

NEXT CHALLENGE. NEXT LEVEL.

NEXSEN | PRUET

New Markets Tax Credit Financing

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Nexsen Pruet Background

- Multi-specialty business law firm founded in 1945 with more than 185 attorneys in the Carolinas
- Headquartered in Columbia, South Carolina, with offices in Charlotte, Greensboro, and Raleigh, NC as well as Columbia, Charleston, Greenville, Hilton Head and Myrtle Beach, SC.
- 22 Economic Development Team members in North and South Carolina

NMTC Background

- At the time of enactment, the New Markets Tax Credits (NMTCs) program was the largest federal subsidy created for economic development in low-income communities.
- The NMTCs program was administered by the US Treasury's Community Development Financial Institutions Fund (CDFI) and the Internal Revenue Service under Section 121 of the Community Renewal Tax Relief Act of 2000. CDFI allocates NMTCs each year based on an application process.
- NMTCs are codified in Section 45D of the Internal Revenue Code.

NMTC General Overview

- Investors receive a credit against Federal income taxes for making qualified equity investments (QEIs) in designated Community Development Entities (CDEs), and CDEs use QEIs to make qualified low income community investments (QLICIs).
- The NMTC is equal to 39% of the QEI and is claimed over a seven year period starting on the date the QEI is made.

NMTC General Overview

- QLICIs are (i) equity investments in, or loans to, qualified active low income community businesses (QALICBs), (ii) other transactions with other CDEs and (iii) services to low-income communities.
- QELs generally consist of investor equity combined with other financing sources, including equity from the QALICBs or an affiliate of the QALICB, government or other public subsidy, private donations, conventional financing or bond financing.

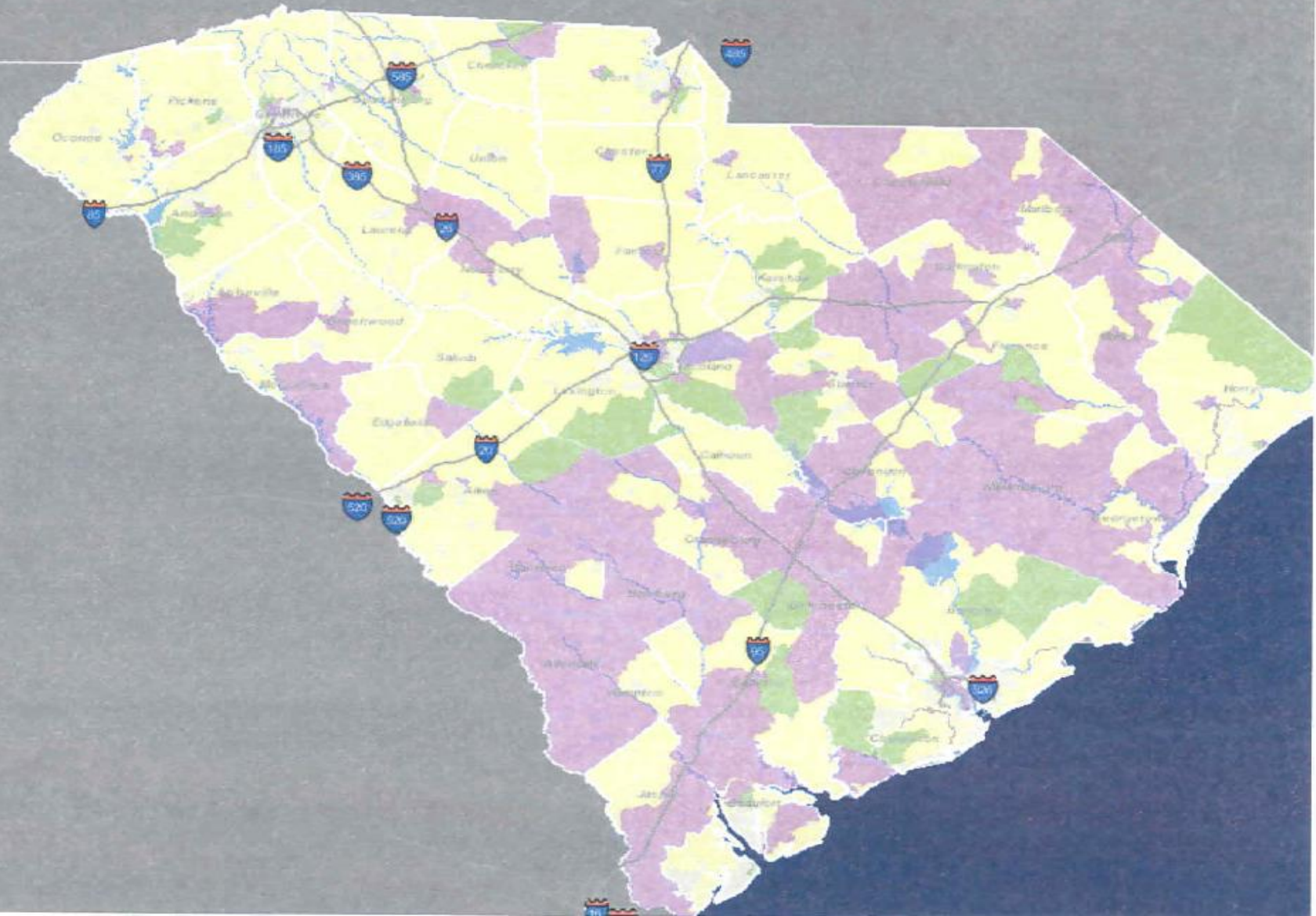
Pros and Cons for a Real Estate Deal

- Why NMTC financing may be desirable:
 - Additional Equity
 - Reduces cost of financing
- Why NMTC financing may not be desirable:
 - Complicated
 - Takes longer to close
 - Document intensive
 - Fees
 - Ongoing compliance and restrictions
 - Guaranty of tax credit recapture in addition to debt payment guarantees

Low-Income Community

- First Question – Will project be located in a qualifying Low-Income Community?
- Determined by census tract designations
- Generally, poverty rate for such tract must be at least 20%; or median family income for such tract must not exceed 80% of statewide (or metropolitan area) median family income
- Resources:
 - CDFI Fund Website
 - SC Jobs Economic Development Authority (JEDA) Website

Qualifying Census Tracts in S.C. JEDA



NMTC Allocations

- CDFI Fund makes NMTC allocations to CDEs annually after a competitive application process
- 2009 (Round 7) Allocations
 - 99 CDEs awarded allocations - combined total of \$5 billion
 - Carolina First Community Development Corporation, headquartered in Greenville, SC, was allocated \$60,000,000 for 2009
- Through 7 rounds to date, CDFI Fund has made 495 awards totaling \$26 billion in allocation authority
- 2010 Allocations - Online Submission of Allocation Application: June 2, 2010

Community Development Entities (CDEs)

- Investment Vehicle/ Intermediary for the provision of loans, investments or financial counseling in Low-Income Communities
- CDFI Fund certifies CDEs on an ongoing basis
- CDE Qualifications
 - Domestic corporation or partnership at the time of the certification application;
 - Primary mission of serving, or providing investment capital for, low-income communities or low-income persons; and
 - Accountable to residents of low-income communities through representation on a governing board of or advisory board to CDE.

Qualified Equity Investment (QEI)

- Stock in a corporation or a capital interest in a partnership or LLC
- QEIs must remain invested in the CDE during 7-year credit period

Qualified Low-Income Community Investments (QLICIs)

- Any capital or equity investment in, or loan to, any Qualified Active Low-Income Community Business (QALICB)
- Purchase of a loan from another CDE if the loan is a QLICI
- Financial counseling and other services to businesses located in, and residents of, Low-Income Communities
- Any equity investment in, or loan to, any CDE

Qualified Active Low Income Community Business (QALICB)

- An operating business located in Low-Income Community, including those that:
 - Develop or rehabilitate commercial, industrial, retail and mixed-use real estate projects
 - Develop or rehabilitate community facilities, such as charter schools or health care centers
 - Develop or rehabilitate for-sale housing units
- Business must meet certain tests (e.g., must derive certain portions of its gross income from business in Low-Income Community, have a substantial portion of its tangible personal property located in Low-Income Community, and perform a substantial portion of its services in a Low-Income Community)

Ineligible Businesses

Residential rental property

Golf courses

Race tracks

Gambling facilities

**Stores where the principal
business is the sale of
alcoholic beverages for
consumption off premises**

Massage parlors

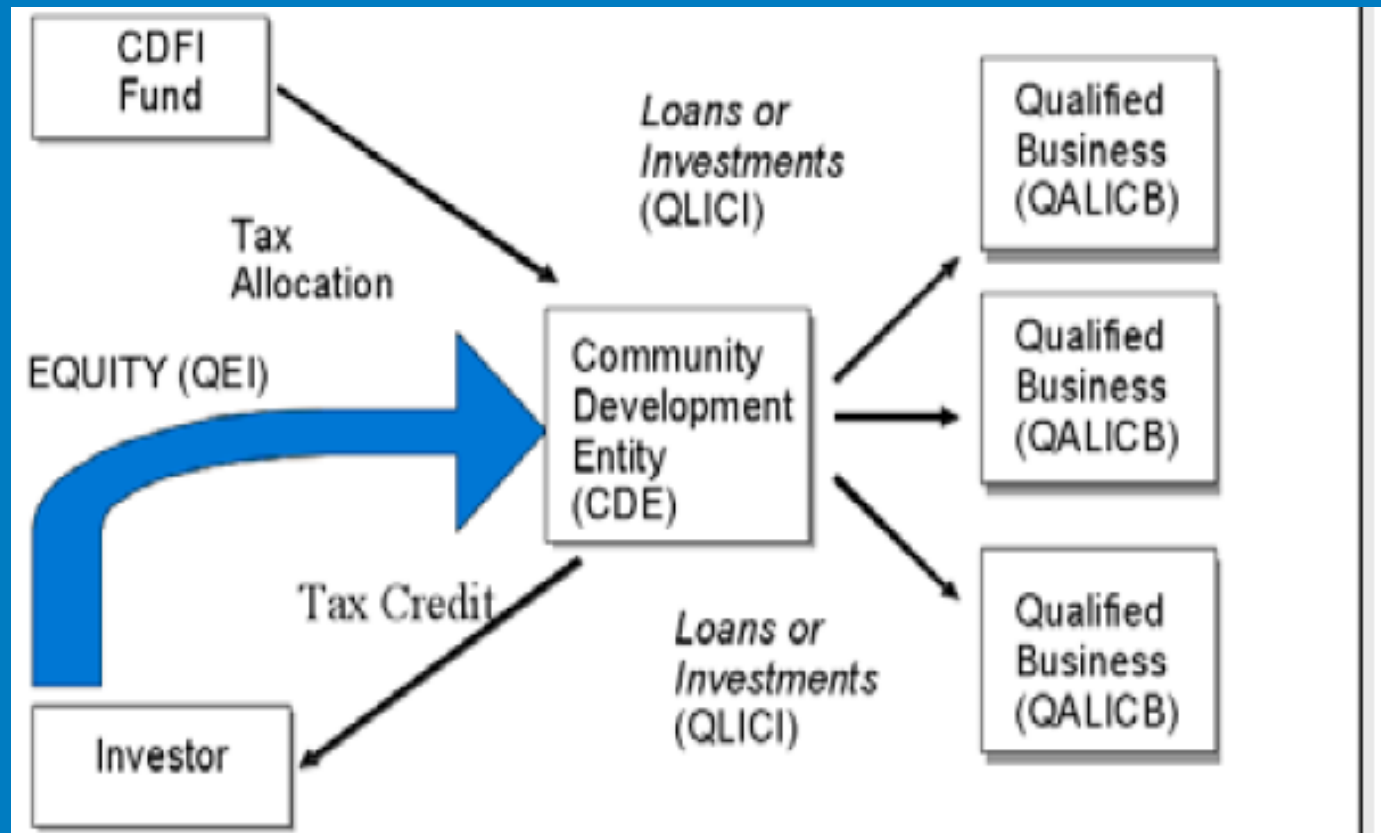
Hot tub facilities

Suntan facilities

**Certain farming
businesses**

Country clubs

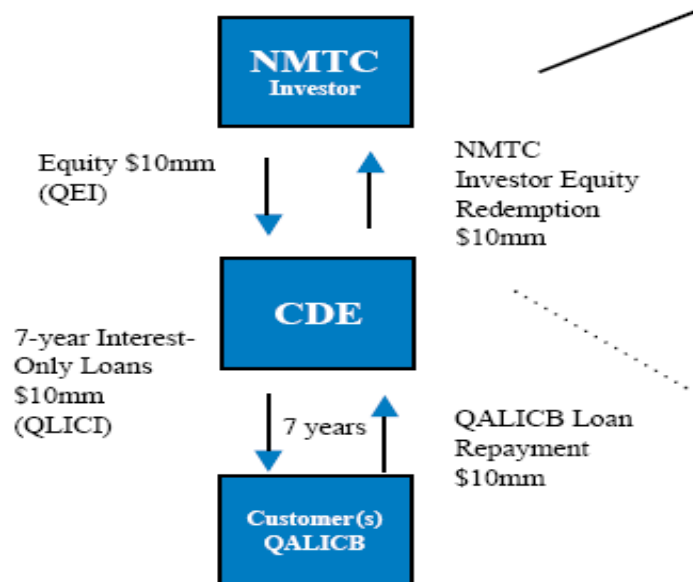
New Markets Tax Credit Program Structure



Borrower Advantages

- Facilitates location of wide variety of projects where often needed most.
- Interest only payments for 7 years
- Due to credits, interest rates typically below conventional loans
- On exit, Borrower usually purchases B piece (either subordinated loan or minority equity interest granted to CDE) at nominal amount, with the net effect of 25%-30% of funding converted to a contribution to capital

Example of NMTC Non-Leverage Transaction



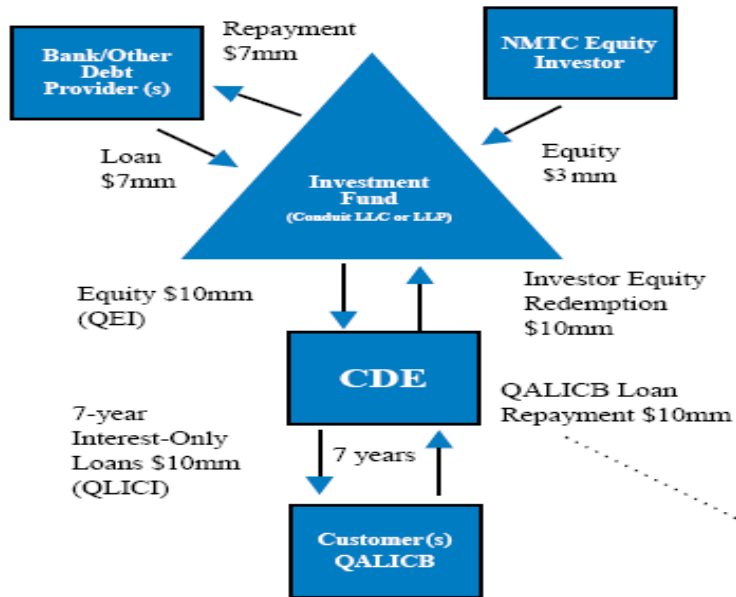
Transaction Summary

- The bank investor(s) provides \$10 million in equity capital to the CDE in Year 1.
- The CDE provides \$10 million in debt financing to the QALICB(s) structured as \$7 million in senior debt and \$3 million in subordinated debt.
- The loans are structured to mature in seven years, consistent with the schedule of tax credits to investors.
- The qualified business borrower makes interest-only payments during the term of the loans. The loans are repaid or refinanced at the end of the seven-year compliance period, at which time the CDE redeems the QEI.

Tax Credit Schedule for NMTC Investors

Year 1	\$500,000	5%
Year 2	\$500,000	5%
Year 3	\$500,000	5%
Year 4	\$600,000	6%
Year 5	\$600,000	6%
Year 6	\$600,000	6%
Year 7	\$600,000	6%
	\$3,900,000	39%

Example of NMTC Leveraged Transaction



Transaction Summary

- The investment fund, the conduit LLC, obtains lender financing of \$7 million and an equity contribution of \$3 million.
- The investment fund, using those combined proceeds, provides a QEI to the CDE totaling \$10 million in Year 1.
- The CDE provides \$10 million in debt financing to the QALICBs, structured as \$7 million in senior debt and \$3 million in deeply subordinated debt.
- The loans are structured to mature in seven years, consistent with the schedule of tax credits available to investors.
- The CDE earns interest on the \$10 million, although the investment fund LLC pays interest only on the \$7 million debt financing portion to the LLC.
- The loans are repaid or refinanced at the end of the seven-year compliance period, at which time the CDE redeems the QEI.

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Year 7	\$600,000	6%
	\$3,900,000	39%

Example of NMTC Return on Equity Calculation

\$10,000,000	Assumes all capital invested at closing
\$7,000,000	Interest-only @ (monthly) Libor + 300 bps senior loan. 7-year maturity/25-year amortization
\$3,000,000	Subordinated loan for 40 years (principal & accrued interest due at maturity) at 0.5% annual simple interest
39.0%	Gross NMTC credits over 7 years
\$7,000,000	Senior loan principal redemption
\$4,081,700	Interest-only payments on senior loan (7,000,000 x .08330 x 7 yrs) Interest rate of (monthly) Libor = 5.83% + 300 bps = 8.330%
\$3,900,000	Gross NMTC credits over 7 years
\$14,981,700	Gross proceeds at redemption
-\$10,000,000	Less original investment amount
\$ 4,981,700	Net proceeds at redemption
÷ 7 years	Investment term
\$711,671	Average annual net proceeds
÷\$10,000,000	Original investment amount
7.12%	Estimated average annual ROE

B PIECE

- Senior loan (A Note) paid in full at end of 7 year term
- Subordinate loan (B Note) or minority equity interest (B Piece) subject to purchase from CDE at end of 7 years at fair market value
- Fair market value typically nominal amount due to terms such as low interest rate and lengthy term, e.g. 1% of face value
- Example: \$7MM Senior Note paid in full
\$3MM Subordinate Note purchased for \$30,000

Recent Proposals by Obama Administration

- **Altering of NMTC program by Congress to allow new markets tax credits to be used to also offset taxes owed under the Alternative Minimum Tax (AMT)**
 - Intent is to expand pool of potential investors, bolster investment by current NMTC investors that currently pay AMT, and put NMTC program on equal footing with other tax credits that offset AMT
- **\$5 billion allocations for each of 2010 and 2011**
- **Justification: Data show that every \$1 of foregone tax revenues under the NMTC program leverages approximately \$12 of private investment in distressed communities on a cost basis.**

Recent Nexsen Pruet NMTC Transactions

- SixAxis / SafeRack – Andrews, SC
- Horsehead Corporation – Barnwell, SC
- Stratford – Hilton Head / Bluffton, SC
- ???

Contact Information

Contact IRS: new.markets.tax.credit@irs.gov

or

Visit the Fund's website: www.cdfifund.gov

or

Contact the Fund Directly:

Program Support

Ph: (202) 622-6355 (option 3)

Fax: (202) 622-7754

Email: cdfihelp@cdfi.treas.gov

Sources

- Various articles and reports on website of Council of Development Finance Agencies, including:
 - Council of Development Finance Agencies
 - Coastal Enterprises, Inc.
 - Kutak Rock, LLP
 - U.S. Dept. of Treasury, Community Development Financial Institutions Fund (CDFI)
- South Carolina Jobs-Economic Development Authority
- American Bar Association, Real Property Section - “Using New Markets Tax Credits to Bridge Financing Gaps in Real Estate Projects”

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