

The New Markets Tax Credit – An Overview

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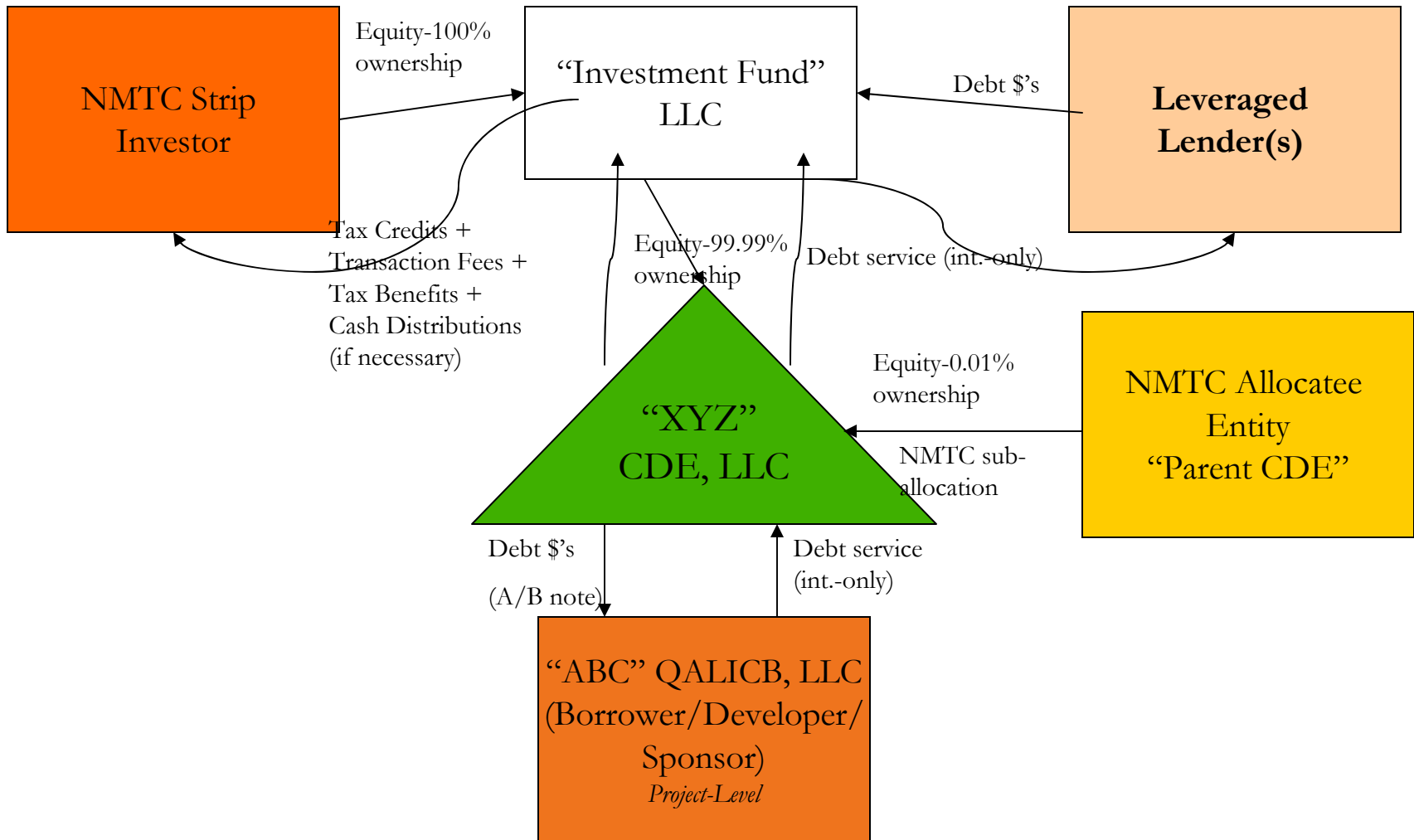
NMTC Discussion Outline

- **Program Background**
- **Sample NMTC Leveraged Structure**
- **NMTC “Role Players”**
- **Developer Benefits**
- **Developer Risks**
- **How to Attract the Parties to Your Deal**

New Markets Tax Credit

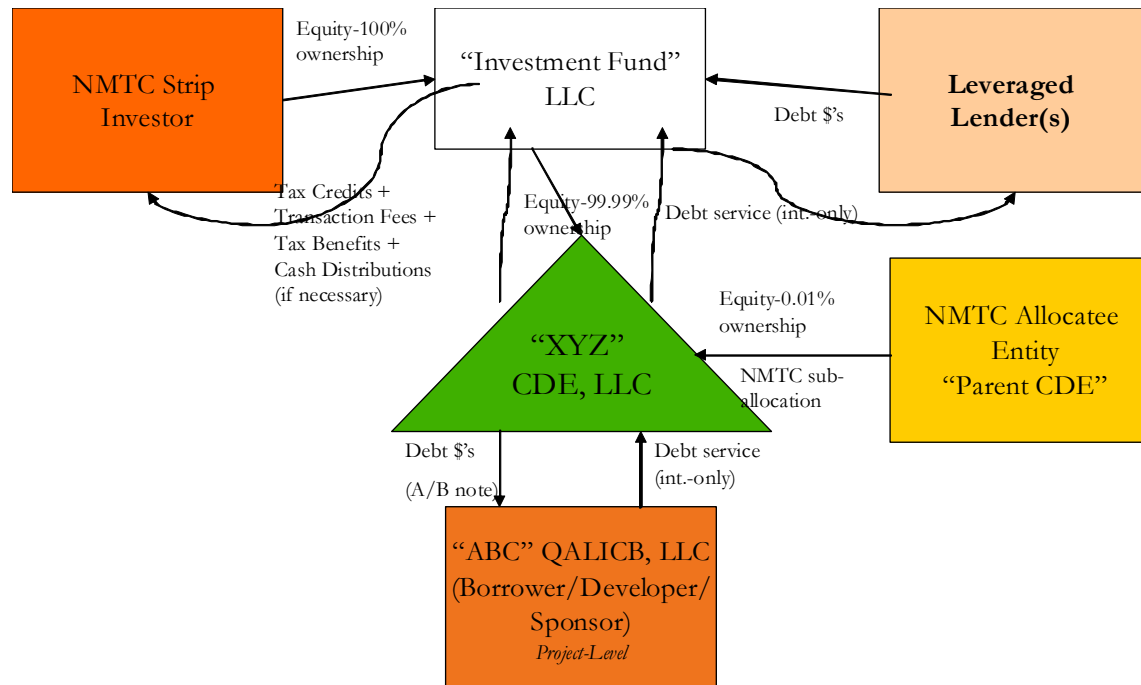
- The NMTC Program permits taxpayers to receive a credit against Federal income taxes for making Qualified Equity Investments “QEIs” in designated Community Development Entities “CDEs”, who in turn finance businesses and real estate developments located in low and moderate-income census tracts.
- The tax credit is equal to 39% of the QEI made in a CDE. The credit is earned over 7 years; 5% for the first 3 years, 6% for the remaining 4 years.
- Administered by the US Treasury’s Community Development Financial Institutions Fund (“CDFI Fund”).
- Most commonly used for commercial and mixed use real estate projects.
- Monetizing (“Leveraging”) the NMTC
 - Can be paired with most public subsidy programs.
 - Can be paired with most other tax credit programs EXCEPT the Low Income Housing Tax Credit.
 - Works particularly well with the federal historic tax credit program.

Leveraged Model-NMTC Strip Equity



NMTC Key Role Players

- NMTC Allocatee
- NMTC Strip Investor(s)
- Leveraged Lender(s)
- Borrower/Developer/Sponsor



Developer Benefits

- **Lower debt loads**
- **Improved LTV reduces refinance risk**
- **Improved debt service coverage deepens developer return**
- **Approximately 25% of traditional debt can be provided in net NMTC subsidy**
 - Additional NMTC subsidy available when leveraging other subsidy sources
- **Potential for improved occupancy via reduced rents**
- **Can eliminate need to attract additional subsidy or additional traditional investors**

Developer Risks

- **Indemnifications/Guarantees**

- Standard negotiated loan guarantees – negotiated with leveraged lender
- Put/Exit Payments to Investor (typically 5%-7% of equity amount)
- Investor recapture caused by loss of “QALICB” Status:
 - EXCLUDED BUSINESSES (runs to tenants as well as QALICBs):
 - Golf course, country club, massage parlor, hot tub or suntan facility, racetracks or gambling, liquor stores, farming
 - 80/20 Rental Housing Test
 - Non-Qualified Financial Property Test
 - Active Conduct of a Trade or Business Test
 - Gross Income Test
 - Tangible Property/Services Performed/Collectibles Tests
 - Substantial Improvement Test
 - Bankruptcy of QALICB is **NOT** a recapture event

- **Execution Risk**

- Is there an easier way to get your deal done?
- Consider opportunity costs
- Soft cost budget

Attracting NMTC “Role Players” – the Investor

- **Current NMTC Market Pricing = \$0.65 - \$0.69 per credit**
- **Price Per Credit =**
 - NMTC Strip Equity Amount / Aggregate NMTCs
 - Aggregate NMTCs = QEI Amount * 39%
- **Factors to Determine NMTC Equity Pricing**
 - Solve for target yield (typically IRR/cash-on-cash including credits, put & passive losses)
 - Timing of equity pay-in (typically front-loaded)
 - Investor’s expected need for tax credits
 - Level of complication of transaction – how difficult will it be to execute the deal?
 - Relative risk of benefits available through put/exit payments
 - Level of compliance risk – degree of asset management effort required
 - CDE Status/Compliance
 - Substantially All Test
 - QALICB Status/Compliance
 - 80/20 Rental Housing Test
 - Non-Qualified Financial Property Test
 - CRA need
- **Has the Investor completed prior NMTC transactions with the Allocatee and Leveraged Lender(s)?**

Attracting NMTC “Role Players” – the Allocatee

- **Service Area**
- **Allocatee’s Business Strategy**
- **Positioning for the Allocatee’s next application**
 - The “but-for” test
 - How much of an allocation is needed?
- **Level of asset management effort required**
- **Fee load available**
- **Will your project really close?**
 - *Is your leveraged loan real?*
- **If yes, *WHEN* will your project close?**
 - ...relative to the next application round
 - ...relative to required QEI issuance dates
- **Has the Allocatee completed prior NMTC transactions with the Investor and Leveraged Lender(s)?**

Attracting NMTC “Role Players” – the Leveraged Lender(s)

- **7-year issues**
 - term
 - forbearance/subordination to investor
 - loan servicing
 - control of default remedies
- **Indirect Collateral**
- **Strategies:**
 - Find a “friendly” party to the deal
 - Allocatee’s loan fund
 - Investor’s lending department
 - Don’t assume your interested lender knows what they’re getting themselves into
 - Relationship-based lenders
 - CRA-based lenders
- **Other sources of “leveraged loans”**
 - Financial intermediaries
 - Subsidy Programs (e.g.: HUD 108)
 - Developer equity
 - Twinning other tax credit types e.g.: Historic & Energy tax credits)
- **Has the Leveraged Lender(s) completed prior NMTC transactions with the Investor and Allocatee?**

Questions?

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