonds may also be used to purchase existing equipment from

outside the zone if the equipment is to be brought to a QZP for its first use. Finally, a QZP can be industrial, retail or commercial property.

Empowerment Zone Business (EZ business).

In order to qualify for EZ bonds, the owner of the QZP must be operating an EZ business. EZ businesses are defined by a set of statutory criteria which, among other things, requires it to be a “qualified entity” that primarily operates within the zone with in-zone activity and assets. More specifically, the definition requires that a qualified EZ business maintain an active, workforce that is comprised of at least 35% zone resident employees.

An EZ business must derive at least 50% of its gross income from the active conduct of an in-zone business. Sales income qualifies as in-zone income if the business making the sale is located inside the zone, regardless of whether the buyer is located inside the zone or outside it.

A “substantial portion” of the use of tangible property by the EZ business must be in-zone. This test may require maintaining records as to delivery routes of trucks, etc., owned by the EZ business. In addition, a substantial portion of all intangible property must be used in and exclusively related to active conduct of a qualified EZ business. Finally, a substantial portion of services of employees must be performed in-zone and 35% of the EZ business’ employees must be zone residents.

To establish that an EZ business meets the resident employee requirement, the Applicant can rely on employee certificates signed under penalty of perjury. The certificates must state that the employee’s address of principal residence is within the zone and that the employee agrees to notify the Applicant of any change of address. However, neither the issuer of the bonds nor the Applicant can rely on such a certificate if either has actual knowledge that the certificate is false. An employee who moves out of the zone may continue to be treated as a zone resident provided that (1) the employee continues to work in the zone and (2) a zone resident is hired for the next position of comparable or lesser grade.

The federal regulations allow use of “any reasonable basis” for application of the 35% test. Specifically approved are a “per employee” fraction and an “employee actual work hour” fraction. If the “per employee” method (i.e. resident employees/total employees) is used, then to qualify as a resident employee, the employee must work at least 15 hours a week and have been employed at least 90 days. If, however, the “employee actual work hour” method is used (i.e. resident employee work hours/total employee work hours) then employee work hours are defined as the actual hours that each employee works during the taxable year.

To constitute an EZ business, the business must meet a definition of “qualified business” that eliminates certain types of otherwise qualified entities from financing with EZ bonds. These disqualified activities are as follows:

- Rental of residential property does not qualify. However, low-income residential rental property can already be financed by an existing category of private activity bonds designed specifically for this purpose.
- Rental of commercial real estate (that is, nonresidential real estate) qualifies only if at least 50% of the gross rental income from the property is from EZ businesses. The lessor may rely on a certificate to this effect by the lessee.
 - a. Absentee landlord OK. The landlord in a qualifying commercial rental does not have to be an EZ business.
 - b. Partial financing OK. Issuer can use EZ bonds to finance portion of facility (at least 50%) occupied by EZ businesses, then finance rest with taxable financing.
- Rental of equipment qualifies only if at least 50% of the rentals are to EZ businesses or zone residents.
- Intangibles. A business cannot qualify if its predominant activity is the development or holding of intangibles for sale or license.
- Prohibited facilities. A business cannot qualify if it is a golf course, country club, massage parlor, hot tub facility, suntan facility, race track or other facility used for gambling, or a store, the principal business of which is selling alcohol beverages for consumption off-premises.

Also, no portion of an EZ bond issue may finance a health club, airplane or private luxury box.

An EZ business can be a division or branch of a larger corporation. Nonqualified activities and non-resident employees at other places of business inside or outside the zone thus will not be taken into account in determining eligibility as an EZ business. The “branch store” rule appears in statutory language to the effect that an EZ business includes any trade or business that would qualify as an EZ business if it were separately incorporated. Allocations of income and activities between in-zone and out-of-zone business must be determined to be reasonable.

The statute contains liberalized compliance requirements for EZ businesses during a startup period and after a testing period.

- Startup period. The startup period is generally the first two years after the in-service date but not more than three years after the bond issue date. Failure to qualify as an EZ business is waived during the startup period provided compliance at the end of the period was reasonably expected and is the subject of bona fide efforts.
- Testing period. The testing period is the first three years after the startup period. If a business complies with the EZ business definitions during the

testing period, the parties may disregard subsequent failures to meet the EZ business requirements other than:

- a. The 35% employee residence.
- b. No predominant activity of holding intangibles.
- c. No prohibited activities.

V. PUBLIC BENEFITS

Job Creation

In addition to being a qualified activity, a project must demonstrate public benefits in order to warrant approval by the Santa Ana Empowerment Corporation. Corporation members have designated job creation as one of the primary public benefits to be achieved. For this reason, the Corporation looks favorably on projects which will employ individuals affected by industrial relocations, new entrants or reentrance to the workforce, unemployed persons, or individuals participating in job training or placement programs. Applicants are also encouraged to develop their own cross training and worker upgrade training programs. Applicants should include written descriptions of the public benefits as part of their application.

Relocation

In addition to the job creation requirement, the Corporation also scrutinizes the relocation effect of projects. The City Council did not intend for tax-exempt financing to be used to facilitate the relocation of a company's operations from one area of the City to the Zone without substantial justification. The Corporation will review carefully and weigh the overall public benefits created against the detriment to the area of the City from which the facilities are relocated.

Applicants who are relocating must document, in their application, their efforts to work with the City before abandoning an existing City facility. Applicants which are relocating must also include the measures they will undertake to defray the expenses of the move for their current employees.

Other Benefits

Other public benefits, which the Corporation will consider, include job retention, energy and resource conservation, and product improvement. The Corporation is required to determine that the proposed bonds are "fair, just and equitable to the purchaser of the bonds." To comply with this provision, the Corporation generally requires that credit enhancement – either bond insurance or an irrevocable letter of credit from an investment-grade financial institution – be applied to the bond issue, if the bonds are to be publicly offered.

A private placement that does not require credit enhancement will only be approved by the Corporation if it is deemed creditworthy, and the placement is limited to sophisticated investors with restrictive resale provisions.

The following standards will normally be applied to the City's approved EZ bond private placements:

- The purchaser must be a Sophisticated Investor, an investor with the knowledge or expertise to evaluate the risk associated with the purchase. The

Sophisticated Investor must fall under the definition of a Qualified Institutional Investor or an Accredited Investor as defined by SEC guidelines, specifically Rule 144A under the Securities Act of 1933.

- The Sophisticated Investor must sign a “traveling” sophisticated investor letter, meaning the requirements and restrictions of the sophisticated investor letter will follow the deal in the event the bonds are sold or traded at a later date. In addition, all secondary market sales of bonds must first be approved by the City.
- The Applicant must provide the Corporation with the Applicant’s last three years’ financial statements and/or tax returns. The Corporation credit advisory staff reviews the financial information as part of their due diligence to ensure the company is a viable entity, as part of the findings the Corporation must make under its enabling Ordinance. The City, however, makes no representation to bondholders as to the Applicant’s ability to repay the debt.
- The Security for private placement debt is the collateral provided by the Applicant. Due to the fact that these bonds will be sold only to Sophisticated Investors they will make the determination of the adequacy of the collateral. If there is a concern regarding the security for the debt, financial covenants can be required such as restrictions on pledging of assets and incurrence of additional debt.
- Bonds will be issued in minimum denominations of \$250,000.

The enforceable language for the preceding requirements will be found in the Loan Agreement and/or Bond Purchase Agreement for each private placement financing.

VI. APPLICATION PROCESS

Prospective User

Principals and financial officers of manufacturing businesses should contact the City of Santa Ana's Community Development Department to review eligibility requirements and the application process. If possible, discussions should begin with the City's Empowerment Zone staff and/or the credit advisors who will be reviewing applications for the Corporation.

If the business is determined to be an EZ business operated on a Qualified Zone Property, then the next step is to initiate discussions with a financial institution willing to issue a letter of credit. Also, the Applicant's principal bank should be contacted in all instances.

If it is determined that credit enhancement is not a viable option, then the Applicant should contact the City's credit advisors to determine if a private placement could be considered. Concurrent with these discussions, the Applicant's attorney should contact the City's bond counsel and the financial advisor in order to discuss legal issues and bond issuance timing procedures.

Application and Fees

If the project appears to meet all of the federal and City eligibility requirements and credit enhancement has been arranged (or a private placement is contemplated) the next step is to submit an application for approval by the Corporation. Two copies of the complete application, with all attachments must be sent to the City. A non-refundable application fee of **\$1,250.00** must be included with the application. Checks should be payable to The City of Santa Ana Community Development Department. The application fee will be used to cover the Corporation's credit review process, including legal fees and other expenses.

Financial Statements

As an attachment to the application, applicants who are contemplating a private placement must submit the most recent three years of financial statements. The highest level of financials should be provided with three years of tax returns being the minimum acceptable submission. Applicants should be aware that they might be required to submit additional documentation and that all documents submitted are consequently considered public documents. Financial statements considered confidential must be discussed with the City's Empowerment Zone staff prior to submission.

Credit Enhancement

Applicants who do not wish to submit financial statements to the City must arrange for credit enhancement prior to submitting an application. Credit providers must be certified by the City prior to the submittal of an application. At a minimum, a potential credit provider must be able to provide an investment

grade rating on the bonds to be issued. For more information on credit enhancement, please contact the City's Empowerment Zone staff.

Bond Financing Procedures

Once the application has been reviewed by the City's Empowerment Zone staff for completeness, it will be submitted to the Corporation for approval. If the Corporation approves the application, a maximum bond allocation will be determined and bonds will be issued.

Prior to issuing the bonds, the bond financing documents must be drafted by the City's Bond Counsel. The bond financing documents shall include all documents related to the issuance of bonds including:

- Loan, Lease or Sale Agreement
- Trust Indenture
- Deed of Trust
- Preliminary Official Statement or Placement Agent Memorandum
- Letter of Credit, Sophisticated Investor Letter and/or other Guarantee Agreements; and
- Bond Counsel Tax Opinion

Upon staff review of the financing documents, the Corporation will issue a certification of the resolution(s), which approves the project and certifies that the conditions specified in the resolution(s) have been satisfied. The Santa Ana City Council will review the resolution(s) for final approval. Upon completion of all transactions, the Corporation will be sent a complete set of final bond documents.

Submission Format

The following application outline represents the minimum information which the Corporation requires in order to consider an application. Relevant additional information, particularly as it pertains to public benefits, is always encouraged.

Please submit two copies of the application in a tabulated format, loosely bound (with ACCO binding, for example) to facilitate copying. The application should constitute the first tab, followed by this list of items, as applicable:

- a bank commitment letter
- relocation letters
- a tax questionnaire from qualified bond counsel
- financial statements; and
- any other relevant documents.

The two copies of the application and all supporting material should be sent to the City of Santa Ana Redevelopment Agency office at the following address:

**Deborah Sanchez
Empowerment Zone Manager
City of Santa Ana
20 Civic Center Plaza – M-25
P.O. Box 1988
Santa Ana, CA 92701**

If time and schedule permit, one of the City staff will visit the site and speak with representatives of the project prior to the Corporation meeting.

VII. APPROVAL BY THE CORPORATION

Approval of projects rests on a simple majority vote. A representative of the company should attend the Corporation meeting when their project is being reviewed, in order to field any questions about the project or company which might arise.

Again, if you have any questions on this material, please call Deborah Sanchez (714) 647-6548 or Melissa Alva at (714) 647-5328.