New Markets Tax Credit Program: Frequently Asked Questions

1. **When and why was the New Markets Tax Credit program created?**
   The New Markets Tax Credit ("NMTC") program was created in December 2000 as part of the Community Renewal Tax Relief Act as a means of encouraging investment in low-income urban and rural areas. The program distributes federal tax credits (a dollar for dollar reduction in federal tax liability) to individuals and institutions who invest in business and development projects.

2. **How large is the tax credit?**
   The tax credit investor provides upfront equity to the business or project in return for a total of 39% in tax credits over seven years.

3. **Who governs the program?**
   The NMTC program is administered by the Treasury Department's Community Development Financial Institutions Fund ("CDFI Fund"), which is responsible for overseeing the allocation of NMTCs.

4. **When were the first allocations given out and how many allocations have been awarded?**
   Since the first round of allocations in 2001-2002, the CDFI Fund has awarded $40 billion of allocations over eleven rounds.

5. **When will the next allocation of NMTCs be awarded?**
   The recipients of the next NMTC allocation will be announced in Spring 2015.

6. **How does the CDFI Fund decide who gets NMTCs?**
   The CDFI Fund staff and a group of external experts review the applications and score them based on community impact, business strategy, capitalization strategy, and management capacity.

   The applicants can receive scores of up to 25 points in each of those four areas and up to 10 additional "priority points" for demonstrating a track record of successfully investing in low-income communities. The Trust's strong track record of investing will be considered in its capacity as the controlling entity of the CDE. After being scored, the applicants are ranked and NMTC allocation awards are made in descending order to the highest aggregate scores to applicants that met minimum thresholds in each of the four areas.

7. **How long does a CDE have to spend the NMTCs?**
   A CDE’s allocation must be spent within five years or the allocation risk being recaptured by the CDFI Fund.

8. **What makes a project eligible to receive NMTCs?**
   The basic NMTC qualifying status requires that the project being financed must be in a low income community, defined as having either a poverty rate of 20% or greater or family income of less than or equal to 80% of the median (using the 2000 Census data). A project can also be eligible if 60% of the individuals benefiting have income below 80% of the median.

9. **Who can create a CDE?**
   Non-profits, community development organizations, investment companies, banks, government agencies and other entities that serve low income communities or persons can create CDEs and become eligible to receive NMTCs.

10. **Once a CDE has been created, is it eligible to apply for NMTC that year?**
    Yes. The CDFI Fund mandates that any prospective CDE must postmark its CDE certification application roughly one month before the application for NMTC allocations is due. The CDE then becomes eligible to apply for NMTCs.

11. **Does it matter if the CDE is a non-profit or for-profit?**
    Yes, a CDE must be a for-profit entity whose mission is “serving, or providing investment capital for low-income communities or low-income persons, and that at least 60 percent of its activities (e.g., loans and investments) are targeted to low-income communities or persons.”

12. **What documentation does the applicant CDE have to provide to the CDFI Fund when submitting its application?**
    When the CDE applies to the CDFI fund for certification it must provide establishing documents filed with the state of its incorporation (it can be a corporation, limited liability corporation or other structure), organizational documents indicating its primary mission, and information about the region where the CDE intends to conduct business, which can be local, statewide, multistate, or nationwide.

13. **Is an advisory board necessary? If so, what are its requirements?**
    Yes, CDE certification requires that the CDE have an advisory board and/or a board of directors. If a CDE has both, then the advisory board must demonstrate that at least 20% of its governing board or advisory board(s) is representative of a cross-section of low income communities within the state(s) that it serves. In the event that the CDE has a multi-state or national service area, it may need to select board members that are from organizations that represent the interests of a cross-section of low income communities (e.g., a state-wide organization or nationwide non-profit community development organization).

14. Who qualifies as a representative of a low income community?

Qualification as a representative requires either residence in the applicant CDE's service area or representation of the interests of residents of low income communities in the service area. Examples of the latter include:

- A small business owner whose business is located in a low income community and provides goods and services to community residents or principally employs low income community residents;
- An employee or board member of a community-based or charitable organization principally serving the low income community;
- A religious leader whose congregation is based in a low income community;
- An employee of a governmental agency or department that principally serves low income communities; and
- An elected official whose constituency is comprised principally of residents of low income communities.

15. What information does the CDFI Fund want to know in the application for an allocation?

Additional critical pieces of information about the CDE's intended scope of work are given to the CDFI Fund in the actual application for an allocation of NMTC. This includes what type of projects a CDE intends to finance, a pipeline of proposed projects and a detailed background on the experience of the staff and the CDE's controlling entity.

16. What type of projects can be financed with NMTCs?

CDEs must tell the CDFI Fund what types of projects they are interested in financing. CDEs select as many as apply from the following categories.

- Business financing
- Financing of other CDEs
- Financial counseling and other services
- Loan purchase from other CDEs
- Real estate financing: (one accompanying sub-category)
  - Retail
  - Office Space
  - Industrial/Manufacturing
  - For-sale housing
  - Community Facilities
  - Mixed-use (housing, commercial, or retail)
  - Hospitality/Tourism

17. What is the structure of a project using NMTCs?

A typical deal involves the CDE securing both a leverage lender and an equity partner for the project. However, the leverage loan is not essential to the issuance of the NMTC. The structure used by CDEs to complete a transaction with leverage loans is as follows. Using a $10 million investment as an example, the leverage lender makes an $8 million loan and the equity partner provides $2 million. The two sources of financing are combined in an "investment fund" that in turn makes the qualified equity investment into an eligible project. The equity partner is then eligible to receive a total of 39% in tax credits from the CDE over the following seven years. The amount of the credit is based on the amount of the entire qualified equity investment, $10 million in this example, minus CDE fees, rather than only on the $2 million equity investment.

18. **What are the typical fees a CDE can generate from NMTCs and how are they determined?**
    Each CDE sets its fees in its application for NMTC and typically charges between 3 and 5 percent of the qualified equity investment. For CDEs acting as a conduit and helping to pair projects with CDEs that have allocations, fees range between 1 and 1.5 percent.

19. **After the financing for a project is completed, does the CDE have any other responsibilities?**
    Yes, once a deal has been completed, the CDE has several critical on-going responsibilities. They include filing annual reports with the CDFI Fund on behalf of each project to maintain compliance with the NMTC program for a seven year period and overseeing annual audits of each project as well as an audit of the CDE itself. Failure to remain in compliance with the NMTC program could result in a recapture of the tax credits.

20. **What happens to the capital if the project is paid off before the seven years or defaults?**
    In the event that a project is paid off early or defaults, the CDE must place the recovered funds into another qualifying project within 12 months for the remainder of the seven year period. Otherwise, the NMTC investor is subject to recapture of its tax credits by the CDFI Fund. Recapture requires repayment of all credits used by the investor with interest and a cessation of any future credits.

21. **Can NMTCs be combined with other tax credits?**
    Yes, the most common tax credits packaged with the NMTC are state and local tax abatements, Historic Rehabilitation Tax Credits, Empowerment Zone and Enterprise Community funding, Brownfield tax incentives, and the Historic Rehabilitation Easement Deduction. Real estate projects receiving NMTCs are more than twice as likely to receive additional public funding as non-real estate projects. Moreover, the median funding from public sources other than the NMTCs is about four times as great as the median for non-real estate projects.

22. **Is the NMTC program experiencing the same or similar problems as the LIHTC program?**
    No, the NMTC program is currently thriving due to the availability of equity investors willing to fund NMTC projects since both corporations and high-income individuals are eligible to use the credits against federal taxes.

23. Can NMTCs be used in conjunction with HUD Programs?

Yes. In response to the demand for increased use of NMTCs in affordable housing, in March 2008 HUD amended regulations to allow for the use of NMTCs as well as Historic Tax Credits for three of Federal Housing Administration's programs, Sections 220 (rental housing in urban renewal areas including mixed-use containing commercial/retail), 221(d)(4) (multifamily construction/substantial rehabilitation) and 231 (rental housing construction/rehabilitation for the elderly and disabled).

Of the FHA programs approved for use with NMTCs, Section 220 looks to be the most viable option due to the similarities of permitted commercial income and the required commercial income under the NMTC program. It should be noted that HUD approval will be granted on a case by case basis and that the commercial FHA limits are not statutory and HUD may approve exemptions for good cause.

24. Can a loan be used to leverage NMTCs?

Yes. Although the original NMTC legislation did not specify that a qualified equity investment could include cash from a loan to the investment partnership as well as equity, a 2003 IRS revenue ruling allowed the inclusion of cash from a nonrecourse loan that was secured only by the partnership interest in the CDE to qualify as part of the qualified equity investment.

25. Can a <u>secured</u> loan be used to leverage NMTCs?

Currently, the above referenced ruling has been interpreted by practitioners to mean that loans secured by real estate or mortgage backed securities ("MBS") as opposed to those secured solely by partnership interests in the CDE did not meet this criteria and therefore are not eligible to qualify for NMTCs. This results in higher interest rates on leverage loans and fewer lenders for NMTC transactions. In the current market with its lack of lending, this has become an even more significant issue as it limits the usefulness of NMTCs in enabling affordable housing transactions.