SEYFARTH ATTORNEYS SHAW LLP

Quick Takes

June 2011

*Quick Takes*: Easy Equity- the NMTC and EB-5 programs

First off, it's not really easy to get that equity. As a developer client told me a long time ago, "You've got to work hard if you want cheap money!"

And secondly, it's not always equity. The funding from these programs can be structured as equity, preferred equity, subordinated/mezz debt or senior debt. Even the equity structure needs to provide an exit for the investors within some period of time.

But- It's available!

At least if your project qualifies.

Here's how it works, and how your project can qualify.

<u>NMTC</u>

The New Markets Tax Credits ("**NMTC**") program is administered by the U.S. Treasury Department. This program is a source of financing for projects from domestic investors motivated in part by access to federal income tax credits.

Greatly simplified, in the federal government's NMTC program, the Treasury Department's CDFI Fund allocates the credits to a Community Development Entity, which sells them to a private sector investor who gets a 39% federal tax credit over 7 years, whereupon the Community Development Entity invests the sale proceeds as loans or equity investments in a Qualified Active Low-Income Community Business (*i.e.*, the project entity) located in a qualified census tract.

A census tract is NMTC qualified if it has a poverty rate of at least 20%. Alternatively, a non-metropolitan census tract can qualify if its median family income does not exceed 80% of the statewide median, or a metropolitan census tract can qualify if its median family income is less than or equal to 80% of statewide median family income or the metropolitan area median family income, whichever is greater. Finally, a "targeted population" (as defined) census tract also qualifies.

According to the New Markets Tax Credit Coalition's 10th Anniversary Report, through 2009 the types of business that received funding from this program included both non-real estate businesses (working capital, equipment loans, etc.) and real estate businesses. The funding just for real estate businesses amounted to $9.7 billion, allocated as follows-

| Type of Commercial Real Estate | Amount of NMTC Funding |
|---|---|
| Industrial/ Manufacturing/Commercial businesses | $3.2 billion |
| Mixed-Use projects | $2.2 billion |
| Community Facilities (schools, health care facilities, etc.) | $1.4 billion |
| Retail businesses | $1.4 billion |
| Housing and Hospitality businesses | $774 million |
| Office space | $704 million |

NMTC funding is usually leveraged with other types of capital. According to the above Report, the average NMTC investment per project was $5.2 million, whereas total project costs per project averaged $18 million.

Although most (91%) NMTC funding took the form of term loans, another 8% of NMTC funding was invested as equity (1% was provided as lines of credit).

In addition, 31% of the businesses surveyed used NMTC funding in the form of subordinated debt, according to another NMTC Coalition survey. This is significant since senior lenders often accept sub debt as a substitute for additional equity in their credit underwriting.

The NMTC program offers real advantages for projects. In the Report, businesses said that the benefits of NMTC funding included below market interest rates (90% of respondents), longer than standard period of interest-only loan payments (64% of respondents), and debt with lower than standard origination fees (27% of respondents).

NMTC funding works best for a project that has a "community impact," such as job creation.

## EB-5

The EB-5 program is a source of funding for projects from immigrant investors motivated in part by access to permanent residency in the United States. It is administered by the United States Citizenship and Immigration Service ("**USCIS**").

Basically, the EB-5 program allows qualified immigrants to invest the requisite capital, obtained from a lawful source, into a qualifying new commercial enterprise that will create 10 or more new full time jobs, per each investor, in exchange for a temporary "green card" (permanent resident visa). If the jobs are created within a two year period and other requirements are satisfied, the green card can become permanent and clear the way for citizenship.

For a minimum investment level of $500,000 (as opposed to the standard minimum of $1,000,000) to apply, the investment location must be a Targeted Employment Area ("**TEA**"), meaning a Rural Area (areas with populations under 20,000) or an area of high unemployment (areas with unemployment rates at least 150% of the national rate).

The investment can be made by an investor on a stand-alone basis, or through a USCIS-designated Regional Center. However, if the investment is stand-alone, indirect jobs are not counted, and practically speaking, the immigrant investor is typically required to reside where the business is located. A Regional Center can be sponsored by a private company or by the public sector. A Regional Center provides the investment opportunity and certain administrative support for the immigrant investor, allows indirect jobs to be counted, and facilitates the ability of the investor to live anywhere, not just where the project is located.

The EB-5 program requires the investment to be at risk for at least 5 years. In many cases, at the end of the 5-year period, the investor will want his investment returned. In those cases, the investment can resemble a "mini-perm" type loan in the real estate industry.

EB-5 funding works best for projects with significant job creation. Sectors that have successfully used this funding include resort, tourism, and hospitality; sports and entertainment, including the film and TV industries; mixed-use developments; manufacturing; and many others. The EB-5 program has even been used to fund public infrastructure loans.

Historically, EB-5 loans have been available substantially below market when compared to similar term business loans from U.S. based lenders. Remember that access to the green card, rather than high profits, motivates many investors. Like Mark Twain said, "I am more interested in the return of my investment, rather than a return on my investment."

## Leveraged Loans

The NMTC program and the EB-5 program can work together for even better funding.

The NMTC program has long offered for some projects a structure (the "leveraged loan structure") that basically involves an "A Note" and a "B Note" issued by the ultimate borrower; *i.e.*, the project entity. The repayment of the B Note is essentially through the tax credit, meaning that repayment of the principal amount of the B Note loan is, practically speaking, forgiven. The A Note is a loan that is repaid.

If the borrower is able to utilize both the EB-5 program and the NMTC program, then it would be possible, if the EB-5 funding were structured as a loan, for the leveraged A Note funding to come from loans from the EB-5 investors. In some other cases, the A Note funding comes from tax-exempt bonds.

In the leveraged loan structure, if the borrower is not a federally tax-exempt organization, keep in mind the need to address the taxability of "forgiveness of indebtedness income."

## Conclusion

These programs can be good sources for equity, or for virtual equity, for the right project. Without them, many projects could not obtain the senior loans they need in order to fund the balance of the project's capital structure.

My Finance Team is very involved in both the NMTC program and the EB-5 program. If you want to know whether your project qualifies for these programs, how to access them, or how the EB-5 Regional Center process works, please let me know.

After all, as Benjamin Franklin said: "An investment in knowledge always pays the best interest."

The "Current Bond Rates" page at danmcrae.info is updated weekly. This week's version is what you see below.


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General note: This issue of *Quick Takes* is a quick-reference guide for elected and appointed officials, economic developers, community developers, participants in the real estate and financial industries, company executives and managers, and their advisors. The information in this issue is general in nature. Various points that could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

| CURRENT BOND RATES |
|---|
| EFFECTIVE JUNE 16, 2011<br><br>**Interest Rates:**<br><br>**tax-exempt -**<br>**floating: 0.20%**<br>**fixed: 2.64%**<br>**(eff. 06/10/11)**<br>**Taxable -**<br>**floating: 0.45% - 0.53%**<br>**fixed: 3.18%** |
| |
| General notes:<br>1. Rates are posted weekly. These rates are for the effective date indicated above, or as otherwise indicated. For intra-week rates, Contact Dan.<br>2. These are interest rates on revenue bonds that are variable rate demand bonds; i.e., floating. These can be synthetically fixed via interest rate swaps, as noted below.<br>3. Tax-exempt rates are for industrial development revenue bonds (IDB's") that are subject to the AMT and are 7 day general market quotes.<br>4. Taxable rates are for taxable IDB's or for taxable "corporate bonds".<br>5. Fixed rates are for 10 year terms via swaps.<br>6. All rates are market extracted and approximations, and are not guaranteed.<br>7. These rates do not reflect all-in costs; e.g., annual letter of credit fees are not included. |
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