New Markets Tax Credits

Illinois Housing Council
Annual Meeting and Conference
February 26, 2009

Debbie Kleban – Applegate & Thorne-Thomsen
Tony Smith – S.B. Friedman & Company
Kirk Taylor – Reznick Group, P.C.
New Markets Tax Credits

• Created in 2000 as part of Community Renewal Tax Relief Act
• Companion program to Low-Income Housing Tax Credit
• Administered by CDFI Fund division of US Treasury
• Primarily support industrial, community facility, and commercial development in qualifying Census tracts
• Can also support direct loans/equity investments to operating businesses
### Federal Authorization

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>$2.5 billion</td>
</tr>
<tr>
<td>2003-04</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>2005</td>
<td>$2 billion</td>
</tr>
<tr>
<td>2006</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>2007</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>2008</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>2009</td>
<td>$3.5 billion</td>
</tr>
</tbody>
</table>

- Additional Approved Allocation for 2008 and 2009 per Stimulus Bill: $3 billion
New Markets Tax Credits (con’t)

• 7-year stream of federal income tax credit benefits triggered by the flow of debt or equity capital through a “CDE”

• Increase access to and/or lower cost of capital (e.g., lower interest rates, partial loan forgiveness, etc.)

• Awarded on a competitive national basis to CDEs
CDFI Fund (US Treasury) allocates NMTCs to Community Development Entity (CDE), which is controlled by various entities:
- Banks and other private investors
- Government entities
- Non-profits

Investors include banks, other private investors, government entities, non-profits, real estate projects, and operating businesses.

"QEI" (Qualifying Entity) provides capital and NMTC benefits to the CDE.

"QLICI" (Qualified Lender/Investor) offers below-market capital to the Qualifying Project/Business (QALICB).

QALICB includes:
- Real estate projects
- Operating businesses
What is a CDE?

• Community Development Entity, certified by CDFI Fund (division of US Treasury)

• Domestic corporation or partnership
  – For-profit or non-profit
  – Controlled by private, non-profit, or government organizations

• Intermediary vehicle for the provision of loans or other investments in “Low-Income Communities” (LICs)

• CDEs are required to demonstrate that they:
  – Have a primary mission of serving LICs and/or Low-Income Persons
  – Are accountable to residents of the LICs that they serve
Who has NMTC Allocations?

• Competitively allocated at federal level
• Strong competition for the credit—demand exceeds supply by about 10 to 1
• In 2008 round, 239 CDEs applied for credits and 70 received an allocation
• Average allocation award per CDE is $50 million
• Banks are the dominant recipients of credit to-date
• City and state agencies
• Non-profits
NMTC Investors

• Type of Investors:
  – Banks/Financial Institutions (e.g., US Bank, JPMorgan Chase, Capmark, Bank of America)
  – Corporations (e.g., Target)

• With proper structuring, Investor can also play other roles in the transaction (lender, CDE, borrower)

• Credit begins to flow when investor makes the Qualified Equity Investment (QEI)
What is the Tax Credit Benefit?

For investment (QEi) of $1.00, investor would receive a 7-year federal income tax credit of:

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.05</td>
<td>$0.05</td>
<td>$0.05</td>
<td>$0.06</td>
<td>$0.06</td>
<td>$0.06</td>
<td>$0.06</td>
</tr>
</tbody>
</table>

TOTAL VALUE OVER 7 YEARS = $0.39

- Up-Front Discounted Value: Generally $0.25 to $0.30
- Above example consumes $1 of “Allocation”
- Investment must remain in place for 7 years minimum
Allowable Uses of NMTC Financing

- Must be provided to a Qualified Active Low-Income Community Business (QALICB)
- Debt, Equity, or “hybrid” financings
- Commercial, industrial, institutional, not-for-profit projects
- For-sale housing (challenging timing issues)
- Mixed-use project (provided rental housing is <80% of income stream)
- Operating businesses
Qualified Low-Income Community Investments (QLICIs)

- Capital provided by a CDE to a “Qualified Active Low-Income Community Business” (QALICB or “Qualifying Project”)
- Generally have term of 7 years
- Debt or equity with better-than-market terms
- Potential for partial forgiveness by CDE at end of Year 7
Areas of Eligibility in City of Chicago
Sample Structure

Lender

7-Year Loan ($7MM)

$3MM Equity Investment

Investment Fund

$10MM QEI

CDE

$9.5MM QLICI

7-Year Mini-Perm Loan @ Low Blended Rate ($9.5MM)

QALICB (Project)

• $500k in CDE fees and other transaction costs (placeholder amt)

NMTC Investor

Tax Credit Benefits ($3.9 MM over 7 Yrs)

$3MM Equity Investment
Year 7 Unwind

Lender

Principal Repayment ($7MM)

Investment Fund

CDE

Principal Repayment ($7MM)

QALICB (Project)

Remaining $2.5MM can be forgiven or restructured

NMTC Investor

Return on and of capital provided via tax credits
Sample “Non-Economic” Deal

- **Charitable Donations**: $5MM Loan
- **Government Grant**: $2MM Loan
- **NMTC Investor**: $3MM Equity
- **Investment Fund**: Tax Credit Benefits ($3.9 MM over 7 Yrs)
- **QLICI**: Nominal Interest Loan ($9.5MM)
- **CDE**: $10MM
- **QLICI** benefits:
  - $500k in CDE fees and other transaction costs (placeholder amt)

**QALICB (Project)***
Year 7 Unwind

- Charitable Donations
  - No Repayment Needed - Loans Can be Forgiven
- Government Grant
- NMTC Investor
  - Return on and of capital provided via tax credits
- CDE
- Loan Can be Forgiven ($9.5MM)
- QALICB (Project)
NMTC Structure with For Sale Housing

- **Lender**
  - 7-Year Loan ($7MM)
  - $3MM Equity Investment

- **Investment Fund**
  - $10MM QEI

- **CDE**
  - Construction Loan Disbursements
  - $9.5MM Revolver
  - Principal Payments w/Sales Proceeds

- **Home Builder (QALICB)**
  - Construction
  - Home In QCT

- **NMTC Investor**
  - Tax Credit Benefits ($3.9 MM over 7 Yrs)

- **Home In QCT**
  - Sales Proceeds

**Notes:**
- Principal must stay at CDE level or below for 7-year NMTC compliance period
- CDE must re-deploy repaid principal within 1 year
Use of Condo Structure to Combine LIHTC & NMTC

• With careful structuring, can create mixed-use building with a NMTC financed transaction:
  – NMTC-financed commercial/community facility transaction on lower floors
  – LIHTC financed affordable rental transaction on upper floors
• Requires division of ownership between the 2 deals within the same building
How Deals are Assembled

- Project Sponsor identifies a CDE (or Investor) and submits project proposal
- CDEs have differing geographic service areas and targeted project types
- CDE typically will assist in identifying the Investor or vice versa
- Possible to have multiple CDEs for larger projects, but it will drive up transaction costs
- Find out CDE and Investor fees up-front. Average fees for 2008 allocatees were 6.75% for for-profit allocatees and 7.25% for non-profit allocatees
- Expect Investors to be looking for IRR at 7-9% on non-profit deals and 8.5-10% on for-profit deals
- $4MM or larger transactions with high community impact are most attractive to CDEs and Investors
New Illinois NMTC

- Signed into law 12/31/08
- Administered by Dept. of Commerce and Economic Opportunity (DCEO)
- Limit allocations to amount that will result in max of $10M of tax credits in any fiscal year
- First-come, first-serve application for allocation, but once received, must close on QEI
- Follows Federal program with a couple of exceptions:
  - Excludes businesses that derive 15% or more of annual revenue from rental or for-sale real estate (carve-out for sponsor lease so long as sponsor passes test)
  - 7-year credit percentages are different split
  - QEI can be debt or equity
  - Max QLICI to any one entity and its affiliates is $10MM
- Small and shallow state credit
What is the State Tax Credit Benefit?

For investment (QEI) of $1.00, investor would receive a 7-year Illinois income tax credit of:

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.07</td>
<td>$0.08</td>
<td>$0.08</td>
<td>$0.08</td>
<td>$0.08</td>
</tr>
</tbody>
</table>

TOTAL VALUE OVER 7 YEARS = $0.39

- Above example consumes $1 of “Allocation”
- QEI for federal purposes can also be considered QEI for state NMTC purposes
Q&A

Debra A. Kleban
Applegate & Thorne-Thomsen, P.C.
322 S. Green Street, Suite 400
Chicago, IL 60607
(312) 491-3323
dkleban@att-law.com

Tony Q. Smith, AICP
S. B. Friedman & Company
221 N LaSalle, Suite 820
Chicago, IL 60601
(312) 424-4254
tsmith@friedmanco.com

Kirk P. Taylor, CPA
Reznick Group, P.C.
4711 W. Golf Road, Suite 200
Skokie, IL 60076
(847) 324-7602
Kirk.Taylor@reznickgroup.com

U.S. Treasury NMTC Information Available at:
www.cdfifund.gov