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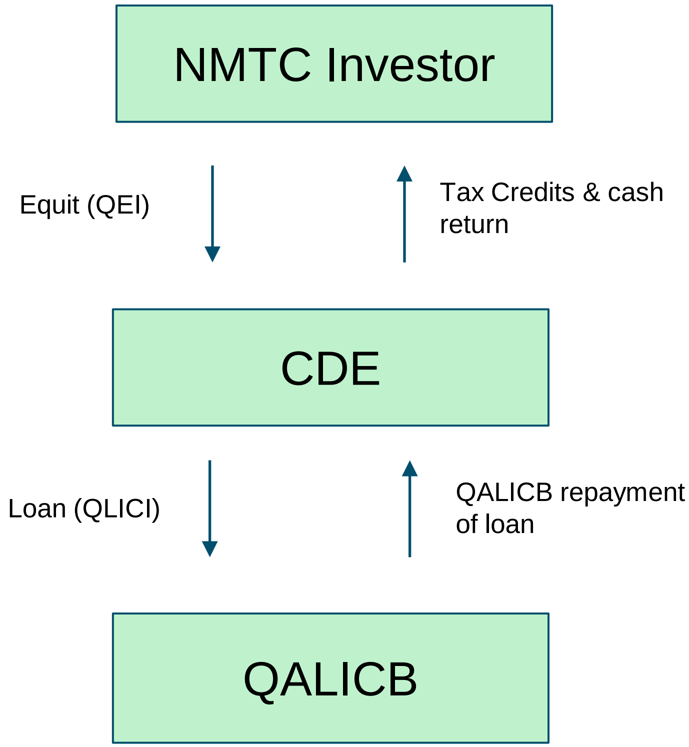
New Market Tax Credits

Sample NMTC Financing Structures

- Unleveraged
  - Direct funding to CDE from the NMTC investor
  - CDE in turn provides financing (debt and/or equity) to QALICB
  - Advantages: simpler and may have lower transaction costs
- Leveraged
  - IRS Rev Rul 2003-20 approved a leveraged structuring
  - Leverages additional NMTC equity
  - Adds additional layer (i.e. upper tier) to the financing structure
  - Funding to CDE is the qualified equity investment
  - Debt financing does not interfere with NMTC investor receiving tax benefits

Sample Unleveraged (Direct Investment) NMTC Structure



Transaction Summary

-NMTC investor provides equity to the CDE
-CDE provides debt financing to the QALICB (may be split as two loans (senior and subordinate)
-The loans have a 7 year term consistent with the tax credit schedule
-QALICB makes interest-only payments during the term of the loans
-Loans are repaid or refinanced at the end of the seven-year compliance period (and CDE redeems the QEI at that time)

Tax Credit Schedule (on $3 million QEI)

-year 1	$150,000 (5% of QEI)
-year 2	$150,000 (5% of QEI)
-year 3	$150,000 (5% of QEI)
-year 4	$180,000 (6% of QEI)
-year 5	$180,000 (6% of QEI)
-year 6	$180,000 (6% of QEI)
-year 7	$180,000 (6% of QEI)

Total: $1,170,000 (39% of QEI)

Leveraged Investment Structure

1. Rev Rul 2003-20 permits a leveraged financing structure
2. Permits splitting economic and tax benefits of an NMTC transaction
   a. Lender receives economic benefits of its loan
   b. NMTC investor receives tax credits on its investment
   c. Loan must be unsecured at this upper tier level (pursuant to Rev Rul 2003-20)

Key Facts of Rev Rule 2003-20

- Non-recourse debt - debt is non-recourse and does not contain a conversion or participation feature
- Unsecured loan - Loan is secured only by Investment LLC's interest in the CDE (i.e. assets of the CDE or QALICB do not secure the loan)

Pros/Cons Leveraged Structure

- Pricing:
  - NMTC investor receives NMTCs on cash investment plus amount of the QEI financed by debt (cf. to direct investment where NMTCs are only generated by cash investment)
  - Example later
- Difficulties:
  - Potential difficulty obtaining unsecured loans from lenders on terms that fit the deal
  - Potential complications on multiple-tier funding structure (e.g. limitations on cash distributions)

Sample New Markets Leveraged Structure

1 Lender → 3 Investment LLC ← 2 NMTC Investor

4 ↓

5 CDE

6 ↓

7 QALICB

1. Lender loans $7.5mm to LLC.
2. NMTC contributes $3mm in capital to LLC in return for NMTCs.
3. NMTC investor owns 99.9% of LLC. Managing member holds 0.1% interest in LLC.
4. LLC makes equity investment (QEI) in CDE.
5. CDE retains servicing fee (e.g. 2%).
6. CDE makes 2 loans to QALICB:
   "A" Loan (leveraged lender): Conventional loan with Lender's loan funds (mirrors terms of leveraged lender's loan)
   "B" Loan (NMTC equity): at least 7 year term, below market interest rate (may be cancelled after 7 years or refinanced)

<u>Other notes:</u>

-At end of 7 years QALICB could purchase NMTC investor's interest [e.g. with funds that were escrowed initially]

-QALICB then would own investor LLC and CDE

Sample Sources/Uses

Investment Fund

Sources		**Uses**	
Equity	$3,000,000	Qualified Equity Investment (QEI)	$10,500,000
Loans			
"A" Loan	$7,500,000		
Total	$10,500,000	Total	$10,500,000

CDE

Sources		**Uses**	
QEI	$10,500,000	"A" Loan	$7,500,000
		"B" Loan (NMTC equity component)	$2,475,000
		Syndication Fees/Expenses (5%)	$525,000
Total sources	$10,500,000	Total Uses	$10,500,000

QALICB

Sources		**Uses**	
"A" Loan	$7,500,000	Total Project Cost	$9,975,000
"B" Loan	$2,475,000		
Total	$9,975,000	Total	$9,975,000

Comparison of Equity Raise

- $3 million of NMTC equity
- Direct Investment NMTC Equity Raise
  - $1,170,000 (39% of $3 million QEI)
- Leveraged Structure NMTC Equity Raise
  - $4,095,000 (39% of $10.5 million QEI)

"A" Loan

- Reflects terms of the leveraged lending source
- Term driven by deal specifics (lender requirements, financial projections, residual analysis, etc.)
- If conventional loan, market rate of interest or, if government agency loan, perhaps below-market rate of interest
- May be interest only for first 7 years
- Term of <u>at least</u> 7 years (i.e. NMTC compliance period)
- Repaid or refinanced after year 7

"B" Loan

- May be interest only for 7 years
- May have a longer term (e.g. 40 years) depending upon transaction details
- Below market rate of interest
- Debt may be subject to cancellation after investor exits

Guaranties to Investor

- QALICB Guaranties
  - Typical loan guaranties
  - NMTC compliance guaranties
    - Maintain standing as QALICB
- CDE Recapture Guaranties
  - Continue to be certified as CDE
  - Utilize substantially all (i.e. at least 85%) of QEI for qualified investments
  - Meet QEI requirements throughout 7-year compliance period

Transaction Costs in NMTC Transaction

- Origination fees (CDE)
- Asset management fee (CDE)
- Reserve Requirements of NMTC investor

- QLICI = QEI – transaction costs

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Exit Strategies

- QALICB can repay or refinance loan(s)
- Put options may be in place (with dedicated reserves) during the initial structuring so the QALICB can buy out the NMTC investor interest
- Debt may be cancelled after investor exits

Other issues with PHAs Participating in NMTCs

- If serving as lender, are PHA sources eligible for financing commercial activities?
  - HOPE VI - No
  - Capital funds if permissible end use (e.g., PHA office space)
- Ill-defined HUD approval process (i.e. is this mixed-finance development?) could increase transaction costs

Other issues with PHAs Participating in NMTCs (con't)

- As potential allocatees:
  - Proper structure to utilize NMTCs?
  - Experience doing commercial development?
  - Sufficient projects in pipeline?
  - Capacity to manage the NMTC program?

Some PHAs with NMTC Allocations

- Hamptons Roads Ventures, LLC (affiliate of Norfolk Redevelopment and Housing Authority)
- Seattle Community Investments (affiliate of Seattle Housing Authority)
- Kitsap County NMTC Facilitators I, LLC (affiliate of Kitsap County Consolidated Housing Authority)

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