New Markets Tax Credit Program Overview

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Background

- Enacted on December 21, 2000
- Part of the Community Renewal Tax Relief Act of 2000
- Creates a tax credit for equity investments in certified Community Development Entities (CDEs)
- Administered by the U.S. Treasury Department's Community Development Financial Institutions Fund (CDFI Fund)

NMTC Program Overview

- Investors receive a federal income tax credit equal to 39% of an equity investment made into a Community Development Entity (CDE)
- The investment must remain in place for 7 years
- Financing Goals
  - Leverage Tax Credit Equity against other capital
  - Buy down the cost of capital to below-market rate
  - Retain a portion of Tax Credit Equity
    - Numerous tax issues apply

Community Development Entity

- CDE is key to accessing NMTC Funding
- A for-profit entity certified by the U.S. Department of Treasury's CDFI Fund
- Primary mission of serving low-income communities
  - Must be accountable to LICs, have specific service area
- A CDE must invest substantially all of its assets by:
  - Making loans to or equity investments in "qualified businesses" located in "Low-Income Communities" (LICs).
- Competes for "Allocation" of NMTCs
  - Allocation is permission to make QEIs to generate credits
- Uses allocation to attract capital for "Eligible Investments"

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Eligible Investments

- Eligible New Markets Investment activities include:
  - Loans or investments to businesses located in low-income census tracts
  - Development of commercial, industrial and retail real estate projects (including community facilities) in low-income census tracts
  - Development of for-sale housing in low-income census tracts
  - Investments in other CDEs
  - Financial Counseling Services
- No farms or "sin businesses"
  - Gambling, liquor, golf courses or massage parlors

Flow of Investment

- CDE sells credits to tax credit investor, then
- invests the proceeds of the equity (QEI) as loans or equity investments (QLICI) in
- a project entity (Qualified Active Low-Income Community Business, or QALICB)
  - located in a Qualified Census Tract or that serves a "Targeted Population"

QUALIFIED CENSUS TRACT

NMTC Qualified Census Tract

- Poverty rate of at least 20%, or
- Income level less than or equal to 80% of -
  - the statewide median (non-metropolitan census tract), or
  - statewide median family income or the metropolitan area median family income, whichever is greater (metropolitan census tract)

TARGETED POPULATIONS

- QALICB serves targeted populations if at least:
  - 50% of its gross income is "derived from" sales, rentals, services, or other transactions with low-income persons, or
  - 50% of its ownership is by low-income persons, or
  - 40% of its employees are low-income persons, and
- it is not located in a census tract that exceeds 120% of the area median family income

WHERE DOES THE MONEY COME FROM?

- most tax credit investors are banks, but this is not just a loan
- It's really a tax-advantaged investment
- many deals are syndicated (sold) by large banks to other taxpayers

THE NMTC LEVERAGED STRUCTURE

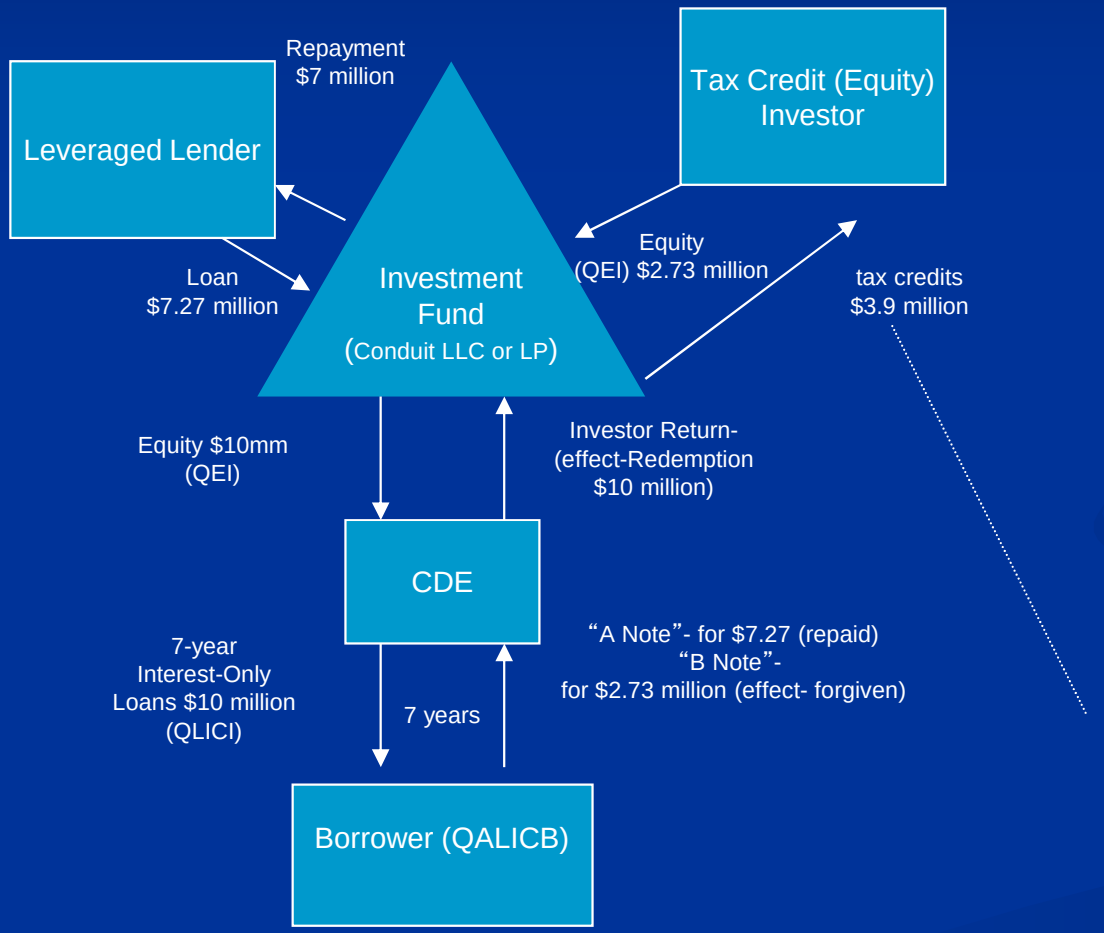
In most cases, the leveraged lender receives its return from the tax credits and does not expect the return of its principal

- economic effect- "forgivable loan", or grant
- numerous tax issues apply
- CDEs are increasingly retaining at least a portion of this benefit

ROLE OF THE LEVERAGED LENDER

- Normally capital stack includes senior debt in addition to NMTC funding
- Source of senior debt is called "leveraged lender"
  - Finding the leveraged lender is often the hardest part of the deal
    - consider "project finance bonds"
- Leveraged lender not allowed to have direct security interest in project assets
  - alternative collateralization structures available

LEVERAGED LOAN STRUCTURE



Tax Credit Schedule for NMTC Investors		
Year 1	$500,000	5%
Year 2	$500,000	5%
Year 3	$500,000	5%
Year 4	$600,000	6%
Year 5	$600,000	6%
Year 6	$600,000	6%
Year 7	$600,000	6%
	$3,900,000	39%

LEVERAGE INCREASES FUNDING

- Normally NMTC proceeds are leveraged against other sources of capital, for example-
  - Project Finance Bonds
  - Proceeds of EB-5 loan or equity
  - Common equity
  - Cash grants; e.g., "1603" grants for renewable energy projects
  - Others
- Sometimes the borrower leverages existing assets via a "one day loan"