

NMSC's New Markets Program (Frequently Asked Questions)

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Thank you for your interest in NMSC!

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GENERAL QUESTIONS ABOUT THE NEW MARKETS TAX CREDIT (NMTC) PROGRAM

What Are New Markets Tax Credits?

The *New Markets Tax Credit* (NMTC) program represents the largest federal community development tax initiative in nearly 20 years. It is designed to provide investors such as banks, insurers, investment funds, corporations, and individuals with credits against federal income tax in return for new investments made in eligible businesses and commercial projects in low-income areas. It is a flexible tool that can be applied to a wide range of qualified business activities, from small business lending to financial counseling to real estate development.

NMTCs are administered by the *Community Development Financial Institutions* (CDFI) Fund, which is part of the US Department of the Treasury. Tax credits for \$15 billion of investments will be allocated by the CDFI Fund between 2002 and 2007 through a competitive process.

NMTCs are intended to spur the investment of new capital through *Qualified Equity Investments* (QEIs) in *Community Development Entities* (CDEs). Each CDE is certified as such by the CDFI Fund and must use substantially all of its QEIs to provide financial support (generally debt or equity financing) called *Qualified Low-Income Community Investments* (QLICIs) to *Qualified Active Low-Income Community Businesses* (QALICBs).

What Is a Qualified Active Low-Income Community Business (QALICB)?

QALICBs must satisfy certain tests regarding the proportion of their gross income, use of tangible property, and employee services that relates to *Low-Income Communities* (LICs). Although QALICBs can engage in a wide variety of business activity (including commercial real estate development and business conducted by nonprofits), there are several restrictions. These include limits on the amount of collectibles or nonqualified financial property that they can hold. In addition, certain business activity is ineligible, including the operation of residential rental property (although a mixed-use project would qualify if a building derives less than 80% of its income from residential dwelling units), the ownership of properties where no substantial improvements are made, the development or holding of intangibles, and the operation of other specified ineligible businesses (which include golf courses, race tracks, gambling facilities, certain farming businesses, and stores where the principal business is the sale of alcoholic beverages).

What Is a Low-Income Community?

A Low-Income Community is a census tract with at least 20% poverty or where the median family income is below 80% of the area median family income. Census tract eligibility can be determined at the CDFI Fund's website helpdesk: www.cdfifundhelp.gov/, and there is a process for designating a portion of a census tract that would not otherwise meet these requirements.

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How Do Investors Benefit from NMTCs?

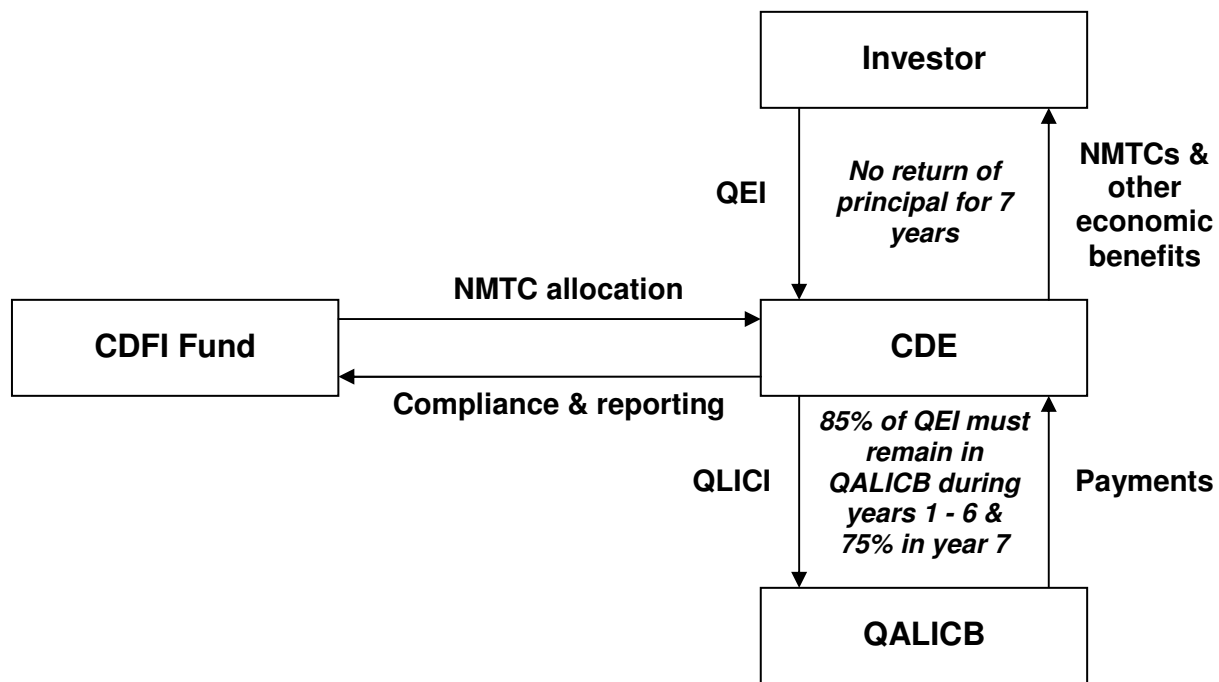
Under the terms of the NMTC program, the investor makes a seven-year QEI in the single-project CDE and receives NMTCs equal to 39% of the investment amount over that seven-year period (5% in years 1-3 and 6% in years 4-7). In addition, the investor may receive economic benefits from the project. During the seven-year investment period, these economic benefits can only consist of some portion of the return on the capital invested, and after seven years, they can include the return of capital as well as the return on capital.

The project / QALICB receives the NMTC benefits remaining after the investor achieves its desired yield and the costs and fees related to the NMTC investment have been covered. The specific distribution of benefits is determined through negotiation among the investor, the project developer, and NMSC.

What Are the Risks Relating to NMTC Investments?

NMTCs are subject to recapture if (1) the CDE loses its certification from the CDFI Fund; (2) the CDE redeems the equity investment within seven years; or (3) the CDE proceeds fail to meet the “substantially all” test (85% of QEI proceeds must be in QLICIs during the first six years; 75% during the seventh year). The amount recaptured equals all NMTCs claimed plus interest. NMSC (LISC’s NMTC affiliate) will work to structure the transaction and administer the single-purpose CDE to avoid recapture. In addition, NMTCs are subject to federal tax on capital gains.

Simplified Diagram of NMTC Investment Structure



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LISC'S ROLE IN THE NMTC PROGRAM

What Is LISC's Role in the NMTC Program?

LISC has received NMTC awards totaling \$155 million, and its NMTC activities are being managed by an affiliate, the New Markets Support Company, LLC (NMSC).

Where Will LISC's Use its NMTCs?

NMSC will use NMTCs to provide loan and equity capital investments that support the community development strategies of LISC programs. LISC operates in the communities served by its 35 local offices and the 75 community development corporations supported by its rural program.

What Types of Transactions Will NMSC Finance?

NMSC's financing activities will build upon LISC's core competency of real estate development. The NMTC is particularly well suited to commercial real estate development, given the credit's longer-term investment requirement, the ability for project-based returns to bolster investor returns, and the geographic-based nature of the credit. NMSC can use NMTCs for a broad array of non-housing real estate projects such as shopping centers, office space, educational and community facilities, child care centers, and community health centers. Under appropriate circumstances, NMSC may also provide business financing.

What Type of Financing Does NMSC Provide?

NMSC generally provides debt financing, although equity may be provided for transactions that involve historic tax credits, or under other appropriate circumstances. Financing generally takes the form of construction financing that converts to mini-perm financing.

What Are the Terms of NMSC's NMTC Financing?

NMSC generally provides NMTC financing in amounts ranging from \$4 to \$15 million, although it may introduce a product to provide NMTC financing from \$1 million to \$5 million. NMSC's NMTC financing generally takes the form of 7-year, mini-perm financing that bears interest only, with a sinking-fund requirement on a 15- to 25-year amortization schedule. NMSC's NMTC financing generally requires a first-position mortgage on project assets, although subordinate financing may be provided under appropriate circumstances. Loan-to-value requirements start at 80%, with higher ratios permitted under appropriate circumstances, and debt coverage ratios start at 1.2 to 1, with lower ratios permitted under appropriate circumstances. The interest rate for NMSC's NMTC financing generally ranges from 50 to 200 BP below conventional rates for comparable transactions, and depending upon project needs, community impact, and other criteria, LISC may structure its NMTC financing to provide (1) a deeper interest-rate reduction (150 BP or more) and 100% repayment or (2) a shallower interest-rate reduction (50 to 150 BP) with a repayment requirement of 80% or more.

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What Fees Does NMSC Charge?

NMSC expects to charge fees to recover upfront expenses to structure the transaction, some ongoing costs for administration, compliance, asset management, and servicing expenses, as well as NMSC's overhead for operating its New Markets Program. The structure and amount of fees depends upon the type of financing provided. If a borrower receives a deeper interest-rate reduction loan with 100% repayment, there may be an origination fee from 1.0% to 2.0%. The fees associated with a partial repayment loan are factored into calculating the interest-rate reduction and repayment percentage, which are therefore provided net of fees.

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ADDITIONAL INFORMATION

Where Can I Get More Information?

You can find information about the NMTC program at the following websites:

- CDFI Fund website: <http://www.cdfifund.gov/programs/nmtc/index.asp>
- NMTC Coalition website: <http://www.newmarketstaxcreditcoalition.org/>

If you have a potential NMSC NMTC opportunity, you should bring it to the attention of the staff of the local LISC office, who will work with NMSC staff to evaluate it.

Thank you for your interest in LISC's New Markets Initiative!

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