PROGRAM SUMMARY

NEW MARKETS TAX CREDITS

PeaksCo LLC

New Markets Tax Credit Financing & Consulting

Real Estate Development Investment & Consulting

Overview

The New Markets Tax Credit (NMTC) program provides an incentive to debt and equity investors in the form of a **39% federal income tax credit** for investing capital into qualified projects in eligible low-income areas primarily designated by census tracts. The NMTC program was established to help attract capital to historically underserved projects and communities.

The NMTC program monetizes federal income tax credits to enhance capital to finance both real estate projects and operating businesses. NMTC tax credits can be also be combined and leveraged with other forms of capital, low-cost financing, guarantees, or other federal and state tax credits (with the exception of Low-Income Housing Tax Credits) to maximize and often catalyze such available enhancements.

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.

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
  - Creates equity in the form of capital that does not need to be refinanced at the end of the seven-year NMTC term.
- A means to create opportunities to innovatively finance projects that otherwise would not be financially viable. 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 (DSCRs) 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.

NEW MARKETS TAX CREDIT PROGRAM BASICS

- The NMTC program was authorized by the U.S. Congress in 2000 and the first NMTC deals closed at the end of 2003. The original Congressional legislation authorized the U.S. Treasury to allow for $15 billion in NMTC tax credit capacity. And through multiple reauthorizations, the program has grown to more than $46 billion in tax credit capacity.
- Prospective NMTC projects are generally eligible if they are in designated low-income areas. On a limited practical basis, IRS rules also allow additional NMTC eligibility in locations based on "Targeted Populations" criteria.
- 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. Most NMTC allocatees 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 some of the elements that are usually initially considered. NMTC sponsors must now approach each deal more holistically using a "triple bottom-line" approach that also takes into account a project's prospects for job-creation, employment retention, essential community services, regional economic development, and environmental sustainability.
- Projects can be undertaken by either for-profit or nonprofit entities.
- The types of projects and businesses eligible to use NMTCs are quite broad. There are, however, some specific prohibitions, such as gambling, golf courses, liquor stores, financial institutions, farming husbandry, businesses dealing primarily with intangible assets, and others.
- The New Markets Tax Credit sector is sensitive to its own calendar that has particular allocatee deadlines and milestones relating to the NMTC application process**.** Strategic timing for approaching potential NMTC sponsors is crucial to increasing the chances finding available allocation for projects. In addition, 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.
- Structuring a New Markets Tax Credit transaction is complex and usually involves 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 closing on a New Markets Tax Credit enhanced financing in a timely manner.

COMPONENTS OF A "MODEL" NMTC PROJECT

☑ Capital requirement of the NMTC-enhanced portion of a project of **$7 million to $50 million**. (A few NMTC allocatees are creating common lending pools that will allow Small and Medium Enterprises (SMEs) to borrow NMTC-subsidized funds in the $500,000 - $3 million range.)

☑ **Strong economic development and/or community impact** (direct or indirect), such as helping to create or retain jobs; acting as the catalyst for larger or additional development or redevelopment, infusing sources of new investment capital into an underserved, low-income area; targeting particularly challenged constituencies for employment training and mentoring; and creating new access to community services such as education, healthcare, child & elder care, and retail services.

☑ **Environmental sustainability and 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, and the implementation of "green" building materials and concepts.

☑ Deal will allow for **"substantially all" (85%) of the capital to stay invested in the project for the entire 7-year tax credit period** (with acceptable refinance risk at the end of this seven years).

STRUCTURAL ELEMENTS OF AN NMTC TRANSACTION

- The NMTC program is very flexible within the boundaries of the eligible geographic areas. Capital can flow to companies as debt, equity or an optimized mix of both. The NMTCs can be used in a "leveraged" capital structure, for instance, so the credits can be used by tax credit investors.

- In an NMTC deal, the capital must flow into a special-purpose financing LLC known as a Certified Development Entity or "CDE" as equity (not debt) to generate the tax credit. The investor(s) owns 99.99% of the CDE. (The New Markets Tax Credit allocatee sponsor typically organizes and manages the CDE and retains a 0.01% membership interest.) The CDE is the conduit that allows the business to access capital on favorable terms and provides the investor(s) with attractive returns that include the use of the tax credits and the mitigation of underlying business risk.

- The 39% New Markets Tax Credits on the amount invested is realized over seven years. The 39% tax credit is allocated so that 5% is available for each of the first three years with 6% available for each of the last four years:

  5% + 5% + 5% + 6% + 6% + 6% + 6% = 39%

- During this period "substantially all" (85%) of the original capital must be available to the borrower and must remain invested. This means that the NMTC investor can receive cash flow (return ***on*** capital), but no return ***of*** capital. For instance, any principal repayments must be held in reserve at the CDE level so as not to violate the "substantially all" test.

- A bank, private equity investor, or other NMTC capital source can invest directly in the CDE or through an upper tier "investment pooling" conduit LLC as a means of leveraging the equity capital.

- In a leveraged transaction, investors can provide the debt, equity, or both. Using this investment structure, the equity investor significantly reduces its project-related risk as its investment and return is realized almost entirely from the tax credits generated. The debt portion of a leveraged NMTC deal can be structured using market rates, as well as other more flexible loan terms that reflect the value of the available tax credits and the NMTC financing rules.

- NMTC "leveraged debt" providers (i.e. banks and others) structure effective security interests in the underlying assets pledged to the CDE and often perform typical bank lending functions. Some loan amortization (i.e. principal repayment made at the borrower level) is sometimes needed and can be achieved without violating the NMTC "substantially all" rule by establishing reserve accounts at the CDE or borrower (reserves which would then be available at the end of the seven years to help mitigate refinance risk). Debt providers still have all of the typical rights and remedies usually associated with making commercial loans as these are established upfront as the NMTC financing structural entities are formed.

- The New Markets Tax Credit allocatee acts as the transaction's sponsoring intermediary and is responsible for obtaining the tax credit investment allocations from the U.S. Government, allocating these credits to the investors, and servicing the investments for the seven-year life of the tax credit financing. Most independent NMTC sponsors collect customary fees using a combination of up-front, management, and back-end fees.

For more information, please contact

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