

U.S. Department of the Treasury




Community Development Financial Institutions Fund

New Markets Tax Credits:
2006 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




CDFI Fund Initiatives

- **CDFI Program:** Provides assistance to CDFIs and emerging CDFIs.
- **Native Initiatives:** 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 at or **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



7

Example

The Fund awards an allocation of \$1 million to a CDE. The CDE offers the tax credit to investors. Ten investors each invest \$100,000 in return for tax credits. How much can each investor claim as a tax credit?

Years 1-3 Tax Credit at 5% Value \$5,000 per year
 Years 4-7 Tax Credit at 6% Value \$6,000 per year

TOTAL VALUE OVER 7 YEARS.....\$39,000



8

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 credit period
- Investors generally may claim credits as of the date a QEI is initially made



9

Amount of NMTC Investment Authority Available

2001-02	\$2.5 billion	
2003-04	\$3.5 billion	
2005	\$2 billion	
2006	\$3.5 billion	current round
2007	\$3.5 billion	
TOTAL	\$15 billion	

Unallocated investment authority may be carried over from year to year through 2014.



10

Process Overview

- Step 1:** Entities apply to the Fund for CDE certification
- Step 2:** Entities apply competitively to the Fund for a NMTC allocation
- Step 3:** The Fund selects CDEs to receive NMTC allocations
- Step 4:** CDEs use allocations to offer NMTCs to investors for cash
- Step 5:** CDEs use proceeds to make "Qualified Low-Income Community Investments" (QLICs)



11

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



12

Timing of Investments

- CDEs must offer NMTCs to investors within **5 years** of receiving an allocation.
- CDEs have **12 months** to invest “substantially all” (85%) of their QEI proceeds into QLICs.
- Generally, CDEs that receive returns of equity, capital or principal will have **12 months to reinvest** those amounts in QLICs.
 - Reinvestment is not required in the final year of the 7-year credit period.



13

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%

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.



14

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** equity, capital or principal 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



15

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



16

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



17

Recapture

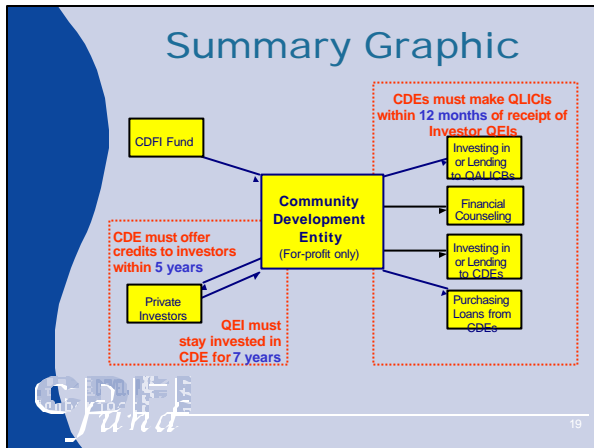
NMTCs may be recaptured from investors during the 7-year credit period if:

- 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 – and an investor may continue to claim NMTCs – if a CDE files for bankruptcy.



18



- ## 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
- 20

- ## 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 tangible property** of the business is within LICs; and
 - 3) At least 40% of the **services performed** by the business' employees are performed in LICs; and
- 21

- ## 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).
- 22

- ## QALICB Criteria: Exceptional Cases
- The gross income test is deemed to be met if either the tangible property or the services test is met at 50% or higher.
 - If a business has no employees, it can meet both the services and gross income tests if it meets the tangible property test at 85% or higher.
- 23

- ## Ineligible Activities
- Residential rental property:
 - Buildings which derive 80% or more of income from residential dwelling units
 - Certain types of businesses:

<ul style="list-style-type: none"> – Golf courses – Race tracks – Gambling facilities 	<ul style="list-style-type: none"> – Certain farming businesses – Stores where the principal business is the sale of alcoholic beverages
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 - Refer to IRS regulations for additional details
- 24

2: Investing in Other CDEs

- Investments may be made through multiple layers of CDEs (i.e., up to 3 CDEs)
- The last CDE recipient 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

All time limits must be met as if the CDE with the allocation directly made the QLICI.



25

3: Purchasing Loans from Other CDEs

CDEs may purchase loans – but **not** investments – from other CDEs if:

- The purchased loans were originated by an entity that was a CDE at the time the loan was sold; and
- The loans qualified as QLICIs at **either** the time the loan was:
 - Originated; or
 - Purchased by the allocated CDE



26

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



27

The NMTC Program

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Renewal Communities and Empowerment Zones



28

Renewal Community & Empowerment Zone Tax Incentives

- Millions for Businesses in Wage Credits
- \$12 Million in Yearly RC Commercial Revitalization Deductions
- Capital Gains Savings: Tens of Millions
- Billions in Tax-exempt EZ Bonds



29

NMTC Investment: Yakima, Washington Renewal Community

- New 120-room hotel & 70 new jobs
- \$6.5 million in RC Commercial Revitalization Deduction Allocations
- \$2.4 million in New Markets Equity
- other financing



30

HUD's RC/EZ Address Locator

- www.hud.gov/crlocator
- Shows if a business or employee address is in an RC or EZ
- Gives map of address and local streets
- Tens of Thousands of "hits" monthly



31

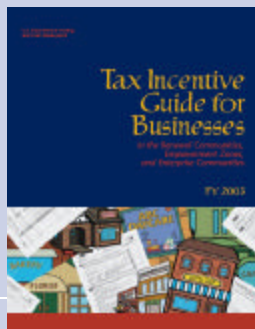
HUD's Office of Community Renewal

- Assistance on New Markets investments in RC/EZ areas
- Information on RC/EZ Tax Incentives
- Publications on RC/EZ tax incentives
- 202-708-6339 or www.hud.gov/cr



32

Tax Incentive Guide for RC/EZ Businesses



33

Applying for CDE Certification



34

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



35

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 2006 round must submit a CDE certification application that is:
 - Postmarked on or before August 22, 2005;
 - and
 - Received by August 30, 2005.



36

Certified CDFIs and SSBICs

- Automatically qualify for CDE certification
- May register as CDEs electronically at: www.cdfifund.gov
- To apply for an allocation of NMTCs under the 2006 round, CDFIs/SSBICs must register as CDEs **by August 22, 2005**.
- Affiliates and subsidiaries of CDFIs and SSBICs:
 - Do not automatically qualify as CDEs
 - Must complete a CDE Certification Application



37

Legal Entity Test

Entities applying for CDE certification must:

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



38

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?



39

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



40

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



41

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?



42

Accountability: Information Needed

Step 1: Identify a service area

- Local (e.g., city; county; metropolitan area; Indian Reservation)
- Statewide or territory-wide
- Multi-state
- National



43

Accountability: Information Needed (cont'd)

Step 2:

Complete the "Accountability tables" 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 information for each advisory board.



44

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.



45

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



46

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.



47

Using the CDFI Fund's Info. Mapping System (CIMS)

- Accessing CIMS:
 - Register as a user through myCDFI-Fund
 - Click on the "Mapping" link
- Identify census tracts throughout the country that qualify as NMTC-eligible LICs
- Geocode addresses of customers, transactions or board members to see whether they qualify as serving LICs



48

Applying for a NMTC Allocation




49

2006 Round Deadlines

Deadline	Date
Anticipated release of online application	Aug. 15, 2005
CDE Cert Apps. must be postmarked on or before	Aug. 22, 2005
CDE Cert Apps. must be received by	Aug. 30, 2005
Notification of intent to submit a paper Alloc. App.	Sept. 7, 2005
Submission of Allocation Application (online or paper version)	Sept. 21, 2005
Attachments and signature page must be postmarked on or before	Sept. 26, 2005
Attchs. and sign. pg. must be received by	Oct. 3, 2005
Previous Allocatees must issue a designated percentage of QEIs by	Dec. 31, 2005 (1 st & 2 nd round) Feb. 15, 2006 3 rd round


See NOAA for additional details



50

Preparing for the Online Application


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



51

Key Differences Between 2005 and 2006


- The order of the 4 major sections of the application changed. Community Impact follows the Business strategy section to better reflect the connection and flow of these two sections.
- Applicants must now designate a controlling entity that currently controls and is expected to have ongoing control of the day-to-day management of the organization (Q #3).
- New questions
 - Q #19 – Applicants can commit to a higher level of flexible products and terms.
 - Q #29 (b) – Applicants can commit to deeper targeting of severely distressed areas.



52

Key Differences Between 2005 and 2006 (cont'd)


- Applicants are asked to provide their track record of monitoring and achieving community impacts (Q#31 & Table C1).
- Applicants will provide more detailed information about the role of its Governing/Advisory Board with respect to its community involvement and feedback (Q#41)
- Applicants will provide sources and uses of funds to cover their operating expenses including fees charged outside of the NMTC program (Q#56).
- Applicants must justify its allocation request (Q#58). If a minimum amount is requested, the applicant will need to provide detailed justification explaining why a lower amount is not viable.



53

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



54

Review Criteria

- Maximum of 110 points
- Four sections of 25 points each:
 - Business Strategy
 - Community Impact
 - Capitalization Strategy
 - Management Capacity

Applicants may earn an additional 10 "priority" points.



55

Priority Points

"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



56

Business Strategy: Key Scoring Factors

Generally, an applicant will score favorably in the Business Strategy section if:

- It will offer products and services that are flexible and non-traditional in form.
- It can demonstrate a high leverage rate for its borrowers or investees.
- It has a track record of providing products and services similar to those it intends to deploy with QEI proceeds.
- It has a strong pipeline of proposed projects
- It can demonstrate that its NMTC strategy will add significant value to the proposed activities.



57

Community Impact: Key Scoring Factors

Generally, an applicant will score favorably in the Community Impact section if:

- It demonstrates that a high percentage of its QLICs will be made in areas of higher distress.
- It articulates credible, detailed, and quantifiable impacts.
- It has a track record of achieving such impacts.
- Its strategy will catalyze other investments into the LICs served.



58

Capitalization Strategy: Key Scoring Factors

Generally, an applicant will score favorably in the Capitalization Strategy section if:

- It has secured QEI commitments from investors or has a strong strategy for doing so.
- It can issue QEIs in the near term.
- It demonstrates that a majority of the economic benefits of the NMTC will be passed through to borrowers and investees.
- It is offering products and services that are substantially different from those of its investors.
- It intends to deploy more than 85% of its QEI proceeds into QLICs.



59

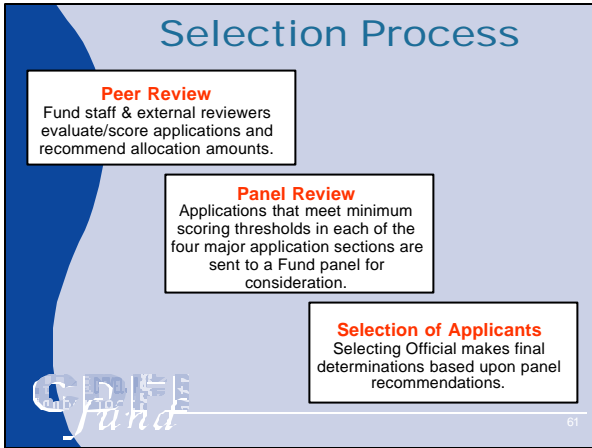
Management Capacity: Key Scoring Factors

Generally, an applicant will score favorably in the Management Capacity section if:

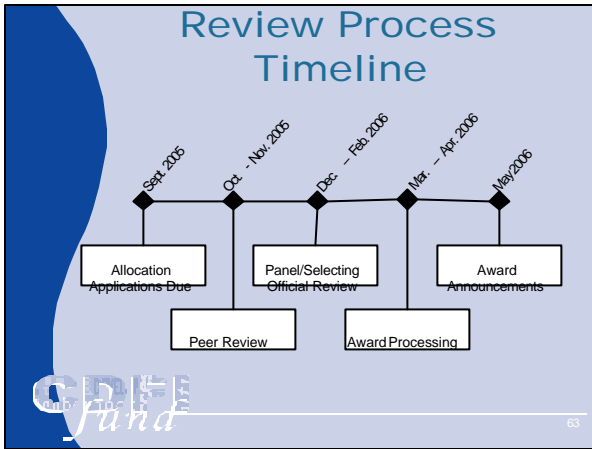
- Its staff has relevant investment experience, particularly in the LICs that the applicant's strategy targets.
- It has a track record of raising capital, particularly from profit-motivated investors.
- It has the capacity to manage the addition of NMTC activities into its current portfolio of activities.
- It demonstrates meaningful involvement with LIC decision makers and coordination with local community plans.



60

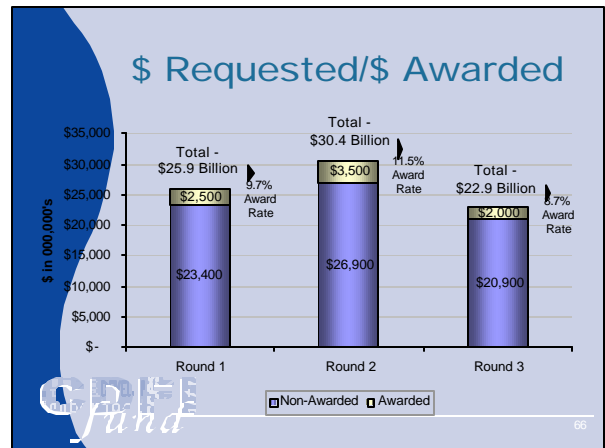
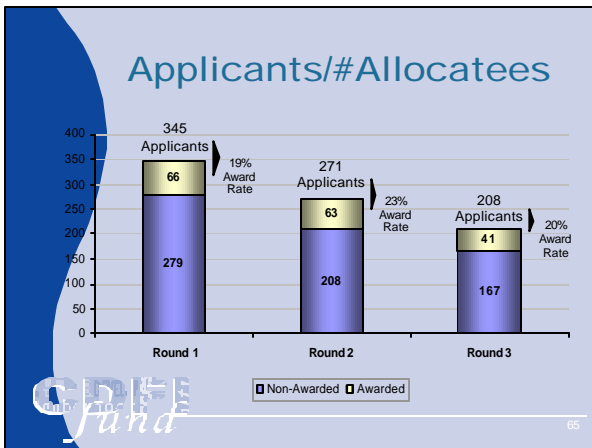


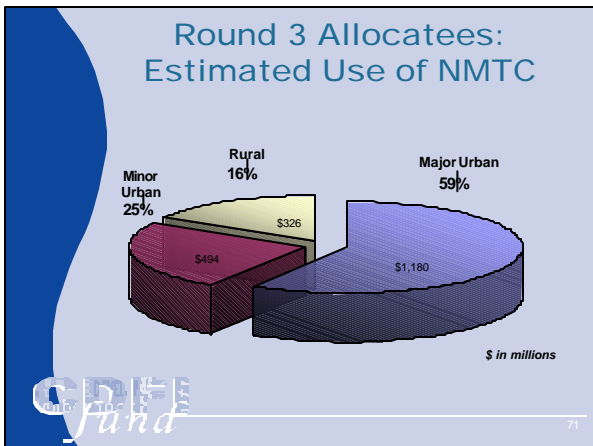
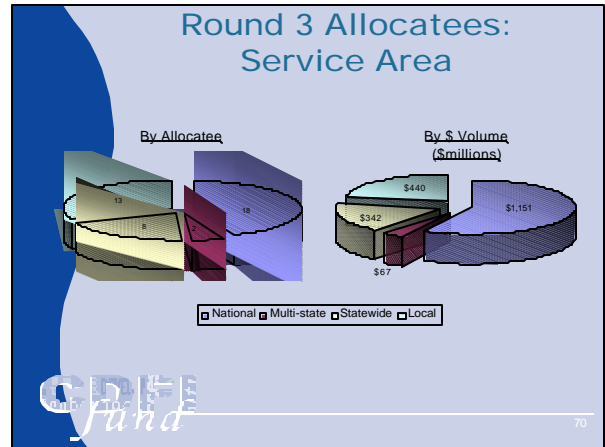
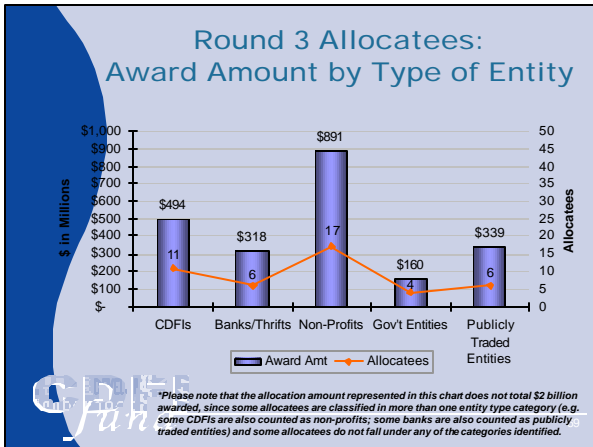
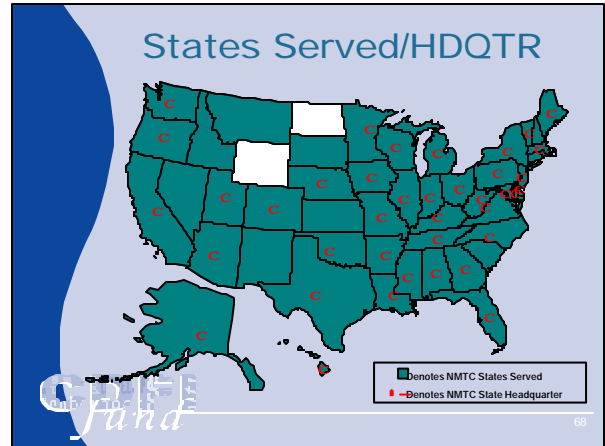
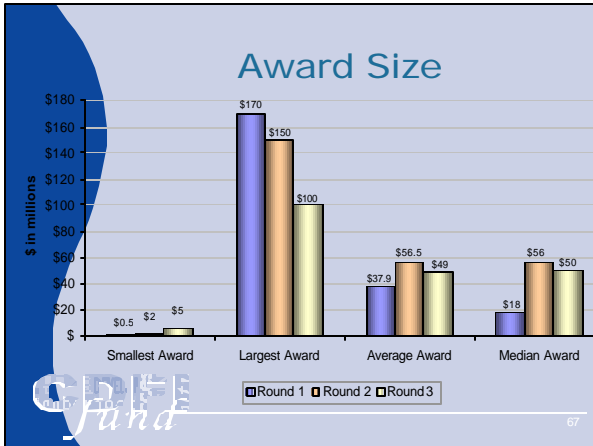
- ## Prioritizing Allocations
- At the panel phase of review, applicants will be ranked in order of their combined scores in the Business Strategy and Community Impact sections of the application.
 - The Selecting Official will generally award allocations in the order of this ranking, subject to applicants' meeting all other eligibility requirements, until allocation authority is expended.
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- 62



Allocation Round Results

64





Round 3 Allocatees: Other Facts

- The 41 allocatees have committed to achieve certain programmatic goals above and beyond what is minimally required by statute and regulation.
- They will be required to meet these benchmarks through their allocation agreements with the Fund
- Each allocatee indicated that at least 75% of their loans and investments will have flexible or non-traditional features, and 36 of the 41 allocatees indicated that 100% of their loans and investments will have flexible or non-traditional features.

72

Other Facts (cont'd)

- 35 of the 41 awardees indicate that they will invest at least 95% of NMTC proceeds into low-income communities, an increase over the minimally required 85%.
 - This includes 9 organizations that have committed to invest 100% (vs. 85%) of NMTC proceeds in QLICs.
 - In real dollars, this means at least \$200 million more in low-income community investments will be made than are minimally required by program regulations.



73

IRS Contact Info.

For questions about:

- IRS Regulations
- Eligibility of possible QLICI activities
- Other tax implications of the program

Contact **IRS** at (202) 622-3040



74

CDFI Fund Contact Info.

For questions about the 2006 Allocation Round:

- Visit the Fund's website at www.cdfifund.gov
- Contact the Fund directly:

Programmatic Support

Ph: (202) 622-6355

Fax: (202) 622-7754

Email: cdfihelp@cdfi.treas.gov

IT Support

Ph: (202) 622-2455

Email: ithelpdesk@cdfi.treas.gov

The Fund will only accept questions about the 2006 Round through **Sept. 19, 2006**



75