

U.S. Department of the Treasury



Community Development Financial Institutions Fund

New Markets Tax Credits:
2003 Allocation Application

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 Aligned with Treasury Mission

| Treasury Goals | Treasury Objectives | CDFI Fund Objectives |
|---|--|--|
| <i>Promote prosperous U.S. and world economies</i> | Increase economic growth and create jobs | Improve the economic and living conditions of underserved communities by providing an array of community development financial services through CDFIs and CDEs. |
| <i>Preserve the integrity of financial systems</i> | Preserve and increase the reliability of the U.S. financial system | Strengthen the financing, capacity, sustainability or self-reliance of a nationwide network of regulated and non-regulated financial institutions serving underserved areas. |

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

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

Look Back Allowance

Equity investments made before an entity enters into an Allocation Agreement with the Fund may be considered QEIs if:

- For the 2003 allocation round, the investment is made on or after July 18, 2003.
- The equity investment otherwise satisfies all other requirements of the applicable IRS regulations.

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.

CDE Use of NMTC Proceeds

“**Substantially all**” of the investor proceeds must be invested in QLICs **within 12 months**

Years 1-6: Substantially All = 85% of amount paid by investor at original issue

Year 7: Substantially All = 75%

Regulations provide for reinvestment of capital recovered over the 7 year period.

At all times, 5% of the original QEI issue amount may be used for certain reserves by the CDE and counts towards meeting the substantially all test.

CDE Use of NMTC Proceeds (Cont'd)

- QEI Proceeds must be invested in QLICs throughout the **7- year** credit period
- CDE reinvestment requirement
 - Years 1-6:
 - Generally, returns **of** capital must be reinvested within **12 months**
 - Periodic loan repayments may be aggregated for up to 24 months before reinvestment is required
 - No reinvestment required in year 7

CDE Use of NMTC Proceeds (Cont'd)

A CDE may demonstrate that it has satisfied the substantially all requirement in 2 ways:

- 1) Direct tracing
- 2) Safe harbor

CDE Use of NMTC Proceeds (Cont'd)

- 1) Under direct tracing, a CDE is required to trace QEI proceeds to specified QLICs
- 2) Under safe harbor, a CDE must demonstrate that 85% of its aggregate gross assets are invested in QLICs

Recapture

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

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

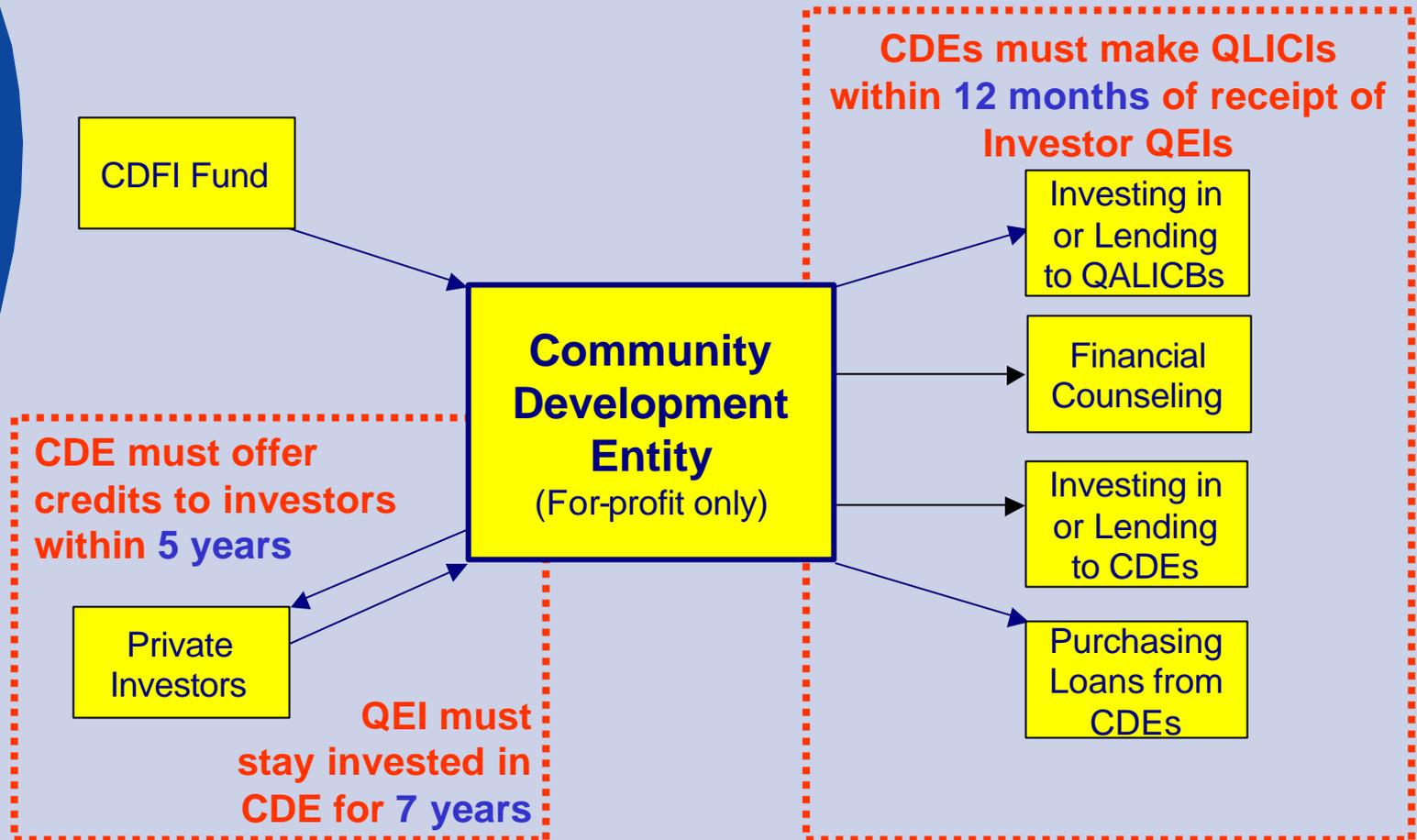
- e.g., Failure to invest 85% as allowed;
- Failure of investment to meet QALICB requirements; or
- Failure to meet one-year investment requirement

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

Sample Strategies: Loan Funds

Option A: Raise Equity Directly

- Qualify as a CDE
- Apply directly for a NMTC allocation to raise equity for project(s)
- Finance related or unrelated project(s)

Option B: Market Deals to other CDEs

- Qualify as a CDE
- Sell qualifying loans to allocated CDEs
- Receive loans and investments from other allocated CDEs

Sample Strategies: Financial Institutions

- Holding company and bank qualify as CDEs; holding company receives tax credit allocation, raises equity from investors and invests in subsidiary CDE bank; subsidiary CDE bank makes eligible QLICs.
- Bank-owned CDC qualifies as CDE, receives tax credit allocation, raises money from investors (which may include the bank) and makes eligible QLICs.
- Bank (or bank subsidiary) qualifies as CDE, sells loans to other CDEs that were allocated NMTCs.

Sample Strategy: Business Investees

- Locate in NMTC eligible census tract
- Develop a business plan documenting long- and short-term capital needs
- Identify NMTC allocation recipients on the Fund's website
- Market your business strategy to CDE investors serving your market niche
- There is no requirement that the business qualify as a CDE

Why Become a CDE?

- For-profit CDEs may raise capital by offering tax credits to investors
- All CDEs (including non-profits) are eligible to receive loans and investments from or sell loans to CDEs that have been issued tax credit allocations by the Fund

Timeframe to Apply for CDE Designation

- Generally, CDE applications are accepted on a rolling basis.
- Any entity not yet certified as a CDE that intends to apply for an allocation of NMTCs in the 2003 round must submit its CDE certification application to the Fund by August 29, 2003.

Certified CDFIs and SSBICs

- Automatically qualify for CDE certification
- May register as CDEs electronically at: www.cdfifund.gov
- Affiliates and subsidiaries of CDFIs and SSBICs:
 - Do not automatically qualify as CDEs
 - Must complete a CDE Certification Application

Legal Entity Test

Entities applying for CDE certification must:

- Be incorporated or formed as a domestic corporation or partnership; and
- Have a valid and distinct Employer Identification Number (EIN)

Primary Mission Test

Key Question:

Does the Applicant CDE – and all subsidiary applicants – have a primary mission of serving or providing investment capital for Low-Income Communities or Low-Income Persons?

Primary Mission: Information Needed

Step 1:

Provide organizational documents evidencing an appropriate primary mission

Such organizational documents may include:

- Bylaws
- Articles of incorporation or organization
- Partnership agreements
- Board resolutions

Primary Mission: Information Needed (cont'd)

Step 2:

Submit “Certification of Authorized Representative” demonstrating that at least 60% of products and services are and will continue to be directed to:

- Low-Income Persons (LIPs)
- Low-Income Communities (LICs), or
- Organizations serving LIPs or LICs

Accountability Test

Key Question:

Is the Applicant CDE – and all subsidiary applicants – accountable to the residents of the LICs it serves or expects to serve?

Accountability: Information Needed

Step 1: Identify a service area

- Local (e.g., neighborhood; city; county; metropolitan area; Indian Reservation)
- Statewide or territory-wide
- Multi-state (2-6 states or territories)
- Regional (e.g., New England)
- National

Accountability: Information Needed (cont'd)

Step 2:

Identify how the Applicant CDE intends to maintain accountability to residents of low-income communities:

- ✓ Through the use of a Governing Board
- ✓ Through the use of an Advisory Board(s)

Accountability: Information Needed (cont'd)

Step 2 (cont'd):

Applicant CDEs fulfilling accountability through an **advisory board** will need to provide narrative indicating:

- ✓ How advisory board members are selected;
- ✓ How often the advisory board convenes;
- ✓ How it solicits feedback from the community; and
- ✓ How it informs the actions of the governing body.

Accountability: Information Needed (cont'd)

Step 3:

Complete the “Accountability Chart” to demonstrate that 20% of the members of either the governing board or advisory board(s) represent LICs in the service area.

Applicants using multiple advisory boards must complete a separate chart for each advisory board.

Who is Representative of LICs?

- A board member must either:
 - Reside in a LIC in the service area; or
 - Represent the interests of residents of LICs in the service area
- Examples of representation include:
 - A small business owner whose business is located in a LIC in the service area
 - An employee or board officer of a community-based or charitable organization primarily serving LICs in the service area
 - An employee of a governmental agency that principally provides services benefiting LICs

Who is not Representative?

- Board members that are principals or staff members of the Applicant CDE, its affiliated entities or its investors cannot be deemed representative of LICs.
- An Applicant CDE may designate board members that are also on the board of an affiliate as representative of LICs, but only if:
 - The board members are not principals or staff members of the Applicant CDE, its affiliated entities or its investors; and
 - The board members can be deemed representative of LICs through means other than their association with the affiliated entity.

Other LIC Representation Tips

- The NTMC Program is geographically targeted to low-income census tracts
- Serving minority or low-income populations is not the equivalent of serving low-income communities
- Applicants seeking a national service area should have either:
 - At least one LIC representative from a national organization; or
 - LIC representatives from a broad cross-section of the nation

Using the Online Help Desk

Visit the Fund's Online Help Desk:

www.cdfifundhelp.gov

- Identify census tracts throughout the country that qualify as NMTC-eligible low-income communities
- Geocode addresses of customers, transactions or board members to see whether they qualify as serving low-income communities

Applying for a NMTC Allocation

2003 Round Deadlines

| Deadline | Date |
|---|---------------------|
| Anticipated release of online application | August 22 |
| Receipt of CDE certification or CDE Certification Application | August 29 |
| Notification of intent to submit a paper Allocation Application | September 15 |
| Submission of Allocation Application (online or paper version) | September 30 |
| Receipt of attachments for <u>paper</u> applications | September 30 |
| Receipt of attachments for <u>online</u> applications | October 7 |

Preparing for the Online Application

- Register as a user through myCDFI/CDE
- Ensure you have sufficient internet access
- Familiarize yourself with the paper application
- Start constructing your responses in MS Word or other word processing software

Key Differences between 2002 and 2003

The general content of the Allocation Application did not change significantly between 2002 and 2003, but there are some key differences:

- Affiliates may collectively submit only one application per NMTC round
- Reduced information collection
- Changes in attachments
 - Upfront collection of investor letters required
 - Resumes no longer required
 - Electronic attachments no longer accepted

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

2002

**Allocation Round
and Allocatees**

NMTC 2002 Applicant Pool

- 345 applications received
- \$25.8 billion requested in total
 - Average = \$75 million
 - Maximum = \$1 billion
 - Minimum = \$300,000

Allocation Amounts

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

QLICI Activities

- 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

Types of Organizations

- 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

Areas Served

- Serve 40 states and the District of Columbia
- 20 allocatees will predominantly serve rural areas
- Service area analysis:
 - 15 are national
 - 12 cross multiple states
 - 17 are statewide
 - 22 are local

Sample Real Estate Activities

- Lend to non-profits to purchase and rehabilitate theaters in LICs
- Develop a transit-oriented commercial center
- Support a loan program for real estate projects such as health clinics, substance-abuse centers, childcare facilities, community-based charter schools, and office buildings for nonprofits
- Property acquisition and development of for-sale housing

Sample Business Activities

- Invest in businesses focused on sustainable forestry and economic development
- Provide equity and “near-equity” investments to companies in any stage of the business life-cycle (from start-up through traditional small business and commercial lending)
- Provide equity capital to disadvantaged individuals/entities seeking to own and operate franchises in underserved urban markets

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

Fax: (202) 622-8911

Email: cdfihelp@cdfi.treas.gov

IT Support

Ph: (202) 622-2455

Email: ithelpdesk@cdfi.treas.gov

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