MEMORANDUM

TO: Members of the Authority

FROM: Tim Sullivan
Chief Executive Officer

DATE: May 13, 2025

SUBJECT: Policy Update for Cultural and Arts Facility Expansion (CAFE)

Request:

The Members are asked to approve a policy for the Cultural Arts Facilities Expansion (CAFE) program for determining the eligibility criteria for cultural arts projects that have commenced construction prior to application to demonstrate that the project could not be completed without the award of tax credits. This policy aims to encourage the completion of projects that are stalled or are at risk of stalling which the Authority deems cannot be completed without the award of tax credits. This policy seeks to provide clarity and ensure fairness to applicants.

Background:

The CAFE Program is designed to support cultural arts projects through the award of tax credits. The Board approved the creation of the program and the program rules at the January 23, 2025, Special Board Meeting.

CAFE encourages the development of arts and cultural facilities in the State by providing tax credits during the 5-year eligibility period, which begins when the Cultural Arts Project is certified as complete. The amount of tax credits a Cultural Arts Institution (or "applicant") receives is up to 100 percent of the eligible project costs and is subject to a statutory cap of $75 million per project.

The program currently operates as a competitive program, as required by statute. The CAFE program began accepting applications for the first competitive round on April 7, 2025, with the closing date set for June 6, 2025.

The CAFE statute and program rules include the following eligibility criteria.

- **Statute:** "Construction has not commenced at the site of the cultural arts project prior to submitting an application, unless the authority determines that the cultural arts project ***would not be completed without an award of tax credits under the program."***
- **Program Rules:** "Construction has not commenced at the site of the cultural arts project prior to submitting an application, unless the work was ordered by a building code or other official with jurisdiction over the site of the cultural arts project to correct a health, safety, or other hazard ***or*** the Authority determines that the cultural arts project ***would not be completed without an award of tax credits under the Program***. Construction shall not include demolition or site remediation activities for purposes of this paragraph."

The proposed policy provides the criteria that applicants must meet to be eligible under the statutory exception referenced above for projects that have commenced construction prior to the application and that "would not be completed without an award of tax credits under the program." The policy focuses on projects that have experienced unexpected increases in construction costs and are unable to fundraise to fill the gap within a reasonable timeframe which would not significantly impact the construction schedule. Consistent with existing policy, an application for a project by a cultural arts institution, who acquires an existing project and is unrelated to the previous developer(s), would be considered a new project. In those instances, the new project would not have been considered to have "commenced construction." Therefore, this policy specifically applies to projects where the applicant is either the party that initiated construction or is related to that party. Consistent with the similar restriction in the Historic Property Reinvestment Program, whether an entity is related to applicant will be based on whether the entity is an Affiliate of the applicant or the entity did the work at the direction of or under contract with the applicant or an Affiliate of the applicant. This policy aims to address the specific needs and challenges of cultural arts projects only while minimizing unintended impacts on other programs. While this policy serves as an initial step in addressing challenges related to unexpected increases in construction costs coupled with fundraising and grant shortfalls unique to cultural and arts facilities, there may be other circumstances that could be considered in the future. Staff will continue to consider how this policy may apply in other contexts and situations.

Program Details:

This policy provides the criteria that applicants must meet to be eligible under exception referenced above that the project "would not be completed without an award of tax credits under the program."

1. **Eligibility:**

   To be eligible for CAFE as a project that has commenced construction prior to submitting a CAFE application per the statue, the applicant must demonstrate that the project would not be completed without the award of CAFE tax credits by meeting the following criteria:

   - **Unexpected Increase in Construction Costs:** Applicants must demonstrate a minimum 10% increase in the construction budget resulting from unexpected increases in construction costs due to factors that they could not reasonably anticipate (for example, cost increases due to tariffs higher than anticipated, or greater than expected inflation). The construction cost increase will be measured against the budget at the time construction commenced. Applicants will need to provide evidence of the budget at the time construction commenced (such as a construction contract, approval of the project budget by the applicant's governing body, or other evidence deemed acceptable by the Authority). This must be substantiated through certification by the CEO or equivalent officer. This 10% threshold aligns with the typical retainage/contingency on many real estate projects. For example, a project might face significant price increases in materials due to sudden tariff changes, making completion financially unfeasible without additional support. As the CAFE program was borne out of a conditional veto of the Community-Anchored Development Program, which was created in the Economic Recovery Act, only projects which commenced construction after the Economic Recovery Act of 2020 was enacted on January 7, 2021, are eligible. Consistent with the program rules and for the purposes of this policy, demolition, environmental assessment, and environmental remediation activities are not considered as the commencement of construction. Applications based on increases in the construction budget due solely to an increase in the project's scope will not be eligible.

- **Credible Financing Plan:** At the start of construction, applicants must have had a credible financing plan; that is, a budget that would have been sufficient to complete the project as of that time. This must be substantiated through certification by the CEO or equivalent officer. This requirement supports that the applicant initially had the capacity to complete their project when they started the project, maintaining consistency with existing policy that requires applicants to demonstrate that the structure and terms of the financial, corporate, and real estate instruments to be utilized are adequate to successfully complete and then operate the project. Embarking on construction without a credible financing structure indicates a lack of capacity and preparedness to successfully complete the project.
- **Inability to Fundraise:** This policy is aimed at nonprofit and governmental entities who have shortfalls in fundraising and grants. Thus, applicants must show they cannot credibly fundraise to fill the financing gap within a reasonable timeframe, which would not significantly impact the construction schedule. This must be substantiated through certification by the CEO or equivalent officer.

2. **Award Amount:**

- Consistent with the current program rules, prior construction costs are not eligible project costs. With the exception of soft costs (which may be incurred up to one year prior to application), eligible project costs only include project costs incurred after application.
- The award size under this proposed policy is limited to the unexpected increases in construction costs, and documentation of increased costs satisfactory to the Authority is required. The increase in construction cost is based on the budget at the time construction commenced. For example, a cultural arts project initially had a budget of $30 million at the time construction commenced, and they have already spent $5 million and raised an additional $10 million (for a total of $15 million raised), but due to unexpectedly high

inflation rates, the project's budget has escalated to $40 million. In this scenario, assuming the CEO certifies and the Authority accepts that the initial financing plan was credible, the award size would be limited to covering the $10 million increase in eligible project costs, provided that the applicant submits thorough documentation acceptable to the Authority substantiating these increased costs. This ensures that the tax credits are allocated specifically to address unforeseen financial challenges, rather than exceeding the project's original scope.

- Although the Board has not yet approved any projects under the CAFE program, this policy does not apply to projects that have been approved as a new project. Once a project is approved, the award amount for the specific CAFE project is capped at the amount approved by the Board, consistent with longstanding Authority policy. This will limit projects that have been previously approved for the CAFE program from withdrawing and reapplying to receive a higher award amount due to higher construction costs. Under this policy, only the "increase" in construction costs is eligible for funding, ensuring that any previously approved amount is excluded from subsequent approvals.
- The award will be further sized by deducting certain sources raised to date and expected to be raised within 12 months of Board approval. Debt sources, such as loans, will not be deducted from the award amount, as these are typically repaid with interest and do not represent net financial support to the project. However, other sources, including but not limited to grants and funds raised, will be deducted, as these directly offset the need for additional funding. Furthermore, any sources included for the original construction budget will also be deducted. This approach ensures that the award reflects the true additional financial need of the project. Thus, in the scenario described above, if the applicant had raised $32 million (rather than $15 million), the award would be limited to $8 million as the $10 million unexpected increase would be reduced by the $2 million in funds raised above the original construction budget.

3. **Prevailing Wage:**

- To be eligible under this policy, the Authority's prevailing wage requirements for construction work will apply to all construction work for the cultural arts project, including work that commenced prior to application. This means that the cultural arts institution (or affiliate) must have paid prevailing wage for all prior construction costs for the project and must satisfy all other prevailing wage requirements, including, but is not limited, to the Public Works Contractor Registration requirements. This means that all contractors and subcontractors must have had their Public Works Contractor Registration in place at the time they conducted any work for which the Authority requires payment of prevailing wage. It is expected that projects that have other State funding will have met such requirements.

4. **Minimum Project Size:**
    - The minimum project size remains unchanged at $5 million in eligible project costs. The $5 million minimum project size will be determined without regard to any additional fundraising, even though the additional fundraising will be subtracted to determine the award amount. In addition, as discussed above, the project must demonstrate a minimum of a 10% increase in construction costs.
5. **Prior Costs:**
    - As discussed above, with the exception of soft costs, as defined in the program rules, work conducted prior to application is not considered an eligible project cost. However, all cumulative project costs are included in the total project cost calculation. Because equity contributions are determined based on the total project costs, this approach ensures that the financial responsibility borne by the applicant is proportional to the entire scope of the project, including both past and future expenses.

To ensure a consistent and fair process, staff recommends implementing this policy after the initial round of applications closes and a new application is released. We anticipate a new application could be developed as early as July of 2025.

Recommendation:

The members are asked to approve the policy for determining the eligibility criteria for cultural arts projects that have commenced construction prior to application to demonstrate that the project could not be completed without the award of tax credits. This policy will make the CAFE Program more accessible to stalled cultural arts projects and cultural arts projects at risk of stalling, enabling their completion with the support of tax credits.

Tim Sullivan, CEO

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