BANKER & TRADESMAN

Reprinted from the Banker & Tradesman online article featured on March 29th, 2010

SEEKING AN EXTENSION

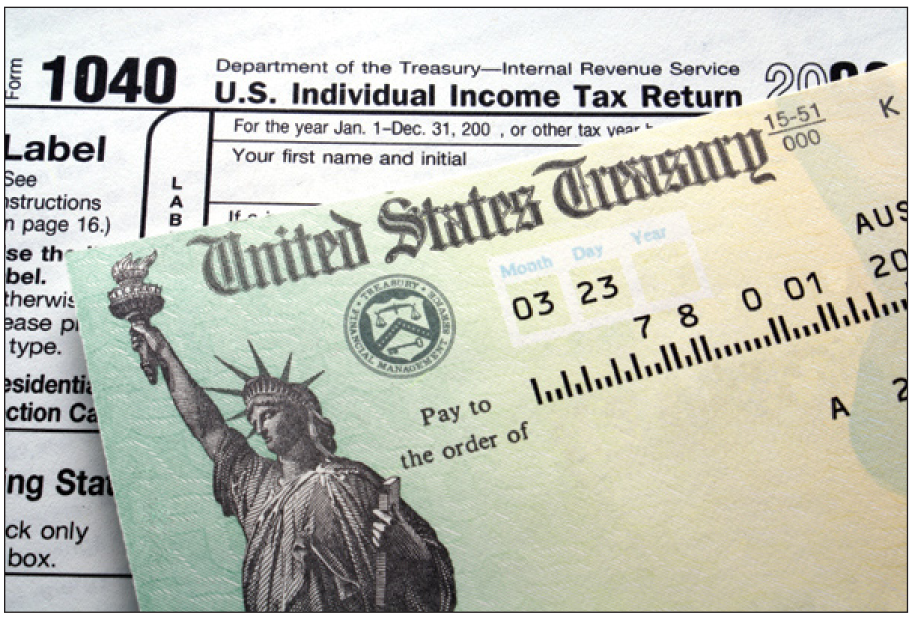
Finding Financing In New Markets Tax Credits

Program Helps Borrowers Bridge Gap In Difficult Economic Times

BY DOUGLAS M. HENRY & BETHANY A. BARTLETT | SPECIAL TO BANKER & TRADESMAN

In the wake of last year's meltdown on Wall Street, traditional real estate financing has been either unavailable or on terms that are onerous or unacceptable to borrowers. However, for certain projects, the federal New Markets Tax Credit program (NMTC) may provide borrowers with a source of equity or lower interest rates that can make a project viable.

NMTC projects involve multiple stakeholders, complicated tax issues, and, as with most federal programs, are not for the acronym adverse. NMTC transactions are complicated, requiring consultants, accountants and attorneys for the various stakeholders. However, the higher transaction costs are more than offset by the lower interest rates or increased equity that can make a project succeed.



How Does The Program Work?

In essence, investors get tax credits for funds they channel through community development organizations into projects in economically depressed areas. Here's how it works in detail: Tax credit investors contribute to an investment fund in exchange for New Markets Tax Credits. The NMTC program allows a credit against federal income taxes for investors whose funds make a "qualified equity investment" (QEI) in designated "community development entities" (CDEs). A CDE must use substantially all of the QEI to provide a "qualified low-income community investment" (QLICI) in the form of debt or equity to a "qualified active low-income business" (QALICB).

Often, the investment fund receives not only contributions from a tax credit investor for the purchase of the NMTC, it also often receives a nonrecourse loan from a community or commercial bank that has the effect of leveraging the tax credits so the investor gets a greater return on its purchase of the NMTC.

Who Can Be A Qualified Low Income Community Business?

Before a borrower lines up tax credit investors, CDEs with NMTC allocations, and leveraged lenders, it should initially determine whether it is a QALICB. A QALICB can be either a for-profit or non-profit entity, but the assets to be financed must be located in a qualified low-income community

Reprinted with permission of Banker & Tradesman. *This document may constitute advertising under the rules of the Supreme Judicial Court of Massachusetts.*

as determined by the government. The NMTC program is administered by the Department of Treasury's Community Development Financial Institution Fund (CDFI). The CDFI Web site (www.cdfifund.gov) lists areas by census track that qualify as low-income communities for the NMTC program.

A QLICB Borrower needs to find a usable NMTC allocation.

Each year, CDFI makes allocations of New Markets Tax Credits to various CDEs throughout the United States. Each CDE, in applying for an allocation, generally proposes to use its NMTC allocation in a specific geographical area and for certain types of projects. Contacting a CDE is usually a good initial step for a borrower to see if any tax credits are available for a specific transaction, and whether the borrower's project fits the criteria for that particular CDE's allocation.

The CDFI Web site identifies all of the NMTC allocatees, including the most recent allocation round completed in late 2009. Three Massachusetts-based entities – a MassDevelopment affiliate, a Massachusetts Housing Investment Corporation affiliate, and Boston Community Capital, Inc. – all received allocations in this latest round.

How Does A Borrower Find A Tax Credit Investor To Purchase The New Markets Tax Credits?

Most CDE allocatees have relationships with different tax credit investors from prior NMTC transactions. Many of the prominent investors in the NMTC area are large financial institutions. The largest investor in the NMTC arena, both nationally and in Massachusetts, is US Bancorp Community Development Corp., an affiliate of US Bank. Several large national banks, such as Bank of America and JP Morgan Chase, are also tax credit investors, but they often serve multiple roles in specific transactions, such as the CDE, investor and leveraged lender.

Does A Borrower Also Need A Leveraged Lender?

NMTC transactions that are "leveraged" are more attractive to tax credit investors because they receive a better return on the tax benefits provided through the credits against the initial purchase price for such credits. The tax benefit is based on the QEI, which includes both the price paid for the credits and the amount of the leveraged loan. Financial institutions in Massachusetts that have served as leveraged lenders include a number of community banks, such as Wainwright Bank & Trust Co., Boston Private Bank and United Bank in Springfield, as well as commercial banks RBS Citizens, N.A. and TD Bank.

The collateral for a leveraged loan is the pledge of the investment fund's membership interest in the CDE, not a direct mortgage on the underlying project. Lenders that have not yet served as leveraged lenders need to get comfortable with this type of collateral. In addition, as there is a seven-year holding period for NMTCs, a leveraged lender is not permitted to exercise its remedies against the investment fund until the expiration of that holding period.

Because of the non-traditional collateral and limitations on remedies, the leveraged lender, CDEs and tax credit investors must come up with creative solutions to "redeploy" the QEI at a project level if a default occurs during this holding period. These negotiations require a sophisticated understanding of each party's interests in these transactions.

Can An NMTC Program Be Combined With Other Forms Of Credit?

The NMTC program can be used with other forms of credit. For example, if the QALICB is a 501(c)(3) corporation, leveraged lenders can purchase tax exempt bonds and use the proceeds of these bonds to make a leveraged loan. The lower interest rates on the tax exempt bonds pass through to the QEI. Federal and state historic tax credits can also be used with NMTC, although leasehold structuring issues have to be resolved to make this combined tax credit approach workable.

What Projects In Massachusetts Have Taken Advantage Of This Program To Date?

Some recent Massachusetts projects that used NMTC are: the Holyoke Health Center in Holyoke; the Hanover Center for Performing Arts in Worcester; The Coalition for Buzzards Bay headquarters in New Bedford; and various Boston projects including the Greater Boston Food Bank, Boston Healthcare for the Homeless, Community Servings, Hope House, Project Place and Harborhealth.

How Long Will The NMTC Program Exist?

The current NMTC program only runs through the end of 2009, although the $5 billion dollars of allocations made in 2009 can be used over the next five or so years. The House of Representatives has already passed a bill extending the NMTC program through 2010. The Senate Finance Committee has promised prompt action on that extension. Many experts in the NMTC industry expect the extension to take place in the very near future for a minimum of another year.

■

Reprinted with permission of Banker & Tradesman. *This document may constitute advertising under the rules of the Supreme Judicial Court of Massachusetts.*