WEAVE SOCIAL FINANCE

New Markets Tax Credits Program Summary

The New Markets Tax Credit Program (NMTC) was enacted in early 2001. The first investments through the program did not occur until the first quarter of 2004. The intent of the program is to encourage capital to flow to businesses and real estate development in low-income communities. NMTC financing typically results in a seven-year loan equal to as much as 20% to 25% of the costs of a business or real estate investment. These loans are often structured to be forgivable after the seven-year period. In some cases, a portion of the loan may need to be paid back, especially for larger businesses.

The Tax Credit Allocation Process

Through a competitive application process, certified Community Development Entities (CDEs) [affiliates of non-profits, government related entities, corporations, banks, and small financial groups or their subsidiaries] apply on a roughly annual basis for an allocation of NMTCs to the Community Development Financial Institutions Fund, an arm of the Treasury Department. Approximately 30% of the 250 to 300 applicants each round receives an allocation.

CDEs that receive a NMTC allocation are responsible for identifying and funding qualifying investments in line with their application to earn the tax credits and to be able to apply again in the future. An allocation means that the CDE can earn $0.39 for every dollar invested in a qualifying business over a seven-year compliance period. In most cases, CDEs sell the seven-year stream of tax credits to large banks or insurance companies at a discount at the time of the initial investment. After the discount to the tax credit buyer, legal and accounting fees, and fees paid to the CDE(s), the net NMTC subsidized financing equals 20% to 25% of the invested allocation amount.

Qualification for NMTC Financing

Qualifying areas are census tracts with either a median income level of 80% or less of area AMI or a poverty rate of over 20%. Over the past several years, virtually all investments have been targeted to “highly distressed” areas which must have a median income level of 60% or less of AMI, a poverty rate of 30% or greater, or an unemployment rate of 1.5x the national rate or higher. Additionally, there are several area designations (brownfields, TIF, etc.) that can qualify an area as “highly distressed”. The vast majority of NMTC investments are made in businesses or real estate that qualify under these rules. You may use the following website to view maps of qualifying areas. The red areas are “highly distressed”.

http://www.novoco.com/new_markets/resources/ct/

NMTC Financing Products

Due to the subsidized financing only being a portion of the required investment amount, NMTC investments must be “leveraged” with other forms of capital. Bank debt, bonds, grants, government loans, equity investments, and in some cases existing value in a business or building can be utilized as leverage. For example, a $10 million building might be purchased with a $7.5 million to $8.0 million loan along with a $2 million to $2.5 million NMTC loan. Due to the legal costs and complexities of the program, few transactions of less than $6 million are conducted. Most CDEs seek to put $8 million to $15 million in allocation into an individual investment. Larger projects will often require multiple CDEs to provide allocation.

In most cases, the NMTC loans are structured to be forgivable/grantable after the 7-year compliance period. The loan will typically require a 2% to 4% interest only payment over the 7-year compliance period but will mature and not require repayment if the community benefit and payment terms of the loan are successfully met over the full seven-year period.

The Market for Qualifying Businesses

The beneficiaries of NMTC financing vary widely. Large commercial real estate projects including retail centers, large hotels, industrial property, and mixed-use developments have received a great deal of NMTC financing. Large manufacturing businesses, renewable energy projects, and small businesses have also benefited from the program. Non-profit facilities, charter schools, community clinics, and job training facilities have also received a significant amount of support.

Each of CDEs have their own individual geographic focus (ranging from a single county to the entire country), preferred business or non-profit types, and targeted outcomes for their investments. Some CDEs will exclusively work with non-profits, others will only finance charter schools or perhaps insist on an environmental benefit, while others primarily hope to create jobs or spur redevelopment in disadvantaged neighborhoods. The NMTC industry is a relatively small but very diverse niche market with hundreds of projects and businesses seeking investments from up to 80 CDEs with allocation at a given time. Awards to the CDEs occur roughly yearly with awards expected in July 2021. Meaning projects that can close in the second half of 2021 or early 2022 will be best positioned for this round.

The tax credit investor market can vary greatly based on economic conditions and current or anticipated corporate tax policies. Projects or businesses that have the "leveraged" funds in place and would be able to close within six months will often receive priority from CDEs and tax credit investors. Most importantly, a business or project must have a good "story" behind it regarding job creation, services to low-income people, or community redevelopment. A CDE's track record of previous investments are the primary driver for gaining additional NMTC allocation. So, projects are evaluated based on fit for the CDE's strategy and attractiveness for future NMTC application rounds with the Treasury Department.

Key Aspects of Strong NMTC Projects:

- Located in "highly distressed" census tracts (red or orange on mapping site)
- $5MM to $60MM or more in total investment
- 75% to 80% of total capital identified/committed/already invested
- Creates jobs for low-income people
- Provides services to low-income people (medical, education, training, or healthy food)
- Spurs additional projects or investments and aids redevelopment or surrounding area
- Strong local support
- For some groups, environmental impacts (LEED, solar, alternative energy)

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