



New Markets Tax Credit Program Native Initiative Training and Technical Assistance Workshop: Introduction to the NMTC Native Initiative

September 21, 2022

Author: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

The CDFI Fund

The Community Development Financial Institutions Fund (CDFI Fund) was established in 1994 by Congress and is a within the U.S. Department of Treasury.

The CDFI Fund's mission is to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers.

The CDFI Fund administers:

- Community Development Financial Institutions Program (CDFI Program)
- Native American CDFI Assistance Program (NACA Program)
- Capital Magnet Fund (CMF)
- Bank Enterprise Award Program (BEA Program)
- New Markets Tax Credit Program (NMTC Program)
- Other CDFI Fund programs

New Markets Tax Credits Program

- The NMTC Program was authorized under the Community Renewal and Tax Relief Act of 2000 and has been subject to reauthorization since 2006. Most recently, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 provided \$5 billion in NMTC allocation authority for calendar years 2021 through 2025.
- In the 17 application rounds to date, the CDFI Fund has made 1,354 allocation awards totaling \$66 billion in tax credit authority.
 - Includes \$3 billion in Recovery Act awards and \$1 billion for recovery and redevelopment from Hurricane Katrina.

New Markets Tax Credits in Native America

This Native Initiative is part of the CDFI Fund's strategy to improve access to capital in *NMTC Native Areas*:

- Federal Reservations
- Off-Reservation Trust Lands
- Hawaiian Home Lands
- Alaska Native Village Statistical Areas

Since inception, the NMTC program has generated more than \$66 billion of investments in low-income communities.

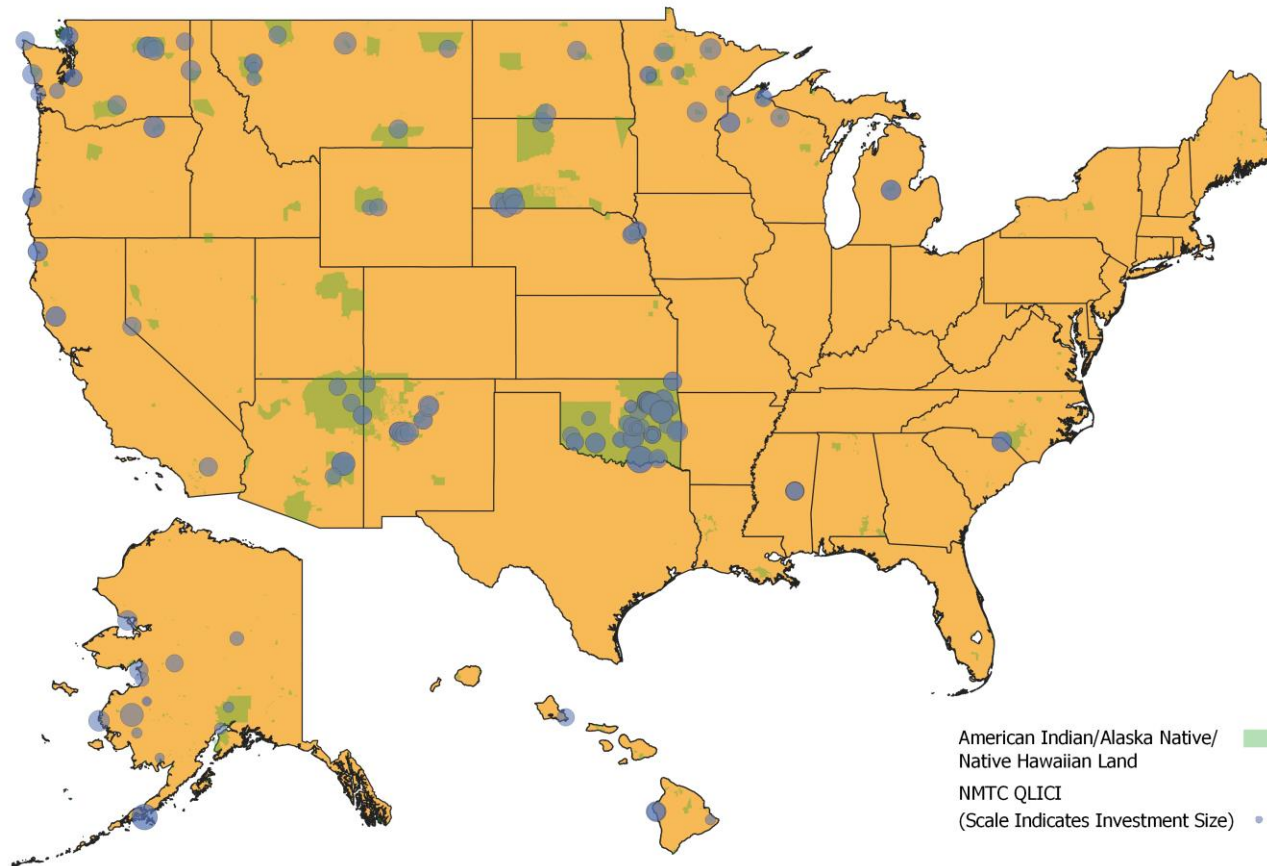
That amount includes \$935.9 million worth of investment in *NMTC Native Areas* (through FY2019).

New Markets Tax Credits in Native America

A snapshot of the current landscape:

- There have been 155 NMTC-financed businesses/projects in NMTC Native Areas and Oklahoma Statistical Areas through FY2019.
- The median amount invested per financed business/project is \$10,571,861 (adjusted for inflation to 2022 dollars)
- The 3 CDEs that have invested the most in NMTC Native Areas are not themselves Native-owned or controlled
- Among the businesses and projects financed are manufacturing facilities, early education centers, health care providers, retail facilities, and infrastructure

NMTC Investment Locations in Native America



Obstacles for Native Participation in NMTCs

The CDFI Fund's research shows that there are unique obstacles to attracting private sector financing (including NMTC-related financing), in NMTC Native Areas.

Through the NMTC Native Initiative, we can better understand and address some of these obstacles:

- The NMTC program generally has been a better fit for projects requiring at least \$5–6 million of financing
- Low population densities and low area incomes make larger commercial projects harder to finance
- Allocations have been made to CDEs with track records that support \$15 million or more in allocation
- Few Native-owned or controlled CDEs have received awards
- A lack of knowledge about the NMTC program among Native-focused organizations has resulted in perceived barriers and avoidance
- CDEs have tried to work with Native sponsors but have struggled with Indian law, Native governments, culture, priorities, and financing methods; CDEs have completed only 125 NMTC transactions in NMTC Native Areas through FY2019, or 225 transactions taking into account Native Statistical areas (including Oklahoma statistical areas)
- NMTC investment in Native Areas has increased (as measured by number of investments) following the CDFI Fund's designation of investment in Native Lands as an Innovative Activity in the 2015-16 application. Prior to the designation, there were an average of 5.5 annual investments in NMTC Native lands. This has increased to an average of 13.25 annual investments since the designation.

Considerations for Investors, Lenders, and CDEs

Sovereign immunity is an important issue and must be treated with due respect.

- Tribes and Native Nations are sovereign and cannot be sued without consent (“limited waiver”), which can affect a lender’s ability to collect debt and perfect security interests
- Trust lands cannot be pledged for a mortgage or sold but can be leased under certain circumstances
- Some businesses/projects established in a separate legal entity may be able to grant limited waivers without involving the larger Native Government
- Each Native Government has processes that must be followed in order to enter into contracts that are binding, enforceable, and have duly authorized leases and limited waivers

Considerations for Investors, Lenders, and CDEs

- Forum Selection:
 - Choice of forum may be Tribal, State, or Federal court
 - Exhaustion of remedies doctrine may limit court jurisdiction
- Choice of Law:
 - Agree on Tribal, Federal, or State, and choice of state law
- Cultural and Community Relationships:
 - Tribes are socially, culturally, and economically unique
 - Priorities, needs, and methods of community involvement need to be understood
 - Governance and decision-making methods differ and must be respected

Considerations for Investors, Lenders, and CDEs

■ Security and Collateral

- Trust lands controlled by the Bureau of Indian Affairs may require two-part determination with State for project approval
- Leasehold mortgages and HEARTH Act authorities
- Various constraints on land uses and ownership often diminish creditors' remedies, such as foreclosure

■ Due Diligence

- Title
- Tribal legislation and requirements (taxes, environmental and archaeological considerations, use, etc.)
- Local law opinions

Possible Solutions

- Workshop 2 will include discussion of successful CDE business plan elements
- Industry-wide education about best practices and cultural competency
- Small-dollar (\leq \$4 million) NMTC loans
- Potential Native entity participation in the NMTC program as project sponsor, project advisor (including capital packager), and/or through CDE mentorship relationships
- Collaboration among Native entities and Native CDEs that have competitive track records
- Greater emphasis by the CDFI Fund on NMTC Native Lands, including:
 - listing NMTC investments in Native Areas as “innovative activity”
 - Growth of Native-controlled CDFIs
 - More Technical Assistance on the Fund’s various financing programs
 - Other training and outreach efforts



New Markets Tax Credit Program Native Initiative Training and Technical Assistance Workshop Module 1: What Are New Markets Tax Credits?

September 21-22, 2022

Author: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

What Are Tax Credits?

- Tax credits are used by a taxpayer (individual/corporation) to offset the taxpayer's amount of tax liability.
- The taxpayer reduces its required tax payment by the amount of the credit.
 - Example: taxpayer owes \$10,000, receives \$2,000 credit, pays only \$8,000 in taxes
- Credits are different from deductions. Deductions reduce amount of taxable income; credits reduce amount of tax paid.

Tax Credits as a Public Policy Tool

- Tax credits are provided when the federal (or state) government decides to forego tax revenue in order to subsidize activities that implement government policy.
- They provide an incentive for private sector entities to provide capital in support of certain aims – instead of having the government directly providing money.
- Tax credit financing packages are not grants – rather, they are a partial subsidy.

Congressional Authority

- The NMTC Program was authorized under the Community Renewal and Tax Relief Act of 2000, and has been subject to reauthorization since 2006. Most recently, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 provided \$5 billion in NMTC Allocation authority for CY 2020 to CY2025.
- In the 17 application rounds to date, the CDFI Fund has made 1,354 allocation awards totaling \$66 billion in tax credit authority.
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Purpose of New Markets Tax Credits

- Attract additional private capital into economically distressed areas throughout the country
- Target geographies that historically have struggled to obtain investment capital
 - Native lands
 - Urban low-income neighborhoods
 - Rural areas

Community Outcomes

NMTCs subsidize qualifying projects and businesses that will bring improved community outcomes in low-income communities.

Each transaction is underwritten and tracked for various community outcomes such as the number of jobs created or preserved, measurable increases in community and commercial goods and services, number of low-income people to be served, etc.

Community development principles are strongly at work. Some examples of community outcomes are:

- Providing goods or services not available in an area, such as building a grocery store in a designated food desert,
- Providing high-quality education for low-income students,
- Increasing access to health care and jobs.

Eligible NMTC Projects

New Markets Tax Credits can be used for a wide variety of projects/businesses, including:

- Commercial, industrial, or retail developments
- Community facilities (health care centers, charter schools, childcare centers, recreational or community centers and cultural facilities)
- Operating businesses (both for-profit and non-profit)
- Some infrastructure (broadband, water/wastewater treatment, electrical power generation)
- Development of for-sale housing or mixed-use projects that include rental housing under some circumstances

Key Terms and Acronyms

Community Development Entities must use...

Substantially All of the proceeds from...

Qualified Equity Investments to make...

Qualified Low-Income Community Investments in...

Qualified Active Low-Income Community Businesses located in...

Low-Income Communities

Let's unpack all that.....

Community Development Entity: CDE

The CDE is:

- A domestic partnership or corporation
- With a mission of serving low-income people and/or communities
- Accountable to those communities through a qualified advisory or governing board, AND
- Certified by the CDFI Fund
- Certified CDFIs qualify as CDEs and may become certified by completing the CDE Certification application

Eligible Geographies - Low-Income Communities

- LICs are census tracts with:
 - At least 20% poverty rate OR
 - Median family incomes at 80% or less of area median income
- Severely distressed LICs receive priority:
 - At least 30% poverty rate OR
 - Median family incomes at 60% or less of area median OR
 - Unemployment 1.5X the national rate
 - Combinations of other identified areas

Allocation of NMTCs

- Credit allocation authority determined by CDFI Fund through annual application process
- Application process is highly competitive
- \$5 billion in aggregate allocation authority available in each calendar year 2020 to 2025.
 - Investors can take credits based on \$5 billion of investment – so total credit value \$1.95 billion per allocation round
 - Each CDE that wins an award will receive a “pot” of allocation it divides among projects the CDE selects
 - Typically, about 75-100 awards made per year

Utilization of NMTCs

- Tax credit investors' equity is blended with other sources that would normally be used by the project
 - Debt
 - Grants
 - Sponsor capital or, in some cases, existing assets or prior expenditures can be recognized
- Net result is typically about 20% benefit to the project
- Tax credit investor receives economic benefit from tax credits, not repayment by the project
- Debt sources do have to be repaid

Utilization of NMTCs

Two models for delivering tax credit capital:

1. Direct model

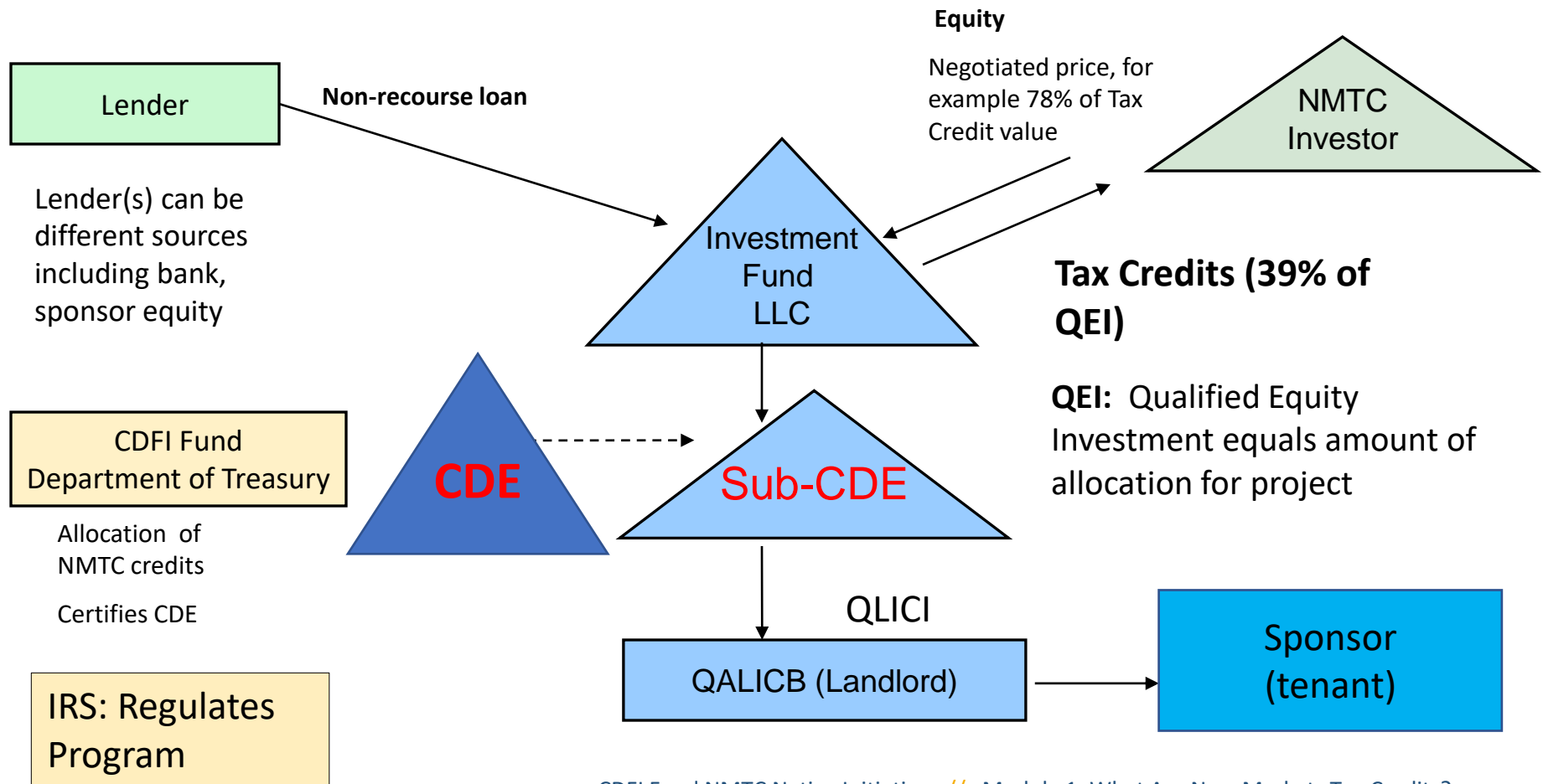
- Provides lower-cost loan to project
- Requires repayment of all capital

2. Leveraged model

- More common (90% or more of transactions)
- Results in about 20% net subsidy of total capital

Revenue Ruling 2003-20

Leveraged Financing Structure — Most Common Method



Community Development Entity: CDE

The CDE is the center of every NMTC deal.

- Applies to the CDFI Fund for tax credit authority
- Identifies qualifying projects that meet the goals described in its application and allocates part of its credit authority to each project
- Obtains qualified investments from taxable entities
- Underwrites & structures the financing transaction
- Originates & funds the transaction
- Manages payments from projects to lenders/investors
- Tracks uses of funds and outcomes of projects
- Reports to the CDFI Fund and investors on impact & compliance

Community Development Entity: CDE

- CDEs can be nonprofits or for-profits
- Most CDEs create project-specific subsidiary CDEs to receive investments targeted for those particular transactions
 - Sub-CDEs are typically structured as for-profit LLCs taxed as partnerships
 - Sub CDEs are the ultimate lender to/investor in the targeted project/business
- To receive the required equity investments, the CDE or Sub-CDE must be a for-profit entity

Community Development Entity: CDE

Defining Accountability to Low-Income Communities

- 20% or greater low-income community representation on governing/advisory board.
- Low-income community representatives may be:
 - Residents of a qualifying census tract
 - Owners of businesses in qualifying tract
 - Elected/appointed public officials representing or primarily serving qualified tracts
 - Employees/board members of entity with primary mission of serving low-income communities/residents (e.g., social service agency, church, CDC, etc.)

Community Development Entity: CDE

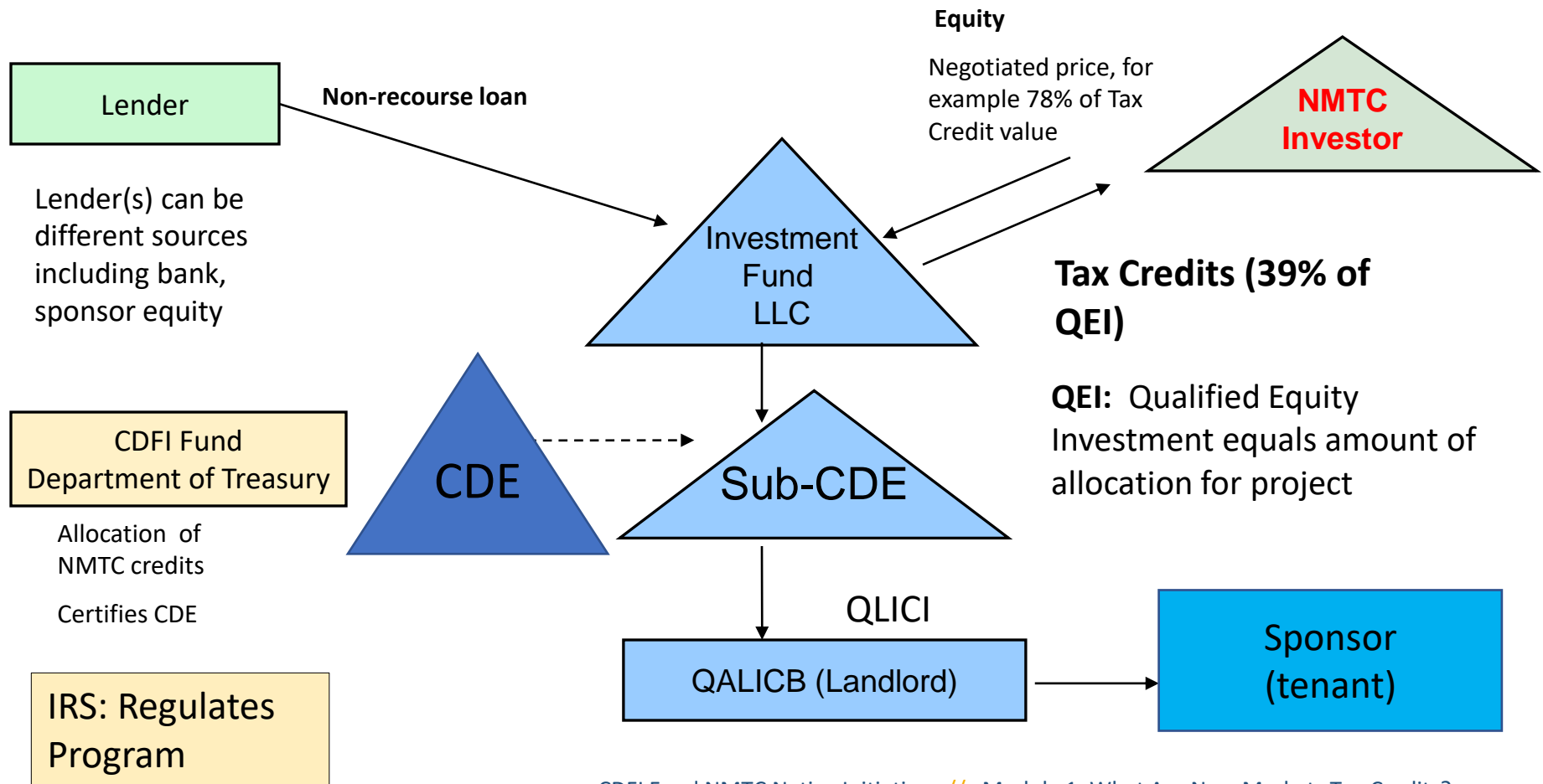
The CDE must:

- Maintain its CDE status (low-income accountability, corporate existence, and other compliance) throughout its allocation and compliance periods
- Have meaningful involvement of its low-income community representatives in its governance, decision-making, and/or ongoing operations
- (If awarded allocation authority) comply with its Allocation Agreement (contract with the CDFI Fund)

Benefits of CDE Certification

- Ability to apply for NMTC allocation authority from CDFI Fund
- Ability to receive NMTC-related capital
 - In exchange for tax credits (as NMTC allocatee)
 - As pass-through entity (from another CDE to invest in qualified projects/businesses)
- Potentially more favorable treatment from banks and other prospective sources of capital

Leveraged Financing Structure



NMTC Tax Credit Investors

- Capital providers in NMTC program
- Taxable entities (corporations, individuals, partnerships, LLCs)
 - NOT nonprofits, public sector entities, tax-exempt entities
 - Typically, banks (can receive CRA credit for NMTC investments) also
 - Other entities with tax liabilities and interest in supporting community development or the project
- Must make Qualified Equity Investments (QEI) in qualifying CDE
- Cannot recoup any investment principal for 7 years

NMTC Investors – Leverage Model

- **The Leverage Model** – provides a way of attracting more favorable capital for targeted project/business
- The Leverage Model also helps increase investor's economic return from the NMTCs
- The Leverage Model typically pools capital from multiple sources and uses that capital to make Qualified Equity Investment into CDE
 - Equity investment from taxable investor
 - Debt and/or grant capital from project sponsor, public entities, foundations, third party lender(s)

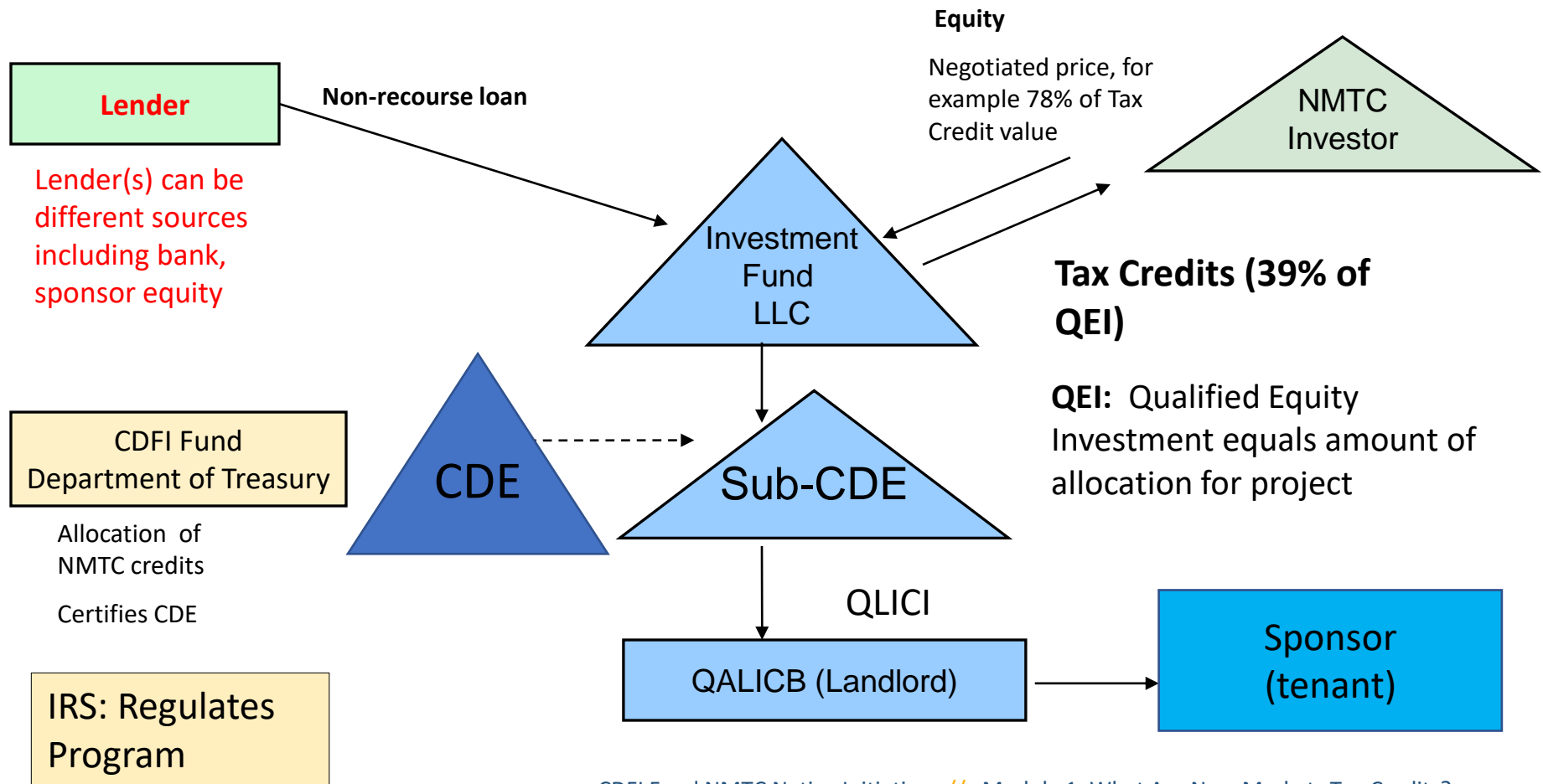
Benefits of Leverage Model for Investor

- Structure enhances economic return of the tax credit
- Compare
 - 1) \$10 million equity investment directly into CDE
 - Investor return: 39% nominal ROI (\$3.9 million of credits/\$10 million equity investment)
 - 2) \$3 million equity investment into leverage fund, supplemented by \$7 million of non-equity capital; all \$10 million invested in CDE, generating \$3.9 million of tax credits that all flow back to the investor
 - Investor return: 130% nominal ROI (\$3.9 million of credits/\$3 million equity investment)

Benefits of Leveraged Investment Model for Borrower

- Enhanced economic return from credits reduces investor's need to recoup investment after 7 years
- Investment dollars can remain with the project and/or CDE
- In effect, borrower ultimately responsible for financing only a portion of the total project cost

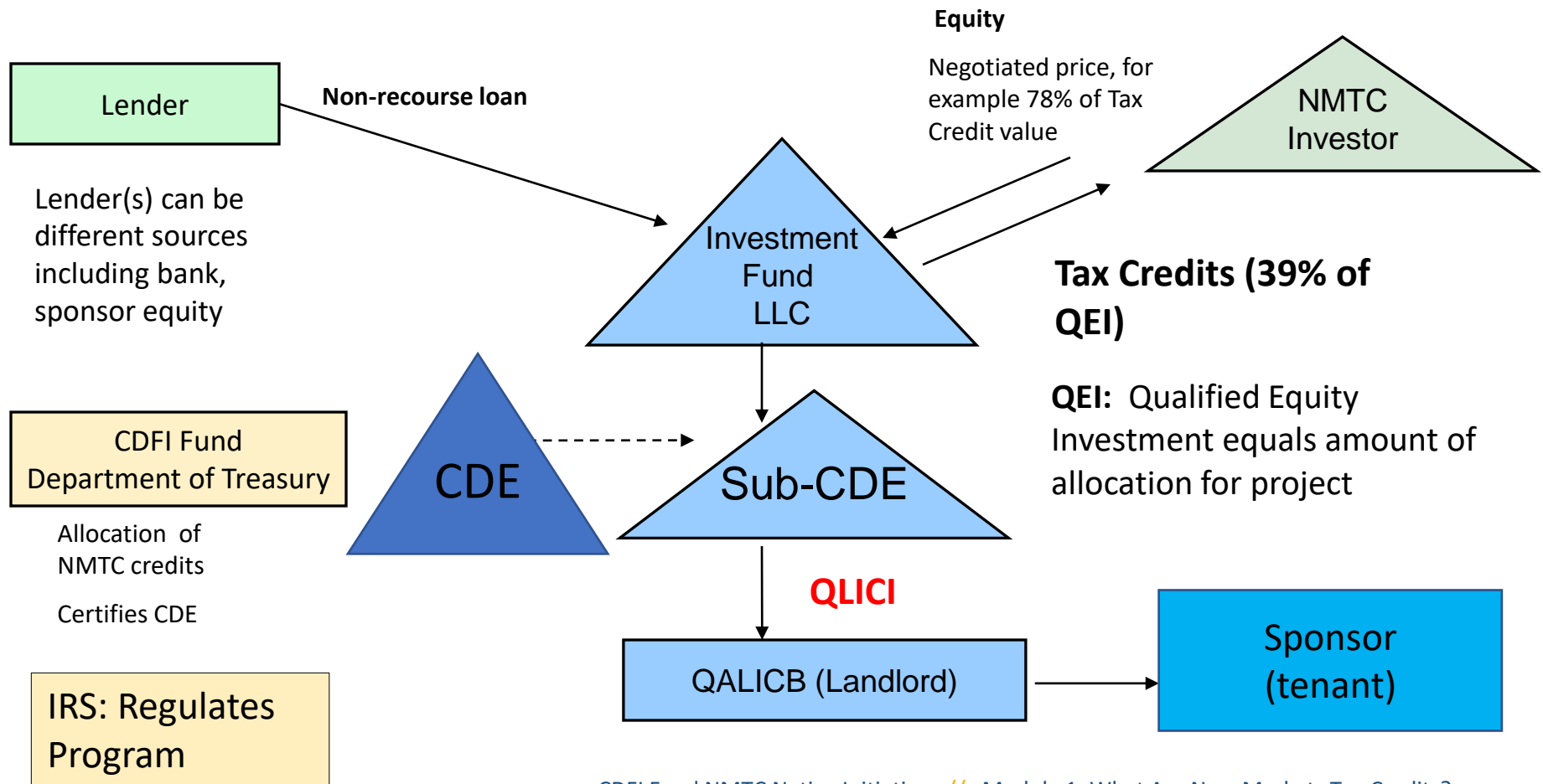
Leveraged Financing Structure



Characteristics of Leverage Capital

- Loans made directly to leverage investment fund
 - Sources may be grants to project sponsor or affiliate, conventional loans, and in some cases sponsor equity
- Loans are technically unsecured
- Capital ultimately needs to remain with CDE for 7 years, so loans typically structured with 7-year terms
- Leverage lenders that provide debt can receive principal and interest payments during the compliance period in amounts that do not cause principal repayment of the CDE loan (QLICI); grant sources do not require scheduled debt service

Leveraged Financing Structure



Qualified Low-Income Community Investment: the QLICI

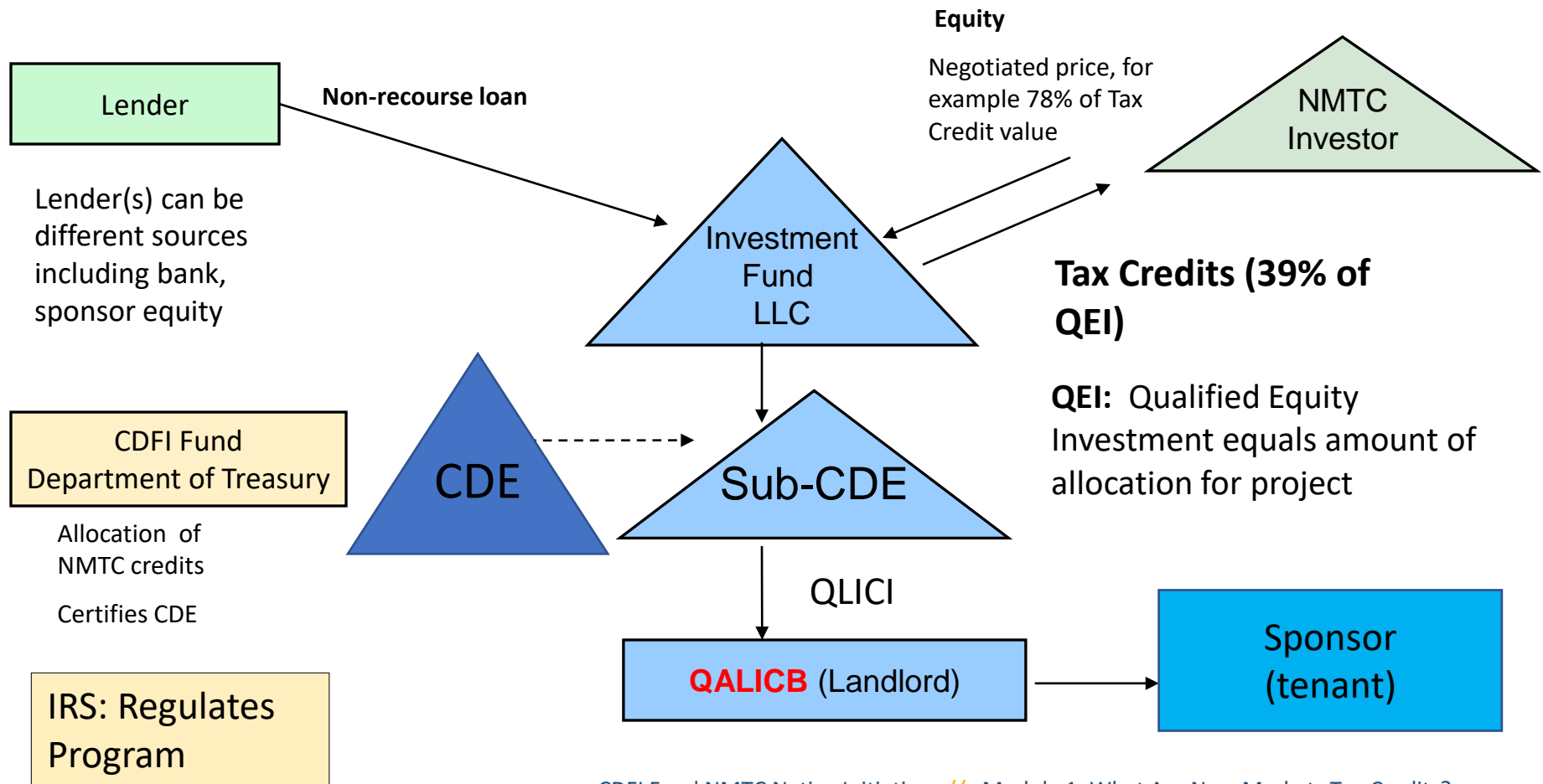
Qualified: The financing *must* be delivered within time requirements to an eligible business or project - a QALICB.

Low-Income Community: The census tract in which the QALICB is located must meet NMTC income qualifications, or the project must be for a Targeted Population.

Investment: The transaction between the CDE and the QALICB *must* be a loan or an equity investment. It may not be a grant or gift. Equity investments make compliance more difficult and can only be provided to for-profit entities, so almost all NMTC transactions are loans.

This means it must satisfy the IRS “True Debt” test. The test is complicated and the primary reason NMTC deals are so technical to structure and expensive to close.

Leveraged Financing Structure



Qualified Low-Income Community Investment: the QLICI

Qualified: Cannot be a prohibited business or hold nonqualified financial property, collectibles, or intangibles.

Active: Must produce revenue implementing its business (for profit) or mission (nonprofit) within three years.

Low-Income Community: Must hold 50% of assets, perform 40% of services, and receive 40% of revenues in low-income census tract(s).

Business: Must be a “trade or business” (not government but nonprofit business is acceptable).

Most NMTC borrowers are single-purpose entities (SPEs) that only own the project; receive the NMTC financing; build out the improvements; and lease the facility to the sponsor.

The SPE is the QALICB and has one asset, no employees, and its only revenue is from the qualifying census tract.

Ineligible NMTC Borrowers (QALICB)

- Prohibited businesses include: casinos/gambling sites, liquor stores, massage parlors, golf courses, tanning parlors, etc.
- Businesses producing intangible products for licensing (software)
- Businesses with non-qualified financial property (high cash on hand or securities including promissory notes)
- Businesses holding collectibles (art, jewelry, stamps) not for sale in the ordinary course of business
- Residential rental developments (except as part of mixed-use project under some circumstances)
- Certain farming activities
- Land banking

Compliance

As the center of the transaction, the CDE carries primary responsibility for monitoring and reporting compliance.

Timeliness of financial transactions, audits, compliance reports, and related activities is very important to the investor and the CDFI Fund.

The CDE requires the Sponsor to provide compliance confirmation reports each year.

Compliance

Sponsor compliance reports typically:

- Verify that the QALICB and the Sponsor continue to meet program requirements (not prohibited business or holding nonqualified financial property, etc.)
- Report on community outcomes such as jobs generated, persons served, other goals met.
- Are not terribly burdensome

Key IRS Compliance Issues

- CDE must remain certified throughout compliance period.
- QEI principal cannot be redeemed by the investor before expiration of the compliance period.
- Substantially all of the QEI proceeds must remain in QLICs throughout the 7-year period, which also means borrower must remain a QALICB throughout the compliance period.
- Failure to meet IRS requirements can result in **Recapture**, which is the investor's return of all the tax credits taken, forfeiture of those not yet taken, and perhaps interest and penalties.

Substantially All (Sub-All) Test

“Substantially all” means not less than 85% according to the statute, and probably about 95 – 100% according to the CDE’s Allocation Agreement. Methods and timing for verifying that the Sub-All test is met are important elements of the CDE’s compliance responsibilities. The key issues are:

- 1) The Sub-CDE places enough QEI principal into the QALICB through a QLICI at closing, and
- 2) The amount of that principal the QALICB returns to the CDE during the compliance period remains sufficiently below the “sub all” threshold.

Substantially All (continued)

The Sub-All test is measured:

- At closing, in the accounting projections and by the attorneys issuing the tax credit opinion, and
- Each year during the audit of the Sub-CDE by the accountant.

Risk mitigation is by loan monitoring and strict compliance with the accounting projections for all cash movement during the compliance period.

Substantially All (continued)

Violation of the IRS regulations related to the Sub-All Test (or redemption of the QEI or a CDE's failure to operate as a CDE) can result in recapture, a severe consequence.

- Recapture results in the IRS claiming *all* of the tax credits (not just the future tax credits) from the Investor, plus interest and possibly penalties.
- If the recapture is caused by an action or inaction of the CDE, the CDE may be liable to the Investor for the financial consequences.
- If the recapture is caused by an action or inaction of the Sponsor, it may be liable to the Investor and/or the CDE for financial consequences.

Violation of the Allocation Agreement does not affect the Investor.

- For the CDE, it may result in future ineligibility to apply for more allocation and/or losing its remaining allocation.

Summarizing the Process

Community Development Entities use...

Substantially All of the proceeds from...

Qualified Equity Investments to make...

Qualified Low-Income Community Investments in...

Qualified Active Low-Income Community Businesses located in...

Low-Income Communities

Limitations on Prior Project-related Expenditures

NMTC guidance found in FAQ 44 of the Compliance materials provides:

- Project-related expenditures made generally two years or less prior to the NMTC closing may be monetized and used as Leverage Loan funds, or
- Project-related expenditures totaling 5% or less of the NMTC financing may be monetized and used as Leverage Loan funds regardless of when the expenditures were made.
- Assets may only be recognized for their actual cost, e.g., not the appraised value of donated assets.

** See CDFI Fund Compliance FAQ publication for precise language and examples*

Consistency with Application

- The CDE must use its allocation in a manner consistent with its application. This is because the CDFI Fund awarded tax credit authority based on the business plan described in the application.
- The CDE may generally use up to 15% of its awarded allocation authority to finance projects outside of its stated service area or for activities not described in the application. This allows some flexibility to deal with unforeseen circumstances.



Native Initiative Training and Technical Assistance Module 2: Community Outcomes and Community and Economic Development Strategies

CDFI Fund NMTC Native Initiative

September 21-22, 2022

Author: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

Community Outcomes – the Heart of the NMTC Program

- How does the targeted project improve economic, social, or other conditions in the Low-Income Community?
- Each transaction underwritten as much for its economic/social/community benefits as for its economic viability
- Wide range of potential benefits, including
 - Quality jobs accessible to disadvantaged people
 - Increased/enhanced quality goods or services (e.g., grocery stores)
 - Increased/enhanced access to health care, child care, quality education
 - Financing Native American and Minority Businesses
 - Environmental Sustainability

Long History of Community Development

- Urban renewal in the 1950's
- Community Development Block Grant in the 1970's and continuing
- HOME, Hope VI, EDI/108, & many other programs
- Historic, Low-Income Housing, and New Markets Tax Credits
- Urban Development Action Grants (1970s)
- Enterprise/Empowerment Zones
- EDA Regional Plans
- BIA infrastructure initiatives
- ARPA Grants

All share common theories and goals of ameliorating blight, which is a progression of conditions that cause disinvestment in real estate, and alleviating the impacts of poverty.

New Markets Tax Credit Program In Context

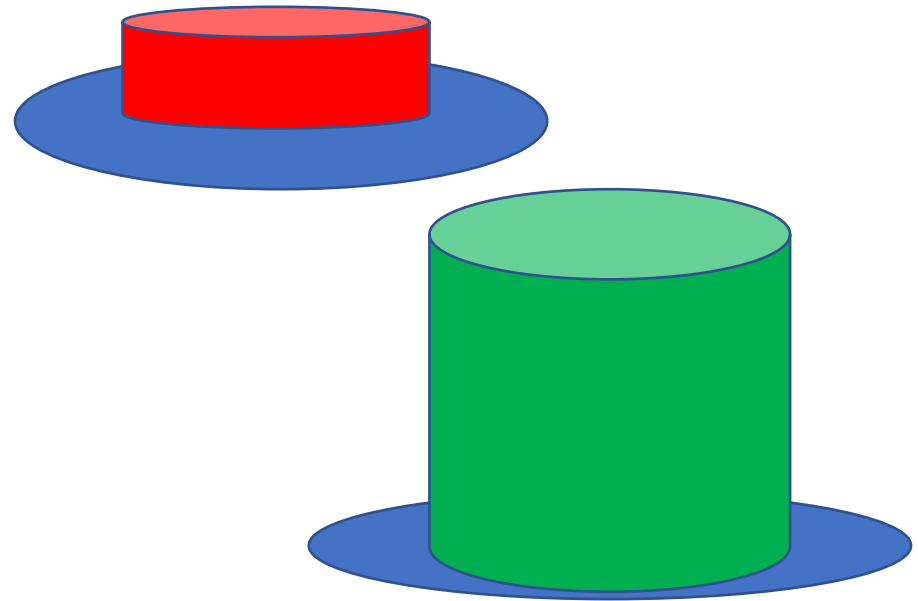
Use of tax credits to spur investment for desired outcomes

- Historic Tax Credits
- Low Income Housing Tax Credits
- New Markets Tax Credits
- Various state/local tax credits or incentives (TIF districts)

Community Outcomes Improve LIC Economic Dynamics and Residents' Quality of Life

Low-income communities (LICs) have certain economic issues in common:

- Relatively low **volume** of capital
- Relatively low **velocity** of capital



Investment Brings Jobs, Goods and Services

Investment in Low-Income Communities creates

- Local jobs
 - Commercial goods
 - Community services
- When Low-Income Community residents are able to buy goods and services within their own community, their capital stays in the local micro-economy, improving the volume and velocity of capital.
 - When they have to buy goods and services outside of their community, the local economy is depleted.
 - Local employment brings capital from outside into the LIC, increasing volume of capital.

Shared Vision for Economic and Community Development

Each sovereign government will have its own goals, concerns, and priorities.

An important step in preparing for outside capital is to have a shared vision among decision-makers before seeking approval for an individual project.

Two key deterrents to outside capital:

- Uncertainty
- Delay

Projects should be seen as incremental implementation of an overall plan, not as stand-alone activities.

Approval process should be clear with certainty as early as possible.

Components of a Comprehensive Strategy

Land:

Policy and process for access to on-reservation or other trust lands

- Are allowed uses for particular parcels clear?
- Is there an efficient approval process?
- Can leases be of sufficient time to facilitate financing? (25 years or more)
- Is the land suitable for the planned activity? (Utilities, roads, community support for use of this site, environmental, archaeological, historic, etc.)

NMTC Underwriting Questions:

- Control of physical property
- Development/enhancement/expansion of buildings
- Most NMTC projects involve real estate development/enhancement
 - Is a leasehold mortgage available?
 - Are sovereign immunity issues an obstacle?

Components of a Comprehensive Strategy

Workforce:

Is there an available workforce with the necessary skills for the employer?

- Does the tribal government want to do targeted hiring?
- Are there obstacles to employment such as transportation, child care?
- Is there a workforce training agency, such as a community college, that can help prepare potential employees?
- If workforce is needed for a large project, are enough people available within a reasonable commuting radius?
- Do housing, grocery, school, and other community infrastructure and services exist to support incoming workers?

Components of a Comprehensive Strategy

Workforce: NMTC Program Goals

Job creation/retention

- Building/sustaining quality workforce
 - Education
 - Job training
 - Health care
 - Living Wage, Benefits
 - Jobs accessible to low-income people in the area
- Substantial proportion of NMTC projects involve education/training/health care in connection with quality job creation and retention

Components of a Comprehensive Strategy

Capital:

Is there money that can help bring the employment or services to the site?

- NMTCs can provide lower cost capital for development or working capital
- Other sources of economic or community development capital?
- Leases that can be offered as security to facilitate capital (HEARTH Act)
- Tax advantages a Native government can offer to employers siting on Trust lands

Components of a Comprehensive Strategy

Infrastructure:

Does the infrastructure exist to make the project feasible?

- Most development requires
 - Roads,
 - Power,
 - Water,
 - Wastewater,
 - Telecommunications
- If not, is capital available to create the infrastructure?
- Can the infrastructure be created as a component of the project?
- Is community infrastructure available?
 - Childcare, grocery, pharmacy, education, recreation, access to services?

Compelling Outcomes: What Makes a Good NMTC Project?

Varies by community/market ... no single “ideal” project

- What are particular needs within community?
- How does project address those needs?

Clearly articulated, documentable outcomes (short and/or long term)

Clear relationship to any existing development/revitalization plan

- Incremental implementation of a comprehensive plan

Strong Community Support

Compelling Outcomes: Quantifiable Results

- Number of new jobs and/or preserved jobs otherwise at risk of being lost
- Number of new or additional low-income community residents served by a community facility, including students, patients, children
- Number of customers served by retail, including grocery stores, pharmacies, etc.
- Amount of renewable energy generated by solar farms, windmills, etc.
- Square feet of construction or renovation
- Number of affordable housing for-sale*
- Number of affordable rental units* developed (80/20 rule)

“Know it when you see it” isn’t enough to be competitive

*at least 20% must be affordable to LMI

Compelling Outcomes: Documented Quality

Number of X (jobs, students, etc.) not enough —

How does project meaningfully enhance community or economic development?

- Quality/accessibility of jobs
- Quality of education/child care/health care provided
- Alleviation/remediation of environmental problems
- Access to/provision of quality goods & services

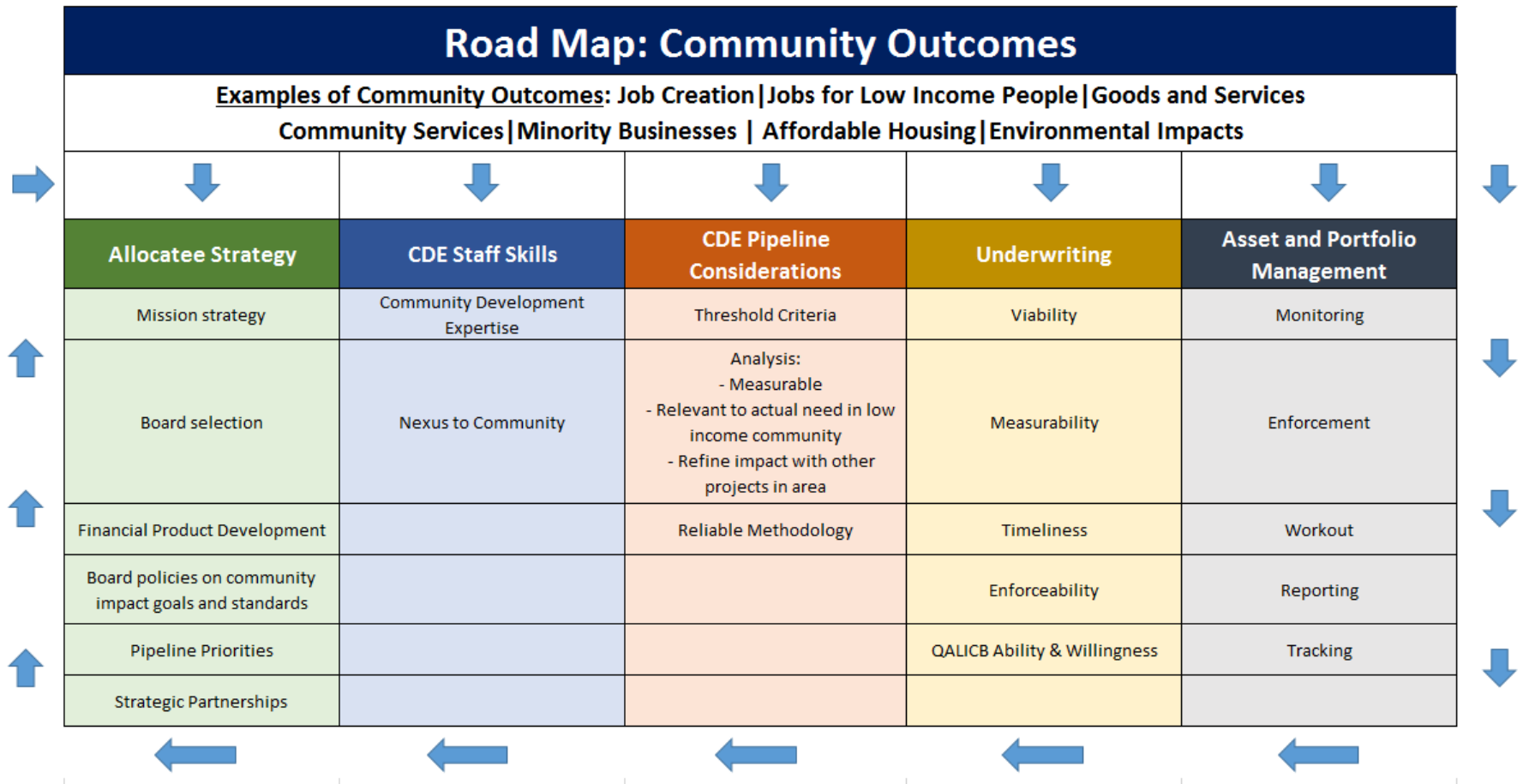
Compelling Outcomes: Categories of Outcomes in the Application

- Direct jobs created/preserved that are quality jobs & are accessible to disadvantaged people
- Enhanced commercial/retail goods & services for Low Income Communities/low-income people
- Quality community goods or services
- Financing minority businesses
- Financing Native businesses
- Affordable housing units
- Environmentally sustainable outcomes
- NO PREFERENCE FOR TYPE OF OUTCOME(S)

Community Outcomes Affect Every Element of a CDE's Operations

- Mission
- Board
- Financial Products
- Pipeline
- Project Selection
- Underwriting
- Terms
- Capital Raising
- Staffing
- Loan Servicing

Community Outcomes Affect Every Element of a CDE's Operations



CDEs Need a Strategy for Defining and Prioritizing Targeted Community Outcomes

- Net number of quality, accessible jobs created
- Number of people receiving quality goods & services
- Extent of need in community
- Empowerment of businesses led by people of color

CDE strategies are strongly aligned with most Native governments' goals.

Documenting and Enforcing Outcomes

Clearly defined benchmarks & measures – if not easily & objectively measured, it can't be enforced.

- NMTC capital is a way of incentivizing certain outcomes
- How can/should anticipated outcomes be enforced?

Role of Low-Income Community Representatives

Understanding of local needs & dynamics

Ability to be objective in assessing projects' potential for meaningful outcomes

Key role in setting social investment criteria, approving transactions



New Market Tax Credit Program

Native Initiative Training and Technical Assistance Workshop

Module 3: Case Studies

September 21-22, 2022

Author: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

Case Study 1: Citizen Potawatomi Nation

Sovereign Pipe Technologies, Iron Horse Industrial Park



Case Study 1: Sovereign Pipe Technologies, Citizen Potawatomi Nation

- Iron Horse Industrial Park is the Citizen Potawatomi Nation's planned site for manufacturing jobs.
- The site is served by rail and near two major freeways.
- It is a designated Foreign Trade Zone, an Opportunity Zone, and a Distressed, Qualified Non-Metro NMTC census tract.
- CPN's CDFI, the Citizen Potawatomi Community Development Corporation, is willing to provide NMTC leverage loans.

Case Study 1: Sovereign Pipe Technologies, Citizen Potawatomi Nation

- CPN constructed a 42,000 sq ft manufacturing facility and related infrastructure for a tenant that was not able to put together its equipment financing and defaulted on the lease.
- CPN's underwriting showed that the proposed pipe manufacturing business was viable, so CPN recruited a qualified plant manager, ordered the equipment, and will commence operations this year.
- The facility will employ approximately 70 new employees earning more than the Living Wage for the area, with benefits. At least half of the employees are expected to be members of CPN or other tribes. CPN's workforce development services include outreach to incarcerated persons to be released within one year, and job training through a nearby technical institute.

Case Study 1: Sovereign Pipe Technologies, Citizen Potawatomi Nation

The NMTC financing for the equipment for this facility generated approximately \$1.5 million in net subsidy benefit from a \$7 million allocation.

CPCDC acted as leverage lender, creating a strong financing transaction and NMTC experience applicable in a future NMTC application as a CDE.

Sovereign Pipe Technologies,

Case Study 1: Citizen Potawatomi Nation

Obstacles

- Late in the cycle outreach to CDEs
- Investor and CDE required limited waiver of Sovereign Immunity because QLICI has to be an enforceable loan
- Equipment financing is more challenging because equipment has a relatively shorter useful life when compared to real estate

Solutions

- Outreach to 21 CDEs, non-metro and tribal project
- Early information to CPN leadership about the extent and need for waiver, negotiation to avoid tribal guarantee of debt
- Combined site lease and equipment lease to show adequate security and debt service revenue.

Case Study 2:

Navajo Tribal Utilities Headquarters Building

The Navajo Tribal Utilities Corporation (NTUA) is a Navajo Nation-controlled company that is the sole provider of some utilities for the Navajo Nation.

The Navajo Nation is over 28,000 square miles—the size of the state of Vermont—and home to about 190,000 people.

Thousands of homes do not have electricity or running water. Population is sparse, consistent with Navajo cultural traditions, and difficult to serve with utilities.

The demands on NTUA's capital budget are very high, so even though NTUA could improve the efficiency of its operations and save money by consolidating into a modern headquarters, it was difficult to dedicate the necessary capital.

Case Study 2:

Navajo Tribal Utilities Headquarters Building



Case Study 2:

Navajo Tribal Utilities Headquarters Building

Obstacles

- Mortgage security was not possible because trust land could not be foreclosed.
- Sovereign Immunity waivers were a significant obstacle for the Navajo Nation at the time

Solutions

- NTUA has a strong revenue stream from its ratepayers. Instead of pledging real estate, it pledged its revenue
- NTUA is a distinct, nonprofit corporation controlled by the Navajo Nation.

Case Study 2: Navajo Tribal Utilities Headquarters Building

Since this transaction was done, NTUA has closed other NMTC financing:

Wastewater Treatment facility

27 construction jobs, environmental improvements

Two Substations

78 permanent jobs, 31 construction jobs

400 families provided with new electric service

Case Study 3:

Pine Ridge School Pine Ridge, SD

The Pine Ridge School is the first local public brick-and-mortar high school on the reservation, created to address a 28% graduation rate.



Case Study 3:

Pine Ridge School Pine Ridge, SD

Pine Ridge youth have shown the consequences of inadequate facilities, resources, and services in reduced educational achievement and attainment, and other problems.

There was no public high school at Pine Ridge. The private Catholic school and the BIE school, over 40 miles away, were not meeting the needs to allow most students to succeed.

The Pine Ridge School was long planned to provide culturally and lifestyle-relevant high school educations for Oglala Lakota youth.

The planning process included years of community outreach and visioning, investigation of what was wrong with the available education and designing a solution.

Case Study 3:

Pine Ridge School Pine Ridge, SD

The school district set aside a portion of its Community Impact Aid Program funds each year to save up for the new school.

A \$21 million allocation filled the rest of the need, accelerating the construction plans. A CDE built a relationship with the tribe, starting in 2004, in support of Pine Ridge's educational and community development plan.

Pine Ridge School is a Career Technical Education site, providing quality high school curriculum through a CTE approach to prepare youth for jobs available in the region.

Case Study 3: Pine Ridge School Pine Ridge, SD

This project had many obstacles—BIA lease approvals and terms, title status problems, cost overruns due to the difficulty of construction in a remote area, and the need to build trust among the participants.

Keys to the project's success:

- Long-term investments in planning,
- community-level input and approval of the project and its goals, and
- a CDE with Native experience, the skill to help solve problems, and the patience to stick with the deal.

Community Success:

- The school exceeds its enrollment expectations.
- Students have hope because they leave school prepared to succeed in rewarding jobs, and as members of their community.



New Markets Tax Credit Program Native Initiative Training & Technical Assistance Workshop Module 4: Financial Products and Key Program Issues

September 21-22, 2022

Authors: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

Eligible Loans and Investments for CDEs

There are 5 types of activities a CDE can finance with its allocation:

- Operating business financing;
- Real estate financing;
- Financing of other CDEs;
- Loan purchase from other CDEs; and
- Financial counseling and other services

Eligible Loans and Investments for CDEs

- Operating Business Financing:
 - Financing facilities to be occupied by the Sponsor (operating business). Sponsor forms a single-purpose entity to be the QALICB and leases the finished project from its QALICB;
 - equipment financing;
 - working capital
- Real Estate Financing:

Financing the development of real estate to be leased to third parties unrelated to the QALICB or its Sponsor, including:

-Retail (Grocery Stores, Pharmacies)	-Industrial / Manufacturing
-Mixed-Use (e.g. housing w/ retail or community space	-For-Sale Housing
-Community Facilities (health, education, social services)	-Office Space
	-Other Real Estate

Eligible Loans and Investments for CDEs

- Financing of Other CDEs:
 - Some CDEs place QLICs in secondary CDEs that are unrelated to the Allocatee. This activity must be discussed in the Allocatee's application.
 - This kind of financing is helpful to the Allocatee to reach areas it has not previously served with on-the-ground resources to monitor the project, and for the secondary CDE because it helps the secondary CDE build a NMTC track record to support its own future application.
- Loan Purchase From Other CDEs:
 - Under some circumstances, a CDE may use subsidized QLICI capital to purchase the loan portfolio of another CDE, recapitalizing its lending capacity.

Eligible Loans and Investments for CDEs

- Financial Counseling and Other Services
 - CDE uses QLICI capital to pay for business-related financial literacy, consulting, or other services in support of NMTC-eligible outcomes
 - While eligible, few if any CDEs have designed a workable structure to finance this activity with an allocation.
 - Many CDEs and CDFIs provide development services, but these activities are rarely financed by the proceeds of a QLICI.
- The vast majority of NMTC transactions are Operating Business or Real Estate financing.

IRS Compliance and Business Plan Considerations

Most CDEs' business plans structure their QLICIs as loans and are motivated in part by IRS compliance.

- Equity can only be placed in a for-profit entity (nonprofits don't have shares of "ownership" that allow equity).
- If a CDE has more than 30% control over its investee, it no longer has the benefit of the "reasonable expectations" safe harbor, so most investors strongly prefer QLICI loans.
- Loan terms can be structured to emulate equity with flexible features, such as subordination, higher-than-standard loan to value, lower debt service cover ratio, unconventional collateral, long amortization, long interest-only period, and ability to acquire the tax credit residual equity.
- All of these support business plan outcomes: reducing the sponsor's cost of building/occupying a facility, or improve its access to credit to grow or start its business.

QLICI Features that Support Business Plan Objectives

- **Subordination** to other lending maximizes the QALICB's access to cash (financing based on accounts receivable, inventory, additional facilities capital, etc.)
- **Higher-than-standard Loan To Value** reduces the amount of cash the QALICB needs to contribute to its project and close its financing
- **Lower Debt Service Cover Ratio** allows the QALICB to manage peaks and valleys in its cash flow without risk of default and to have higher initial borrowing

QLICI Features that Support Business Plan Objectives

- **Unconventional collateral** improves the QALICB's capacity for other debt when the CDE limits its collateral to the real estate asset and does not require pledges of all assets and/or personal guarantees.
- **Long amortization** reduces the cash necessary for debt service, improving cash available for services or operations.
- **Long interest-only period** also reduces cash necessary for debt service.
- **Potential for equity acquisition** in the leverage model is possible because the tax credit investor is made whole from the tax benefits alone.

Program Issues: Scale

Few NMTC transactions use less than \$5 million in allocation, but some community development projects need smaller loans.

The reason is the math:

An allocation of \$5 million or less, and a tax credit investor price of 72 cents or lower, will result in very little net benefit to the project because of transaction costs and fees.

How Scale and Fees Affect Proceeds

\$5,000,000 Allocation

Investor Proceeds:

$$\$5,000,000 \times .39 = \$1,950,000$$

$$\$1,950,000 \times .78 = \$1,521,000$$

$$\text{CDE Fees: } 8\% = 400,000$$

$$\begin{array}{l} \text{Legal and Accounting} \\ \text{Fees to Close +/-} \end{array} 400,000$$

$$\text{Net subsidy benefit: } \$ 721,000$$

\$10,000,000 Allocation

Investor Proceeds:

$$\$10,000,000 \times .39 = \$3,900,000$$

$$\$3,900,000 \times .78 = \$3,042,000$$

$$\text{CDE Fees: } 8\% = 800,000$$

$$\begin{array}{l} \text{Legal and Accounting} \\ \text{Fees to Close +/-} \end{array} 400,000$$

$$\text{Net subsidy benefit: } \$1,842,000$$

Program Issues: Scale Solution

Some CDEs design a small dollar loan program in which QLICs of less than \$4 million are made practical by their offering structure.

The concept is that the CDE and the investor agree that the CDE will finance a loan pool with NMTC-subsidized capital.

The loan pool will be made up of smaller transactions that the CDE assures are NMTC qualifying loans. Similar to an investor's Blind Pool structure, the CDE is responsible to assure compliance.

The investor must be satisfied with the CDE's experience, capacity, and pipeline.

Some sponsors combine more than one facility in a single financing.

Program Issues: Leverage Loan(s)

Leverage Loans can be made up of many sources:

1. Conventional bank debt
2. Grant proceeds
3. Public or tribal “soft” debt
4. Anticipated capital campaign, donor, or grant funds (such as grant reimbursement funds)
5. Sponsor equity
6. Reimbursement of sponsor’s reasonable expenses under some circumstances (2-year look-back or 5% limitation)

Program Issues: Leverage Loan(s)

- Conventional bank debt: *Requires principal and interest debt service*
- Grant proceeds: *Do not require scheduled debt service**
- Public or tribal “soft” debt: *May or may not require scheduled debt service**
- Anticipated capital campaign, donor, or grant funds (such as grant reimbursement funds): *Bridge financing usually requires contribution when funds are received*
- Sponsor equity: *Does not require scheduled debt service**

**are included in True Debt analysis*

Leverage Lender(s) and Tax Credit Equity: The QLIC Capital Stack

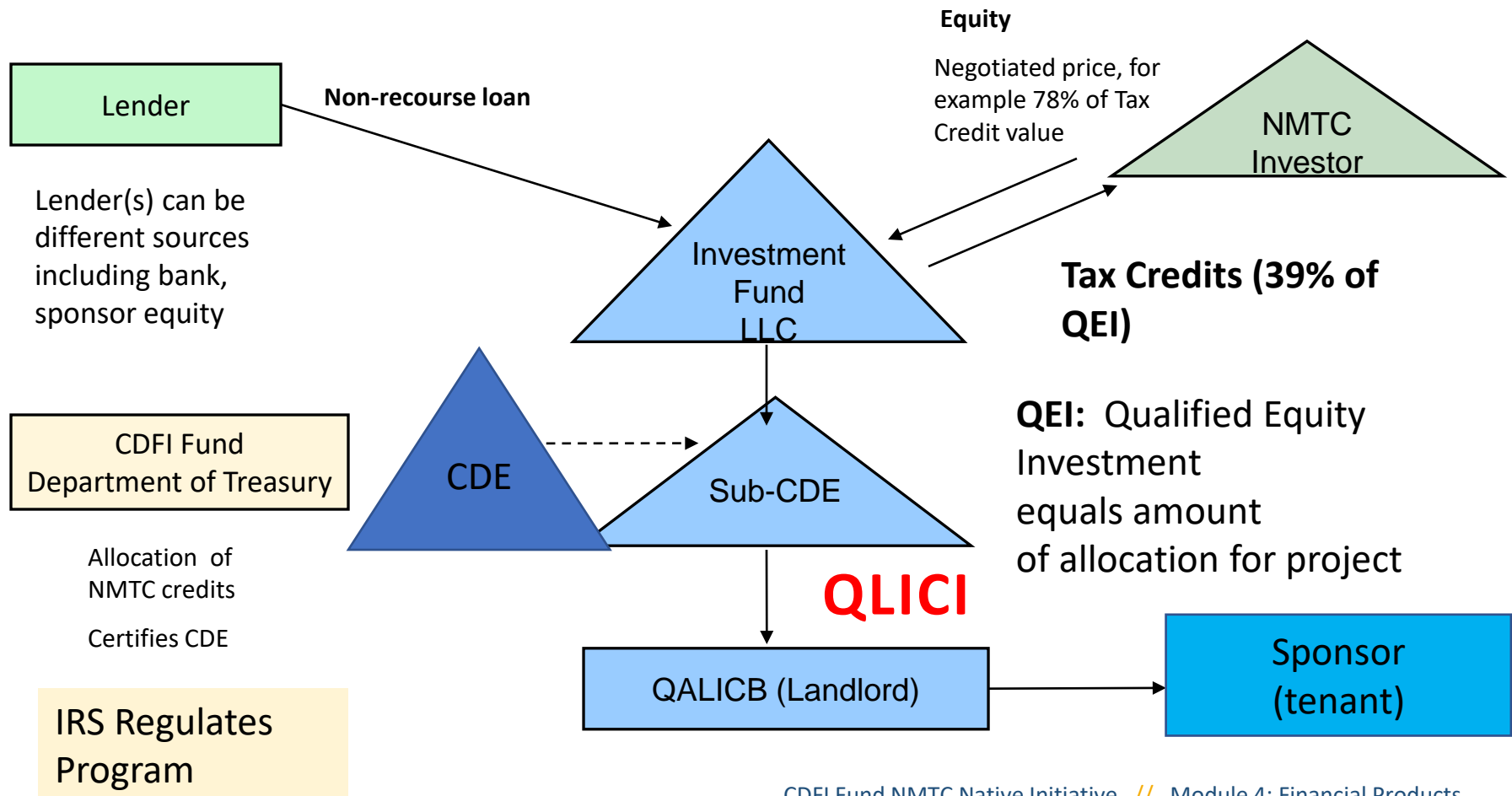
\$8.5 million in Leverage Loan, \$2 million NMTC tax credit equity proceeds

- \$2 million conventional debt
6%, 30-year amortization, 7-year term *\$11,991/month*
- \$4.5 million grant proceeds
No scheduled debt service
- \$2 million grant reimbursement bridge loan
1.5% origination fee, 5% annualized interest
Payments made by Sponsor to Leverage Lender outside
NMTC structure when reimbursements are received
- \$2 million NMTC tax credit equity proceeds
No scheduled debt service

Total financing \$10.5 million

\$11,991/month

Program Issue: The QLICI True Debt Opinion



Program Issue: The QLIC True Debt Opinion

The financial transaction between the CDE and the QALICB will generally be provided as debt. A tax lawyer will provide a legal opinion analyzing the transaction and concluding that the IRS should hold the transaction to be debt.

The lawyer will examine the facts and circumstances, including factors such as:

- The parties intend for it to be paid in full.
- The borrower has sufficient revenue to retire the debt according to its terms, e.g., 30 years.
- The borrower has pledged adequate security.
- The debt is documented by a valid and enforceable promissory note, and security interests are properly perfected.
- The borrower is reasonably expected to continue in business to be able to retire the debt or refinance it,
- And other facts.

Program Issue: The QLICI True Debt Opinion

Most sponsors approach NMTCs as if the funds are a grant.

CDEs and Tax Credit Investors (and their tax lawyers) approach the NMTCs as a highly-regulated tax transaction that requires proof of true debt.

Program Issue: The QLICI True Debt Opinion

Implications for Wind-up

- At the end of the 7-year compliance period, most tax credit investors include an option to “put” their interest in the Investment Fund, and therefore the Sub-CDE, to the project sponsor or its designee.
- If the tax credit investor exercises the “put”, the sponsor is in control of the Sub-CDE and can make the election to “cancel” the QLICI debt or convert to permanent equity.
- However, this is documented as an optional “put” by the tax credit investor, and, if the investor does not “put”, the sponsor can exercise a “call” to acquire the residual equity at market value.
- If the put were a contractual obligation, the QLICI would likely be determined to be a grant and the tax credits would not be earned by the investor because grants are not permissible forms of QLICI.
- This structure requires a leap of faith for sponsors that are hoping for the put.

Program Issue: Enforcing Community Outcomes

- The QLICI documents almost always include a Community Benefits Agreement, in which the sponsor promises to report on and/or deliver the jobs, services, goods, and environmental or other outcomes promised.
- The CDE is not allowed to enforce creditors' remedies (foreclosure) without permission from the investor because return of principal to the CDE during the compliance period requires that the capital be placed promptly into another project, or recapture will occur.
- Most CDEs enforce the CBA by imposing a penalty on any potential for the sponsor to retain the tax credit equity at the end of the compliance period.

Program Issue: Taxable QALICBs and the “Put”

If the QALICB is a taxable entity and the put results in debt forgiveness at the end of the compliance period, it will likely be subject to income tax because cancellation of debt is taxable income.

SOLUTION:

If the QALICB leases trust land from its host tribe, the put can go to the tribe and the residual tax credit value can be allocated between the tribe and its tenant as a business deal term.

In the hands of a nontaxable or tax-exempt entity, the value of the put has no tax implications. A favorable negotiation between the tribe and its tenant may not have tax consequences, but it is important to discuss this issue with tax counsel during the initial negotiations.

Program Issue: Financing Related Entities

To be competitive, the statute requires that a CDE will have to commit to use at least 85% of its allocation to finance projects owned by unrelated entities. A CDE controlled by a tribe will be limited in using its own allocation to finance projects controlled by its tribe, though it may be possible to finance 3rd party projects on land leased from the tribe.

SOLUTION:

After receiving an allocation, a CDE may work with other Native or non-Native CDEs to consider each other's projects for allocation consistent with both CDEs' applications: CDE A will finance a project for tribe B, and vice versa.

Agreements like this should not be solidified before an allocation is awarded because organizations that are working in concert with common control over project selection must file a single joint application.



New Markets Tax Credit Program Native Initiative Training & Technical Assistance Workshop Module 5: Underwriting

September 21, 22, 2022

Author: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

Key CDE Responsibility: Due Diligence

The CDE functions as a lender to the project. The IRS NMTC regulations require that the CDE act as a “reasonably prudent” lender.

This means the CDE must engage in appropriate due diligence, and structure its financial transactions to be reasonable in light of its due diligence.

Key CDE Responsibility: Due Diligence

The CDFI Fund requires that each CDE describe its due diligence performed in determining QALICBs' ability to remain financially viable and operational, including but not limited to:

1. Financial considerations of the borrower or investee (i.e. QALICB Affiliate or Project Sponsor);
2. The likelihood of project completion;
3. Management team; and
4. Market demand or other economic analysis.

The Eight C's of NMTC

Allocation, Investment, and Lending

1. Character
2. Capacity
3. Capital/Cash Flow
4. Collateral
5. Conditions in the market
6. Control
7. Compliance
8. Community Outcomes

Character – Willingness to Pay

Know your customer (QALICB and its Sponsor, Guarantor, Board of Directors)

- One of the most important components of the underwriting process, character examination, helps to answer the question, “Will you pay the loan back?” not just “Can you pay the loan back?”
- Does the project sponsor have a reputation for integrity and fairness? Sponsors may include business owners, nonprofits, landowners, investors, or promoters.
- Character is a matter of trust, verified by documented experience.

Capacity to Participate in NMTC Financing

Capacity

- Is the borrower/investee able to implement this project?
 - Operate the proposed business, and
 - Complete the proposed development
- Traditional underwriting considerations apply:
 - What is the sponsor's history of business operations?
 - How secure is the borrower's revenue stream if it's a nonprofit or relies on government or other contracts? Is market fluctuation a risk?
 - Is the proposed development budget accurate? Are bids in hand?
 - What is the skill and capacity of the development team?
 - Are the construction sources and uses in balance?

Capacity to Participate in NMTC Financing

Compliance

- Does the borrower/investee qualify as a NMTC QALICB?
 - Does the borrower have other sites or businesses? If so, how do they affect capacity and compliance?

Forbidden Activities

- Residential rental property
 - Buildings or structures that derive 80% or more of their gross rental income from renting dwelling units
- “NMTC Prohibited” businesses

Capacity: Eligible Enterprise

Qualified Active Low-Income Community Business (QALICB)

A QALICB must meet these requirements:

- At least 50% of the total **gross income** is from the active conduct of a qualified business in Low-Income Communities (LICs); and
- At least 40% of the **use of tangible property** of the business is within LICs; and
- At least 40% of the **services performed** by the business' employees are performed in LICs; and
- Less than 5% of the average of the aggregate unadjusted basis of the property is attributable to **collectibles** (e.g., art and antiques), other than those held for sale in the ordinary course of business; and
- Less than 5% of the average of the aggregate unadjusted basis of the property is attributable to **non-qualified financial property** (e.g., debt instruments with a term in excess of 18 months); and
- The business is not production of intangibles.

Capacity: Readiness-to-Proceed

Conventional underwriting investigation, plus NMTC considerations:

- Site control
- Plans at least adequate for bids
- Permitting, land use
- Utilities
- Geotech
- Environmental
- Verifications of project revenue (market study, pre-leasing, customer or funder contracts, etc.)
- Leverage loan sources compatible with NMTC
- Community Support

Capital/Cash Flow

Cash Flow

- Financial statement analysis.
- Cash flow, not sales or net income, repays loans. Net income builds equity and growth.

Sources & Uses

- Finding/Funding the right amount –What is the gap? What is the best way to close it?
- NMTC financing should pass the “but for” test. “But for” the use of NMTC, the project, or the impactful outcomes of the project, would not be achievable.

Capital/Cash Flow

Interest Only/Amortizing?

- Because the CDE may provide a return on the QLICI, but not a return of the QLICI or QEI during the compliance period of 7 years, most NMTC transactions are interest-only for 7 years.
- Some transactions are underwritten with principal and interest payments being made to the leverage lender, but rarely retire the leverage loan by Year 7. Sometimes, payments outside the NMTC transaction or debt service reserves to reduce the refinancing amount (“sinking funds”) are necessary.

End of Transaction Cash Flow

- What happens at the end? Refinance the leverage loan.
- Project must be able to refinance or buy out with a sinking fund at the end of the 7-year period and monitor its progress toward that goal during loan servicing.

Collateral

CDE

- Traditional First Deed of Trust, Assignment/lien on specific or all business assets. CDE may subordinate its interest to a prime lender, or accept non-traditional forms of collateral.

Leverage Lender

- Assignment of Interests:
Because the leverage fund injects equity (the QEI) into the CDE, the leverage lenders can only take an assignment of the investment fund's interest in the CDE, not a direct assignment of the QALICB's assets.
- Forbearance:
The LL agrees to “forebear” its creditor's rights for the compliance period to give the CDE and tax credit investor the opportunity to redeploy any proceeds recovered from a defaulted QLICI into another eligible project, to avoid recapture of the NMTC.

Collateral

CDE

- Establishing Collateral Value

Sometimes, due to the conditions of the surrounding LIC, a completed project may be appraised for less than the cost to develop the project. Tribal security interest issues may make real estate collateral impractical.

- NMTC Recovery Strategy – Bankruptcy of an NMTC QALICB or sponsor is not a recapture event, but is important to the leverage lender expecting debt service.
- Redeployment of recovered assets may be difficult so foreclosure is not done as readily as it might be in a non-NMTC financing.
- Capital returned to the CDE must be redeployed into a qualifying project within six months to avoid recapture.
- Recovery and redeployment to a different tribe may be a significant issue/obstacle if the sponsor tribe put capital in the project.

Market Conditions

- Is the timing right – Are market conditions conducive to QALICB's success? Does other economic analysis confirm the business plan?
- Discussion: Is there a “wrong” time for good community development? Should a restaurant or theater be the anchor tenant at the height of a COVID outbreak?
- Economic Environment – Availability of capital; interest rates
- Political Considerations – Permit process, local “turf wars”
- Community Considerations – Community readiness, desires, perception
- Tribal political support

Control

Ability to properly document and monitor the transaction, perfect Collateral and Security Agreements.

- Does the CDE have everything in place to secure this deal?
- Can you “control” the deal, legally, community-wise?
- Is the long-term lease long enough? Too long? Is it suitable to offer a security interest? Are there BIA or other federal or tribal considerations that might prevent closing or the start of construction?
- See NMTC transaction closing checklist.

Compliance

Front-End Compliance Underwriting – Ensuring the transaction starts off correctly, and has a good chance of staying on track

NMTC:

Programmatic – CDFI Fund

- Community outcomes –tracking and reporting (Community Benefits Agreement)

Regulatory – IRS

- Census tract
- QALICB characteristics
- Reasonable expectations
- True debt tests

Traditional:

- Lender – any jurisdictional regulatory agencies
- Borrower – good standing; no violations

Underwriting Community Outcomes

1. What are the promised outcomes? Are they quantifiable? Do they meet a clear LIC need? Are they reasonable considering project scale and capacity? How do they compare to industry standard metrics?
2. Relevancy: Does the project implement a part of a larger community plan? Does it have demonstrated support from the community, local government, other service providers, etc.?
3. Likelihood of Success: Is the project likely to succeed and create the projected community outcomes? Does the sponsor have a track record of serving Low-Income Communities?

Underwriting Outcomes Considerations

- Underwriting reasonableness, timeliness, and “enforceability” through Community Benefits Agreement
- Establishing accountability before and after funding through evaluation of promised outcomes and capacity to deliver, and through ongoing reporting of compliance with the Community Benefits Agreement
- Providing for enforcement of the CBA by documenting Financial consequences – fees; incentives
 - Charging/Waiving an Exit Fee

Important Considerations

NMTC Structure Underwriting Considerations:

- Who takes the lead?
 - Leverage Lender – “at risk” lender
 - Tax Credit Investor – recapture risk
 - CDE – Capital may not be at risk, but allocation is
 - All entities should do some level of underwriting
- Important legal issues
 - Put/Call of residual tax credit equity
 - Original Interest Discount (OID)
 - True Debt Test
 - Reasonable Expectations Test
- Long-term lease between QALICB and sponsor
- Likelihood of successful closing & wind-up

CDFI Fund Requirements – FAQ 42 - 44

What are the restrictions on the use of **QLICI proceeds** to **repay or refinance** any **debt or equity provider**, or an Affiliate of any debt or equity provider, whose **capital was used**, directly or indirectly, **to fund a QEI**?

- Beginning with the CY 2015-2016 round, only **documented reasonable expenditures** that are **directly attributable to the qualified business of the QALICB** can be **repaid or refinanced with QLICI proceeds**. These expenditures must either:
 - have been incurred no more than 24 months prior to the date on which the QLICI transaction closes, or
 - represent no more than 5 percent of total QLICI proceeds from QEI.

CDFI Fund Requirements – FAQ 42 - 44*

- Only under these two conditions can QLICI proceeds be used to repay or refinance any debt or equity provider, or Affiliate of any debt or equity provider, whose capital was used, directly or indirectly, to fund a QEI.

* **See:** CDFI FUND | NMTC Compliance & Monitoring FAQs | November 2021

CDFI Fund Requirements – FAQ 42 - 44*

Summary

The CDE's allocation agreement requires it to allow the QALICB to either:

- reimburse the **full amount** of documented reasonable expenditures incurred within 24 months of the QLICI closing date or
- reimburse reasonable expenditures that represent **up to 5% of the QLICI proceeds** incurred at any time prior to the QLICI closing date.
- The CDE may not allow both, or longer time or higher amounts, respectively.

* See: **CDFI FUND** | NMTC Compliance & Monitoring FAQs | November 2021



New Markets Tax Credit Program

Native Initiative Training & Technical Assistance Workshop

Module 6: Doing Good While Doing Well—Economic Expectations of the Participants

September 21-22, 2022

Authors: Karen Williams, Sean Zielenbach, Roman Bitsuie, Big Water Consulting

CDE Financial Results

- CDE or Controlling Entity with an NMTC Allocation
 - Manage dependence on NMTC: No or sparse (amount/frequency) allocations
 - Income sources – current examples of fees
 - Allocation/Sponsor Fee: 1 time - at closing; examples range from 0.5% – 5.00%
 - Loan Origination Fee: 1 time - at closing; examples range from 0.0% – 2.00%
 - Asset Management Fee: examples range from 0.5% – 1.0% of QEI each of 7 years
 - CDE total fees from various components over 7 years typically 8 – 14% of QEIs
- CDE or Controlling Entity without an NMTC Allocation
 - Various sources of income (unrelated program income, loan interest, origination fees loan servicing fees, etc.)
 - Lending activity, deposit activity
 - Non-profit Controlling Entity revenues
 - Federal Grants
 - State & Local Municipality support
 - Program Related Investments (PRI)

CDE Financial Results

- Expenses:
 - Start-up Cost
 - Business Strategy Implementation
 - Staffing – Size of organization; expertise needed; shared?
 - Fixed Costs – infrastructure, systems, occupancy etc.
 - Professional Fees (legal, accounting)
 - NMTC application cost
 - In-House – Time and Talent
 - Out-Source – Writer, Consultants
 - Professional Fees
 - Conferences

			NMTC income									
Closing fee Management fee	5.8% 0.5%	Assumes 5% closing fee in year of award, and 0.5% mgmt fees for 7 years thereafter										
			2017	2018	2019	2020	2021	2022	2023	2024		
		Award amount										
2017		\$ 30,000,000	\$ 1,500,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	
2018				\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
2019					\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
2020						\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
2021							\$ -	\$ -	\$ -	\$ -	\$ -	
2022								\$ -	\$ -	\$ -	\$ -	
2023									\$ -	\$ -	\$ -	
2024										\$ -	\$ -	
2025											\$ -	
Total			\$ 1,500,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	

Tax Credit Investor Financial Results

- Investors receive tax credits over seven years equating to 39% of the “allocation” provided to a transaction.
 - Investors collect credits over seven years at full face value – 100 cents.
 - Investors typically unwind using put/call agreements.
- NMTC Tax Credit pricing
 - During 2021 average credit pricing was approximately 72-77 cents per credit (equating to IRR range of 4-6% *for the Investor*). Pricing less than 100 cents per credit due to “time value” of money and fact that NMTCs are collected over the seven-year compliance period.
 - This is how the investor gets its return on investment.
- Investor demand and hence the price for NMTC credits are driven primarily by CRA-motivated banks.
 - 2022 pricing is trending slightly higher in part because of recent changes to CRA rules; also because of economic factors, bank earnings and tax credit appetite, etc.

Leverage Lender (Not Affiliated with Sponsor)

- Usually receives normal amortizing principal and interest
- Conventional leverage lender – “Economically driven/market rate lender” as opposed to “mission driven lender” like a CDE or CDFI.
- CDFI lenders are mission driven, seeking opportunities in their Target Market
- Often familiar with either the borrower, area, or type of project involved in the NMTC transaction, and therefore familiar with the risk being undertaken.
- Major risk is the default of the QLICI (no “hard” collateral) and negotiated forbearance agreement. Risk sometimes mitigated by lending to sponsor affiliate that provides collateral, then affiliate acts as leverage lender.

Secondary CDE Investment

- While IRS regulations allow NMTC investments to be made through multiple layers of CDEs (e.g., up to 4 CDEs), generally a CDE that invests in an unrelated CDE provides QLICs to only one unrelated CDE, which in turn makes the final QLICI in the QALICB.
- The Allocatee makes a QLICI to an unrelated CDE that does not have an allocation (CDE A). CDE A makes a separate QLICI to the project's QALICB.
- CDE A needs to demonstrate that it used those dollars to:
 - Make loans to, or investments in QALICBs; and/or
 - Provide FCOS to businesses or residents of LICs.



Secondary CDE Financial Results

- Secondary CDE (CDE to CDE) - Collaborative Community Development Strategy
 - Included in NMTC Application Question 13 as one of the options for a CDE's financing activity.
 - Can be a good way for a CDE to meet its community development goals.
- Also cited as an Innovative Use of an NMTC Allocation
 - “Innovative Uses of an NMTC Allocation...Investing in Unrelated Minority- or Native American-owned or controlled CDEs that do not have NMTC Allocations”.
- May enable emerging CDEs to build track record for applying for allocations in future rounds.

Bringing It All Together

- What does this mean for your organization?
- Where can you fit in?
 - CDE with Allocation
 - Leveraged Lender
 - NMTC Investor
 - Secondary CDE
 - Qualified Borrower/Sponsor
 - Advisory Board Member