

An affiliate of LISC



New Markets Support Company

# New Markets Tax Credits

## An Overview of Equity Investing



# Program Summary

- New Markets Tax Credit (NMTC) program stimulates private investment in low-income communities that are traditionally overlooked by conventional capital markets
- \$33 billion program administered by Community Development Financial Institutions (CDFI) Fund of U.S. Treasury Department
- Program provides a credit against federal income taxes for investors that participate
  - CDFI Fund allocates tax credits through competitive process to qualified Community Development Entities (CDEs), which provide loans, investments, or financial counseling in low income communities to primarily real estate projects or businesses
  - Investor participates by making equity investment into CDEs, thereby allowing it to redeem the tax credits, subject to rules of program
- \$1 to \$5 billion annual market for NMTC equity investments

# The Tax Credit

- Tax credit equals 39% of total investment made in CDE
  - Opportunity to increase tax credit amount by using financial leverage when making investment into CDE (see Sample Investment Flow Chart)
  - Leverage provider may also be equity investor
  
- Tax credit is claimed and compliance is over seven-year period
  - 5% of investment in years one through three, 6% for each year thereafter
    - Full 5% may be taken in year one, regardless of closing date
    - Investor capital must be invested in CDE for seven years to earn all credits

# Example and Benefits Schedule

## Example Project

- \$10 Million Project
  - ▣ \$3.0 million investor equity
  - ▣ \$7.0 million loan from investor or 3<sup>rd</sup> party
- 39% tax credit = \$3.9 million
  - ▣ \$500k (5%) in years 1 – 3
  - ▣ \$600k (6%) in years 4 – 6
- Investor pays \$0.77 per tax credit
  - ▣  $\$0.77 * 39\% = \$3.0$  million

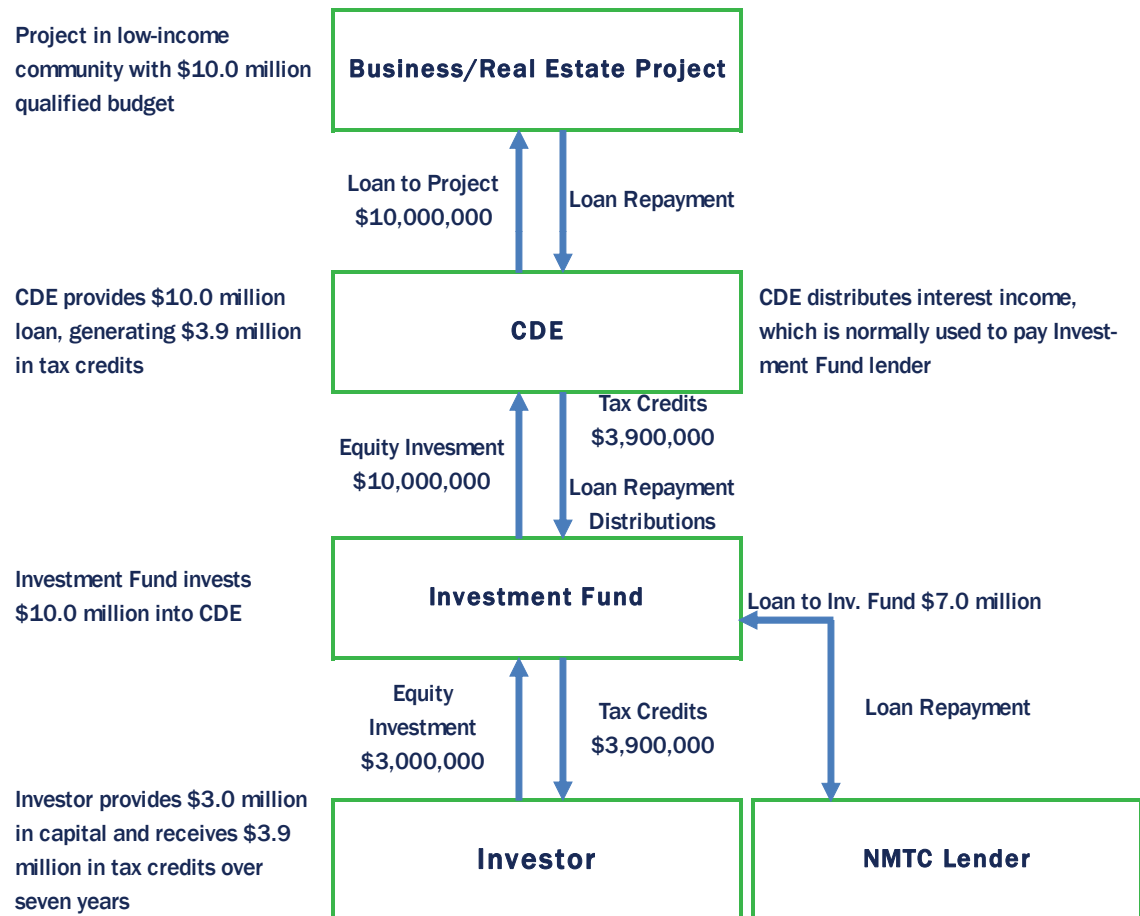
## Investor Benefits Schedule

Year	Capital Contributions	Federal NMTC Tax Credits	Tax Benefits From Capital Loss/(Gain)	Total Tax Benefits	Tax Benefits Less Capital Contributed	Cumulative Tax Benefits As % of Capital Contributed	IRR
2012	3,000,000	500,000	-	500,000	(2,500,000)	16.67%	
2013	-	500,000	-	500,000	500,000	33.33%	
2014	-	500,000	-	500,000	500,000	50.00%	
2015	-	600,000	-	600,000	600,000	70.00%	
2016	-	600,000	-	600,000	600,000	90.00%	
2017	-	600,000	-	600,000	600,000	110.00%	
2018	-	600,000	(315,000)	285,000	285,000	119.50%	
<b>Totals</b>	<b>3,000,000</b>	<b>3,900,000</b>	<b>(315,000)</b>	<b>3,585,000</b>	<b>585,000</b>	<b>119.50%</b>	<b>6.59%</b>

Investment model of capital, tax credits, and after tax benefits/costs of tax deductions and resulting annual IRR. The numbers used in this benefit schedule are hypothetical and are for illustrative purposes only. They should not be considered a prediction, forecast, or guarantee of actual results to be realized.

# Flow of Funds

Sample Investment Flow Chart\*



\*simplified example which assumes no transaction costs

# Primary Rewards

- Financial
  - Typical *after-tax* internal rates of return range from 6% to 12% depending on level of pricing and timing of transaction closing
  
- Social / Public Relations
  - Projects normally have strong community impact, generating social returns and creating positive public relations opportunities
  
- Regulatory
  - Investment in New Markets Tax Credit project may satisfy Community Reinvestment Act requirements of financial institutions

# Primary Risks

- Tax
  - Taxable income required
  - Cannot be used to offset AMT
  
- CDE Performance and Management
  - CDE must do the following or tax credit recapture can occur:
    - Continually meet CDFI Fund's requirements for maintaining its CDE certification and compliance with tax credit allocation agreement
    - Continuously invest "substantially all" of original investment proceeds, defined as at least 85% of investment amount
    - Redeploy capital that has been repaid earlier than seven-year compliance period by project
  
- Liquidity
  - No active secondary market

# For More Information



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