

NEW MARKETS TAX CREDIT (NMTC) PROGRAM SUMMARY

Congress created the NMTC program in 2000 to incentivize investments that create jobs and provide services in economically disadvantaged areas. NMTCs can subsidize approximately 20% of a project’s capital needs, usually in the form of low-interest, forgivable debt.

The program is primarily used to fund commercial and industrial developments, community facilities, operating businesses, and mixed-use projects located in qualifying Census tracts. While NMTC can support a wide variety of project types, all projects need to create positive community impacts that can be quantified and documented. NMTCs can also be layered with many different financing sources, such as traditional debt, grants, tax increment financing and Historic Tax Credits.

To benefit from NMTCs, a project must obtain financing from an organization certified as a Community Development Entity (CDE) by the Community Development Financial Institutions (CDFI) Fund. The CDFI Fund, a division of the U.S. Department of Treasury, administers the NMTC program. It allocates tax credits to CDEs, which in turn use the tax credits to provide subsidized financing to projects.

This document provides an overview of how NMTCs work and how it affects the way a project’s financing is structured. A glossary of key program terms is at the end of this document for reference.

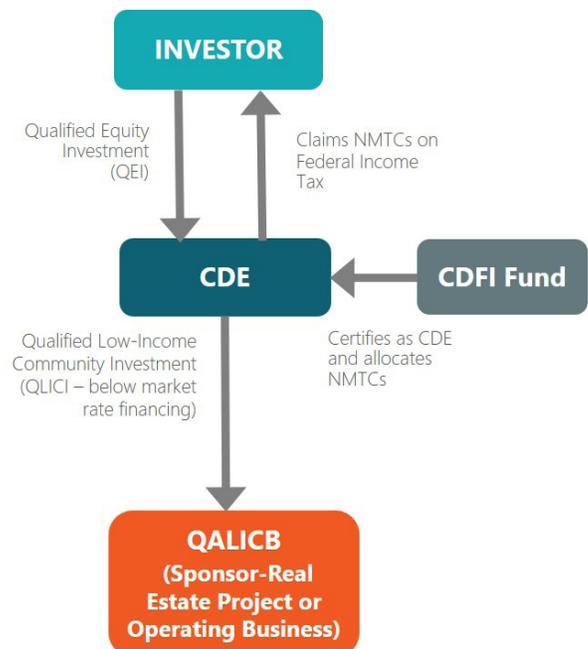
How it Works

CDEs use NMTCs to provide subsidized financing for qualifying businesses or real estate projects. Projects must meet the Federal definition of a Qualified Active Low-Income Community Business (QALICB) to be eligible for NMTC financing. QALICBs are businesses that are located in, or provide services to, Low-Income Communities.

CDEs obtain funds to invest in QALICBs through private investors. The NMTC program provides these investors with federal income tax credits based on equity investments made in CDEs. This investment is known as a Qualified Equity Investment (QEI). Investors receive a tax credit for 39% of a QEI, which is claimed over a seven-year schedule. A QEI must be fully invested in a CDE for seven years in order for an investor to meet NMTC compliance requirements.

In most cases, a QEI is linked to a specific project. Therefore, the amount of subsidy a project can receive is dependent upon the size and cost of the project itself. CDEs must use the proceeds of a QEI to provide below-market rate equity or debt capital to qualifying businesses or real estate projects. The capital that a CDE provides to a qualifying project is known as a Qualified Low-Income Community Investment (QLICI – below market rate financing). CDEs typically structure QLICIs as seven-year, interest-only loans in order to mirror the NMTC compliance period for QEIs. To finance a project with NMTCs, a CDE must first be certified by the CDFI Fund as a valid CDE, and must then obtain NMTC

allocations from the fund through a competitive application process. After a CDE receives NMTC allocations, it can sell these tax credits to an investor to generate subsidy for the project. The chart below outlines the basic flow of funds for NMTCs.



Value of the Tax Credit

Investors claim NMTCs on their federal income tax returns over seven years, totaling 39% of the amount invested as a QEI. Investors claim tax credits on the following schedule:

Year	YR 1-3	YR 4-7	Total
Tax Credit as Percent of Investment (QEI) Amount	5%	6%	39%

Based on this formula, an investor providing \$1 to a CDE in the form of a QEI would receive tax relief benefits of \$0.05 in each of Years 1 through 3, and \$0.06 in each of Years 4 through 7, for a total of \$0.39 of benefits. In this example, \$1 of the CDE's NMTC Allocation would be expended.

Because the tax relief is phased in over a seven-year period, investors typically apply a discount factor when determining how much up-front cash they are willing to provide to the CDE in exchange for the \$0.39 of benefits. Investors typically quote tax credit pricing as the amount of up-front equity they will pay in to the deal per \$1 of total tax benefit they will be able to claim over the 7-year NMTC credit/compliance period. For example, if an investor pays \$0.80 per \$1 of tax benefit, this translates into \$0.31 per \$1 of total QEI invested ($\$0.80 \times 39\%$). Investors have historically paid between \$0.70 and \$0.85 per \$1 of NMTC benefit, with recent pricing clustering around \$0.83. Investors pay discounted rates of less than \$1 for the NMTC benefit because the investor equity is provided up-front while the NMTC benefit is spread over the 7-year compliance period.

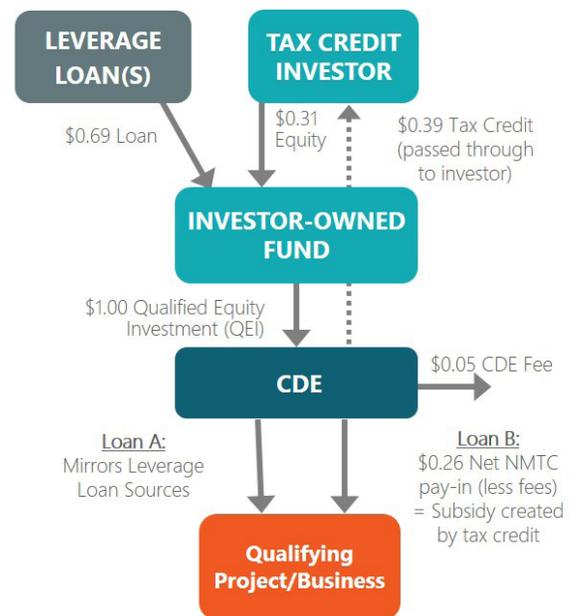
The NMTC structure differs from that of many other federal tax credits because the NMTC investor indirectly finances a project through the CDE. Typically, with programs such as the Low-Income Housing Tax Credit or the Historic Tax Credit, the investor receives a tax benefit for investing directly in a project. In NMTCs, the tax credit investor invests money with the CDE, not the project. The CDE in turn provides below-market financing to the project, but does not usually invest directly in the project. The CDE is essentially a mission-driven financial intermediary.

Basic Transaction Structure: The Leverage Model

In many cases, the investor buying the New Markets Tax Credit only wishes to make a tax investment, not provide the entire financing package for the project. Since the tax credit investor only provides \$0.31 of each \$1 of QEI in the example above, the remaining \$0.69 must come from other sources. The NMTC frequently industry uses the "leverage model," illustrated below, to combine these multiple financing sources into a single QEI.

In the leverage model, the tax credit investor creates an investment fund to pool tax credit equity with other financing

sources. These other sources put capital to the investment fund as debt so that the tax credit investor maintains ownership of the fund and can claim 100% of the tax credits. The loan to the investment fund is known as a leverage loan. In many cases, the leverage loan is a traditional commercial loan based on the project's underlying economics. In other cases, the original source of a leverage loan comes from the project sponsor itself or other non-bank sources such as grants, donations, tax increment financing (TIF), HUD 108 loans, etc. Depending on the nature and credit-worthiness of the project, the project sponsor is often primarily responsible for arranging the sources to fund the leverage loan.



When the project pays debt service on the QLICI loan to the CDE, the CDE passes this cash up the structure to the investment fund as income. The investment fund uses this income to pay debt service to the leverage lender. The tax credit investor's return typically comes solely from claiming the tax credit on its federal income tax return. In this case, the investment fund does not pay the tax credit investor any return through the structure, nor does the \$0.31 equity need to be repaid.

CDEs often structure QLICI loans in two pieces, to mirror the leverage loan and the NMTC equity layers at the investment fund level. The A Loan mirrors the leverage loan, while the B Loan mirrors the tax credit equity net of fees. The B Loan is often sold to the project sponsor for a nominal amount after the seven year NMTC compliance period, thus converting the NMTC equity into a permanent subsidy to the project. This net subsidy is generally about 20% of the total financing amount.

Obtaining NMTC Financing for Projects

Obtaining NMTC financing for a project can be competitive. Because they must regularly re-apply to the CDFI Fund for NMTC allocations, CDEs finance projects that best meet the goals of the NMTC program — providing real, measurable benefits to Low-Income Communities — not just projects that meet the program's requirements. Qualifying as a QALICB does not guarantee that a project will receive NMTC financing.

High-impact projects will generate the most interest from CDEs and the best pricing from tax credit investors. These projects tend to:

1. Create a large number of jobs, or create high quality jobs;
2. Provide needed goods or services to Low-Income Communities;
3. Foster minority business ownership;
4. Create environmentally sustainable outcomes; and/or
5. Promote other related impacts

Job training centers, community health clinics, green commercial buildings and grocery stores in underserved areas are examples of high-impact projects that receive NMTC financing.

CDEs will also consider projects high-impact if they are located in, or serve, areas that meet the criteria for Targeted Distressed Communities. These are typically areas that show particularly strong signs of economic distress, such as extraordinarily high poverty rates, very low income levels and high unemployment rates. Qualifying Census tracts in rural areas (tracts that are located in a county not within in an MSA) are also considered Targeted Distressed Communities.

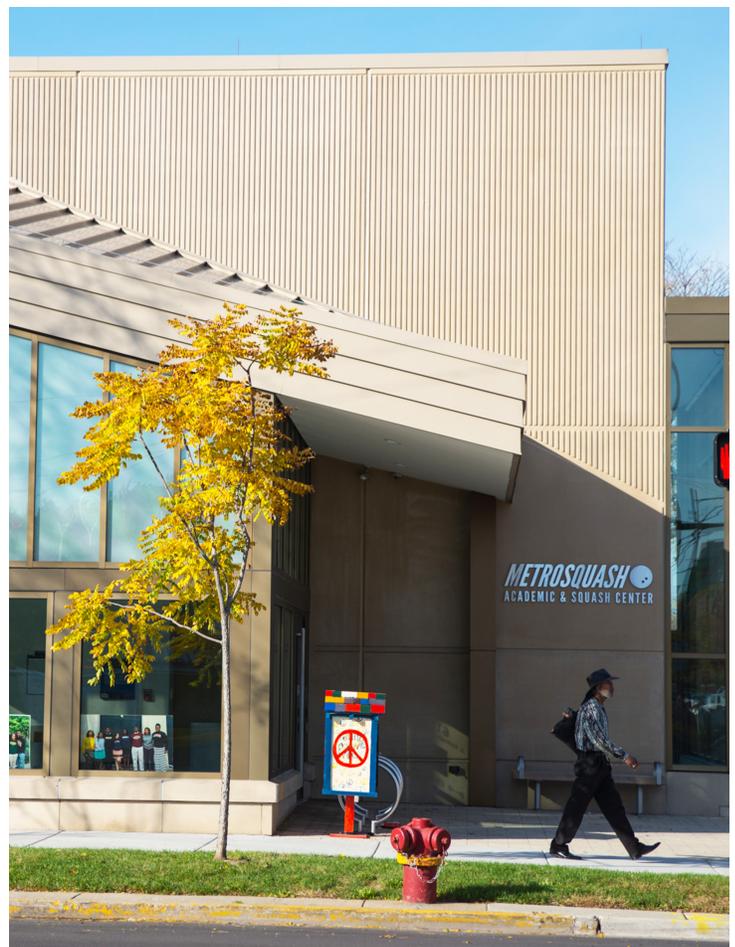
In addition, many CDEs only finance projects that have a demonstrated need or financing gap that NMTCs can fill.

Additional Resources:

CDFI Fund – www.cdfifund.gov

NMTC Mapping – http://www.novoco.com/new_markets/resources/maps_data.php

For more information, please contact: Tony Smith at **(312) 424-4254** or tsmith@sbfriedman.com or Ryan Hagerty at **(312) 424-4258** or rhagerty@sbfriedman.com



NMTC GLOSSARY

Community Development Financial Institutions (CDFI) Fund: A division of the U.S. Treasury Department. The CDFI Fund administers the federal NMTC program, and awards NMTC allocations to CDEs on a competitive basis.

Community Development Entity (CDE): Entity certified by the CDFI fund as eligible to receive an allocation of New Markets Tax Credits. A CDE acts as an intermediary for providing loans, investments and/or financial counseling in Low-Income Communities (LICs). CDEs must have a primary mission of serving or providing investment capital for LICs or Low-Income Persons. They must also maintain accountability to residents of the LICs that they serve.

Leverage Loan: A loan to an investment fund which is combined with an investor's equity to make up a QEI. A leverage loan may originate from different sources, such as grants, TIF, bond proceeds or traditional commercial debt. In addition, multiple sources can be packaged together to create one or more leverage loans.

Low-Income Community (LIC): Generally, Census tracts with a poverty rate of at least 20 percent or a median family income at or below 80 percent of the area median.

Targeted Distressed Communities: LICs that show particularly high levels of poverty or economic distress. Targeted Distressed Communities generally must have poverty rates of at least 30 percent, a median family income below 60% of the area median, or have unemployment rates 1.5 times the national average. Other criteria can also be used to qualify a project as being in a Targeted Distressed Community, such as being located in a TIF district, being a brownfield site, or being located in a county that is not contained within a Metropolitan Statistical Area (MSA) as of the most recent Census.

Qualified Active Low-Income Community Business (QALICB): Businesses that are eligible to receive assistance through the NMTC program. A QALICB must meet several tests confirming that the majority of its activities take place in, or that it serves primarily residents of, a Low-Income Community.

Qualified Equity Investment (QEI): Any cash investment in a for-profit CDE that triggers the flow of New Markets Tax Credits benefits to the investor. The QEI must remain invested in the CDE for seven years to maintain program compliance.

Qualified Low-Income Community Investment (QLICI): Loan and/or investment provided by a CDE to a QALICB or to another CDE. Typically takes the form of debt or equity that carries below-market interest rates and/or return expectations.

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