Introduction to New Markets Tax Credits

Moderated by:
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Presented by:
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Tom Oldenburg – US Bank
Guillermo Franco – Community Capital Link

Today's Panelists

Community Development Entities (CDEs)
- Aisha Benson – TruFund Financial
- Brenda Loya – Nonprofit Finance Fund
- Jonevan Hornsby – Empire State New Markets Corp

NMTC Investors
- Tom Oldenburg – US Bank
- James Simmons – Chase

NMTC Professionals
- Tim Favaro – Cannon Heyman & Weiss, LLP
- Steve Kunin – Rise Community Capital
- Gloria Lee – Rise Community Capital
- Guillermo Franco – Community Capital Link

NMTC Program Background

- Codified in Section 45D of the IRC; Enacted in 2000
- Administered by the CDFI Fund, an arm of the U.S. Department of the Treasury
- Allocation authority awarded on annual basis
  - $43.5B awarded to date;
  - $39.0B used by businesses and project sponsors
- CDFI Fund typically awards $3.5B of NMTCs annually to 70 – 85 CDEs with an average of $40 - $50MM per CDE

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 Basics – Earning the Tax Credit

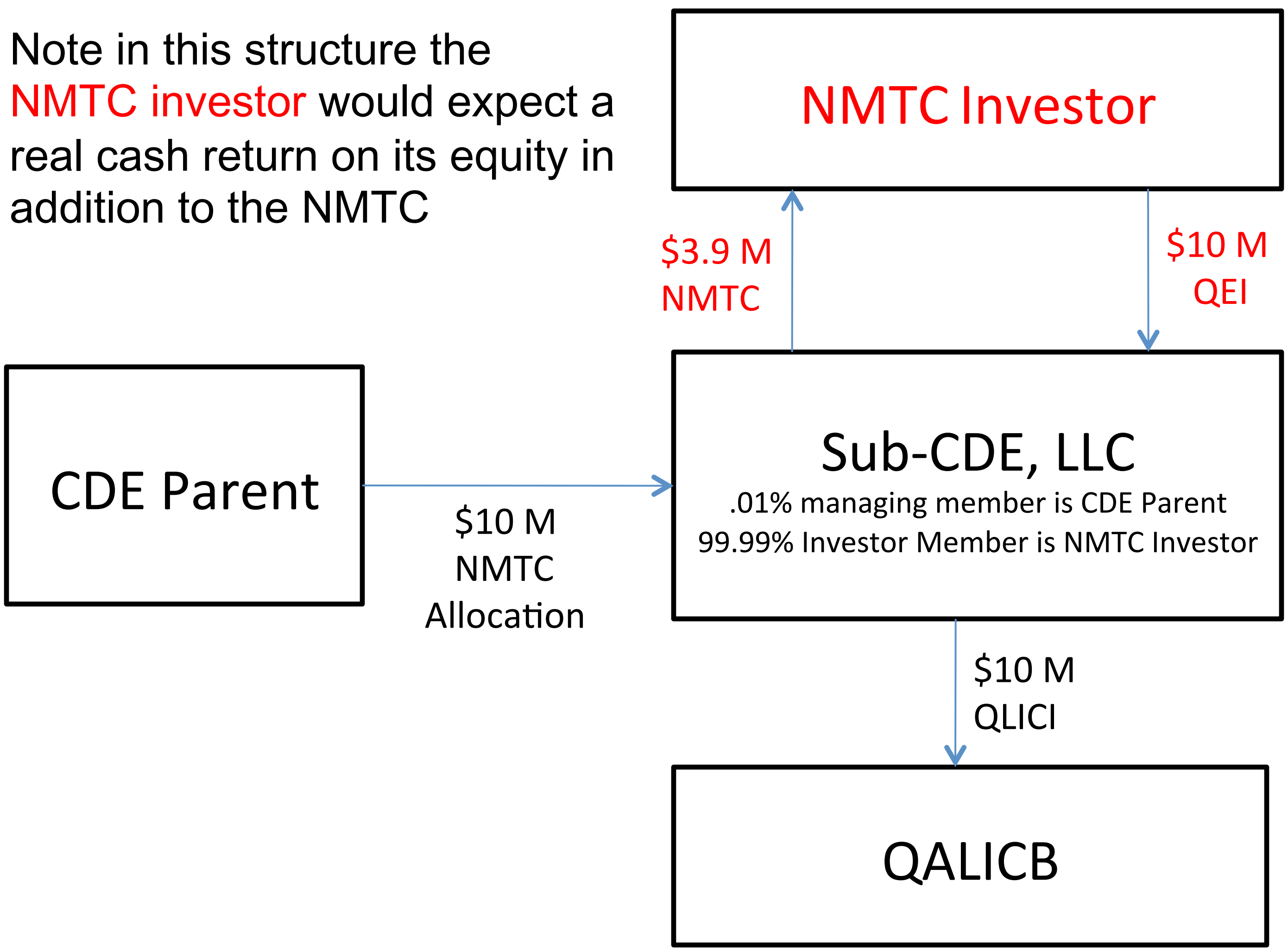
- Equal to 39% of QEI
  - claimed over 7 year compliance period
  - 5% in years 1 through 3
  - 6% in years 4 through 7

- CDEs must use substantially all (at least 85%) of QEIs to make QLICIs which must remain invested for the full seven-year compliance period

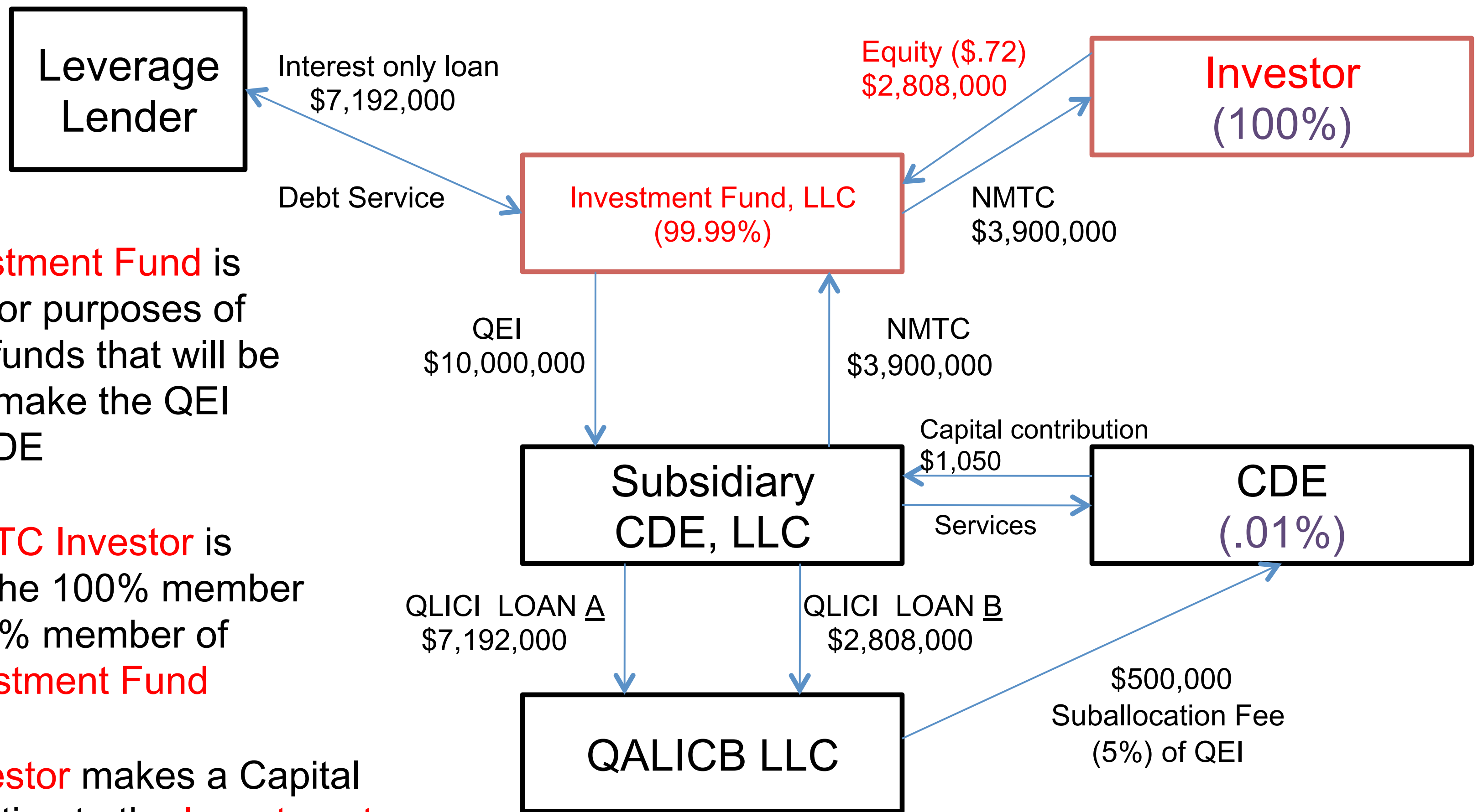
- Amount of NMTC is solely a function of amount of QEI

Basic NMTC Structure

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



Leveraged NMTC Structure

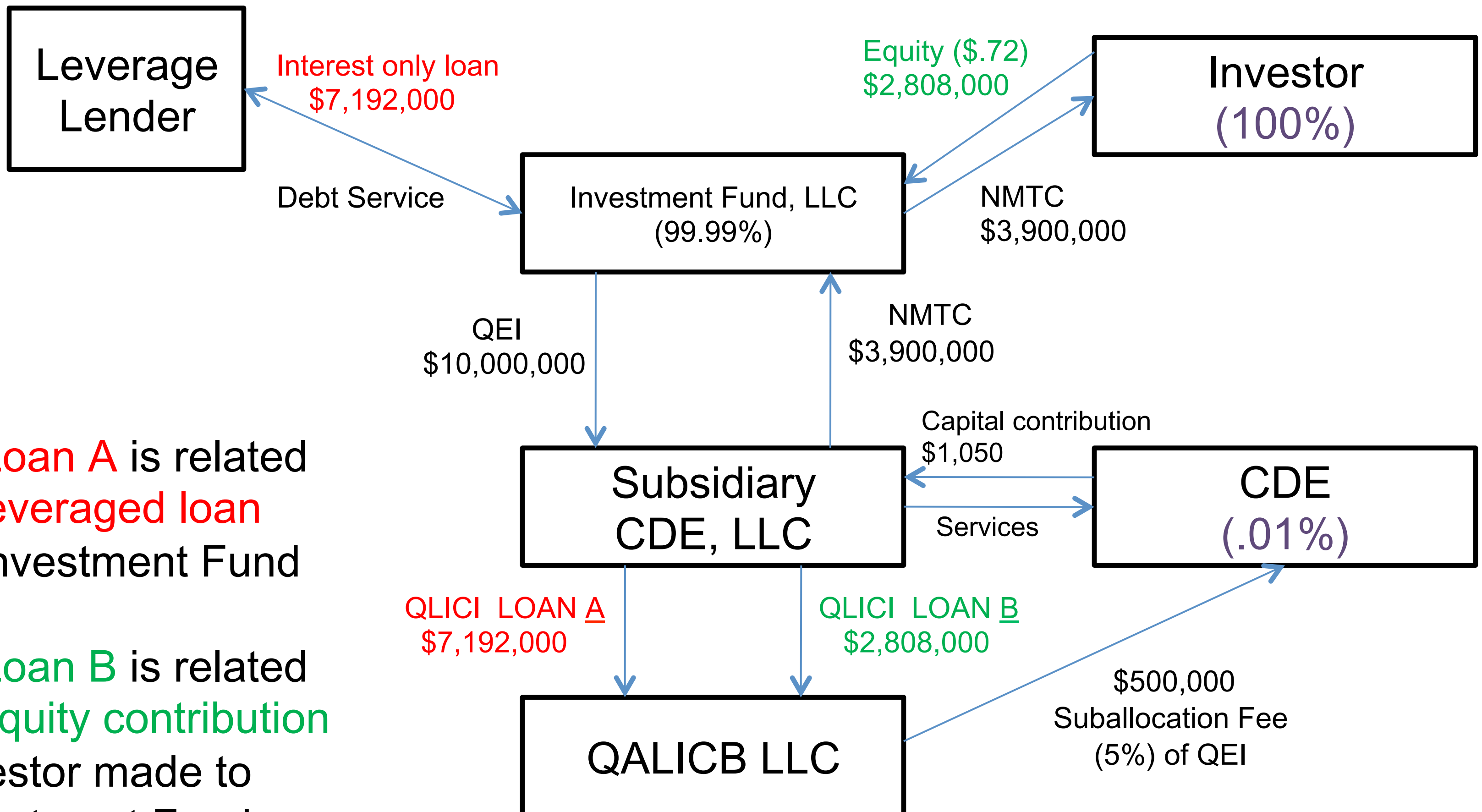


An Investment Fund is formed for purposes of pooling funds that will be used to make the QEI to the CDE

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

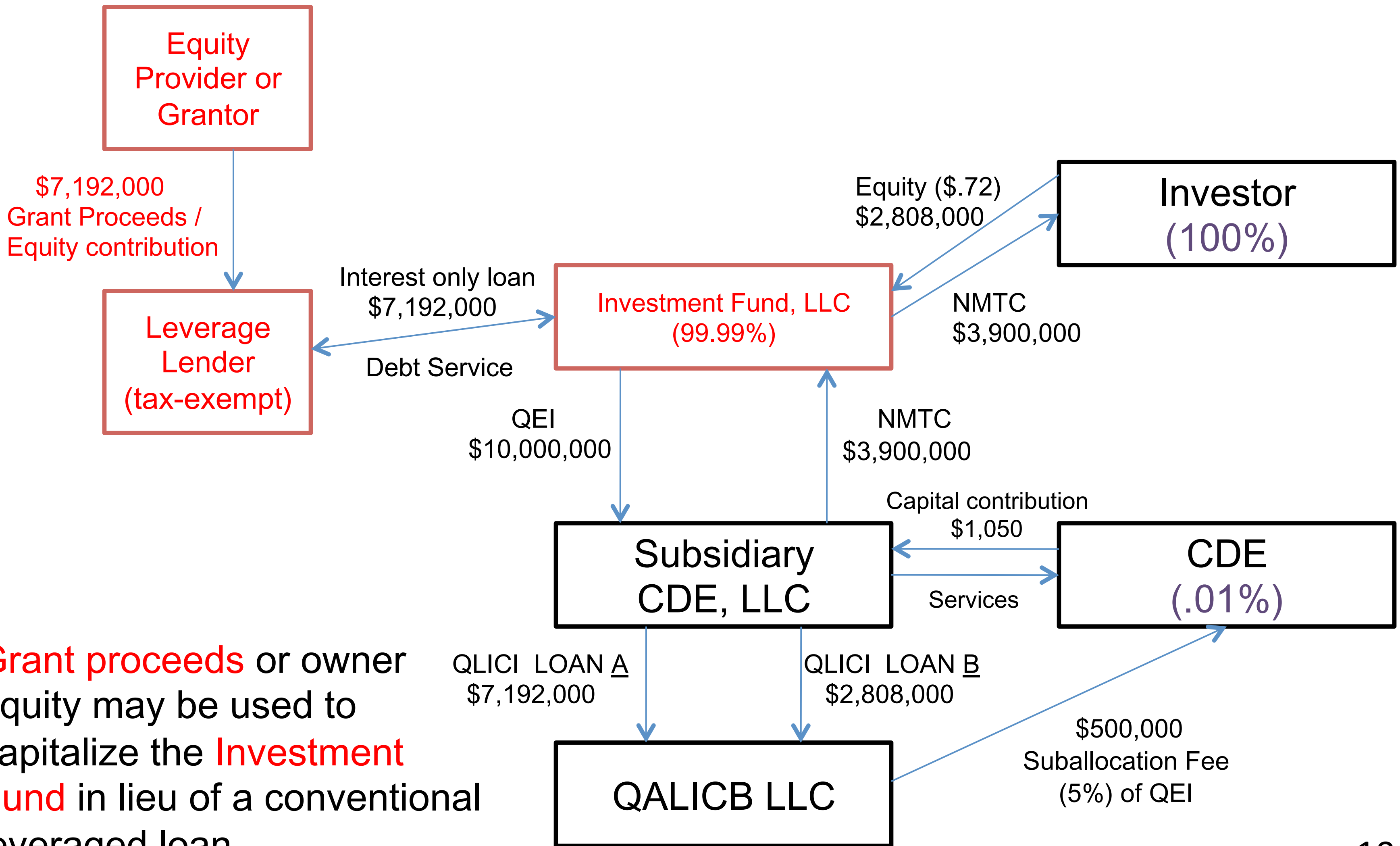
Leveraged NMTC Structure



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

Leveraged NMTC Structure



Grant proceeds or owner equity may be used to capitalize the Investment Fund in lieu of a conventional leveraged loan

Leveraged Model – How do you Maximize the Benefit?

- Maximize the QEI – to do that you need to:
  - Secure enough allocation
  - Have enough Leverage Sources

- Potential Leverage Sources
  - Bank debt
  - CDFI debt
  - Below market rate loans
  - Grants and other soft sources
  - Sponsor equity including equity spent to date (Note: 2-year look back on costs)
  - Leveraging transaction sources that have already been spent

Maximizing the NMTC Benefit

Securing 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

Maximizing the NMTC Benefit

Leveraging sponsor equity / 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 a “Short Term Bridge Loan” to the Investment Fund
- Investment Fund combines these proceeds with other leveraged sources and equity to make required QEIs
- Proceeds from QLICIs are then used to reimburse the sponsor for costs incurred to date (Note: There’s a hard 2-year look back limit)
- Developer, or an affiliate then uses those proceeds to purchase the Short Term Bridge Loan, so it is a long term lender to Investment Fund

Respecting the NMTC Structure

Mortgage / Lender Collateral Considerations

- 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

Use of soft sources / grants 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

Is the Juice Worth the Squeeze?

Quantifying the Benefits

- Benefits are generally equal to NMTC 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 or about 15 – 20% of the "QEI"

- The greater the QEI, the greater per credit net benefit received from the NMTC

- Some "economies of scale" for projects with greater allocation. but it is harder to secure larger amounts of allocation

Is the Juice Worth the Squeeze?

Timing and Expense Considerations

- QALICBs say that the extra time, expense and complexity involved with the NMTC is justified for the subsidy provided available through the program
- NMTC transactions require lengthy period of time from “start to finish”
- Timeframe includes having a deal “ready to go”, 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 once a project is ready but can be longer
- Recommendation is to start early and iron out the details before engaging NMTC Investors and CDEs

Is the Juice Worth the Squeeze?

Guarantee Considerations

- NMTC transactions require a guaranty in addition to those typical with borrowing
- Sponsors 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?

Community Impact Reporting Considerations

- 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!
The NMTC program is very competitive

- Confirm proposed project is in a LIC

- Document the following:
  1. The project's a community and economic impact (job creation, etc)
  2. Confirm the project is in a highly distressed area
  3. Is there a need for the NMTC subsidy (i.e. what is the "But For"?)
  4. Describe what valuable community services or provision of essential goods are being provided in the LIC and to low-income residents?

- Have the right team in place (Architect, GC, Legal, NMTC Consultant and NMTC Accountant)

- Find a CDE(s), Investor and Leverage Lender(s)

So how do I start?

Next Steps – Have the Project "Ready to Go"

- Complete typical development steps
  - Secure site control
  - Create a budget
  - Line up a GC with a GMP contract
  - Prelease commercial space
- 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

- Sign term sheets with an investor and leverage lender and reservation letters with CDE(s) to memorialize the proposed investment and/or loan terms
- Engage NMTC Accountant to create Financial Projections for the closing
- Kick-off highly organized closing process to ensure control of closing costs
- 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_00000045---D000-.html

- NMTC Coalition site:
http://nmtccoalition.org/

- Cannon Heyman & Weiss, LLP homepage:
http://www.chwattys.com/

Presenter Contact Information

For additional follow-up or questions about potential transactions please contact:

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