

US Department of the Treasury



Community Development Financial Institutions Fund

New Markets Tax Credit Briefing
Wilkes-Barre, Pennsylvania
April 26, 2002

CDFI
fund

What Topics Will the Workshop Cover?

- General CDFI Fund Information
- Overview of NMTC Process
- CDE Certification Application
- NMTC Allocation Application

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 by:
 - Supporting community development financial institutions (CDFIs) and community development entities (CDEs); And
 - Providing incentives for banks and thrifts to increase their lending, investment, and services within distressed communities.

CDFI Fund Initiatives

- CDFI Program
 - Core/Intermediary Component
 - NACTA
 - SECA Component
- Bank Enterprise Award (BEA) Program
- New Markets Tax Credit (NMTC) Program

New Markets Tax Credit

- Passed on December 21, 2000, as part of the Community Renewal Tax Relief Act of 2000
- Creates a tax credit for equity investments in Community Development Entities (CDEs)

Process Overview

Step 1: Organizations may apply to the Fund for designation as CDEs

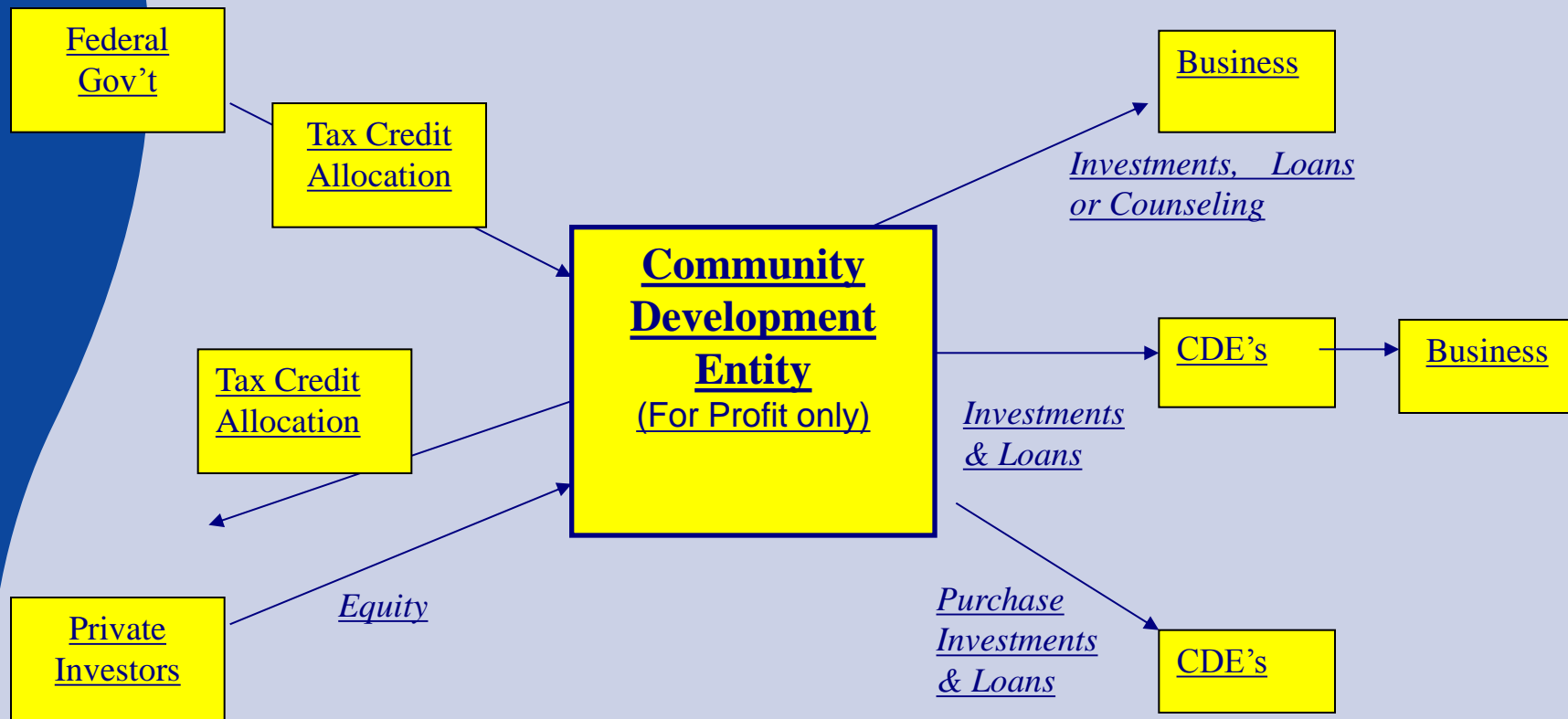
Step 2: CDEs may apply to the Fund for allocation of tax credits

Step 3: CDEs are selected to receive tax credit allocations in a competitive process

Step 4: CDEs awarded tax credit allocations will sell tax credits to investors

Step 5: CDEs use the proceeds to make qualifying low-income community investments

How the NMTC Will Work



Offering NMTCs to Investors

CDEs must offer tax credits to investors in exchange for Qualified Equity Investments (QEIs)

A QEI is any purchase of stock or a capital interest in a for-profit corporation or partnership

Offering NMTCs to Investors

- CDEs must exchange their allocations with investors within five years from entering into an allocation agreement
- An equity investment occurs when the investor provides its cash to the CDE

Offering NMTCs to Investors

- An investor may begin to claim tax credits as of the date of its initial investment
- An investor may not redeem its investment in the CDE for a period of seven years

Use of NMTC Proceeds

CDEs have one year from the date they receive the QEI to invest “substantially all” of the proceeds into “Qualified Low-Income Community Investments (QLICIs)”

Proceeds must remain invested in QLICIs continuously throughout the seven year credit period

Use of NMTC Proceeds

Returns of capital realized by the CDE during years 1-6 must be reinvested into QLICs within one year

Periodic loan repayments may be aggregated for up to 2 years before reinvestment is required

No reinvestment is required in year seven

Substantially All

Years 1-6: Substantially All is defined as 85% of the amount paid by the investor at the original issue

Year 7: Substantially All is defined as 75% of the amount paid by the investor at the original issue

At all times, up to 5% of the original issue amount of the QEI may be held as reserves by the CDE

Substantially All

There are two methods by which a CDE may demonstrate that it has fulfilled the substantially all requirements:

- 1) Direct Tracing
- 2) Safe Harbor

Substantially All

Under direct tracing, a CDE is required to trace QEI proceeds to specified QLICs

Under safe harbor, a CDE must demonstrate that substantially all (i.e., 85%) of its aggregate gross assets are invested in QLICs

- Unlike direct tracing, CDEs are not required to link QEI proceeds to specified QLICs

Qualified Low-Income Community Investments

- Any capital or equity investment in, or loan to, any “Qualified Active Low-Income Community Business” (QALICB)
- Any equity investment in, or loan to, any CDE
- The purchase of a loan from another CDE if the loan is a Qualified Low-Income Community Investment
- Financial counseling and other services to businesses located in, and residents of, Low-Income communities

QALICBs

- **Gross Income:** At least 50% of gross income is derived from the active conduct of the business in Low-Income Communities
- **Use of Tangible Property:** At least 40% of the use of the tangible property of the business is located in Low-Income Communities
- **Services Performed:** At least 40% of the services provided by the business are performed in Low-Income Communities
- The gross income requirement is deemed to be met automatically if either the tangible property test or the services test is at 50% or higher

QALICBs

- **Collectibles:** Less than 5% of the average of the aggregate unadjusted bases of the property is attributable to collectibles, other than those held for sale in the ordinary course of business
- **Nonqualified Financial Property:** 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).

Control Over QALICBs

- If the CDE controls the QALICB, the business must continue to qualify as a QALICB throughout the period of control
- If the CDE does not control the QALICB, it needs to certify, at the time the CDE makes its investment, that it reasonably expects the business will qualify as a QALICB throughout the seven year compliance period
- Control is generally defined as owning, or having voting rights, totaling 33% or more of the QALICB – except in circumstances where an unrelated person exercises greater control

Investing in Other CDEs

- CDEs providing loans to or investments in other CDEs will be required to demonstrate that the recipient CDE uses those dollars to:
 - Make loans to or investments in QALICBs; and/or
 - Provide financial counseling and other services to businesses or residents of Low-Income Communities
- The recipient CDEs will be required to meet the same timelines (with respect to substantially all) as if they were awarded a direct allocation of tax credits

Purchasing Loans from Other CDEs

- CDEs may purchase loans (but not investments) from other CDEs
- CDEs may only purchase loans originally made to QALICBs
- The business had to have qualified as a QALICB at either:
 - The time the loan was originated; **or**
 - The time the loan was purchased by the CDE

Recapture

The NMTC may be recaptured from investors if:

- Substantially all the proceeds received for the NMTC are not used to make Qualified Low-Income Community Investments during the 7-year period
- The CDE which sold the investment ceases to qualify as a CDE
- The CDE redeems the investment

CDE Certification Application

Why Become a CDE?

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

Applying for CDE Designation

- An entity may apply for CDE designation solely on its own behalf, or it may apply on behalf of itself and one or more subsidiary organizations
- Applicant CDEs seeking to certify subsidiary organizations may do so in one consolidated application

Certified CDFIs and SSBICs

- Automatically qualify for CDE certification and need not fill out a CDE Certification Application.
- CDFIs and SSBICs may register electronically at: www.cdfifund.gov
- Affiliates and subsidiaries of CDFIs and SSBICs do not automatically qualify as CDEs – these organizations must complete a CDE Certification Application.

CDE Certification Requirements

- Must be a duly organized domestic corporation or partnership
- Must demonstrate a primary mission of serving, or providing investment capital for, Low-Income Communities or Low-Income Persons
- Must be accountable to residents of the Low-Income Communities that it serves
- Must be certified as a CDE by the Fund

Primary Mission

Purpose:

To determine whether an Applicant has a primary mission of serving or providing investment capital for Low-Income Communities or Low-Income Persons.

Information Needed (primary mission)

- ✓ Organizational documents evidencing such primary mission
- ✓ “Certification of Authorized Representative” to demonstrate that at least 60% of the applicant’s (and any subsidiary applicants’) products and services are or will be dedicated to Low-Income Persons, Low-Income Communities or to organizations that principally serve Low-Income Persons or Low-Income Communities.

Information Needed (primary mission)

If submitting on behalf of one or more subsidiary organizations, the applicant CDE must either submit:

- ✓ Separate organizational documents demonstrating the primary mission for **each** entity seeking certification; **or**
- ✓ A signed form, “Certification Attesting to Primary Mission of Subsidiary Applicants.”

Accountability

Purpose:

To ensure that Applicants maintain accountability to the residents of Low-Income Communities they serve or expect to serve.

Accountability

❖ Based on the service area, 20% of the governing board or advisory board must be comprised of individuals that represent:

- ✓ Local service area: any Low-Income census tract within the area.
- ✓ Multiple local service areas: Low-Income Communities from each of the areas.
- ✓ Statewide, multi-state, or national service areas: a cross-section (e.g., urban and rural) of Low-Income Communities within the areas.

❖ Multiple advisory boards or board members that represent the interests of a cross-section of Low-Income Communities may meet this requirement.

Who is Representative?

To represent a service area, a board member must either:

- Reside in a Low-Income Community; or
- Otherwise represent the interests of the residents of a Low-Income Community.

Examples:

- A small business owner whose business is located in the community
- An employee or board officer of a community-based or charitable organization serving the community
- An employee of a statewide community development organization

What Areas Qualify as Low-Income?

- Census tracts with at least 20 percent poverty, or
- Census tracts where the median family income is below 80 percent of the area median family income

Visit the Fund's online help desk:

www.cdfifundhelp.gov

Maintaining CDE Certification

CDE certification is valid for the life of an organization, but CDEs will be required to annually certify that they continue to meet the primary mission and accountability requirements.

Timeframe to Apply for CDE Designation

- The Fund will accept CDE applications on a rolling basis.
- If an entity wishes to apply for an allocation of NMTCs, it must submit its CDE application prior to the date by which NMTC allocation applications are due.

NMTC Allocation Application

Credits for up to \$15 Billion in Investments Are Available

2002	\$2.5 billion
2003	\$1.5 billion
2004	\$2 billion
2005	\$2 billion
2006	\$3.5 billion
2007	\$3.5 billion
TOTAL	\$15 billion

Unallocated tax credits may be carried over from year to year until 2014.

Applying for an Allocation of Tax Credits

- A Notice of Allocation Availability (NOAA) will be published by the Fund this Spring
- The Fund will simultaneously make available applications for allocations of the tax credits
- There will likely be a 60 to 90 day application period

Application for NMTCs

General Review Criteria:

- Investment Strategy
- Tax Credit Capitalization Strategy
- Compliance Strategy
- Management
- Community Impact

Application for NMTCs

Priority given to CDEs:

- With a track record of having successfully provided capital or technical assistance to disadvantaged businesses or communities; or
- Which intend to invest in businesses in which unrelated parties hold the majority equity interest.

Award Decisions

- The Fund anticipates making award decisions and entering into allocation agreements with Awardees in the Fall of 2002.
- Awardees may offer tax credits to investors once allocation agreements are signed.

Please Contact Us:

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www.cdfifund.gov

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