

Capital for Communities – Opportunities for PeopleSM



Community Reinvestment Fund, USA

Presented by:
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Using New Markets Tax Credits



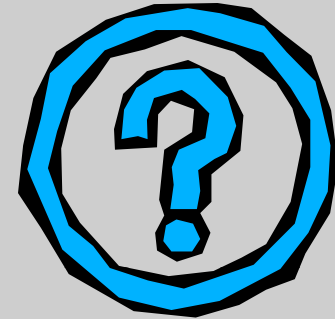
Introductions

A national non-profit financial services organization based in Minnesota

Provides capital to communities by purchasing economic development and affordable housing loans from community development lenders

Helped establish New Markets Tax Credit as member of NMTC Coalition

Received \$522.5 million in NMTC Allocations to date



What is CRF-USA?

New Markets Tax Credits Overview

Participants in a NMTC transaction

Qualifying a Business



Our Goals



Enacted on December 21, 2000, NMTC Coalition is working to extend program through 2013

Part of the Community Renewal Tax Relief Act of 2000

Creates a tax credit for equity investments in Community Development Entities (CDEs)

Encourages investment in Low Income Communities



Overview of NMTC Program

Provides Capital to
Businesses in Low Income
Communities

Benefits: capital that has
lower interest rates or more
flexible terms while

Provides market rates of
return to investors

Programmatic forms:

Loans or investments

Single project or pools of
projects

Various levels of risk and return

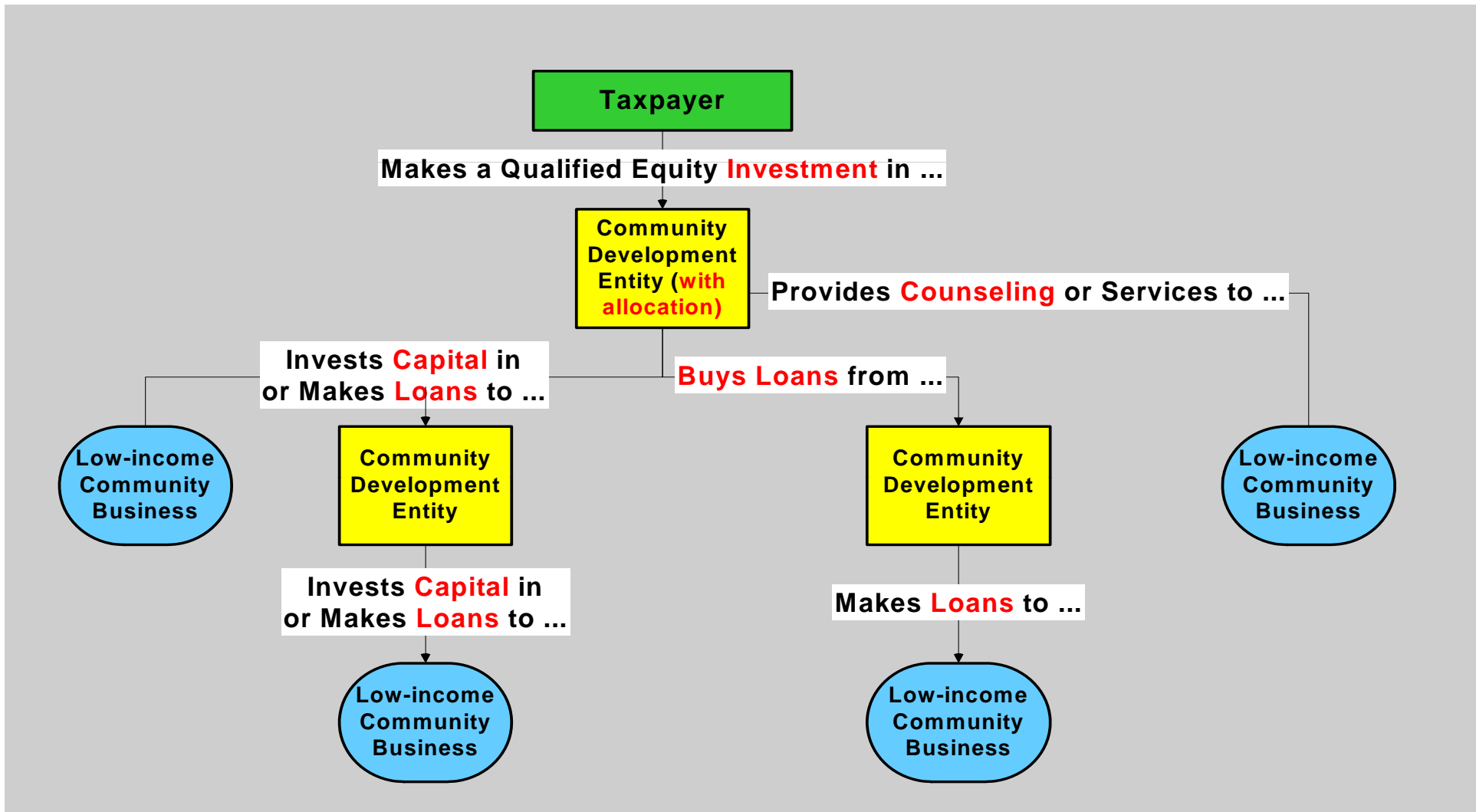
Will support \$19.5 billion in
investments

\$16 billion allocated so far

Best guess of next application
date: September 2009



New Markets Tax Credit – The basics



Many paths to take to get benefit to businesses

Teaming Up with Another CDE – What are the possibilities?

Another CDE may make a loan to your organization that is backed by loans you make to NMTC-eligible businesses

Another CDE may make an investment in your organization, allowing you to make loans to eligible businesses

Another CDE may provide “back-office” services for your CDE on a fee for service basis



Team Up With Another CDE

Teaming Up with Another CDE – What are the possibilities?

Another CDE may buy your NMTC eligible loans

It may be possible for you to originate and service, maintaining the relationship with your business customers

The purchasing CDE may be helpful in providing standard documents and underwriting guidelines

The purchasing CDE finds the investors and handles all NMTC compliance and reporting



Team Up With Another CDE

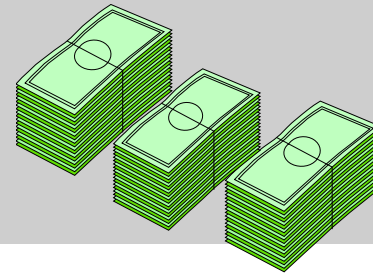
May purchase loans if

The Purchasing CDE has a commitment to purchase under an advanced commitment agreement;

The purchased loans were originated by the selling CDE to QALICBS AND

The loan qualified as a QLICI at EITHER the time the loan was

- Originated by the selling CDE or
- Purchased by the allocated CDE



Purchasing Loans from other CDEs

If a CDE provides loans or investments in other CDEs, they must demonstrate that the recipient CDE uses the money to

Make loans to or investments in QALICBs

Provide FCOS to businesses or residents of LICs

All time limits must be met as if the CDE with the allocation directly made the QLICI



Investing in other CDEs

FCOS is “advice provided by the CDE relating to the organization or operation of a trade or business.”

Eligible FCOS activities:

Developing business plans

Assistance with financials

Operating assistance to non-profit organizations



Financial Counseling and Other
Services

Capital or Equity Investment in, or loan to any “Qualified Active Low-Income Community Business” (QALICB)

Any equity investment in, or loan to, any CDE (QEI)

Purchase of a loan from another CDE if the loan is a QLICI

Financial Counseling and Other Services (FOCOS) to businesses located in, or residents of, LICs



Qualified Low-Income Community
Investments

Credit taken over a 7-year period

Credit rate:

5% in each of the first 3 years

6% in each of the final 4 years

Equals 39% of the amount of the original investment



What is the Value of the Tax Credit

A CDE receives a tax credit allocation of \$1million

The CDE offers the tax credit to investors

Ten investors each invest \$100,000

Each investor may claim a tax credit:

Years 1-3 Tax Credit at 5% Value \$5,000/year

Years 4-7 Tax Credit at 6% Value \$6,000/year

TOTAL VALUE OVER 7 YEARS \$39,000



Example of the Value of the Tax
Credit

A CDE receives a tax credit allocation of \$1million

Investors invest \$1,000,000

Investors may claim a tax credit:

TAX CREDIT VALUE OVER 7 YEARS \$39,000

The CDE makes \$1,000,000 in loans with the investment @ 10%
with a single payment due on the date the tax credit expires:
Earnings may be shared with investors: \$700,000.

TOTAL BENEFIT TO INVESTOR: Up to \$739,000



Example 2 of the Value of the Tax
Credit

A domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments or financial counseling in “Low Income Communities” (LICs)

CDE’s must demonstrate

A primary mission of serving or providing investment capital for, LICs or Low Income persons

Accountability to residents of the LICs they serve

Certification by the CDFI Fund



What is a CDE

May be For Profit or Not For Profit to be
“Certified”

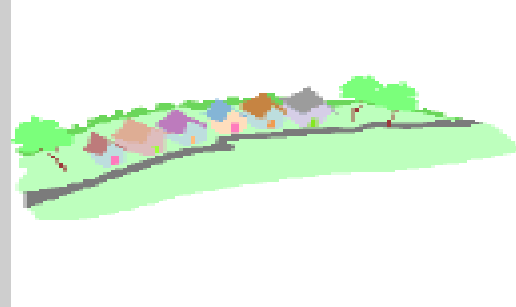
Only For Profits may receive allocation

Domestic Corporation: exchanges stock for NMTC investment

Partnership or LLC: exchanges partnership interest for NMTC investment. (Preferred because can pass other tax benefits in addition to tax credits to investors)



What is a CDE



“Low Income Communities”

Census tracts with at least 20% poverty, or

Census tracts where the median family income is below 80% of the area median family income



What is a LIC

NMTC is a geographically based federal program

When in doubt the CDFI Help Desk is deciding source

Low Income Community

Poverty rate > 20%

Median incomes < 80%

Greater Economic Distress:

Poverty rate > 30%

Median incomes < 60%



The Mysteries of Geo-Coding

Identify census tracts that qualify as NMTC eligible

Geocode addresses of customers, transactions, or board members to see if they qualify as serving low income communities



CDFI Online Help Desk

To use CDFI FUND's "Mapping" feature you must:

Register as a user at <https://www.cdfifund.gov/myCDFI/>

Once registered, go to the "Mapping" tab to geocode addresses or look up census tract conditions.



CDFI Online Help Desk

You will need **your organization's EIN** to:

register your organization,

for each user to register,

to request permission to use the site under an already registered organization's name, **and each time you log on!!**

You do not have to be a CDFI, a CDE

You have to present a valid EIN or social security each time you want to use the site.



Some Tips

The CDFI Investment Areas tab will give you the most data, but you must apply the NMTC area -- 20% poverty and 80% median income criteria -- to determine if the area is eligible under NMTC.

If you want to determine only NMTC eligibility -- without getting information about other measures of greater economic distress than poverty and income, go to the "NMTC Low Income Community" option.



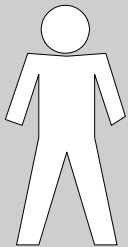
using CDFI Fund's Web site



At least 50% of gross revenue from business activity conducted within qualifying area



At least 40% of tangible property in qualifying area



Person 1

At least 40% of services provided by employees within area

If either the tangible property or the services test are 50% or more, the gross income test is deemed to have been met= Safe Harbor

CRF uses the 50% level on both the services and tangible property tests.



What qualifies as a low-income community business?

Example 1:

Ajax Co has a manufacturing plant in a LIC.

Headquarters, accounting, sales and marketing are at another location, which is NOT in a LIC.

How is each component of the business measured for its contribution toward gross income?

No IRS ruling to guide, so use "safe harbor"



Gross Income Test

Example 2:

Grins-R-Us is a mail order business.

Both the office and warehouse are in a LIC, but sales are national.

How do you determine which sales are conducted within the LIC?

No IRS guidance, so use the "safe harbor"



Gross Income Test

Example:

Able Cement makes deliveries from its office, which is located in a LIC.

More than 40% of its assets are delivery trucks, which are stored at night at the office.

During the day, deliveries are made outside the LIC.

IRS rule: Only consider the business hours usage.



Tangible Property Test

Able Cement Assets

Office (cost basis): \$200,000

Business hours: 10 hours/day, 6 days/week.

Truck (40--cost basis \$25,000 each): Used 6 hours/day outside the LIC and 4 hours/day inside the LIC

The calculation: $40 \times \$25,000 \times 4/10 + \$200,000 / \$1,200,000 = 50\%$. Exceeds the 40% requirement.



Tangible Property Test

40% of the Services Performed by employees must be in a LIC.

Calculation:

Salary expense paid to employees for services within the LIC

divided by

Total Salary expenses paid for employee services during the tax year.



Services Performed Test

Problem: Typically real estate is owned by LLCs and have no employees.

If an entity has no employees, the IRS has ruled that it satisfies both the income and services performed test

IF 85% of the tangible property use is within a LIC.



Services Performed Test

If 5% or more of the business's assets are collectibles (art, antiques, metal, gem, stamp, coin, alcoholic beverage), unless it is held for sale in the ordinary course of business (inventory)



Investments might make a business ineligible

If 5% or more of the business's assets are attributable to "nonqualified financial property" (debt instruments, stock, partnership interests, options, futures contracts, warrants, notional principal contracts, annuities)

Does not include: working capital held in cash, cash equivalents or debt instruments with a term of 18 months or less; or accounts or notes receivable acquired in the ordinary course of business for services rendered.



Investments might make a business ineligible

Banks, credit unions, and other financial institutions are generally excluded from the definition of a QALICB because of their ownership of Nonqualified financial property.

Proceeds that will be expended for construction of real property within 12 months after the date of investment and/or loan is treated as a “reasonable amount of working capital”.



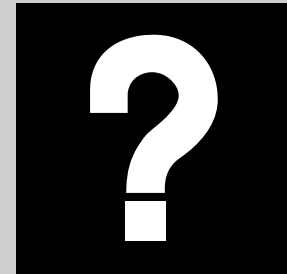
Investments might make a business ineligible

What if business moves to another locale two years after loan made?

Raises “reasonable expectations test”
– what did lender reasonably expect at time of loan?

If lender knew business was moving, big trouble.

If lender reasonably expected business to stay, okay.

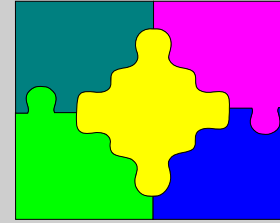


Reasonable expectations test

What fits:

Longer-term deals (more than 7 years)

- Commercial real estate, major equipment



What doesn't fit as well:

Short-term deals (less than 7 years)

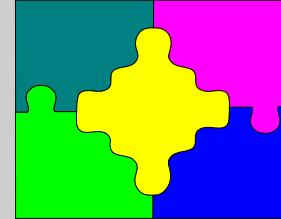
- Working capital, equipment with rapid depreciation schedules



Types of loans that fit

Who fits:

Manufacturers, retail businesses
acquiring real estate



Who doesn't fit :

Businesses with minor holdings in low-income areas
(unless clearly-identified separate unit)

Housing projects (except to finance developer in low-
income area)



Types of businesses that fit

Residential rental property

Buildings which receive 80% or more of their income from residential dwelling units— measurement is building by building

Certain business types

Golf courses, race tracks, gambling facilities, certain farming businesses, stores where the principal business is the sale of alcoholic beverages

IRS regulations at CDFI website



Ineligible Activities

Lend to non-profits to purchase and rehabilitate theatres in LICs

Develop a transit oriented commercial center

Support a loan program for real estate projects such as health clinics, substance-abuse centers, childcare facilities, community-based charter schools, and office buildings for nonprofits

Property acquisition and development of for-sale housing.



Sample Real Estate Activities

Invest in businesses focused on sustainable forestry and economic development

Provide equity and “near equity” investments to companies in any stage of the business cycle

Provide equity capital to disadvantaged individuals/entities seeking to own and operate franchises in underserved urban markets



Sample Business Activities

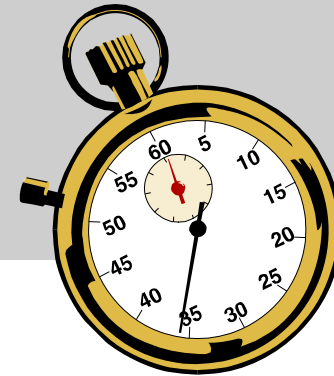
Within 5 years of receiving an allocation, NMTCs must be offered to Investors

Substantially all (85%) of the proceeds from QEIs must be invested into QLICs within 12 months of receipt

Returns of capital must be reinvested into QLICs within 12 months of receipt

Periodic loan repayments may be aggregated for 24 months before reinvestment is required

Reinvestment is not required in the 7th year



Timing of Investments

Investor makes a “Qualified Equity Investment (QEI) in a CDE

A QEI is any purchase of stock or capital interest in a **for-profit** corporation or partnership.

QEIs must remain invested in the same CDE for a 7-year period

Investors may claim tax credits as of the date a QEI is initially made; and each of the subsequent six anniversary dates.



What is the role of the investor

Track record of the CDE

Experience with the proposed activity

Access to and ability to reach eligible businesses

Game plan for managing risks

Credit risk

Compliance risk

Return risk

Investment/lending criteria

Rate of return compared to risks



New Markets Tax Credit –
Investor Issues

Years 1-6: Substantially All = 85% of amount paid by investor at original issue

Year 7: Substantially All + 75%

Capital recovered over the 7-year period must be reinvested

5% of the original QEI may be used for reserves and still count toward meeting the substantially all test.



Substantially All test

NMTC may be recaptured from investors if:

The QEI fails the “Substantially All requirement

Failure to invest 85%

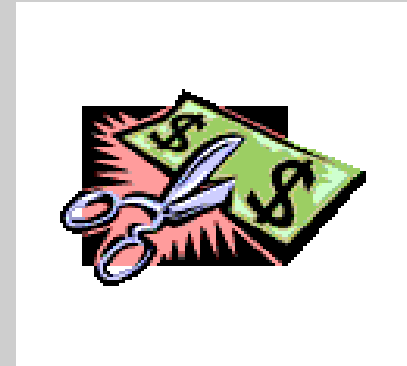
Failure to meet QALICB requirements

Failure to invest QEI within one year

The CDE ceases to qualify as a CDE

The CDE redeems the investment

Note, it is NOT an event of recapture if a CDE files for bankruptcy.



Recapture

The Applicant CED—and all subsidiary applicants—must have a primary mission of serving or providing investment capital for Low-Income Communities or Low-Income Persons

Step 1: Provide organizational documents evidencing an appropriate primary mission.

Bylaws; Articles of incorporation or organization; Partnership agreements; Board resolutions

Note: Marketing materials do not demonstrate primary mission



Primary Mission Test

Step 2: Submit “Certification of Authorized Representative” demonstrating that at least 60% of products and services are and will continue to be directed to:

Low Income Persons (LIPs)

Low Income Communities (LICs) or

Organizations serving LIPs or LICs



How do you meet
60% requirement?

Business Strategy

Capitalization Strategy

Management Capacity

Community Impact

Bonus points for CDFI priorities



Previous Review Criteria

Define products, services and targeting

Discuss track record

Discuss impact of allocations

Identify current and potential transactions



Business strategy

Strategy to attract investors

Sources and uses of capital for the organization

Strategy to use credits over 5 years

Include any subsidiary transfers



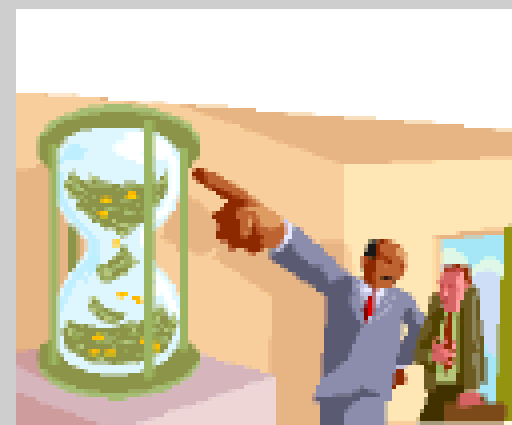
Capitalization Strategy

Identify management and key personnel

Describe staff experience in deploying capital and services, in raising equity, asset and risk management, and program compliance

Discuss systems and procedures

Discuss how input from low-income community stakeholders will be utilized by the board

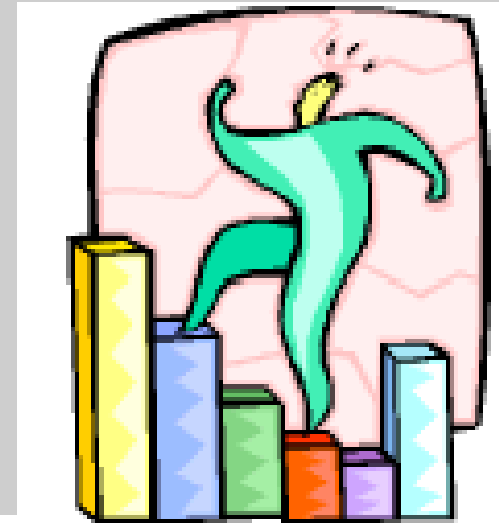


Management Capacity

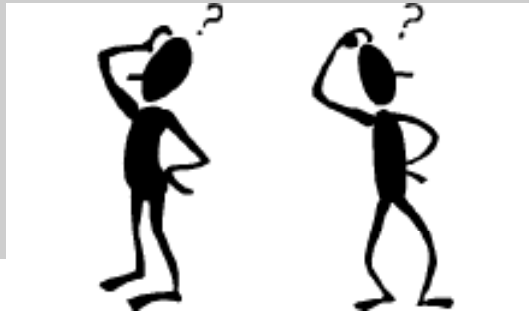
Evaluate strategy for bringing about community impacts

Define how activities will be directed to the most distressed communities

Quantify economic impacts



Community Impact



Questions?