New Markets Tax Credit Program 101
The Details

MAKING THE NEW MARKETS TAX CREDIT WORK IN NATIVE COMMUNITIES

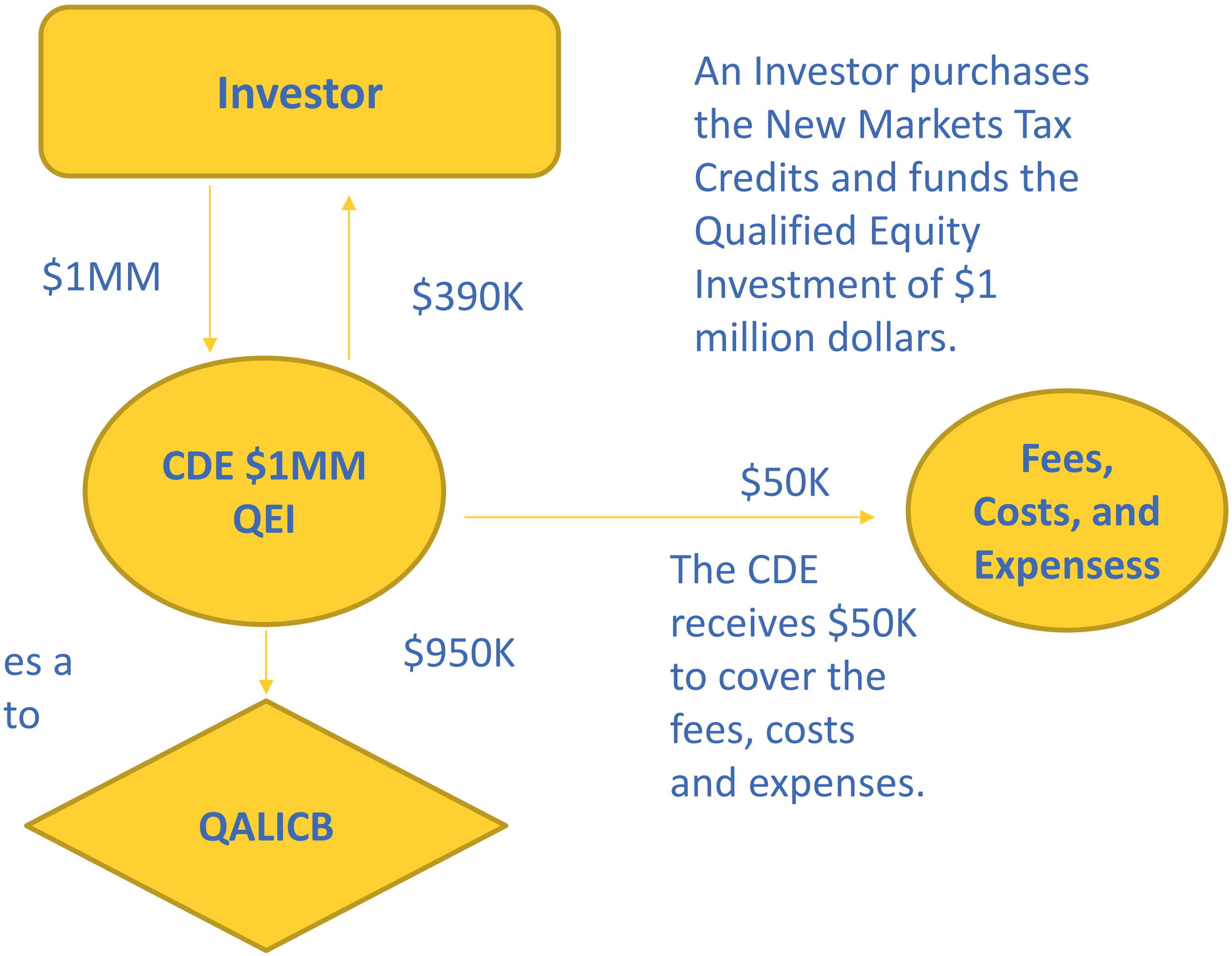
MAY 24, 2018

FEDERAL RESERVE BANK *of* MINNEAPOLIS

The Other Players

- NMTC Investor
- Leverage Lender
- Community Development Entity (CDE) - Allocatee
- Secondary CDE (if utilized)
- Qualified Active Low-Income Community Businesses (QALICB)
- Low-Income Community Representatives

NMTC Investment Structures - Unleveraged Structure

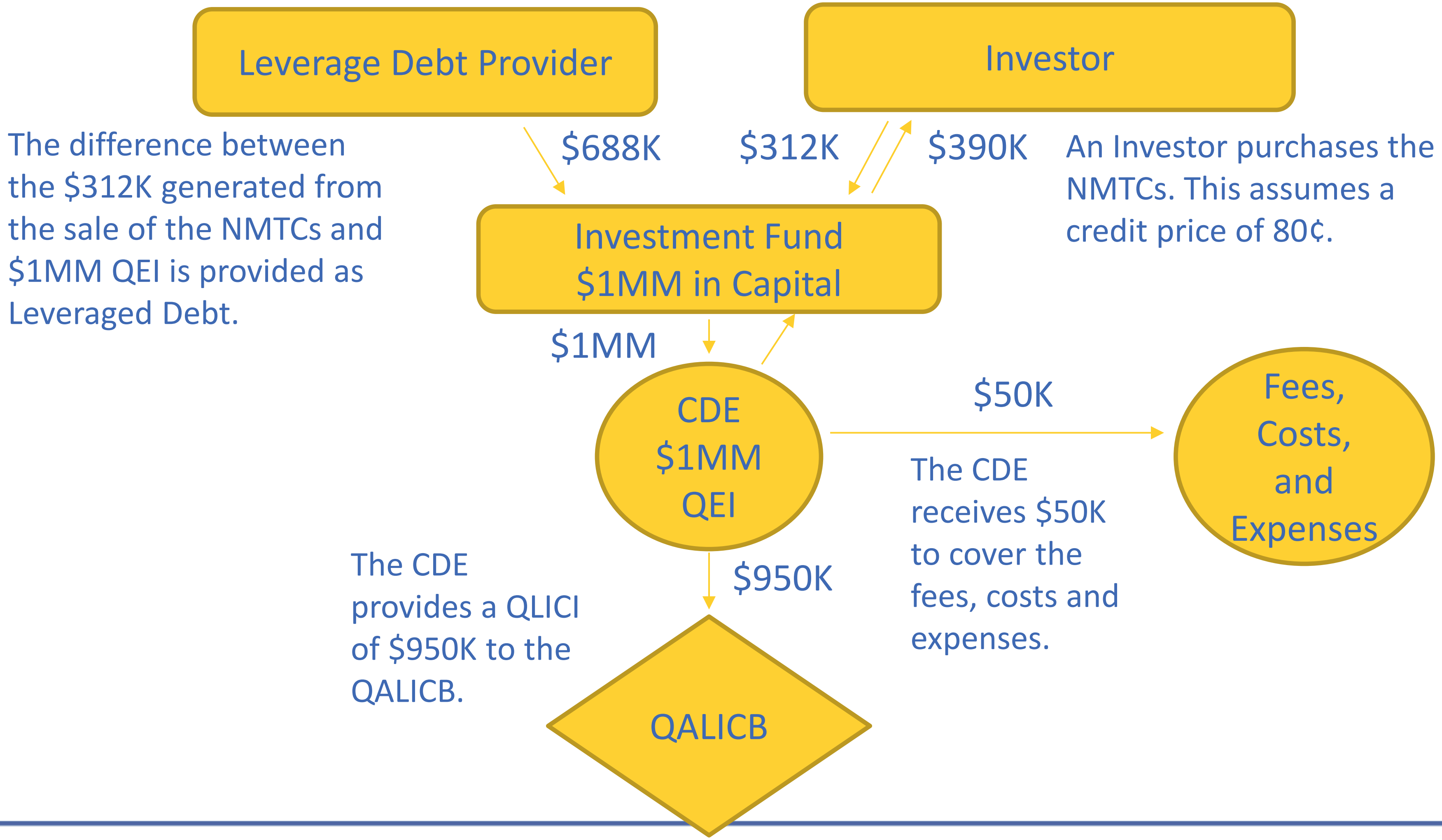


An Investor purchases the New Markets Tax Credits and funds the Qualified Equity Investment of $1 million dollars.

The CDE receives $50K to cover the fees, costs and expenses.

The CDE provides a QLICI of $950K to the QALICB.

NMTC Investment Structures - Leveraged Structure



Tax Credit Investor

- The tax credit investor is looking to reduce its taxes.
  - Buys the tax credit at a discount based on current market pricing for the tax credits
  - Minimize taxation (capital gains) at the unwind of the NMTC investment after the 7 year compliance period.
- It wants to ensure that the tax credit is not recaptured
  - The QLICI and QALICB must meet IRS requirements
  - Recapture risk is isolated on a QEI by QEI basis if using direct tracing method.
  - CDE & QALICB must remain compliant for full 7 years of the compliance period.
- Other motivations-- CRA, social impact

CDE-Allocatee

- Incurs the time and expense of applying for an allocation
- If awarded, Allocatee CDEs are responsible for
  - Finding tax credit investors
  - Finding borrowers/investees consistent with the business strategy in the Application
  - Financing projects/business that will result meaningful economic and community development outcomes for the communities they serve.
- This is why each Allocatee CDE must have:
  - Low-Income community representatives participating meaningfully in its board of advisors or governing board;
  - a business plan likely to bring about significant, and measurable community outcomes; and
  - a demonstrable track record of success.

NMTC Application Round Opening

- Notice of Allocation Availability
- The Application (pdf)
- Application FAQ – provides additional details
- Application Roadmap – slide presentation
- Electronic Application
- On-line Application Instructions

NMTC Application Evaluation Process: Flowchart

Phase 1: Peer Review

External reviewers evaluate and score Part I and Part II of applications.

Phase 2: Panel Review

Applications that meet minimum scoring thresholds are evaluated, based on rank score, by a CDFI Fund panel.

Selection of Applicants:

Selecting Official makes final determinations based upon panel recommendations.

NMTC Application Evaluation Process: Phase 1 – Peer Review

- Each Reviewer may award an application a maximum of 60 points.
- Two sections of 25 points each:
  - Part I: Business Strategy
  - Part II: Community Outcomes
- Applicants may also earn 10 "priority points."
  - Up to 5 points for Track record of serving distressed businesses and communities (DBCs)
  - 5 points for Committing that at least 85% of QLICIs will be to unrelated entities (not scored)
- Not Scored in Phase 1: Part III (Management Capacity), Part IV (Capitalization Strategy), and Part V (Previous Awards).

Phase 1: Characteristics of Highly-Ranked Applicants.

- 5-year track record of providing debt or equity (to for-profit entities) in LICs/DBCs
- Requested allocation amount is similar to 5-year deployment
- Track record of financing similar projects or businesses.
- Pipeline & strategy for timely deployment
- Commit to investing sub-all in Unrelated Entities.
- Notable Relationships provide clear benefits to end-users.

Phase 1: Characteristics of Highly-Ranked Applicants (cont'd)

- Commit to investing in Areas of Higher Distress
- Planned investments will result in significant quantitative and qualitative community development outcomes in LICs
- Projected outcomes supported by methods & Metrics
- Potential investments are supported by and beneficial to the communities it serves
- The Applicant also demonstrated an extensive track record of community engagement in past investment decisions.
- Proposed investments will result in add'l private investment in LICs beyond the initial NMTC investment

NMTC Application Evaluation Process: Phase 2 – Panel Review

- The Panel reviews the Application contents, Phase 1 reviewer comments, as well as any other relevant compliance, eligibility, due diligence and regulatory matters.
- The Panel reviews Section III (Management Capacity), Section IV (Capitalization Strategy), and Section V (Information Regarding Previous Allocations).
- Additionally, the Panel reviews past transactions from Applicants who are prior Allocatees.
- Compliance with prior awards & late reports
- The conclusion of Phase 2, the Panel's allocation award recommendations are forwarded to the Selecting Official.

NMTC Application Evaluation Process: Phase 2 – Panel Review

- Prior Allocations:
  - Generally consistent with prior representations (e.g., proposed product offerings, QALICB type, fees and markets served);
  - Issued QEIs and made QLICIs in a timely manner; and
  - Substantiated a need for additional allocation authority.
- Management team, personnel & systems:
  - Deployment: identifying, underwriting & financing loans, equity investments in LICs, particularly those to be served with allocation
  - Asset and risk management; and
  - Fulfilling government compliance requirements, particularly tax credit program compliance.

NMTC Application Evaluation Process: Phase 2 – Panel Review

- Capitalization – ability to raise QEIs
  - Demonstrate a track record of raising investment capital;
  - Has secured investor commitments, or has a reasonable strategy for obtaining such commitments;
  - Demonstrate that the economic benefits of the tax credit will be passed through to a QALICB; and
  - Commitment to invest more than 85 percent of the QEI proceeds as QLICIs.

NMTC Application Evaluation Process: Phase 2 – Panel Review

- **Non-Metropolitan Activities**
  - The response to this question will be considered in Phase 2 of the *Allocation Application* reviews and may affect the size of the Applicant's *NMTC Allocation.*
  - Applicants are required to provide two target estimates:
    (1) a minimum percentage and (2) the maximum percentage of *QLICI*s that the *Applicant* is willing to commit to invest in *Non-Metropolitan Counties*.
  - For more information on Non-Metro Activities, please see the NOAA (Section V, Subsection D) and/or the Application FAQ document (Q. 109 – Q. 114)

NMTC Application Evaluation Process: Phase 2 – Panel Review

- Innovative Activities
  - Investing in *Unrelated CDEs* that do not have *NMTC Allocations*.
  - Investing in states identified by the CDFI Fund as having received fewer dollars of *QLICIs* historically.
  - Providing *QLICIs* where the total *QLICIs* received by the *QALICB* are $2 million or less.
  - Making *QLICIs* with an original term less than or equal to 60 months.
  - Providing *QLICIs* for non-Real Estate Activities, such as working capital, inventory or equipment purchase.
  - **Investing in *Federal Indian Reservations, Off-Reservation Trust Lands, Hawaiian Home Lands,* and *Alaska Native Village Statistical Areas*.**

Investment, Jobs, Goods, and Services

Investment in the Low-Income Communities creates

- Local jobs
- Commercial goods
- Community services

- When Low-Income Community residents are able to buy goods and services within their own community, their capital stays in the local micro-economy, improving the volume and velocity of capital.
- When LIC residents have to buy goods and services outside of their community, the local economy is depleted.
- Local employment brings capital from outside into the LIC, increasing volume of capital.

What Are the Kinds of Outcomes Possible with NMTC?

- Direct jobs created or retained
- Quality jobs
- Accessible jobs
- Commercial goods or services
- Healthy food financing
- Community goods or services
- Financing Minority businesses
- Flexible lease rates
- Housing units, % affordable
- Environmentally sustainable outcomes
- Other

"Know It When You See It" Is Not Enough

To implement the goals of the NMTC program, community outcomes must be:

- Relevant to the LIC being served
- Meaningful
- Predictable
- Measurable

What is Relevant, What is Meaningful?

- Each Low-Income Community has unique issues and needs.
- The Low-Income Community representatives must have a real voice in designing community outcomes and prioritizing high-impact results for their communities because they understand the local issues, dynamics, and community development plans.

What are Predictable and Measurable Outcomes?

- Each CDE must have an established methodology for evaluating the outcomes proposed by the projects its investees will be delivering.
- The methodology must be consistent and based on data that can be measured and validated.
  - How many direct jobs? How many construction jobs?
  - How many customers or people served?
  - How do lease rates compare to the market area?

Community Outcomes Affect Every Element of a CDE's Operations

- Mission
- Board
- Financial Products
- Pipeline
- Project Selection
- Underwriting
- Terms
- Capital Raising
- Staffing
- Loan Servicing

NMTC Allocation Agreement Compliance FAQ #44-46

- Q. 44: Beginning with the CY 2015-2016 round, any debt or equity provider, or Affiliate of any debt or equity provider, whose capital was used, directly or indirectly, to fund a QEI, may receive QLICI proceeds to repay or refinance reasonable expenditures that are incurred by the debt or equity provider (or Affiliate) and that are directly attributable to the qualified business of the QALICB if the expenditures **(i) were incurred no more than 24 months prior to the date on which the QLICI transaction closes**, or (ii) represent no more than 5 percent of the total QLICI proceeds from the QEI.

For Additional details, see the NMTC Compliance FAQ on the CDFI Fund's web site.

NMTC Allocation Agreement Compliance FAQ #44-46 (con't)

- Q. 45: CDEs must include covenants in financing agreements with QALICBs as may be necessary to reflect this restriction. The agreements containing such covenants must be available for inspection by the CDFI Fund. In addition, the CDE should collect information as may be necessary and maintain documentation to trace the use of QLICI proceeds by the QALICB at the time the initial QLICI is made and at least annually thereafter. ..
- This documentation must be available for inspection by the CDFI Fund. Documentation to support compliance with this restriction must be retained for the entire period of the QLICI in the QALICB plus three years or the seven-year compliance period plus three years, whichever is shorter.

NMTC Allocation Agreement Compliance FAQ #44-46 (con't)

- Q. 46: The QALICB may use QLICI proceeds to repay or refinance expenditures incurred by the debt or equity provider (or their Affiliate) for the acquisition of any asset contributed, sold, or otherwise transferred to the QALICB to the extent such asset represents a reasonable expenditure directly attributable to the qualified business of the QALICB. **The amount that can be repaid or refinanced for such an asset is limited to the asset's original cost** and **not** to any accreted value obtained by appraisal or other valuation methods. Such transactions **remain subject to the 24 month rule or 5 percent rule indicated in Question 44 above**.

Resources:

- CDE Certification Application
- CIMS mapping: www.cdfifund.gov/mapping.
- NMTC page: Application, NOAA, FAQ
- 2017 NMTC Program Allocation Evaluation Process: https://www.cdfifund.gov/Documents/2017%20NMTC%20Round%20Characteristics%20of%20a%20Highly%20Ranked%20Application%20-%20FINAL.pdf