

Introduction to **New Markets Tax Credits**

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Introduction

The New Markets Tax Credit Program:

The Bottom Line to a Complex Tool:

- NMTCs can provide approximately 20% of a project's required capital.
- NMTC “equity” capital is subordinate to other project capital in the stack.
- NMTC “equity” is ultimately low-cost/no cost and is non-dilutive to other true equity.

Introduction

The New Markets Tax Credit Program:

- Established to help attract capital to historically underserved projects and communities.
- Provides an incentive to investors in the form of a 39% federal income tax credit for investing capital into qualified projects.
- Projects must be in eligible low-income areas primarily designated by census tracts.

Some Basics

The New Markets Tax Credit Program:

- Uses tax credits to enhance capital to finance both real estate projects and operating businesses.
- Can also be combined and leveraged with other forms of capital, low-cost financing, grants, guarantees, or other federal and state tax credits to maximize and often catalyze such other enhancements.
 - *NMTCs cannot be combined with Low-Income Housing Tax Credits (LIHTCs).*
 - *A mixed-use project must derive at least 20% of its income from commercial (non-residential) sources.*

Some Basics

Who Has New Markets Tax Credits?

- NMTCs are available through certified Community Development Entities (CDEs) that have received an “allocation” of New Markets Tax Credit capacity.
- Such “allocatees” must have available NMTC capacity and must be certified to work in the geographic area in which a project or business is located.

Some Basics for a Developer or Business **New Markets Tax Credits Can Provide:**

- Approximately 20% of a project's requisite capital in the form of "New Markets Tax Credit equity."
- Project funding at very favorable terms:
 - Usually about 100 – 300 basis points below market;
 - Often interest-only for seven years;
 - Higher LTVs; and
 - The ability to create equity ("residual equity") in the form of capital that does not need to be refinanced at the end of the seven-year NMTC term.

Some Basics for a Developer or Business **New Markets Tax Credits:**

- Can provide a means to create opportunities to innovatively finance projects that otherwise would not be financially feasible.
- NMTCs can, for instance:
 - ☑ Reduce a developer's required initial capital investment in a project;
 - ☑ Reduce a project's debt service requirements and cash flow needs during the seven-year NMTC term;
 - ☑ Allow the financing to be structured with significant better-than-market terms, such as substantially lower interest rates, no or low amortization, lower overall debt-service coverage ratios (DSCs) and higher than usual loan to value ratios (LTVs).
 - ☑ Create substantial back-end "equity" in a project and reduce the refinance risks for the project, developer, and lender.

NMTCs

The 39% Federal Income Tax Credit

- Calculated on the amount provided by the investor as the qualified equity investment (the “QEI”).
- Realized over seven (7) years.
- $39\% = 5\% + 5\% + 5\%$ (Years 1 – 3)
 $+ 6\% + 6\% + 6\% + 6\%$ (Years 4 – 7)

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Some Basic NMTC Rules

- “Substantially all” (85%) of the original capital must remain invested in the project for the seven-year NMTC term.
- Investors can get cash flow (return on capital), but no return of capital.
- Any principal repayments must be held in reserve at the CDE level.

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Other Key NMTC Guidelines

- Prospective NMTC projects are only eligible if they are in designated low-income areas (pre-qualified census tracts).
 - *“Targeted Populations” rules have opened NMTC eligibility to formerly ineligible geographic locations based on low-income service criteria, but can be challenging to in practice.*
- Projects must usually also meet additional higher “targeted distressed” qualifications, as well.
- “Metropolitan” vs. “Non-Metropolitan” county designations will be crucial to some NMTC sponsoring allocatees.

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Other Key NMTC Guidelines

- The types of projects and businesses eligible to use NMTCs is quite broad, but there are specific prohibitions against gambling, golf courses, liquor stores, financial institutions, farming husbandry, businesses dealing primarily with intangible assets, and others.
- Projects can be undertaken by either for-profit or nonprofit entities.

New Markets Tax Credits **Components of a “Model” NMTC Project**

- Capital requirement of \$8 million to \$40 million.
- Project is financially sound and can be reasonably underwritten by capital investors and lenders.
- Project is mature and financial close can occur in near-term.
 - Equity & debt commitments in place; permits and construction docs finalized; input & offtake agreements finalized; etc.

New Markets Tax Credits **Components of a “Model” NMTC Project**

- Strong economic development and/or community impact (direct or indirect):
 - Projects should help create or retain jobs; act as the catalyst for larger or additional development or redevelopment, infuse sources of new investment capital into an under-served, low-income area; and create new access to community services such as education, healthcare, child & elder care.

New Markets Tax Credits **Components of a “Model” NMTC Project**

- Environmental sustainability is becoming a more important factor to many mission-oriented allocatees.
 - Projects should incorporate green-design principles when possible (in keeping with USGBC LEEDs guidelines).
 - Beneficial impacts, such as supporting land conservation efforts, sustainable forestry practices, use of recycled materials, an increase in energy efficiency, the reuse of existing or historic structures, the manufacturing of sustainable products, and the implementation of “green” building materials and concepts.

New Markets Tax Credits **Need for a Strategic NMTC Approach**

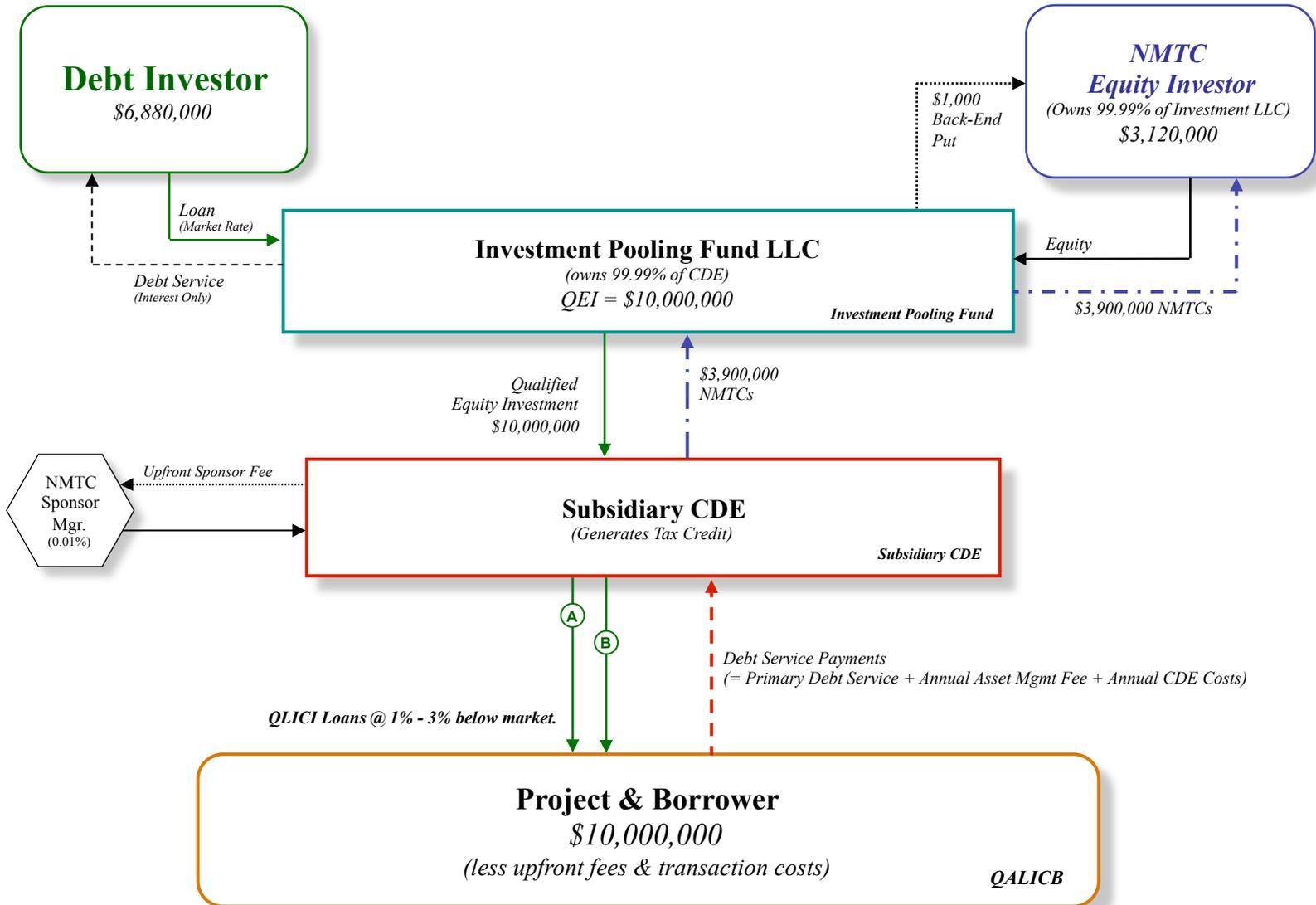
- The demand for NMTCs has grown exponentially as capital markets have recognized the value of the program and sponsors have learned how to more effectively apply the benefits to low-income communities.
- The marketplace has grown increasingly more competitive for developers and businesses seeking NMTCs capacity and for allocatees applying for NMTC authority from the U.S. Treasury Department.

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NMTC Upfront Dollars Calculation

Allocation	\$10,000,000
NMTC %	39%
NMTCs Generated	\$3,900,000
NMTC Pricing	\$0.80
Gross \$ Generated	\$3,120,000
~Front-End Net \$ %	75%
Net \$ Generated	\$2,340,000

NMTC Leveraged Deal Structure



New Markets Tax Credits **Need for a Strategic NMTC Approach**

- Many current and prospective NMTC allocatees now bring a strong mission-oriented perspective to underwriting proposed NMTC transactions.
 - An evaluation of a project's eligibility and likelihood of financial success are only the some of the elements that are now usually considered.
- Many NMTC sponsors must now approach each prospective deal more holistically using a “triple bottom-line” approach that also takes into account a project's beneficial community and environmental impacts.

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Need for a Strategic NMTC Approach

- Structuring a New Markets Tax Credit transaction can be complex and can involve significant transaction costs for legal expenses, tax opinions, and specialized financial modeling.
- Assistance from NMTC experienced legal, tax, accounting and other professionals can reduce associated transaction expenses and increase the likelihood of successfully closing on a New Markets Tax Credit enhanced financing in a timely manner.

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Need for a Strategic NMTC Approach

- The New Markets Tax Credit sector is very sensitive to its own calendar that has particular allocatee deadlines and milestones relating to the NMTC application process.
- Timing can be a critical factor in approaching a potential NMTC sponsors to help increase the chances finding available allocation for projects.
- Those projects and developers that are able to craft a project's "triple bottom-line" to be most attractive to potential NMTC sponsors and can present complete introductory packages to such sponsors will have the most success in securing New Markets Tax Credit allocation.