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Cannon Heyman & Weiss, LLP

Law Practice Concentrating in Affordable Housing and Community Development Law

New Markets Tax Credit Webinar

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New Markets Tax Credit Program background

- Codified in Section 45D of the IRC
- Enacted in 2000
- Administered by CDFI, an arm of the U.S. Department of the Treasury
- Allocation authority awarded on annual basis

New Markets Tax Credit (NMTC) Program Lexicon

- CDE – Community Development Entity
an entity that provides investments serving low-income communities and persons
- LIC – Low Income Community
a census tract with a poverty rate of more than 20% or median family income less than 80% of the applicable area median income
- QEI – Qualified Equity Investment
an equity investment in a CDE
- QLICI – Qualified Low Income Community Investment
an investment in or loan from a CDE to a qualified borrower
- QALICB – Qualified Active Low Income Community Business
a qualified borrower

QALICB Requirements

- A QALICB is any corporation, including not-for-profit, or partnership engaged in the active conduct of a qualified business that meets five requirements:
- Must meet all five requirements
 1. Gross income
 2. Use of tangible property
 3. Services
 4. Collectibles
 5. Non-qualified financial property

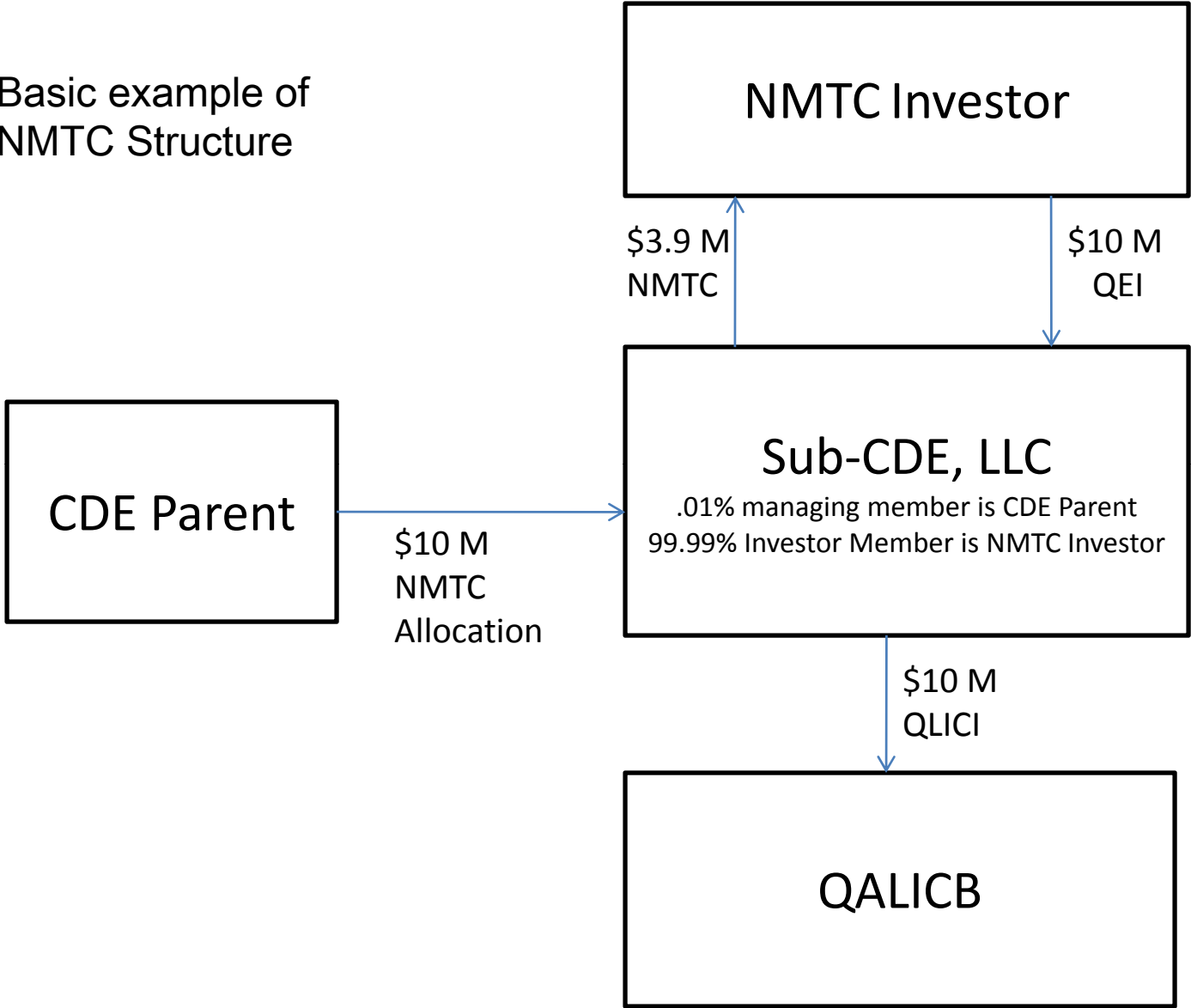
QALICB Requirements cont.

- Active conduct (three years revenue test)
- Qualified business – generally, any trade or business except:
 1. “Sin” businesses
 2. Rental of “residential rental” property as defined in Section 168(e)(2)(a) of the IRC
 3. Rental of real property to tenants that are “Sin” businesses

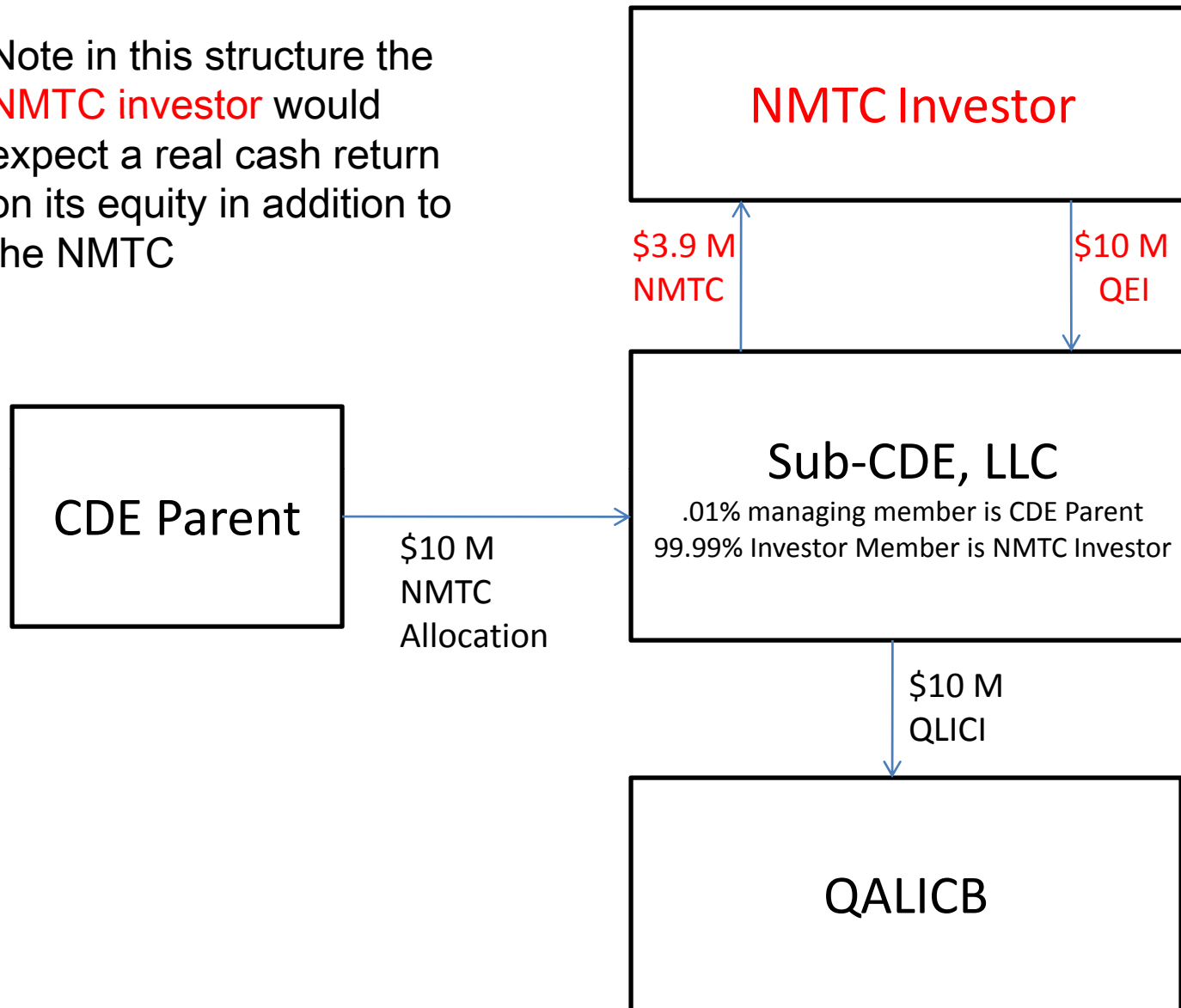
NMTC Structure

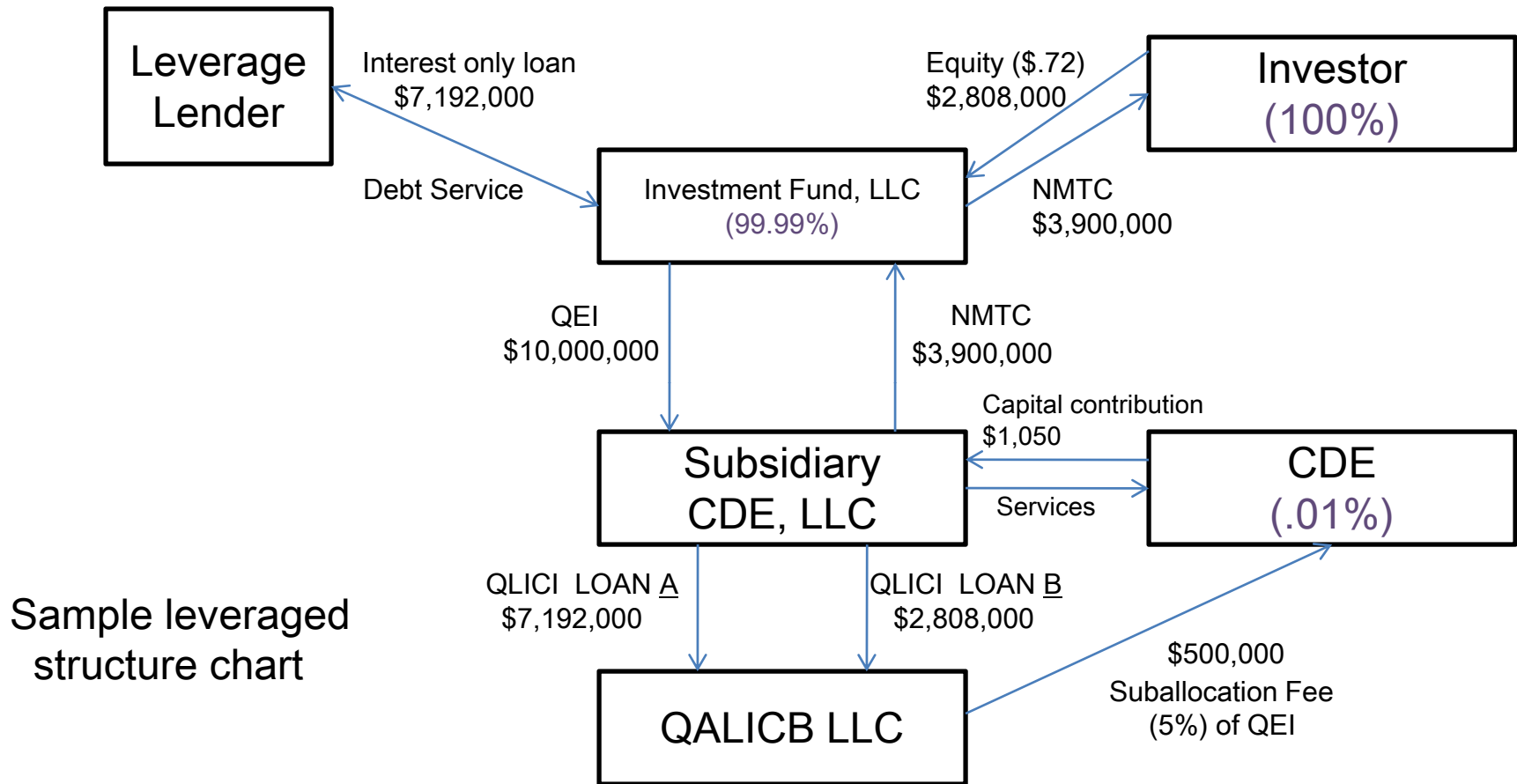
- Equal to 39% of QEI
 - claimed over 7 year compliance period
 - 5% in years 1 through 3
 - 6% in years 4 through 7
- CDEs must use substantially all (at least 85%) of QEIs to make QLICs which must remain invested for the full seven-year compliance period
- Amount of NMTC is solely a function of amount of QEI

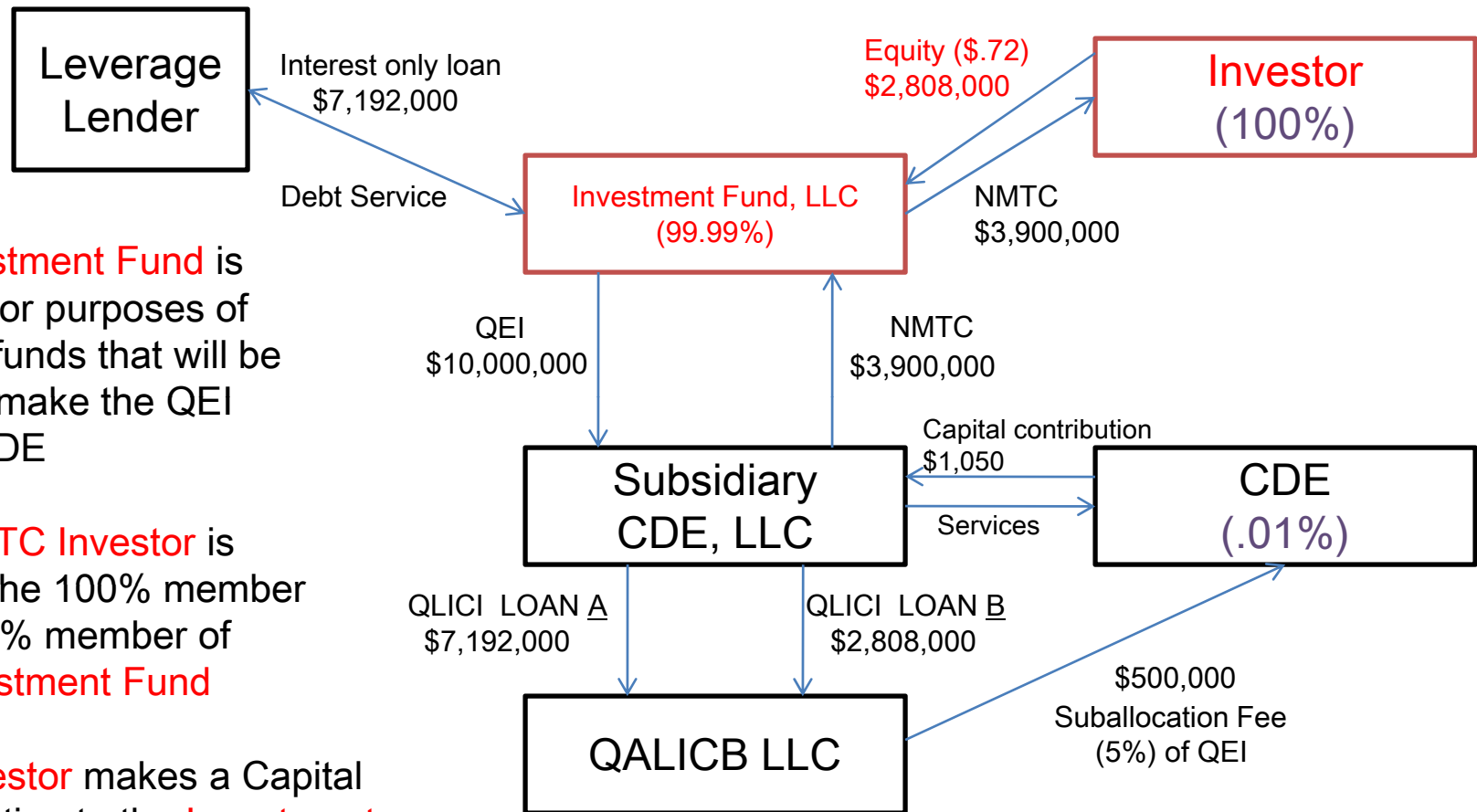
Basic example of NMTC Structure



Note in this structure the **NMTC investor** would expect a real cash return on its equity in addition to the NMTC



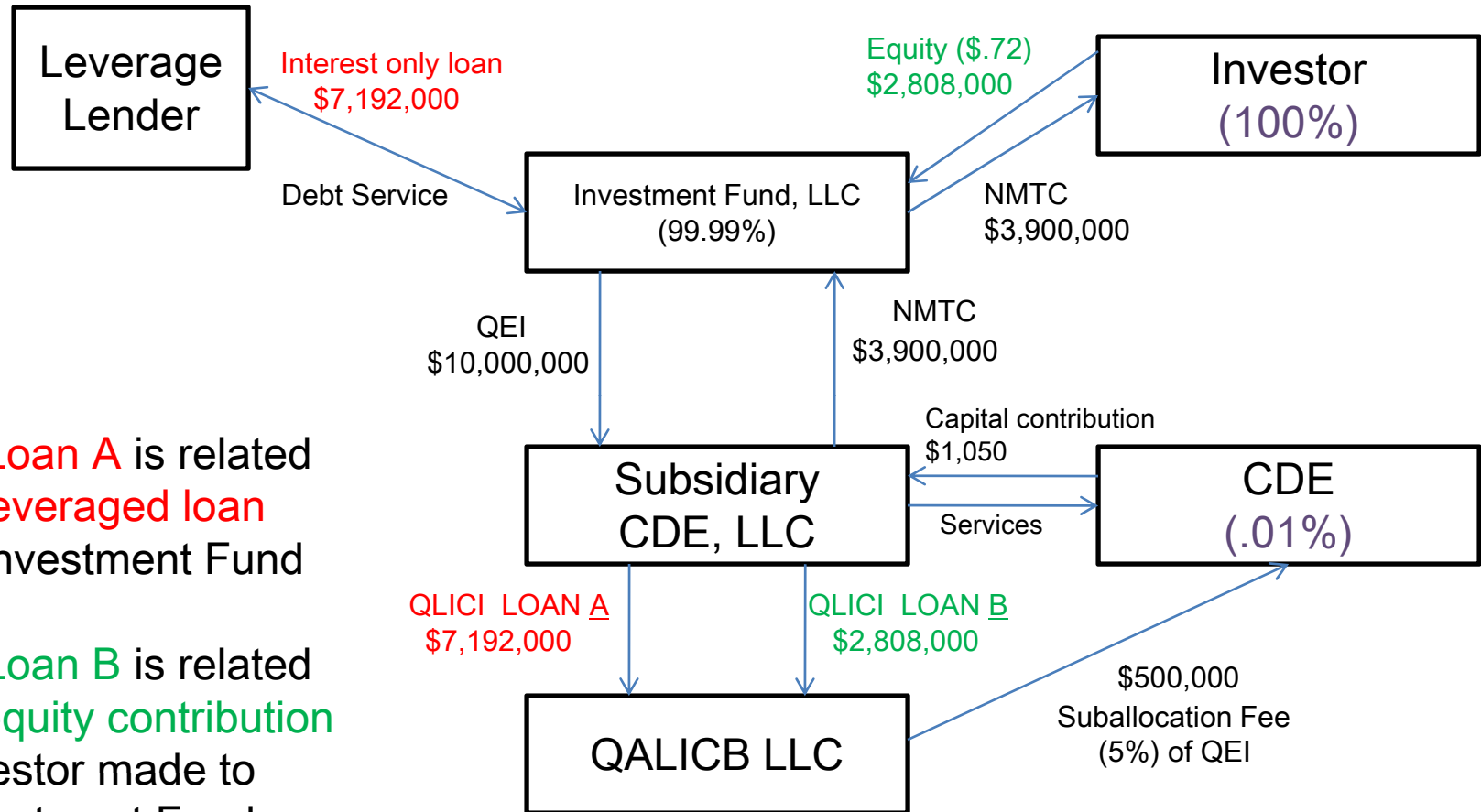




An **Investment Fund** is formed for purposes of pooling funds that will be used to make the QEI to the CDE

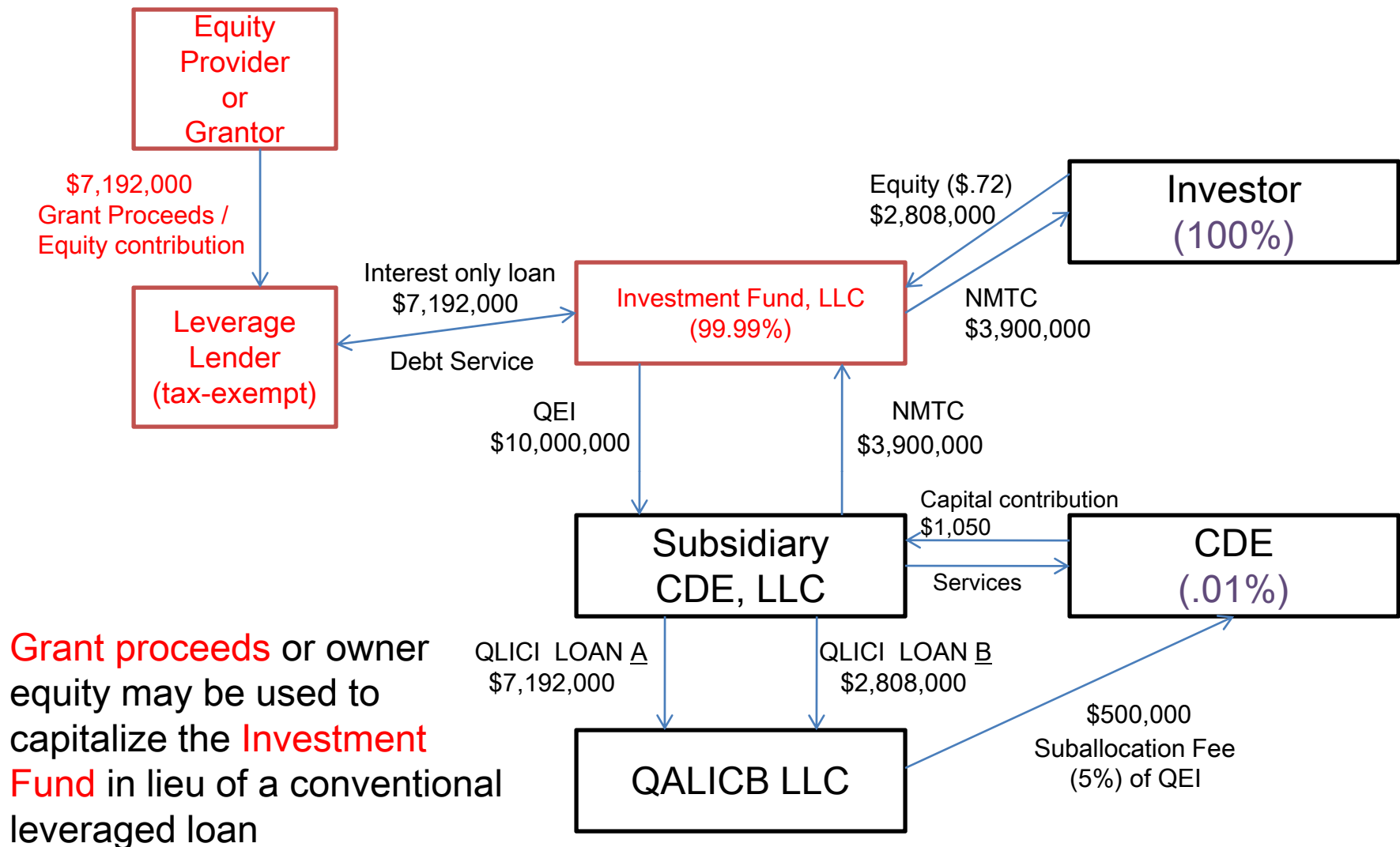
The **NMTC Investor** is usually the 100% member or 99.99% member of the **Investment Fund**

The **Investor** makes a Capital Contribution to the **Investment Fund** at a price per credit in the range of **\$.69 - \$.75**



QLICI Loan A is related to the leveraged loan to the Investment Fund

QLICI Loan B is related to the equity contribution the Investor made to the Investment Fund



Leverage Model

- Leveraging transaction sources that have already been spent
- Owner equity that has already been spent on pre-development costs can be used to fund the Investment Fund through the use of “One Day Loan” to Investment Fund
- Investment Fund combines these proceeds with other leveraged sources and equity to make required QEIs
- Proceeds from QLICs are then used to reimburse the developer
- Developer, or an affiliate then uses those proceeds to purchase the One Day Loan so it is a long term lender to Investment Fund

Respecting the NMTC Structure

- Use of soft sources as a leveraged loan
- Grant proceeds and other soft sources often have strings attached
- Challenges associated with soft sources
 - a) contractual privity issue
 - b) timing of grant equity
- Ways to convince grant providers and other soft source financing providers to participate as leveraged lender

Respecting the NMTC Structure cont. - Mortgages

- Leverage lender can not have a direct mortgage on the property securing its loan to Investment Fund
- In lieu of a mortgage, leverage loan secured by pledge of Investment Fund's membership interest in the CDE
- What happens if QLICI loans are in default?
- Investor request to forebear on enforcement of pledge

Respecting the NMTC Structure cont. – CDE Allocation

- Typical limits associated with CDE allocation
- Range between \$10 to \$15 million
- Must use multiple CDEs when dealing with transactions with QEI requirements in excess of \$10 to \$15 million
- Ramifications of having multiple CDEs
 - a) costs
 - b) paperwork
 - c) time

Is the Juice Worth the Squeeze?

- What are the benefits of using NMTC for your real estate project?
- Benefits are generally equal to Investor Equity minus incremental costs associated with NMTC such as:
 1. fees to CDE or CDEs
 2. fees to attorneys, accountants and/or consultants for the CDE, Investor and QALICB
 3. expenses related to CDE audit and investor asset management
- Focus on the net benefit to the transaction, typically from \$.40 to \$.50 per NMTC
- The greater the QEI, the greater per credit net benefit received from the NMTC

Is the Juice Worth the Squeeze?

- Our developer clients often say that the extra time, expense and complexity involved with the NMTC are justified by the rationale that the \$.40 to \$.50 per credit is “found money”
- NMTC transactions require lengthy period of time between engagement of CDE and closing of transaction
- Timeframe includes finding a CDE with allocation, finding a NMTC investor, finding a leverage lender and time to get all project participants and funding sources on board with the proposed structure
- Typically 4 to 6 months but can be longer

Is the Juice Worth the Squeeze?

Guarantees

- NMTC transactions require a guaranty in addition to those typical with borrowing
- Developers will be expected to guaranty yield generated by the NMTC to the Investor in the event of disallowance or recapture
- Typical recapture triggers
- Greatest risks of recapture
- Results of QLICI default

Is the Juice Worth the Squeeze?

Reporting

- CDEs are required to report various community and economic impacts of their investments to the CDFI Fund
- QALICB will be required to provide detailed annual reports with respect to such community and economic impacts

So how do I start?

First Step - Have a story!

- Need to confirm proposed project is in a LIC
- Find a CDE, Investor and Leverage Lender
- Ask about the Project:
 1. Will the project have a community and economic impact?
 2. Will the project be developed in a highly distressed area?
 3. Will there be a need for NMTC subsidy sources?
 4. Will the project provide valuable community services or provision of essential goods to a low-income area?

So how do I start?

Next Step - Establish a Pro Forma

- Transaction must pass the underwriting scrutiny of investors and lenders
- Have development and operating budgets that meet investment and/or lender criteria
- CDEs, accountants, consultants and attorneys can assist with finding investors and lenders, assembling budgets and structuring proposals

So how do I start?

Final Steps

- Signing of a term sheet that memorializes the proposed investment and/or loan terms
- Getting to closing
- Gear up for the next NMTC transaction!

Helpful NMTC links

- IRS NMTC information site:
<http://www.irs.gov/pub/irs-utl/atgnmtc.pdf>
- Novogradac & Company, LLC site:
http://www.novoco.com/new_markets/index.php
- CDFI Fund site:
<http://cdfifund.gov/>
- IRC Section 45D:
http://www.law.cornell.edu/uscode/html/uscode26/usc_sec_26_0000045---D000-.html
- NMTC Coalition site:
<http://nmtccoalition.org/>
- Cannon Heyman & Weiss, LLP homepage:
<http://www.chwattys.com/>

Webinar Conclusion

Thank you for your participation in the Webinar.

This Webinar has been presented by:

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