

U.S. Department of the Treasury



Community Development Financial Institutions Fund

New Markets Tax Credits:
2004 Community Reinvestment Conference
March 30, 2004

CDFI
fund

CDFI Fund Mission and Background

- Created in 1994
- Mission:
 - To expand the capacity of financial institutions to provide capital, credit, and financial services in underserved markets

CDFI Fund Initiatives

- ***CDFI Program:*** Provides assistance to CDFIs and emerging CDFIs
- ***NACD Program:*** Supports development and growth of Native American CDFIs.
- ***Bank Enterprise Award (BEA) Program:*** Provides awards to insured depository institutions for increasing investments in CDFIs and/or activities in distressed communities
- ***New Markets Tax Credit (NMTC) Program***



Overview of NMTC Program

- Enacted on December 21, 2000
- Part of the Community Renewal Tax Relief Act of 2000
- Creates a tax credit for equity investments in Community Development Entities (CDEs)

What is a CDE?

- A domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments or financial counseling in “Low-Income Communities” (LICs).
- CDEs are required to demonstrate that they:
 - Have a **primary mission** of serving, or providing investment capital for, LICs or Low-Income Persons
 - Are **accountable** to residents of the LICs that they serve

What is “Low-Income?”

Generally, “Low-Income Communities” are:

- Census tracts with **at least 20%** poverty, or
- Census tracts where the median family income is **below 80%** of the area median family income

Credit Amount

- 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 amount of original investment

Example

The Fund awards a tax credit allocation of \$1 million to a CDE. The CDE offers the tax credit to investors. Ten investors each invest \$100,000 in return for the tax credit. How much can each investor claim as a tax credit?

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

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

TOTAL VALUE OVER 7 YEARS.....\$39,000

Investor's Ability to Claim NMTCs

- NMTCs are offered to investors for “Qualified Equity Investments” (QEIs) in the CDE
- 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 generally may claim credits as of the date a QEI is initially made

Amount of NMTC Investment Authority Available

2002	\$2.5 billion	
2003	\$1.5 billion	Combined for 2003 round
2004	\$2 billion	
2005	\$2 billion	
2006	\$3.5 billion	
2007	<u>\$3.5 billion</u>	
TOTAL	\$15 billion	

Unallocated investment authority may be carried over from year to year through 2014.

Qualified Low-Income Community Investments

- 1) Any capital or equity investment in, or loan to, any “Qualified Active Low-Income Community Business” (QALICB)
- 2) Any equity investment in, or loan to, any CDE
- 3) Purchase of a loan from another CDE if the loan is a QLICI
- 4) “Financial Counseling and Other Services” (FCOS) to businesses located in, or residents of, LICs

Timing of Investments

- CDEs must offer NMTCs to investors within 5 years of receiving an allocation
- CDEs have 12 months to invest “substantially all” (generally 85%) of their QEI proceeds into QLICs
- Generally, CDEs that receive returns of capital will have 12 months to reinvest those funds in QLICs.
 - Reinvestment is not required in the final year of the 7-year credit allowance period.

Recapture

NMTCs may be recaptured from investors during the 7-year credit period if:

1)The QEI fails the “**substantially all**” requirement

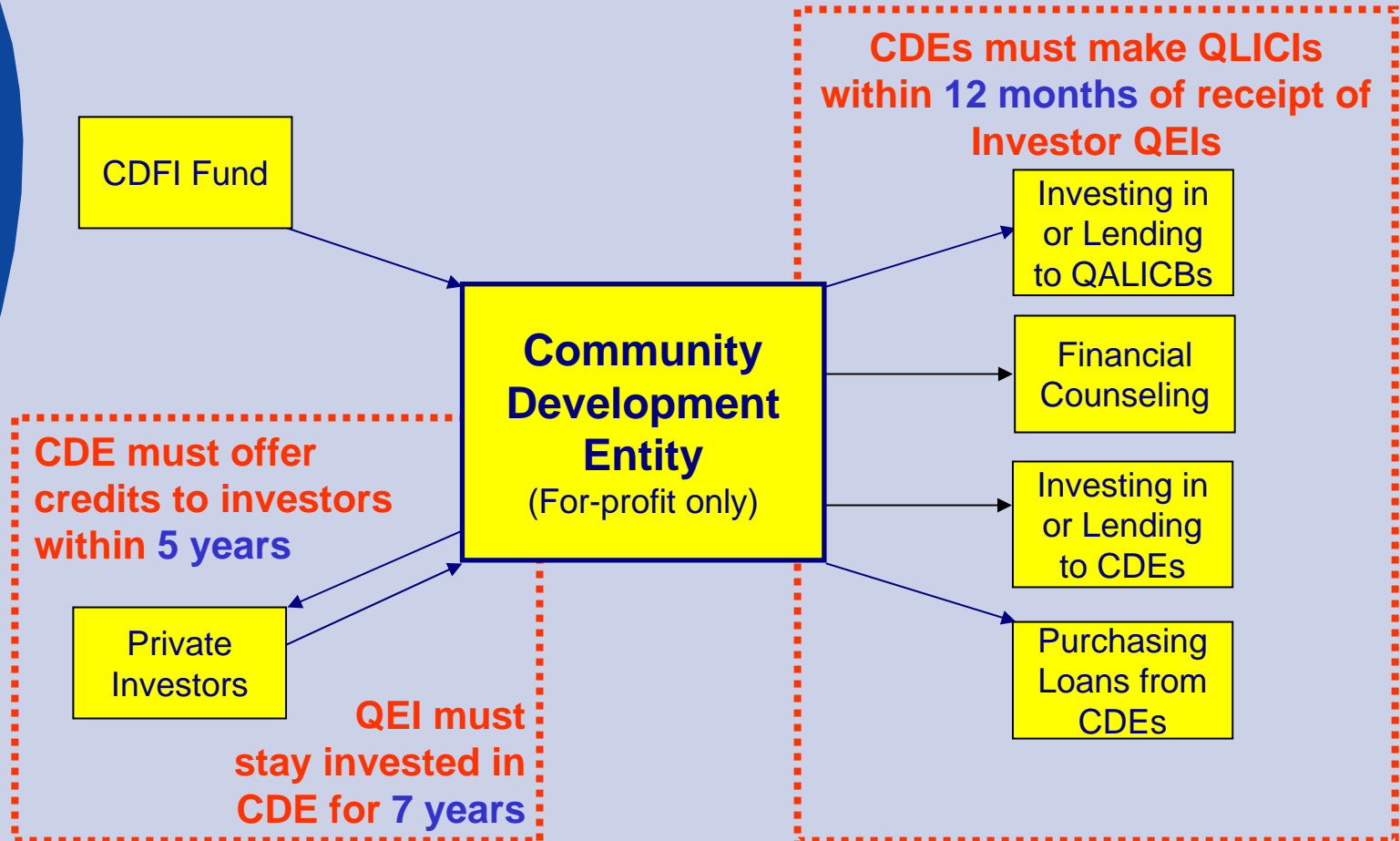
- e.g., Failure to invest 85% as allowed;
- Failure of investment to meet QALICB requirements; or
- Failure to meet one-year investment requirement

2)The CDE ceases to qualify as a CDE

3)The CDE redeems the investment

It is not an event of recapture if a CDE files for bankruptcy.

Summary Graphic



1: Investing in QALICBs

Eligible QALICB activities may include:

- Loans or investments to businesses located in low income census tracts
- Development of commercial, industrial and retail real estate projects (including community facilities) in low income census tracts
- Development of for-sale housing in low income census tracts

QALICB Criteria

- 1) At least 50% of the total gross income is from the active conduct of a qualified business in Low-Income Communities (LICs); and
- 2) At least 40% of the use of the tangible property of the business is located in LICs; and
- 3) At least 40% of the services provided by the business' employees are performed in LICs; and

The gross income test is deemed to be met if either the tangible property or the services test is at 50% or higher

QALICB Criteria (cont'd)

- 4) Less than 5% of the average of the aggregate unadjusted bases of the property is attributable to **collectibles** (e.g., art and antiques), other than those held for sale in the ordinary course of business (e.g., inventory); and
- 5) Less than 5% of the average of the aggregate unadjusted bases of the property is attributable to **nonqualified financial property** (e.g., debt instruments with a term in excess of 18 months).

Ineligible Activities

- Residential rental property:
 - Buildings which derive 80% or more of income from residential dwelling units
- Certain types of businesses:
 - Golf courses
 - Race tracks
 - Gambling facilities
 - Certain farming businesses
 - Stores where the principal business is the sale of alcoholic beverages
- Refer to IRS regulations for additional details

2: Investing in Other CDEs

CDEs providing loans to or investments in other CDEs need to demonstrate that recipient CDEs use those dollars to:

- Make loans to or investments in QALICBs; and/or
- 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.

3. Purchasing Loans from Other CDEs

CDEs may purchase loans – but **not** investments – from other CDEs if:

- The purchased loans were originated by the selling CDE to QALICBs; and
- The loans qualified as QLICs at **either** the time the loan was:
 - Originated by the selling CDE; or
 - Purchased by the allocated CDE

4. Financial Counseling and Other Services

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

- Possible FCOS activities:
 - Business plan development
 - Assistance with business financials
 - Operating assistance to non-profit organizations

Applying for a NMTC Allocation

Who Can Apply?

- Both for-profit and non-profit entities may apply
- In its Allocation Application, a non-profit applicant must discuss its strategy to:
 - Form at least one for-profit subsidiary
 - Transfer its entire allocation to for-profit subsidiaries

Review Criteria

- Maximum of 110 points
- Four sections of 25 points each:
 - Business Strategy
 - Capitalization Strategy
 - Management Capacity
 - Community Impact

Applicants could earn an additional 10 “priority” points in Business Strategy.

Priority Points (in Business Strategy)

“Priority” points given under Business Strategy section to CDEs:

- 1) With a **track record** of having successfully provided capital or technical assistance to disadvantaged businesses or communities; or
- 2) Intending to invest in businesses in which **unrelated parties** hold the majority equity interest

Business Strategy

Evaluates a CDE's ability to make QLICs with QEI proceeds – applicants will:

- Define products, services, and targeting
- Discuss track record, especially in proposed NMTC activities
- Explain impact of allocations on activities (e.g., increased volume; better products)
- Identify current and potential transactions

Capitalization Strategy

Evaluates a CDE's ability to use tax credits to raise capital – applicants will:

- Describe strategy for securing investor capital, including the extent to which NMTC capital has been committed by investors.
- Discuss sources and uses of capital for the organization, including non-QEI funds
- Describe strategy for use of allocation, including any transfers to subsidiaries and plan to use credits over 5 years

Management Capacity

Evaluates the experience and track record of the management team – applicant will:

- Identify management and key personnel
- Describe staff experience in deploying capital and services, raising capital (specifically equity), asset and risk management, and program compliance
- Discuss systems and procedures
- Discuss the extent to which the board and management utilize input from low-income community stakeholders.

Community Impact

Evaluates the CDE's strategy for bringing about community impacts thorough its business strategy – applicant will

- Define the extent to which activities will be directed to the most distressed communities and/or in conjunction with other programs
- Quantify economic impacts

2003 Application Round

Milestone	Date
NMTC Allocation Application due date	9/30/03
First phase review of applications (internal and external reviewers)	Nov '03
Second phase analysis of applications (internal Fund panel review)	Jan '04
Date by which applicants that are 2002 allocantees must issue at least 50% of their QEIs	3/05/04
Award Announcements	April 2004

Applicant Pool Comparison

2003 Applicant Pool	2002 Applicant Pool
271 applications received	345 applications received
Total request: \$30 billion	Total request: \$26 billion
Average request: \$111 million	Average request: \$75 million
Largest request: \$1.5 billion	Largest request: \$1 billion
Smallest request: \$670,000	Smallest request: \$300,000

2002 Allocatees

- 66 allocation recipients received a total of \$2.5 billion in allocation authority
- Allocation size:
 - Average = \$38 million
 - Largest = \$170 million
 - Smallest = \$500,000

2002 Allocatees (cont'd)

- 48 plan to invest in or lend to non-real estate QALICBs
- 52 plan to invest in or lend to real estate QALICBs
- 18 plan to invest in or lend to other CDEs
- 12 plan to purchase loans from other CDEs

2002 Allocatees (cont'd)

- 28 CDFIs or affiliates of CDFIs
- 15 depository institutions or affiliates of depository institutions, including 3 CDFI-banks
- 4 public entities or affiliates of public entities

IRS Contact Info.

For questions about:

- Temporary Regulations
- Eligibility of possible QLICI activities
- Other tax implications of the program

Contact **IRS** at (202) 622-3040

CDFI Fund Contact Info.

For questions about the 2003 Allocation Round:

- Visit the Fund's website at www.cdfifund.gov
- Contact the Fund directly:

Programmatic Support

Ph: (202) 622-7373

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Email: cdfihelp@cdfi.treas.gov

IT Support

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The Fund will only accept questions about the 2003 Round **until September 26, 2003.**