



New Markets Tax Credits:

A Discussion of Legal & Tax Issues and Best Practices

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What are New Market Tax Credits?

New Markets Tax Credit

- Provided under Section 45D of the Internal Revenue Code
- Designed to incentivize investment in businesses within communities that have traditionally lacked access to financing and capital markets (including rural communities)
- These communities are known as Low Income Communities and must be located in Qualified Census Tracts
- Investments typically take the form of low-interest loans to qualifying projects



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What are New Markets Tax Credits?

- First tax credit program to stimulate **commercial investment** in “**low-income communities**” (LICs)
- The program is administered by the US Department of Treasury through a division called the **CDFI Fund**, in a unique public/private partnership with Community Development Entities (CDEs)
- Program is **very competitive**, with a limited supply of credits



Goals of NMTC Investment

- Create additional economic development in LICs
- Attract and retain skilled workforce
- Bring new goods or services (such as education or healthcare) to LICs
- Drive capital investments to underserved, qualified LICs



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NMTC Alphabet Soup

- QEI – Qualified Equity Investment
- CDE / QCDE – Community Development Entity or Qualified Community Development Entity
- QALICB – Qualified Active Low Income Community Business
- QLICI – Qualified Low Income Community Investment
- NQFP – Non-Qualified Financial Property



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How does the Program work?

Through a competitive process, CDEs are delegated NMTC allocation authority from the CDFI Fund.

CDEs search for qualifying businesses and real estate developments to provide NMTC-subsidized financing, which is also a very competitive process.

CDEs use NMTC allocation authority to attract third party investors and lenders to provide capital to qualifying projects in exchange for the federal tax credits.

The proceeds are used to fund qualifying projects. Typically, these proceeds are structured as low interest rate loans.



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NMTC Basics

- 39% Federal tax credit earned over 7-year compliance period for an investor's qualified equity investment (QEI) into a qualified community development entity (QCDE) that has received an allocation of NMTCs from the CDFI Fund, if substantially all (or 85%) of the QEI is invested through a loan or equity into a qualified active low-income community business (QALICB) within 12-months of the date of the QEI
- Thus, a \$10 million QEI will generate \$3.9 million of NMTCs over the 7-year compliance period.
- Tax Credit Investors typically make their equity investment (the "NMTC Equity") in an "Investment Fund" that is wholly owned by the Tax Credit Investor



QALICB Requirements

QALICBs can be any corporation (including a nonprofit corporation) or partnership if all of the following conditions are satisfied:

- at least fifty percent (50%) of the total gross income of such entity is derived from the active conduct of a “qualified business” within any Low-Income Community;
- a substantial portion (at least forty percent (40%)) of the use of the tangible property of such entity (whether it is owned or leased) is within any Low-Income Community;
- a substantial portion (at least forty percent (40%)) of the services performed for such entity by its employees are performed in any Low-Income Community (or, if the entity has no employees, eighty-five percent (85%) is substituted for forty percent (40%) under clause (ii) above);
- less than five percent (5%) of the average of the aggregate, unadjusted bases of the property of such entity is attributable to “collectibles” (other than collectibles held primarily for a sale to customers in the ordinary course of business); and
- less than five percent (5%) of the average of the aggregate, unadjusted basis of the property of such entity is attributable to “nonqualified financial property” (the “NQFP Test”).



What is a CDE?

Certification by CDFI Fund

- By statute, private for-profit entities with a mission of serving LICs
- Can be formed by governments
- The party that applies to the CDFI Fund for NMTC allocation

Can be affiliates of...

- Governmental agencies
- Banks and other lenders such as CDFIs
- Non-profits and for-profit entities

Roles & Responsibilities

- Have defined geographic service areas
- Evaluate transactions for LIC impact
- Responsible for compliance and management of loan portfolio
- Report to CDFI Fund on their portfolio



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Who are NMTC Investors?

Federal Taxpayers

- Provide Qualified Equity Investments (“QEIs”) to CDEs in return for tax credits to offset Federal Tax liability.

Typically Banks

- Credits have historically been acquired by regulated financial institutions
- Top 20 Banks by asset size acquire majority of the annual credits
- Can be syndicated

Leveraged Funds

- Tax Credit Investments leverage loans from banks or project affiliates in order to ensure adequate investment returns



Others in the Room?

Sponsor

- Originator of the project being financed (QALICB likely SPE)
- Makes the leverage loan to the fund
- Leads compliance for the project

Source Lender

- Finance source of leverage for the Sponsor
- Could be secured by other property, charitable
- May include other financing programs (USDA Guarantee, etc.)
- Can have participants

Consultants

- Market projects
- Support project preparation for closing
- Support project teams through compliance



Sources of Leverage

- Pre-Incurred Costs (24-month look back)
- Equity in the project (land value)
- Loan financing
 - Secured by other property, charitable pledges, other assets, etc.
 - USDA guarantees
 - Tax-exempt bonds
- Twinning with other funding programs (C-PACE, LIHTC, etc.)



Project Impact



NMTC proceeds provide gap financing for up to **15-20% of project costs**



Paired (or “leveraged”) with owner equity, borrowed funds, or other grant/public funds (70-75%)



Project benefits include flexible terms, such as:

- Subordination to other lenders
- Low interest rate
- Interest-only terms for 7 years
- A portion of the NMTC investment may not have to be repaid

Total Project Funding



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The New Market Tax Credit

39%
tax credit

Realized by the
investor over a
seven-year
compliance period

Year	1	2	3	4	5	6	7	Total
Credit	5%	5%	5%	6%	6%	6%	6%	39%



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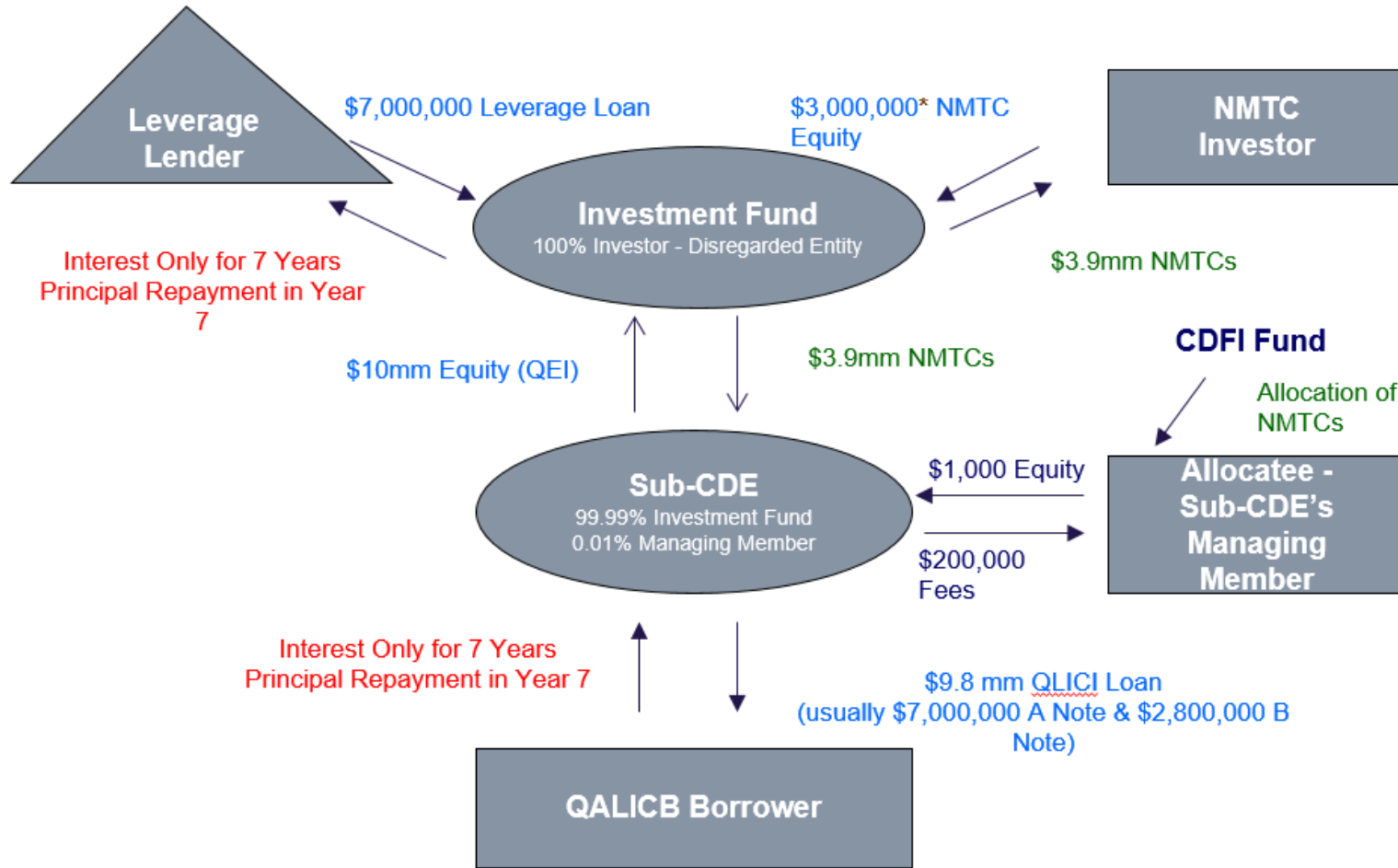
The Math

NMTC Allocation	\$10,000,000
NMTC Rate	39%
Tax Credits	\$3,900,000
Investor Monetization (estimated \$0.75 per credit example)	\$2,925,000
(Less) Estimated Closing Costs & Fees	<u>(\$1,000,000)</u>
Estimated Net NMTC Cash to the Project	\$1,925,000



Sample NMTC Structure Chart

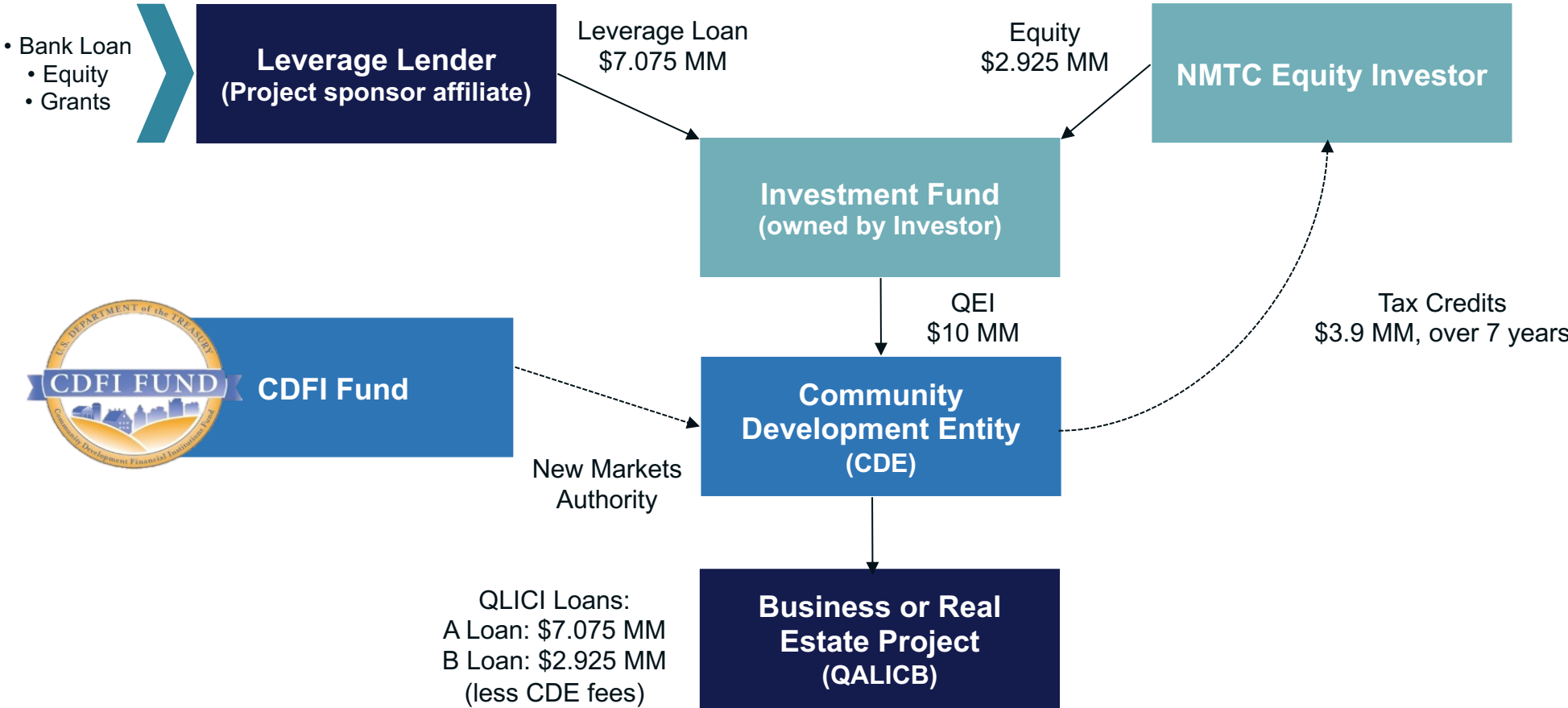
*Not meant to reflect actual pricing; dollar amounts rounded and used for illustrative purposes only.



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Basic New Markets Flow Chart



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Good Projects vs. Ideal Projects

What makes a good NMTC project?

Qualification and determination of the extent of subsidy based on three criteria:

Census Tract



Must be in a NMTC qualified census tract and in an “area of high distress”




Community Impact




Must demonstrate a significant quantifiable community impact (e.g., quality jobs, increased community services, etc.)



But-For



Must demonstrate a need for subsidized funds to bring community impacts to fruition, i.e. non-bankable gap financing, capital constraints



+ TIMING

Project needs to be fully sourced and ready to go before NMTC funding is committed

- Other sources of funds are committed (e.g. borrower equity, bank debt, etc.)
- Approvals in place



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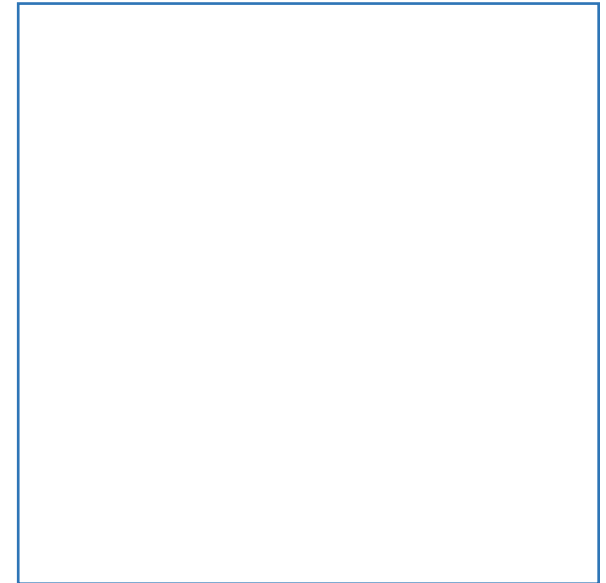
Qualifying Projects



Industrial Manufacturing

- Workforce training initiatives and living wages

Real Estate & Construction



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Qualifying Locations

What is a “LIC”?

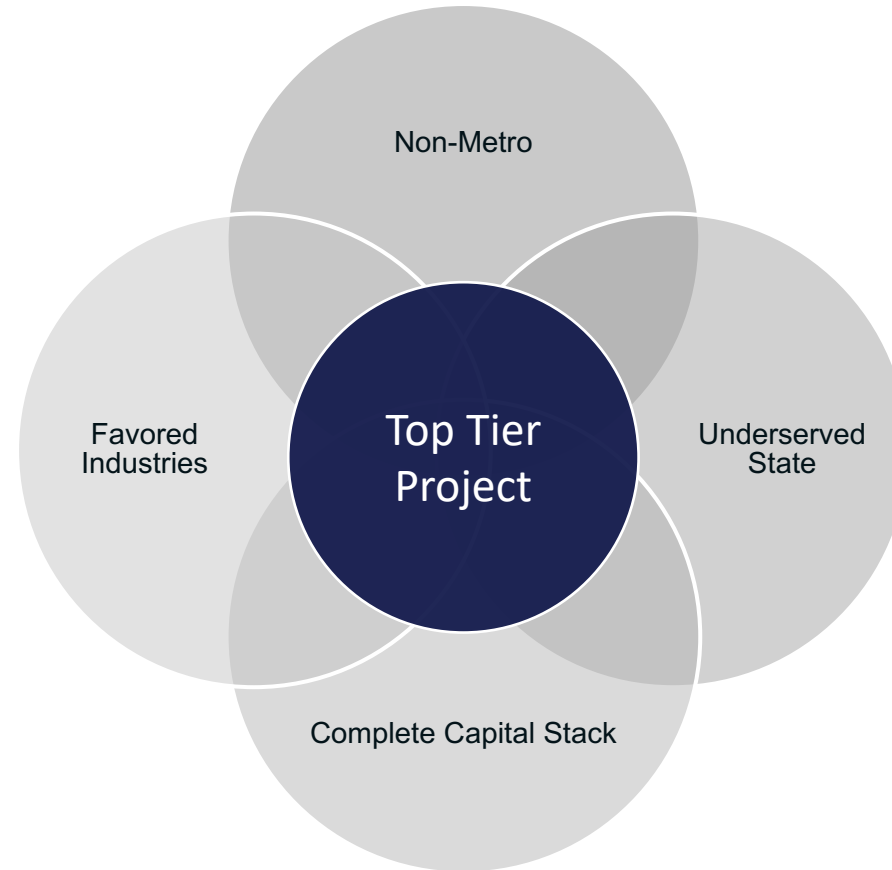
- **Based on 2015 census tract data**
 - Median Family Income < 80%
 - Poverty > 20%
- **Qualifying vs. “High Distress”**
 - **Primary:** Meet one of the following:
 - Poverty > 30%
 - Median Family Income < 60%
 - Unemployment 1.5x Nat’l average
 - Non-Metropolitan County
 - **Secondary:** Meet any two of a list of other characteristics



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What makes an Ideal NMTC project?



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Targeted Geographies

CDE's are incentivized to invest in projects located within two targeted geographies



Non-Metropolitan

Census tracts located in counties not contained in a Metropolitan Statistical Area (MSA)



Underserved States (2021)

- Arizona
- California
- Colorado
- Florida
- Nevada
- North Carolina
- Tennessee
- Texas
- Virginia
- West Virginia



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Project Examples

Red Lake Trading Post

Red Lake, MN



Total Project Cost: \$10,600,000

NMTC Allocation: Travois, inc.

NMTC Investor: PNC Financial Services

Lenders: Native American Bank,
Clearinghouse CDFI, Midwest Minnesota
Community Development Corporation

Community Outcomes:

27,000 square-foot Grocery Store and
retail center

45 construction jobs

20 permanent jobs

Lower-Income Community:

Poverty: 40%

Non-Metropolitan County



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Turtle Mountain Recovery Center

Belcourt, ND



Total Project Cost: \$19,550,000

NMTC Allocation: Bremer Bank and Midwest Minnesota Community Development Corporation

NMTC Investor: Bremer Bank

Lender: Native American Bank

Community Outcomes:

34,000 square-foot care clinic

200 construction jobs

38 permanent jobs (34 new, 4 retained)

Lower-Income Community:

Poverty: 40%

Non-Metropolitan County



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Best Practices of Using Legal Counsel

- Treat as a partner – share your goals
- Engage early in a transaction
- Use Alternative fee arrangements (flat fee, deferred payment, etc.) – set expectations



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Questions?



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