

PUBLICATION

CDFI Allocates \$3.5 Billion in 2012 NMTCs

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Recently, the Community Development Financial Institutions Fund (CDFI) announced its allocation of \$3.5 billion in 2012 new market tax credits (NMTC) to 85 community development entities (CDEs) nationwide. In the next 10 – 12 months, CDEs will be allocating their NMTCs to qualifying developments, but now is an important time in pairing deals with the credits. Our Firm has worked closely with many of these CDEs and maintains relationships with their principals and counsel.

Background

The New Markets Tax Credit Program, created by Congress in 2000, is an important and growing alternative financing complement to conventional financing sources. The Program, which is authorized by section 45D of the Internal Revenue Code and administered by the CDFI, operates to attract private sector investment to spur economic growth in low-income communities that have traditionally had inadequate access to capital. Since the Program's inception, the CDFI has allocated over \$36.5 billion in tax credit authority to CDEs. CDEs apply, annually, to the CDFI for an allocation of new market tax credits. If awarded, the CDEs, through single-purpose affiliates, will utilize investor funds and other funds to make qualified equity investments in qualified active low income businesses in low income communities.

Qualifying Developments

A more detailed definition of a qualified active low income business is provided in the Code, but generally it must:

- be serving a low income community (typically by location in a qualified census tract);
- be an "active business";
- not be an excluded business, such as golf courses, race tracks, gambling facilities, spa/suntan facilities, stores where the principal business is the sale of alcoholic beverages, development of or holding of intangibles for sale or license, certain farming activities, and a development that derives 80 percent or more of its income from residential dwelling units.

Real estate developments have been the biggest beneficiaries of the program to date, but CDEs each have different targets. CDEs often focus their investments geographically, by business type, or both. For example, a CDE might commit to only fund inner city redevelopment projects or rural development projects, or it may prefer an operating business over a real estate development. Examples of recently funded businesses include rural health care facilities, nursing homes, assisted living facilities, modular housing manufacturing facilities, museums, restaurants and hotels.

Investor and Developer Benefits

In exchange for their investment, investors receive a federal income tax credit equal to 39 percent of the qualified equity investment, which is taken incrementally over a 7-year period. Typically, the investors have little concern with the development's ongoing business operations because the NMTC structure is often leveraged in a way that provides the investor more tax credit value than its investment cost.

From the developer standpoint, NMTCs bring equity to the project. Results vary based on deal size and structure, but generally NMTCs can add equity of 20 – 25 percent of the project's cost. NMTCs can also be stacked with other incentives that in the aggregate bring significant value to developers. Several states have enacted new markets tax credit programs. These state credits can be stacked with the federal credits. Developers in those states with new markets programs should consider this funding option because many state programs follow the federal program in substance, thus minimizing the transaction costs associated with the addition of state credits.

Summary

CDEs have received a new allocation of \$3.5 billion in new markets tax credits. This is an important time in pairing qualifying developments with those credits. Over the next 10 – 12 months, CDEs will be looking for opportunities to invest in qualifying businesses. NMTCs bring bottom line value to developers and should be carefully considered in developing project financing.

If you would like to discuss the New Markets Tax Credit Program, please contact one of the following attorneys associated with the Firm's Tax Department.