NEW MARKETS TAX CREDITS
SECTION 45D OF THE INTERNAL REVENUE CODE

FOCUS. VALUE.

SOME TAKE CREDIT. WE TAKE INITIATIVE.

Our approach allows us to anticipate challenges and find creative solutions.
After all, we measure our success by yours.

LAW ELEVATED

NEW MARKETS TAX CREDIT PROGRAM BASICS – SECTION 45D OF THE INTERNAL REVENUE CODE

- The New Markets Tax Credit ("NMTC") Program is administered by the Community Development Financial Institutions Fund (the "CDFI Fund") of the United States Department of the Treasury.
- The NMTC Program is a federal statutory program, created in 2000 and currently extended through 2025, that is designed to encourage capital investment in low-income communities that have had inadequate access to capital. For those who are very technical here, it is codified in Section 45D of the Internal Revenue Code.

NMTC PROGRAM – PROGRAM BASICS

- To attract private investment, the NMTC Program permits institutional investors to receive a credit against federal income taxes for making qualified equity investments (“QEIs”) in CDEs.
- For every dollar invested into the CDE, a 39% federal tax credit is generated over a 7 year period (the “Compliance Period”). You’ll recall that when we talked about the potential forgiveness of the investor equity portion, we alluded to the fact that that comes after the Compliance Period. This 7 year period is what we were referring to.
- The credit rate is 5% in each of the first 3 years and 6% in each of the final four years (of the original investment).
- CDEs use the qualified equity investments to make investments in, or loans to, businesses located in low income areas. The tax credit equity investor does not bear the economic risk of the CDE investment.

**Please note that the project cannot invest in its own federal NMTCs.*

NMTC PROGRAM – MAJOR PLAYERS AND DEFINITIONS

- Federal Investor (purchases the Federal NMTCs)
- Leverage Lender (upper tier lender)
- Investment Fund (conduit to leverage the NMTCs)
- QEI = Qualified Equity Investment
- CDE = Community Development Entity (receives NMTC allocation from CDFI Fund and acts as the project lender)
- QALICB = Qualified Active Low-Income Community Business (project borrower)
- QLICI = Qualified Low-Income Community Investment (project loans)
- Compliance Period = 7-year NMTC Compliance Period
- Federal NMTCs = Federal New Markets Tax Credits
- State NMTCs = State New Markets Tax Credits- **There are currently 12 states that have or have had State NMTC programs** and 2 that have had legislation introduced. Some have been fairly consistent, like Mississippi, some come and go and come again, like Louisiana, and some were one and done, like Arkansas.*

- So, how does this all work? Well, in order to understand that, first we have to talk about investment vehicles known as Community Development Entities (“CDEs”).
  - CDEs are eligible to apply annually for an allocation of NMTCs through a rigorous application process.
  - Before they can even submit an application, CDEs must first be certified by the CDFI Fund as a community development entity (this means another application for most of them- but this one is a one time thing).
  - A CDE’s mission, first and foremost, is to provide capital to businesses in low income communities, many CDEs also have secondary missions, but providing capital to businesses in low-income communities is their primary purpose.
  - CDEs have service areas that they identify when they submit their allocation application.
  - Service areas can be changed.

SOME APPLICATION AND HIGH LEVEL NMTC ALLOCATION FACTS

- CDEs have pipelines of potential projects in their allocation applications and the allocation amount that they ask for is based on that pipeline.
- The CDFI Fund then determines an amount (if any) to award to a CDE
- In total, allocations totaling $61 billion have been allocated in tax credit authority pursuant to over 1,254 awards;
- Most recently, in the CY 2019 Round released in July 2020, 76 awards were made totaling $3.55 billion.
  - 206 Applicants applied for the CY 2019 round- only 76 (or 37%) of the applicants received any allocation at all;
  - Although only $3.55 billion was available, the applicants, all told, requested $14.7 billion in allocation authority
  - This means that only 24% of the allocation authority requested was awarded, so you can see that this is a very competitive process

Sourced from CDFIFund.gov

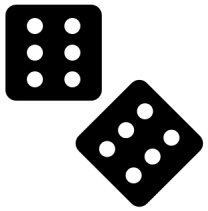
- Allocation awards ranged in size from $15 million to $70 million. The 76 allocates who received awards last round are headquartered in 30 different states and the District of Columbia.
- 12 of the allocatees (or 15.8%) are minority- or Native-owned or controlled entities. They received allocations totaling $543 million.
- 39 of the allocatees (or 51.3%) will focus investment activities on a national service area.
- 17 of the allocatees (or 22.4%) will focus on a multi-state service area.
- 12 of the allocatees (or 15.8%) will focus activities on a statewide service area.
- 8 of the allocatees (or 10.5%) will focus on local markets (e.g., a citywide or countywide area).
- 29 of the allocatees (or 38.2%) are certified Community Development Financial Institutions (CDFIs) or subsidiaries of certified CDFIs. They received allocations totaling $1.373 billion.
- 75 of the allocatees committed to providing at least 75% of their investments in areas characterized by: 1) multiple indicia of distress; 2) significantly greater indicia of distress than required by NMTC Program rules; or 3) high unemployment rates.
- 14 of the allocatees (or 18.4%) met criteria for “Rural CDE” designation. They received allocations totaling $740 million.
- 58% committed to providing some or all of their allocation in non metro areas

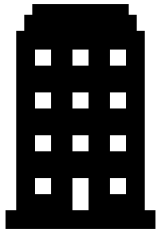
WHAT CAN NEW MARKETS TAX CREDIT PROCEEDS BE USED FOR?

- Real estate acquisition
- Refinancing
- Reasonable Working Capital
- Site prep
- Substantial Rehab
- New Construction
- Tenant Build Out
- Equipment
- Soft Costs
- Closing Costs and Reserves

SOME EXAMPLES OF WHAT NMTC FINANCING CANNOT FINANCE…

- Ineligible Businesses
  - Gaming;
  - Tanning and massage parlors;
  - Golf Courses;
  - Country Clubs
- Farming
- Businesses the primary business of which is the sale of alcoholic beverages for off-site consumption
- Residential Rental Property (80%- mixed use)

DOES MY PROJECT WORK? DOES MY PROJECT PASS THE QCT REQUIREMENT?

In most cases, the NMTC program utilizes geographic qualification based on census tract.

The New Markets Tax Credit is currently using census tract data based on the American Community Survey 2011-2015 information.

- Qualifying census tracts have either:
  - A poverty rate that exceeds 20%, or
  - Median income that is below 80% of the greater of:
    - Statewide median income, or
    - Metropolitan area median income
- To put that into perspective, about 40% of all census tracts are eligible and about 36% of Americans live in eligible census tracts

WHAT CONSTITUTES AREAS OF HIGHER DISTRESS?

Even though the qualifications that I just discussed will get you past the gatekeeper and in the door, approximately 75% of all NMTC investments have been made in areas that are classified as areas of higher distress.

What is an area of higher distress? Those are:

- Census tracts with a median family income less than 60%;
- Tracts with poverty rates greater than 30%;
- Census tracts with an unemployment rate of at least 1.5 times the national average;
- Tracts located in counties not contained within a Metropolitan Statistical Area (MSA)* those are the counties we refer to as rural counties;
- Projects serving Targeted Populations.

SECONDARY CRITERIA

Census tracts with one of the following: (a) poverty rates greater than 25%; or (b) if located within a non-Metropolitan Area, median family income that does not exceed 70% of statewide median family income, or, if located within a Metropolitan Area, median family income that does not exceed 70% of the greater of the statewide median family income or the Metropolitan Area median family income; or (c) unemployment rates at least 1.25 times the national average

U.S. Small Business Administration (SBA) designated HUB Zones, to the extent that the QLICIs will support businesses that obtain HUB Zone certification from the SBA

Brownfield sites as defined under 42 U.S.C. 9601(39)

Areas encompassed by a HOPE VI redevelopment plan

Federally designated as Indian Reservations, Off-Reservation Trust Lands or Alaskan Native Village Statistical Areas, or Hawaiian Home Lands

Areas designated as distressed by the Appalachian Regional Commission or Delta Regional Authority

Colonias areas as designated by the U.S. Department of Housing and Urban Development

Federally designated medically underserved areas

Federally designated Promise Zones, Impacted Coal Counties, base realignment and closure areas, State enterprise zone programs, or other similar state/local programs targeted towards particularly economically distressed communities

Counties for which the Federal Emergency Management Agency (FEMA) has (a) issued a “major disaster declaration” and (b) made a determination that such County is eligible for both “individual and public assistance;” provided that the initial project investment was made within 36 months of the disaster declaration

A Census tract identified as a Food Desert, which must either: 1) be a census tract determined to be a Food Desert by the U.S. Department of Agriculture (USDA), as identified in USDA’s Food Desert Locator Tool; or 2) a census tract that qualifies as a Low-Income Community and has been identified as having low access to a supermarket or grocery store through a methodology that has been adopted for use by another governmental agency

DETAILS OF A "TYPICAL" NMTC TRANSACTION

- Investor would provide an equity investment into a special purpose entity or "Investment Fund" in exchange for 100% of the membership interests.
- Lender would make loan (the "Leverage Loan") to the Investment Fund.
- This debt/equity combination would generate the Qualified Equity Investment ("QEI").
- The Investment Fund would acquire NMTCs based on the total amount of the QEI.
- Upon the Investment Fund making the QEI in the CDE, Investor will immediately generate NMTCs. There is no ramp up period like other tax credits.
- In a typical transaction, the CDE(s) use the proceeds of the QEI to make loans to a qualified active low income community business ("QALICBs"). The loans are generally structured to mature or be refinanced in seven years.
- QALICBs are businesses that are corporations or partnerships that meet certain requirements
- The senior "A" loan will mirror the terms of the Leverage Loan. The subordinated "B" loan (which is derived from the tax credit equity less CDE fees) is generally at a below market interest rate with favorable terms such as full or partial loan forgiveness.

TRANSACTION DETAILS CONTINUED…

- CDE would use the QEI to make one or more loans to QALICB.
- QALICB would use the proceeds of the loans to finance the Project.
- The loans to QALICB would be interest only for 7 years and structured with an exit strategy after such 7-year period.
- The interest rate on the loans would typically be blended to pay (i) interest on the Leverage Loan and (ii) annual CDE fees.

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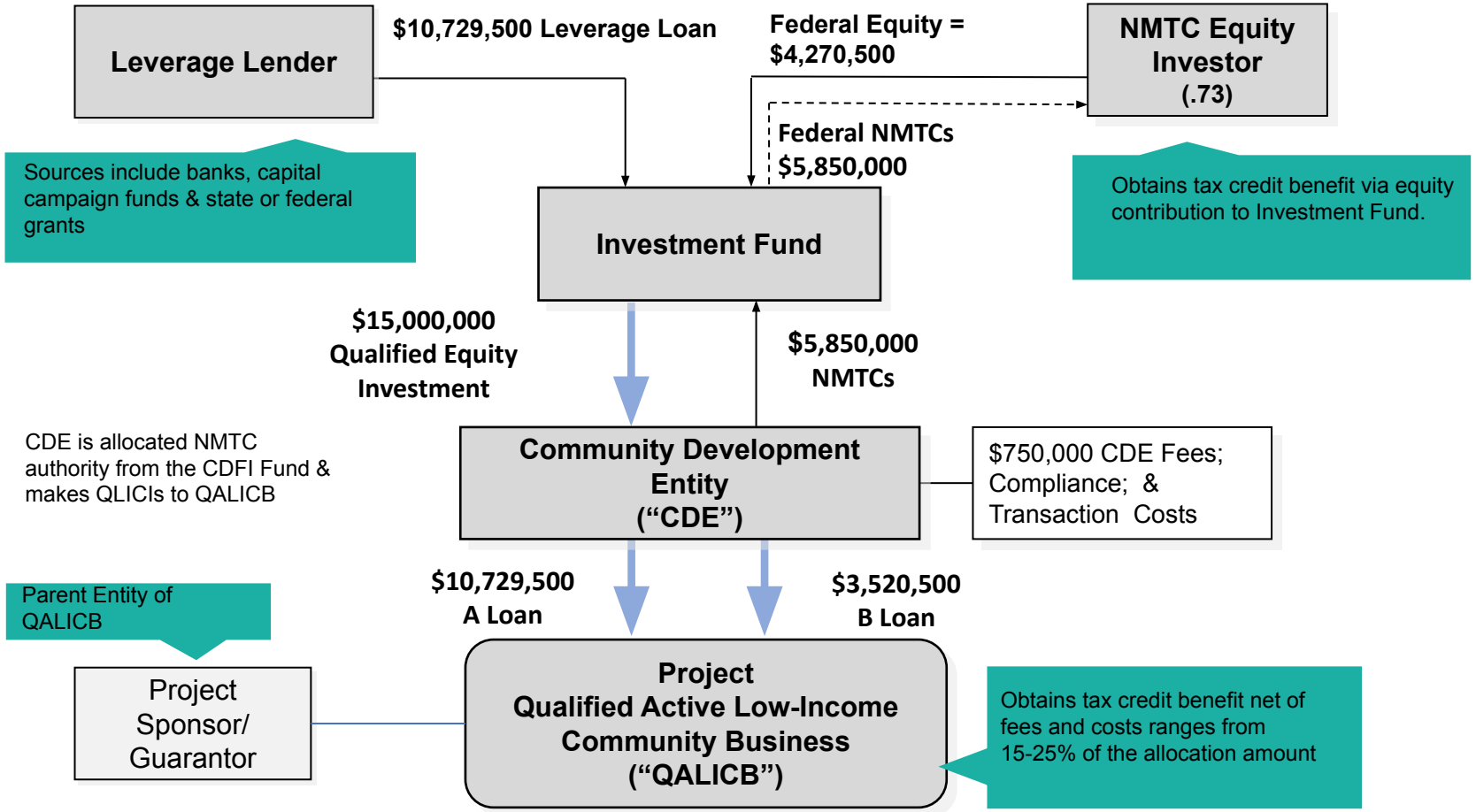
SAMPLE $15,000,000 NMTC TRANSACTION STRUCTURE



WHAT OTHER SUBSIDIES WORK WITH NMTCs?

Historic Tax Credits;

Energy Credits;

USDA Financings;

SBA Loans;

EB-5 Financings;

Property Assessed Clean Energy (PACE);

Opportunity Zones;

State NMTCs.

*LIHTC and NMTCs cannot be used together, however, a project can utilize both using a condo structure.

TO CONCLUDE…

The NMTC is a powerful economic tool that is especially relevant in the current economic climate as a job creator and as a way to spur economic development.

The potential benefit to the project is 18-25% of the allocation received.

There are several benefits to doing a NMTC financing v. a conventional financing.

The project must be a qualified business and cannot include one of the ineligible businesses.

Food deserts, projects with Indian Tribes, MUAs and projects in underserved states or territories are areas of focus.

Please feel free to reach out to one of us to further discuss.

BUTLER | SNOW

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