Nonprofit financial and real estate resources

Where nonprofits come first

Overview of New Markets Tax Credits

New Markets Tax Credit Basics

- Program was created December 2000
- Administered by the CDFI Fund of the US Treasury Dept
  - Certifies Community Development Entities (CDE)
  - Allocates NMTCs to CDEs
  - Monitors CDEs
- NMTCs are claimed over seven years starting on the date the equity investment is made and each subsequent anniversary
  - 5% credit of the investment in years 1 through 3
  - 6% credit in Years 4 through 7
  - 39% credit total

Qualified Projects

NMTC Investments can be made in:

1. A qualified real estate project located in a qualified census tract OR
2. A qualified business that meets the following tests:
    - Gross Income Test: More than 50% of gross income must be generated by activities performed in qualified census tracts
    - Tangible Property Test: More than 40% of the value of the tangible property must be located in qualified census tracts
    - Services Test: More than 40% of the services of the employees must be performed in qualified census tracts

Qualified Projects

- Project(s) must be in a qualified low-income census tract
    - Poverty level greater than 20%
    - Median Income below 80% of the State or Metro Area
    - Other qualifications:
        - TIF, Empowerment Zones, Enterprise Communities, rural counties with high migration, FEMA Counties
    - CDEs are now looking to invest in more deeply distressed communities to score higher on CDFI applications

Qualified Projects

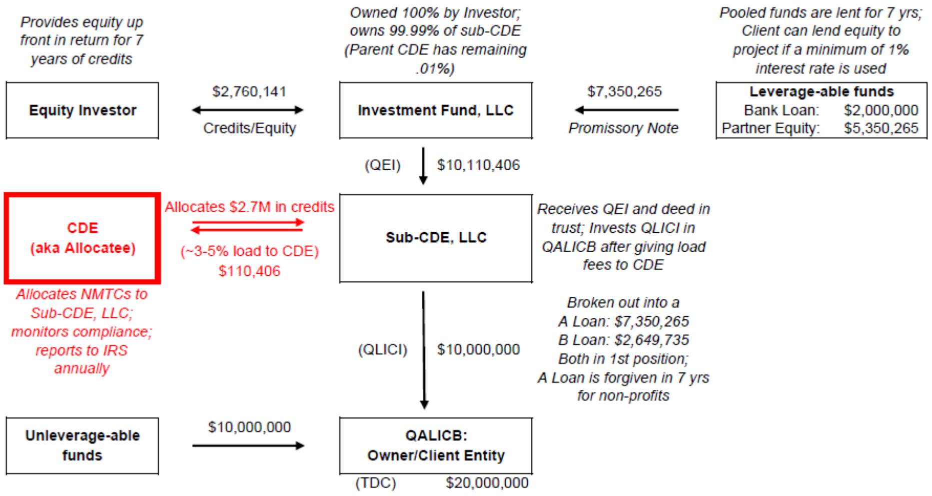
- Ineligible Businesses
  - The business cannot be a financial institution or finance company
  - The business can't have more than 5% of assets attributed to collectibles for sale (e.g., art, antiques, baseball cards, etc.)
- There must be a reasonable expectation that the business will continue to meet these tests for the next 7 years
- Businesses can use NMTCs to finance working capital, machinery and equipment, furniture, fixed assets, and research and development

Transaction Components

- NMTC Components/Terms
  - CDE/Allocatee
  - Investor
  - QEI (Qualified Equity Investment)
  - Leverage Lender
  - QLICI (Qualified Low Income Community Investment)
  - QALICB (Qualified Active Low Income Community Business)

Transaction Components: CDE/Allocatee

Diagram of Sample NMTC Project



Provides equity up front in return for 7 years of credits

Equity Investor

$2,760,141

Credits/Equity

Owned 100% by Investor; owns 99.99% of sub-CDE (Parent CDE has remaining .01%)

Investment Fund, LLC

$7,350,265

Promissory Note

Pooled funds are lent for 7 yrs; Client can lend equity to project if a minimum of 1% interest rate is used

Leverage-able funds

Bank Loan: $2,000,000

Partner Equity: $5,350,265

(QEI) $10,110,406

CDE (aka Allocatee)

Allocates NMTCs to Sub-CDE, LLC; monitors compliance; reports to IRS annually

Allocates $2.7M in credits

(~3-5% load to CDE) $110,406

Sub-CDE, LLC

Receives QEI and deed in trust; Invests QLICI in QALICB after giving load fees to CDE

Broken out into a
A Loan: $7,350,265
B Loan: $2,649,735
Both in 1st position;
A Loan is forgiven in 7 yrs for non-profits

(QLICI) $10,000,000

Unleverage-able funds

$10,000,000

QALICB: Owner/Client Entity

(TDC) $20,000,000

Transaction Components: CDE/Allocatee

- The CDE is the entity that receives the tax credits from CDFI Fund
- The CDE has a 5 year period to find investors
- In reality, most CDEs want to get out 85%-95% of their credits in Year 1 to be more competitive in the next CDFI round
- Many banks look for projects before they receive their allocation (forward fund)

Transaction Components: CDE/Allocatee

- CDE Expectations
  - Minimum project size: approximately $8 million
  - Maximum project size per CDE: $10-12 million
    - Usually assemble multiple CDEs for larger development budgets
- CDE Fees
  - Initial load: Initial fee charged on the Qualified Equity Investment (QEI); typically ranges from 2-5%
  - Annual asset management fee: CDE's annual fee for managing the investments; typically ranges from 25-60 basis points of the QEI paid annually (over 7 years)
  - Annual audit/legal charges: Annual fees for required CDFI audits, certification, and partnership legal costs; typically $7,000-$11,000 annually (often capitalized up front)

Transaction Components: Equity Investor/QEI

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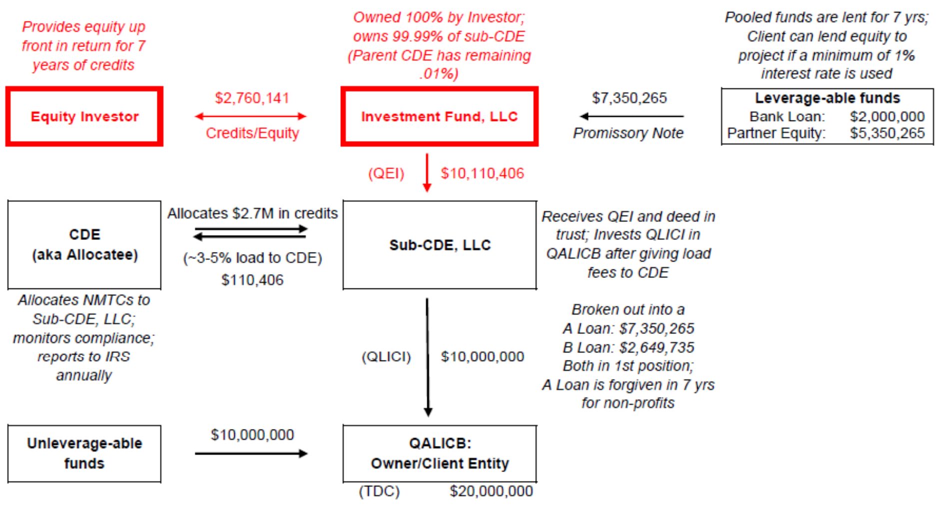

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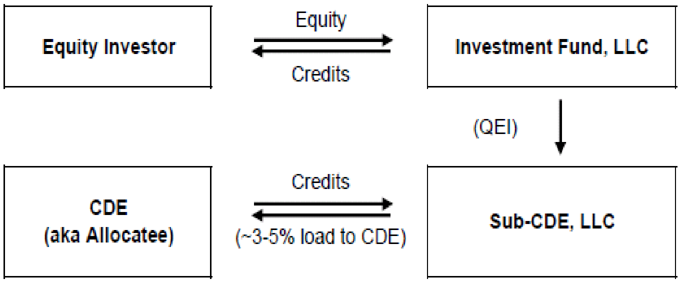
Transaction Components: Equity Investor/QEI

- Investor makes a Qualified Equity Investment (QEI)
- The QEI is the purchase of a capital interest in a for-profit corporation or partnership established by the CDE
- The QEI is the amount of the NMTC allocation made from the CDE
- The QEI is the basis for the amount of tax credits received by the investor
- The QEI is equity, not debt
- By IRS definition, the QEI cannot be collateralized
- The QEI must remained invested in the same CDE for the seven year credit period

Transaction Components: Equity Investor/QEI

- Transaction Set-Up
  - Investor creates an Investment Fund, LLC: wholly owned by the Equity Investor
  - QEI is passed to a Sub-CDE, LLC with the CDE as managing member (0.1%) and the Investment Fund, LLC as beneficiary member (99.99%)



Equity Investor

Equity

Credits

Investment Fund, LLC

(QEI)

CDE
(aka Allocatee)

Credits

(~3-5% load to CDE)

Sub-CDE, LLC

Transaction Components: Leverage Lender

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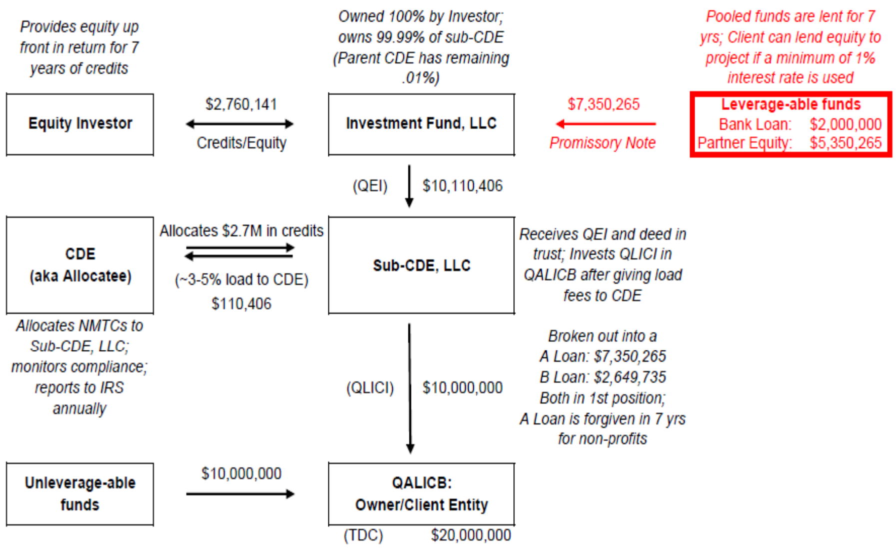

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Transaction Components: Leverage Lender

- Project can fill gap between Total Development Costs and NMTC equity with a loan, equity, or a combination of both
  - Equity must be loaned to the project at a market rate (typically 1%) for a minimum of 7 years
  - Lender typically wants project owner to have some equity in the deal (cannot finance deal with only NMTC equity and loan)

Exit

- At the end of the seven year compliance period, the CDE will exit the deal
- The CDE will have assets: the outstanding balance of the QLICI
- The CDE will also have a capital account: the QEI
- To assist unraveling, there will be both put and call options built into the partnership or operating agreements that essentially force a transfer of interests

Exit: Put/Call Agreement

- Investor & Lender sign Put/Call Option Agreement
  - To insure unraveling, there will be both “call” and “put” options built into the partnerships or LLC agreements between the Investor and the Leverage Lender
  - These are pre-agreed upon terms in which partners can “put” their interest to another partner (they have to take it) or can “call” an interest from a partner (they have to give it)
  - Investor can sell interest at end of 7 years, name entity who will be recipient, and name “put” price (usually nominal)
  - In the event that Leverage Lender needs to call an interest from a partner, the value is significantly reduced through accounting methods