U.S. Department of Housing and Urban Development (HUD)
Autumn 2003 Community Renewal Workshop
Panel Discussion on New Markets Tax Credits
October 21, 2003, 3:00 P.M.
Costa Mesa, California
Edited Transcript

A 2-hour session on the New Markets Tax Credit program was part of HUD's 2-day Autumn 2003 Community Renewal workshop held at The Westin, Costa Mesa, located at 686 Anton Boulevard, Costa Mesa, California. HUD and the City of Santa Ana, California co-hosted this workshop.

PANELISTS:

LINDA SCHAKEL, moderator: Partner, Ballard, Spahr, Andrews & Ingersoll, LLP.

THOMAS TRACY, guest speaker: Principal Owner and Managing Director, Hunter Chase & Company, speaking on behalf of KHC New Markets, a Community Development Entity (CDE) that received a $134 Million New Markets Tax Credit allocation in 2002.

DOUGLAS BYSTRY, guest speaker: President & CEO, Clearinghouse CDFI, a CDE that received a $56 Million New Markets Tax Credit allocation in 2002.

ROBERT McGILL, guest speaker: Chairman of the Board & CEO, Neighborhood National Bank, a CDE that received a $5 Million New Markets Tax Credit allocation in 2002.

WILL COOPER, guest speaker: President & CEO, WNC Associates, Inc., a CDE that received a $50 Million New Markets Tax Credit allocation in 2002.

Notes: the statements below are based on a transcription of statements from those present during the discussion. Due to the possibility of human error in transcribing the proceedings and editing the transcription, HUD cannot guarantee that the words below are exactly what all speakers stated. Unidentified SPEAKERS noted below are either HUD staff personnel or audience members.

SPEAKER: If everyone can have a seat, we'll be starting in just a few moments. Our final session for today in this room, we are going to be talking about the New Markets Tax Incentive. And also in another room, we have a roundtable discussion regarding the current -- the concerns of the Hispanic Business Community. And that is taking place in the Mesa Verde room, which is right down the hall a little bit.

All right. So what we are going to be talking about today is Linda Schakel is going to give an overview of the New Markets Tax Credits and introduce the panel of experts representing the community development entities that are receiving the New Markets Tax Credits allocations.

LINDA SCHAKEL: We need to make sure we are on. Okay. I'm going to go ahead and start with the slides on -- it kind of gives a little bit of an overview of the New Markets Tax Credit. I think these are the gentlemen with the money, so you would prefer to hear from them instead of me talking and droning on about the tax rules. So we'll make sure we give them enough time to speak. And I think once I do my little overview, I'll let each one of you in turn talk about your incentives. And I assume that you're willing to take questions from the audience. So far today, they've had lots of them.

So the New Markets Tax Credit is really a bold new step for the federal government. What we are talking about is something that was enacted in 2000 along with a renewal community provision. And it essentially is a tax credit for investors in what we are going to call a community development entity or a CDE.

So the tax credit is somewhat like taxes and bonds in that it's the holder of the investment that's getting the credit. And that credit is going to be based on how much they invest in the community development entity, in a CDE. The amount of credit they're going to get is dependent on whether that CDE has got an allocation of the market tax credit.

Essentially what the investor is going to do is make an investment, either by purchasing a partnership share or a credit -- or a stock in a corporation that is going to be the intermediary in this whole process. And in order to get designated as a community development entity, each one of these entities would have gone to the U.S. treasury department and filled out an application. And in that application, they had to show that they had a primary mission of serving low-income communities and that they were also accountable to low-income communities. And for our purposes here, a low-income community is a census tract where the poverty level is at least 20 percent or a census tract where the area median income is 80 percent of the state's family area median income. So that means for those of you who are involved in a renewal community or empowerment zone, that's pretty much going to cover every single census tract in your renewal community or your empowerment zone. It may also cover some of the census tracts that actually were left out of your RC or EZ application.

And I think some people earlier today suggested that they didn't include all of the areas in there because if they added an area, it might have taken them over the population limit or if you added an area, it might have taken you over the permitted square miles. So also for the empowerment zones, there may be some parts of the empowerment zone that don't meet this definition because they don't have people. They're those developable sites and they did not have a population so that you could measure the unemployment or the area median income. So there may actually be some parts of the empowerment zone that won't qualify for this incentive.

You're permitted to go to treasury and include a census tract or part of a census tract to meet either one of those tests, either the 20 percent poverty level or the 80 percent median income. But you would still need people in that in order to meet that. I think some of those development sites won't make it even with the ability to go to treasury and get it designated.

The credit is actually taken over -- it's described as taken over a seven-year period. But it really -- it's really on the date you make the investment and then the next six anniversary dates. So, for example, if I have a million dollars to invest and I was going to invest it today, which is October 21st, I get a 5 percent credit, 5 percent of my million dollars today. I earn that credit today. The date I make my investment. And so I've got $50,000 in credits. I'm going to earn $50,000 today and each one of the next two anniversary dates, October 21st. And then the next four anniversary dates I'm going to earn a 6 percent or $60,000 credit. So if I actually hold that investment for the full seven credit dates, I'm going to get $390,000 in credits. That's a credit against my federal tax liability for my one million dollars investment.

This is how much there is to be allocated under this statute. And look at that bottom number. $15 billion -- that is a B, not an M -- $15 billion. So over the next several years, the U.S. Treasury Department is going to be allocating $15 billion in credits. So potentially that is $15 billion in investments that go -- can go into low-income communities.

They had their first allocation poll and decisions this past March. If you look at the figures up there, they had 345 applications. And in those applications, they were requesting $25.8 billion in tax credits. And they only had $2.5 billion to allocate. So there were 66 recipients. So we have some winners in the group. It says the average amount of allocation was $38 million. But like most averages, it's not very representative. In some cases, the allocation may have been a half million dollars. I think the most allocated may have been $160 million. $170 million. So it can really run the gamut. The $38 million doesn't really perhaps represent the best description of who received what.

And then here's our kind of plug. It was discussed on a satellite broadcast. And there are tapes available. And you can get them outside. So if you weren't able to listen to the broadcast and you would like to hear the presentation, make sure that you get your tape. This Web site that's up here, the allocations were actually handled by the CDFI fund, Community Development Financial Institutions. And if you log on to that Web site, you will see a break- -- an interesting breakdown of the 2002 entities that received the allocation [www.cdfifund.gov/]. It will show you geographically. It will show you a description of what it is that entity said it was going to do with its allocation once it received it.

So, for example, if you're in California, there's one of the variations of sorting that will tell you the names of the entities that have put into their allocation application that they intended to serve California. And those descriptions will also tell you what percent they expected to use in rural areas, what percent in urban. There really is quite a bit of information. So if you're interested in figuring out who to talk to, the CDFI Web site will give you a lot of information. It also gave information on the second round of allocation applications. Those were due at the end of September. And I read they had 171 applications. So that's a little bit less than last year. But I think they were still asking for ten times more than what they can allocate this year. They will be -- by combining two years, they'll allocate $3.5 billion in credits this year. Is that the end? Okay.

THOMAS TRACY: I guess so. Thanks Linda. I guess we are supposed to give a very short bio because somewhere in the Internet jungle, the bio may have gotten lost. Since I'm starting off, I'm Tom Tracy. And I'm actually substituting for Dave Carr. Dave is the contact person for KHC New Markets, LLC, which is a long-winded way of saying the Key Hunter Chase allocation. I'm the Hunter Chase part of the Key Hunter Chase allocation and the principal owner of that company.

What we did -- I'll tell what you that our allocation was for $134 million. And it will be divided into two parts. One part is going to be $50 million, which we hope to use for mezzanine funds for homebuilders to try to promote affordable housing. Both of these are national funds.

The second fund is a commercial mezzanine fund. So, again, we are trying to promote primarily redevelopment activities. And in both -- in our application, we agreed that 60 percent of our total investment would go into what is called the distressed communities, which is a whole category of different items, redevelopment areas, empowerment zones, SBA hub centers or cycles, whatever they call it. There are seven or eight in there. So you can see the kind of flavor from our fund alone. You can see the flavor of what New Markets is really supposed to accomplish.

Kind of in a closer vein, our company is associated also with Excellent Education [LA Charter School New Markets CDE LLC], which is right up the road in Los Angeles County. And they have a $36 million allocation, and they hope to provide financing for charter school facilities. And if they can finance these facilities they'll be able to open six or seven new charter schools in the more distressed parts of L.A. At least the funds that I'm associated with are really trying to focus in on channeling as much money as we can to distressed areas.

I'll give you just some general thoughts and then I'll pass it on. First, I really think and believe that the intent of congress when they passed the New Markets legislation, which was allocated into the allocation applications, was to encourage private equity or private money to go into communities that historically didn't have an opportunity to go get that private capital from -- from the private -- from the public marketplace, the capital markets. And you can see kind of this in the allocation application. You get extra points. And I think that's what Linda was mentioning earlier, bonus points. They're really extra -- it's a four-part application. You get 25 points for each part, and you're scored separately on each part. And you have to score reasonably high on each part to get an award. And community impact is one part. And if you elect to go either 0 percent to 100 percent of your investments in these distressed communities. So I venture to say that most of the applicants on the second round, if not the first round, are -- are -- in order to get the points to compete for the award, are going to channel their energies into the different types of activities that everyone in this room are involved in, in the redevelopment areas and renewal communities or things like that.

Another thought about the New Markets is on the second round, a couple of banks, including Key Bank, were successful in the first round. Key Bank I believe got $150 million. And Key Bank got the other application and through Chase got another $134 million. I think there are going to be a lot of banks that do apply. I think that's a good thing for the communities and people who work in this area because I had the opportunity to consult with two of the largest banks that applied in putting together their applications, Bank One and Fifth Third out of the Midwest. They have some absolutely wonderful programs that they want to do. And they're programs that are really extending into the really distressed areas or the renewal areas or the empowerment zones.

For example, Bank One has one program where they will give subsidized loans to create facilities for large retailers who are willing to take and put stores into part of developed areas. And they've subsidized these retailers through cheaper financing for a period of time just to allow them to get through the normal start-up period. You know, of course this will create a lot of jobs and a lot of impact. Both of those banks also had several programs targeted to small businesses. There were programs that had a lot of cheaper money, cheaper fees, and lower credit standards. They would pointedly go towards smaller borrowers rather than the richer, larger borrowers.

I think as this program develops, you can certainly see at least an early trend that it will be a wonderful program for redevelopment agencies and others that are trying to get into certain areas of the communities to get back on par. And it's so flexible. The programs can consist either of equity investments in or loans to qualified active businesses. Qualified active businesses are primarily commercial real estate, rental real estate, or a whole variety of other businesses that are predominantly in a lower income community. So when you start to talk about loans to or investments in, that's the whole gamut of private capital, from venture capital. There are some. Advantage [Capital] Partners is one that got an allocation in venture capital. They will be doing it. There are a number of others that will be doing small business loans. A lot of real estate. A lot of real estate loans, mezzanine loans. And there will be some equity investments made.

So I think it's a program for all of you to at least try to understand and try to find out who the CDE in your communities are. As Linda mentioned, they're all on the CDFI Web site as to the planning [www.cdfifund.gov]. Again, you can also find out who plans to be a CDE in the future. [The City of] Phoenix scored with $170 million on the first round. And so I expect quite a few cities or state -- state components of state agencies who are supporting CDEs to do redevelopment programs. And I think the program is flexible enough to handle that. With that, I'll pass it onto Doug.

DOUGLAS BYSTRY: Okay. Thank you, Tom. My name is Doug Bystry. I'm the president of the Clearing House CDFI. By way of introduction, CDFIs are community financial institutions. We have a mission of providing credit to distressed and underserved areas of the country. Before I get too much into where we've been and what we are doing with the new markets, I wanted to ask a question. Just a show of hands. How many prior to coming to this session today had heard of New Markets Tax Credits?

Okay. So it sounds like most of you. And I think one of the things that I've said to people in talking about New Markets is that it's really in some ways similar and in many ways different to the Affordable Housing Tax Credit Program. I think New Markets Tax Credit Program is a tool that can bring economic development to underserved areas in the same way that the Affordable Housing Tax Credit has brought resources to create affordable housing. I think it's appropriate for those of you here at this conference to understand this.

By way of introduction, the Clearing House CDFI is located right here in Orange County. We serve regional Southern California. We've been doing so since 1990, when we started out as a brokering agency. As a clearing house, we would get all of the information necessary for credit request, package it, make sure it had all the pro formas and calculations, and go and solicit lenders and get it met. We were somewhat successful in doing that.

In 1995, we decided that we would be for successful in moving away from a brokering model to becoming a direct lender. We created CDFI in an effort to be a direct lender in order to make direct loans into the community. So what we've done since 1995 is we now have assets in excess of $40 million. We've made over 120 loans and we've had tremendous impact in the community.

Is there anyone left here from the City of Santa Ana or did they all go on a tour? We have Alan, who is actually on our advisory board, who is one of our key members. But I think in terms of looking at how New Markets Tax Credit Program, I think it's a perfect blend with communities that have an empowerment zone, a renewal community, or even a redevelopment area.

As Tom mentioned, in our applications, we had to indicate whether or not we were going to focus on those areas. And for the most part, I think a lot of us who received an allocation indicated that we would, in fact, focus on those areas. It's unfortunate that the City of Santa Ana people aren't here because they'll come back and say, "We've never heard of you. We didn't know that you were here." "Gee, if you just stayed at the conference." From our standpoint, those are the areas that we want to make loans in, through the markets. I think in your own communities if you can contact CDEs that have an allocation and you have something that is attractive to them, that is a way for them to fulfill what they probably put in their application. Specifically, we received an allocation of $56 million. It was the 14th largest in the nation. And we are proud of that since we have a regional-based organization.

As I mentioned, we serve Southern California. It's L.A., Orange, Ventura, San Bernardino, and Riverside counties. As a direct vendor, we are looking at projects that can be secured by the real estate. For businesses where it's a start-up, it's someone's dreams, they want to start a business, but they don't have collateral, that's not the type of loan that we are going to make. However, if it's a small business out there like the one they talked about in the last session, where there are two or three people working this small business and they're ready to expand and buy their first building or expand on the property that they have, those are the types of projects that we are looking to do.

We can do both construction and acquisition with the funds that we have. As it relates to construction, we are probably going to want to roll that into a permanent or a quasi semi-permanent loan. You'll find with New Markets that the magic number is seven years. Most of us are going to be requiring that the loans we make be repaid or restructured after a seven-year period, as was indicated. That's the term for the credit to the investors.

Quickly, some of the types of the properties that are eligible under this program, some of the types of properties that we are looking for. Any commercial, retail, manufacturing, office is allowable. For-sale residential. Tom indicated they're doing that. We will look at that. We haven't really taken any of these and made them a priority, with one exception. Churches and synagogues we can do. We've done a lot of church lending in the past. And the one area that we have actually made a focus is mixed use projects. And mixed use is a little tricky with New Markets. The rule is at least 20 percent of the income from the project must be from a commercial or nonresidential source. The great example that I use is if you have commercial down below and you have lofts or residential units above, as long as that commercial endeavor or business is generating 20 percent of the overall income, it is eligible for New Markets. We made that a priority in the work that we are going to be doing in Southern California. What that means is if someone comes to me with a mixed-use project, they'll go to the front of the line in terms of the types of projects that we are looking at.

Some of the types of projects that can't utilize the New Markets Tax Credit are rental residential properties, as was mentioned, liquor stores, golf courses, or gambling facilities. What the treasury is trying to do is improve the neighborhood and not -- you know, not be a detriment in creating things in the neighborhood that won't be beneficial. Interesting enough, we had a mixed-use project downstairs that was a nightclub. I thought because they primarily served alcohol, it would be ruled out. We talked to the IRS and they said no, if it was consumed on the premises as it would in a restaurant, it would meet the tax and not be excluded under the liquor store provision.

THOMAS TRACY: How about slot machines?
DOUGLAS BYSTRY: Slot machines in hotels, as long as it wasn't 20 percent, you're okay.
THOMAS TRACY: We had that with the Indian casinos. Residentials.
DOUGLAS BYSTRY: Yeah. One of the things when we first received an award, there were some people at Santa Ana that contacted us and said, "This is great." I was surprised because they got way more money than we did. Why would you be coming to us? You've got all the resources. They said, "Well, as we understand it, your funds are less restrictive." And I got a little education. That may be one of the benefits that we have over the empowerment areas. While we have said to the government, to the treasury, that we are going to be doing good in the community and creating jobs, there's no formula in our loans, so we don't have to create a certain number of jobs per every loan that we give or every million dollars that we lend out to the community. It's expected and intended that we will. But, again, there is no silver bullet or threshold that we have to hit.

One of the other things, you know, we found is that while we want to focus on the empowerment areas or the renewal communities, really in Southern California, the areas that are eligible for New Markets are very vast and very broad. And for those of you that are familiar with Santa Ana, almost the entire city is eligible. It wouldn't be just the empowerment or renewal communities that they have; it's really very broad in definition.
(Inaudible comment from the audience.)

DOUGLAS BYSTRY: No. No. There are quite a lot of areas in Orange County that are eligible. Yeah. For us, as I mentioned, we are a direct lender. We are going to be looking at doing loans for seven years. We are going to have a substantial prepayment penalty. We are saying to the folks, "If we give you this money, we don't want it back for seven years. However, in seven years, we do absolutely want it back." We love projects where there is city or county involvement. We look at that as an additional strength. So we are outreaching to folks like yourself. We want your projects. We really want to work with you. We love leveraging. Since there is no one left from the City of Santa Ana, I'll reserve my comments. We want your projects.

In closing, prior to -- in preparation for this session, they asked us to answer some questions that relate to whether we would encourage other groups to become CDEs and apply. And actually, it's somewhat selfish, but I would say no. Certainly in Southern California, I wouldn't encourage people to become a CDE. We received $56 million in the first round. We applied for an additional 100 million. We've done the legwork. We are ready to address your need certainly here in Southern California.

The other big negative about incorporating is the costs involved. We are in excess of $120,000 in start-up legal costs to come up with the vehicle that we think will work in our community.

LINDA SCHAKEL: Legal costs are not bad.

DOUGLAS BYSTRY: Legal costs are not bad, but they're not good. And finally, I'll just run through a sample of some of the projects we have actually done and are continuing to do New Markets loans for right now. A number of the loans that we have furnished or are in the pipeline, some of them may strike a cord with you in your own community, but just here in Santa Ana on Bristol Street, we did a loan for a dental clinic, low-income dental income serving one of the communities. In the City of Vernon, we did a loan to a cold storage facility where they take the goods that come off the ships and keep them until they go to the restaurants. We did in South Central Los Angeles, or South Los Angeles as they call it now, a Harvard Medical Group, which is another medical group serving the community. We are doing a veterans' transitional housing in Inglewood. We are doing mobile home parks with residents purchasing the park in the San Marcos area of San Diego. We are looking at church loans throughout our area.

And then one of the last ones we did is actually very interesting and we are very proud. There's land out at March Air Force base. We approved a loan for a business that has a catering facility to go in there. These are the types of tax market loans that we are doing and can be done in your commune as well. With that, I would turn it over to Bob.

ROBERT McGILL: Thank you, Doug. Does this work? I've got very little voice left today. I can't remember the last time I had to talk this much. And my wife is just pleased because I go home and listen all night long.

LINDA SCHAKEL: Well, you at least won't talk.

ROBERT McGILL: That's right. Spoken like a true spouse. In the little comments I'm going to make here, I'm going to focus mainly on what I was asked to do, which is put myself in your place as directors of empowerment zones or enterprise communities or municipalities that are involved in use of these tax credits and explain how you could use them, rather than tell you too much about our organization. But I am chairman and CEO of Neighborhood

National Bank. We are owned by a financial holding company, Neighborhood Bancorp. I'm also president and chief executive officer of.

The tax credit -- and part of what I want to make clear is -- it's always interesting when I listen to other people on the panels talk about the money as though everybody has it in their pocket. Maybe they all do. But most of us, we have the tax credit allocation, and we have to go out and raise the real money. Tax credit is just an incentive that we can provide to potential investors to get the real money, and then we then put it out into the community. And in doing that, the application process that we all went through required us to identify specific projects. I thought Bonnie Contreras -- I know she's here, but I don't see her out in the audience -- from the city of San Diego was very helpful to us.

I served on the Enterprise Board in San Diego for a number of years. And through that process, I got to know a lot of people in city government that helped us work through this whole application process. But at heart, we are a bank just like every other bank, except we are a community development bank. And by definition of community development bank, we go into distressed communities, underserved communities, communities where you don't see a bank on every corner. And we have been in business now six years. We have become a fairly profitable institution. We went through all the struggles that traditional banks go through the first couple of years. But we turned the corner, and now our profitability matches or exceeds every other community bank in the city.

And I think we've gotten people's attention because as we put money into these distressed communities, we are very careful what we do with that money. And we built a track record that has been one of our keys to success in raising capital which is when people are looking where they're going to put real money, not tax credits, not subsidiaries that come down from heaven, but really come out of an investor's pockets with required rates of return that have to be competitive in the marketplace, they don't have to necessarily meet the market. And, in fact, in most cases with this -- this tax money, tax credit money that we are raising, we have to demonstrate that we are more flexible than we are with our other loan dollars, that our terms meet or exceed the terms of traditional loan that's we make, that the pricing is competitive at or below market. And one or all three of those things have to be demonstrated. Besides all the other things that have already been discussed, that we go into the appropriate census tracts, that we support the appropriate -- appropriate to our application and to regulation the appropriate projects that have been defined in this whole allocation process.

But part of the uniqueness of a bank and especially a community development bank is that all of this ties into our mission. All of this goes back to the track record that we've established in the varied communities that are identified in the tax credit legislation. Neighborhood National Bank received a $5 million tax allocation. Bancorp’s stated purpose of that $5 million allocation is an investment in its primary subsidiary, which is Neighborhood National Bank. Once we make that investment, we are 100 percent invested in the CDE that has been identified. And we passed one of the biggest hurdles in terms of that investment.

Neighborhood National Bank takes that $5 million into its capital account and then leverages that out. We anticipate we'll grow the bank by $60 million in assets over the next three years with that $5 million in capital. We do that through requiring deposits, $50,000 to $60,000 in deposits, that will go into the marketplace and grow those deposits with that capital support. With those deposits in the bank, we will put out in loans 40- to $55 million. As you know, all the appropriate regulatory ratios apply there in new loans out to the community. While the requirement is that you exceed 60 percent and 85 percent and all these other percentages that apply, in point of fact, from the $5 million tax credit allocation, our anticipation and our track record over the past six years show that we will put out in the community somewhere between 25- and $40 million worth of -- qualified investments.

The trick is that -- that's why attorneys do pay for themselves occasionally. The trick is that we have to track those loans. The trick is that to track the dollars that go out into the community. So it does become a bit of an administrative burden. But it is also something that is fairly well defined and we just have to set that up. What does all this mean to you folks out in the audience? From a banker's standpoint what we are going to be looking for are projects that make sense. And when I say, "make sense," they should pencil out. Self-sustaining is the catchword these days it seems like. But what we are looking for is something that protects our principal and gives us a reasonable probability that we are going to get a market rate of return on the loan that we put out there. And it's going to be a minimal loss ratio.

So we are really looking for not some pie in the sky, gee, I think we can do that. As a banker, you hear that all the time. You have the people that are all worked up and they just have the best idea that they've ever heard of before. And it's something that they thought of that morning, but it can't fail. And, you know, we hear that all the time. I'm sure some of you have run across that on a fairly regular basis.

What we are looking for is groups that have a track record that can show us what it is that they plan on doing and how they plan on doing it. They make church loans and synagogue loans. We are one of the few banks in San Diego that consistently lends into the religious community in San Diego. It is, to our mind, one of the best loans that can be made. Most bankers will hide behind the story that we don't want to have to foreclose on a church. We pretty much tell people right upfront, if you don't pay us, we'll foreclose on the church. We haven't come close to having to do that.

It's a business proposition, and we want to be real clear with our customers and I want to be real clear with you that right now out of the 66 recipients of the New Markets Tax Credit, only three were community development banks. I think that's shameful, quite honestly. There are 50 some community banks scattered around the country now. We are focused on the communities that most of us are interested in serving. When you talk about leverage, there is no better investment of tax credit dollars in terms of leverage than to put it in a depository financial institution. There's no other leverage vehicle that comes close to returning that kind of leverage.

When I say that's shameful, let me be clear. I'm not disparaging the other methods of using the tax credits. I think out of 66, I think that number itself is low, shameful. You're looking at this panel up here of four people. We are seven percent of the recipients of tax credits around the entire country. You look at the dollars that go out, and most of those dollars are going to be un-leveraged dollars. So even if it's billion, with a "B," when you look at the dollars that are spent on other things within this country, what is coming into our communities is very limited. We need to be efficient with those dollars. We need to be focused with those dollars. And the way that happens is by folks like you that come into contact with us; try to learn what it is that we are all about. And don't waste your time.

If you're in a rural community, coming to one of the investors that -- that is an urban investor, don't come and see us if we haven't identified census tracts in your particular community. Don't come and see us if you don't have a project that's going to make sense and tie into what it is we put in our application. I mean, we don't -- I don't want to hide behind regulations or application. But there are a limited amount of uses that our dollars can be put into. And when we do that, we want to make sure we are sitting down with you in good faith, not because you're conscientious hardworking people that are trying to build something in your community, but that there's a fit between what you want to accomplish and what we are trying to do with the dollars that we have to put into that community. So we have to understand what you're doing you need to take the time to put a presentation -- written, oral or both -- that tells us what it is that you want to accomplish. You need to do your homework and find out what it is that you're looking for, to put our dollars out into. And if we can make that match and make the use of those dollars, that's really where this New Markets Tax Credit is really going to impact the community. And that's how we are going to get beyond the next few years into a more meaningful program with larger dollars that can benefit all of us.

WILL COOPER: Thanks, Bob. My name is Will Cooper. I'm with WNC Associates. We were asked to cover different topics. One of the topics is if you should think about applying or advising community groups to apply for New Markets Tax Credit. And I'll touch on that because I think that's a big question that should be considered here. We are a company that's been in business for 32 years. We are in Irvine. We are primarily an investor. We acquired now 750 properties in 40 states across the nation worth approximately $2 billion. We raise capital through the private markets, institutional and individual public markets. We've got 60,000-some-odd investors. And we work with primarily community development groups, nonprofits and for-profit developers and build these properties out.

And that's part of the reason why we decided to go ahead and put an application in 2002. It was because we felt that a lot of our developers are in this business anyway in the form of community development. And as well as our investors -- a lot of our investors are CRA motivated that are out looking for opportunities to invest back into the communities. We felt a New Markets Tax Credit was a unique opportunity.

I want to follow up with something that Doug said earlier. That is what is exciting for you all in the audience about this program is this program is really a flexible program. I think that's one of the key defining terms for it because -- and I don't know that it's always going to be that way. And that's an important thing to consider when you look at other programs that have come out in the past that are tax oriented, like the Low Income Tax Credit. When that credit came out 15 some odd years ago, you could really use that tax credit to build properties in any community for any type of property, et cetera. Very flexible program. Over the years, as it started to grow in popularity and become much more in demand, the restrictions that were placed on the program become more intense and severe and limited the opportunity to see use that program.

I think the New Markets Tax Credit program is flexible. And if you work for an RDA or city government or development company, I think it's important to realize that people who get involved early can take advantage of this early on and run with it. Our allocation was a $50 million allocation in 2002. We submitted $100 million application in that year and they gave us $50 million. We have subsequently applied for another $150 million. We are looking to invest our money either with debtor equity fairly flexible program in several states, California, New York City, New Jersey, Minnesota and Nevada. And we chose those states because that's where we spend most of our capital currently. We have most of our relationships in those communities, in those states. So that's where we are looking to put our New Markets capital.

Like Tom mentioned earlier, you know, most of the CDEs that want allocation are required or going to be required to put at least 60 percent of the money into more distressed communities because that's one of the ways that you're able to get the points needed in order to get the allocation. What that means is you're talking about areas where the poverty rate is over 30 percent.

As far as the types of businesses or projects we are looking to participate with, like I said earlier, we are looking to put out debt and equity. The bottom line is that we are looking for good investments. Just like Bob said, I mean, this is a private sector program. As a result, investments or the loans that are going to be made have to be good loans, have to be good investments with a good, very strong, you know, opportunity to get not only a return on your money, but also return of your money.

But with that said, I think what's unique about the New Markets program is it can be used in so many different ways. We are looking at some fairly large retail shopping centers, basically in Southern California, where we are going to bring senior debt to those properties. And with that senior debt, we are going to be able to provide low interest loans to the developer. And with the savings that we believe are going to be brought to the table, we are going to require that the developer put back into the community through job training or job placement and employment centers.

And we think that's another way to look at this, not only to bring developers to a community and bring anchor tenants to a commercial facility, office facilities, but also to get those parties to use some of the capital that we are bringing in to reinvest into the community through these types of services. That's what we are looking at on our side. We like retail in particular. The reason we like it is we think it makes the most sense for this program. And that's because we believe that the New Markets Tax Credit Program truly is a job program.

If you look at the whole program, I think the real emphasis that congress has made here is revitalize communities, talking about wealth building. And there's a real focus on job creation and job maintenance. And after looking at the different types of commercial real estate that we can get involved with, we think retail makes the most sense. And with that, we also believe that the centers that we want to participate with are centers that have credit-worthy anchor tenants.

It's kind of a tough balancing act that we have as a CDE because we want to attract business and we want to build communities. But at the same time, we want to make sound investments as well as provide jobs. Not just temporary jobs, but jobs that are going to be there for the long-term. We think the way to do that is attracting large entities that can come in and that are credit worthy and can execute a seven-year lease, which is the term of our investment or loan that we are going to make. We want the confidence that they're going to be there to provide the jobs ongoing, which is the best way to benefit the community in the long run.

A question on whether you should credit applying for New Markets credits or whether you should advise your community development groups to get involved in this. I think that it's definitely a program you should look at. And if you have the opportunity to refer some entities to get with New Markets, there will be areas to look at.

There are really only four areas that the CDFI plan is going to require, and it's built the business strategy, what is the -- what is the entity? What is the CDE going to do with the capital? What kind of programs, what kind of financial services or financial products is it going to put out? Does the entity have the experience in putting those products out? That's going to be critical. How are they going to raise the money? It's one thing to have a bank put up a letter that they may be interested in investing into a New Markets program. But if it's an entity that has a history in investing capital, it will be critical if the allocation goes out, this entity has the ability to raise the capital in the community.

The other thing is the management capacity. Does the entity or group that you're looking at have the infrastructure in place to not only identify the investments or loan, but also to underwrite them as well as to monitor them during the holding period to make sure that these programs or these projects are performing. Because there's very strict reporting programs with the New Markets Program.

And lastly, like Tom said earlier, the community impact. I think this is going to be an area that's going to become much more scrutinized with future application, future rounds. And we found in the second round that the CDFI fund was much more focused on identifying and quantifying what kind of impact we would have with the capital that we received. And we were fortunately able to look to the applicants or the developers that we've been partners with for this round, and we've got a questionnaire that each one of these tenants has completed that identifies how many jobs they're going to bring to the community with the commercial project that they're proposing, what types of jobs are they temporary construction jobs or are they permanent jobs that are going to stay in the community. I think that's going to be a much greater focus for the fund. I think that's something to keep in mind.

We have a Web site that's got quite a bit of information on the program, our program, as well as the overall New Markets Program, including a way to break down your actual community to see if it qualifies. And you can go to www.wncinc.com/. Included in there, you'll find our project questionnaire, which you can complete. If you've got a property or development that you want to look at as a possible candidate for a market credit, you can complete and send it back to us and we can evaluate that. And the questionnaire will look at things like what types of jobs will be brought to the community through this development, et cetera.

One of the other questions that was asked of us is what is the key for our success in applying for this program and getting an allocation. I think the main thing for us is we have an infrastructure in place to underlie properties as well as to oversee them, as well as we've got an existing group of investors that are prepared to invest with us. We raise $200 million a year in the low-income housing program. And most of those investors are very interested in participating with us in the New Markets Program. That was critical for us, having not only the investors in place, but also the projects that we submitted to the fund.

So that's kind of a snapshot of what we are doing and how we see the program as it's evolving. So maybe this is a good time to open it up for questions at this point.

LINDA SCHAKEL: I'll go ahead and do some pointing here, and you can direct your questions. We are sharing mikes.

SPEAKER: Can an investor be a borrower and an investor in a CDE and then borrow money from a CDE to take advantage of the credit?

DOUGLAS BYSTRY: I would say no. I think that the IRS would look at that unfavorably. I know a group that tried to do it. But you have to realize, there's no expertise -- I shouldn't say there's no expertise. There are a lot of gray areas. And I don't know if anyone would disagree with me.

THOMAS TRACY: The only thing that I can think of is the related party rules where if more than 51 percent of your investors are owners, which means they're either the borrowers, I guess, that you get -- if you're not a related party -- in other words, this rule was put in there to prevent like a Kmart from putting together their own CDE, putting their money in and using that money to create a building that they own. So that they're subsidizing themselves, which is kind of like running money through and getting it back.

And while -- if you read it in the regs, it doesn't mention borrowers. I think I would agree with Doug that there would probably be some interpretations that would look at that dis-favorably. The risk is if you get a related party and you get points for being a related party that would affect your allocation.

LINDA SCHAKEL: I think that unrelated party rule is really in there for points of allocation of the credit. But -- so you would have had to have disclosed that in your application. I think as all the gentlemen mentioned, their applications were pretty specific. And they're going to be held to what's in that application, evaluated and monitored for what they said they were going to do with their money.

If you had disclosed in your application that you were going to give the money in a loan or equity investment to a related party, they might have lowered your point score, and you might not have gotten an allocation. I guess there is a mike if you're going to ask questions.

SPEAKER: Yes. This question is for the -- you mentioned that your strategy. But for the others, do you have an exit strategy at the end of seven years, if some of your borrowers are not able to make their loans?

THOMAS TRACY: I guess I'll go first. On our homebuilders fund, there's an easy exit strategy. That is they're building the homes for sale. So obviously, you know, if it takes them longer to sell, it's less and less returns to everyone. But the ultimate goal, I think, would be to develop the homes and then sell them to homebuyers. The commercial mezzanine situation is a little bit, I guess, more fluid. Because there, you're putting 5 or $10 million into a retail development center or an office building or warehouse or industrial park or something dealing with commerce. And I guess the way Key Bank approached it in their application was that they would -- they would try and structure a loan so that you could have permanent take-out on the loan in seven years. What Key did in their application was say basically if there's a take-out, a shortfall, a permanent loan shortfall, they would work with the developers like a bridge loan extender for an additional period of time for that deficit to allow -- to allow the properties to get better cash flow and then finance out.

LINDA SCHAKEL: I was going to say there's no requirement that you pay it back in seven years. It's simply -- but if the money comes back in, the tax regulations require that they recycle it back out into qualifying loans or equity investments within one year of receiving the money. And I think that's the reason you mentioned having a large prepayment on it is because once they get the money out, unless they know there's a really good pipeline out there, in order to meet the tax requirements, 85 percent of the money that they get from investors has to be in qualified investments. That's the reason they're discouraging, if you will, getting money back in during the seven-year period.

THOMAS TRACY: You'll find a lot of the funds are doing straight seven-year loans for the very reason that they don't want to have a reinvestment issue arise during that -- during that credit period. And at least early on with some of the investors, one of the biggest concerns that they -- from the economic point of view is it's free investment. That is what happens if the economy changes and you're doing like three-year loans and they're coming up and rolling off midway through your seven years, and you've got 12 months to reinvest. And let's say you can't find any suitable investments. Do you lose the tax credits or do you make unsuitable investments in order to reserve the tax credits.

So there's a lot of give and take in structures these things. And a lot of the funds are doing straight seven-year loans. Some of them are doing seven-year bullet loans because they don't want the principal amortization. That principal amortization is subject to reinvestment also under a different rule, which is more generous. Eventually you have to channel that back into the reinvestment also. And, of course, the investors, if they're bank investors, are saying "We would certainly like a little amortization in order to improve our collateral positions." So the reinvestment thing is a really fluid thing right now. And there's no, I guess, easy answer for it.

WILL COOPER: Let me give you an example of the project that we are looking at right now. And it comes to your question of exit strategy. I think it really comes down to you've got the developer/borrower, and you have the investor. They have competing needs. One wants a high deal, low-risk, short-term investment. The other one wants cheap money for as long as possible. So we are right now looking at a transaction where, you know, we are looking at a seven-year loan because -- at a low interest rate. And the investor -- and that generates a higher yield for the investor. Once the credits stop coming to the investor, obviously the yields start to fall, unless you have a corresponding bump on the interest rate. So we are now trying to figure out what's the magic formula. Is it a seven-year loan or a ten-year loan? If we go ten years, we have lower yields to the investor. Then we have to charge a higher interest rate to the investor. It really comes back to the developer's needs and the investor's needs.

The other thing is it comes to, like Tom said, seven-year is the minimum, without having to worry about the reinvestment. That's what we are looking at. We'll do construction loans that are taken out by permanent loans that will lead into permanent loans. That's how we get around that.

DOUGLAS BYSTRY: I just --

SPEAKER: I guess we'll go to the next question. My understanding was that one of the factors for a successful application was that you had to identify the specific projects. I would like to get some sense on that. It's also my understanding that you need to invest in a good consulting group. I would be interested on what those fees ran. Anywhere from 100- to 150,000 just to answer that. Thank you.

THOMAS TRACY: Key Bank CDE paid $30,000 for his consultant during the application. He got $150 million. So I don't think there's any range in what companies are -- obviously someone paid quite a bit. But it wasn't necessarily high.

SPEAKER: Maybe a follow-up question to help with your answer. He was attached to a lending institution that might have other resources. Let's say if you're in an empowerment zone or a municipality, you know, there are dollars that you may have had in-house that you could do. But I mean, the whole package, are we still talking $30,000? And then the specifics around do the projects that are successfully funded need to be very specific in the application?

DOUGLAS BYSTRY: Well, to the extent that you identify projects that you're going to do in the application, the treasury will hold you to that. If you say we are going to do this project and you get an allocation, you have to do it. If you say these are projects that we think we are going to do and they don't come to fruition, you're going to be okay. To the extent that you identify a project, you better do it. We did not hire a consultant. I did the application myself. I would be happy to help any you out there for much less than $30,000.

ROBERT McGILL: I think it's important to understand because this is becoming a burgeoning industry from what I hear around. The success of your application is not dependent on the consultant. It's not a ratio of how much you pay a consultant to how many dollars you're going to ask for. It's the quality of what you put in it. The kind of consultant that can help you most isn't someone -- the pro formas are critically important, and you're going to have to live with those. You ought to know that, no matter what industry you're in or municipality or part of a municipality that you're in. The input that goes into that application is more important than having a consultant that understands the system and is going to massage what you say. It's what you say that's going to be the critical piece to this.

THOMAS TRACY: I think the most expensive piece that you would ever sign out to someone before you would be racy applicant from the equity investors. So if you had like a $50 million allocation and then you went out for bids to have investment bankers or fund-raisers capital, I think that would probably -- I think they would probably range from one to two points. But in terms of the actual just consulting, I mean, I consulted this year with Bank One and Fifth Third. And I mean, they drained me dry on this during the application process. And I got $20,000 from one and $25,000 from the other. So it's not a high-price thing at this point.

WILL COOPER: I think one of the things that's unique about this whole application is it's a written business plan. It's not a real complicated application; it's just a thorough one. And you've got to enjoy writing. You spend a lot of time writing out these narratives and you have to be organized and consistent. You have to have a story to tell.

SPEAKER: Question back here. We've been spending most of today talking about the tax incentives for renewal communities and empowerment zones. To the extent that there are advantages to those types of investments, are you making investments in those types of projects to take advantage of those incentives?

THOMAS TRACY: I guess.

SPEAKER: Specifically, for instance, the commercial -- the commercial revitalization deductions or the capital gains?

THOMAS TRACY: I think at least in terms of our CDE, we may be -- what we would probably be a participant so that the developer who is putting together a retail center or whatever -- whatever is going on, whether it's work force housing, retail, industrial, he's going to go in and get a lot of different layers of subsidiary for his overall project. Our layer of subsidiary would be, let's say, a mezzanine loan up to 95 percent of cost at reasonable rates. So we would not be drawing any of the subsidiary available. The developer would be going and reaching into many different pockets to make that project work. And our contribution to the overall project would be cheaper financing and probably relaxed credit standards.

SPEAKER: Just to interject right now. We are going to keep the floor open to ask a lot of questions. Just so you know, we have moved our reception, which will be at 5 o'clock, to our lobby because it's very hot by the pool. And we thought you would be more comfortable in a nice air-conditioned place.

SPEAKER: Why don't we go back up to the front for more questions.

SPEAKER: Can you give us an idea of how you structured your administrative charges? Did you deduct from the investment of the fund, do you charge upfront fees? Obviously if the borrower is getting a lower interest rate, they would expect lower fees as well. So how do you get paid, I guess is the question?

THOMAS TRACY: I think it's structured in different ways. And we all could probably share in our different structures. A lot of that is dictated. The administrative fees and charges will be dictated by the investor. They don't want to see a lot of stuff taken out. In our area, being real estate, traditionally, real estate supporters have to be a partner with the investor. And if the project is successful, then they share at the back end what they call carried interest in the loans, in the profits. So, you know, the law allows you to take up to 15 percent of investor's equity and use it for something other than qualified equity investments. And you can still take tax credits on the entire amount.

SPEAKER: But you could lose your investment?

THOMAS TRACY: Yeah. Like in our funds, we budgeted maybe 3 to 5 points -- 3 to 5 percent, so up to a third of the 15, probably maybe as low as 1/5 of it, for recovering costs to, you know, do the syndication, setting aside reserves for third-party expenses for the seven years. We have to pay these guys over here. We have to pay the accountants every year. And then compliance, New Tax Markets compliance is going to be -- you know we have to do that every year along with income tax reporting. We'll set up certain reserves for fund expenses. And then generally the investors are requiring us to put the rest of the money into the projects. And in some cases, to get points with the city, you actually say that you will invest more than 85 percent. And then if -- you know, at the end, then we cut a deal with our investors that maybe we'll get another 5 percent as a preferred fee at the back end if everything comes out okay. (Inaudible question posed from audience.)

THOMAS TRACY: A lot of times we are setting up in -- a Fannie Mae fund that we are doing, we are setting up a 10 percent.

LINDA SCHAKEL: That counts against the 85 percent.

THOMAS TRACY: Yeah, 5 percent of the loan loss reserve is good. 5 percent would be, you know, against the 85 percent.

ROBERT McGILL: If I could just -- there's an implication to the question that I want to touch on. Because we are a bank and we charge like most other banks accommodation of fees and spread and pricing of the loan. But the one thing we are always very upfront with our borrowers about or potential borrowers when they come in is we are not the cheapest deal in town. It depends how you price things and look at. We can quote you a rate that's going to look like the best rate and front-end fees that is going to make it a profitable deal. It's not pricing necessarily. It is flexibility. It is terms. But most of all, it is accessibility. And it's making a deal that doesn't fit in the box credit-worthy. And sometimes that costs a little bit of money.

Because you can go to a large bank that needs a CRA credit, whatever the heck that is in today's world. But you pitch it as a CRA deal and you do it for the good of the community. And we know that you want to bet this other bank down the street, so you have better get this to make the deal work. That sometimes works. Not so much anymore. What you need is to come forward with a transaction. And quite honestly, the more work you put into it, the more research you put into it, the better it's going to be priced. The less any lender has to put into it to get beyond the risk return formula is going to help you with the pricing, is going to help make that transaction work. But, again, I would emphasize, it's not just price. It's whether or not you want the transaction to actually take place.

THOMAS TRACY: There is an important difference too between two types of CDEs. The type that I was describing where you have outside investors, you put up -- like Will's or

Doug's. You have outside investors. You put the whole thing together for the investors, and the investor is actually getting the tax credits and benefits. So you expect to get compensated for putting something together. The major type of CDE that's going to be out there, and probably even more -- more dominant in the future, are the banks who are internally funding their -- their New Markets programs. There will probably be ten banks on the second round. They won't take any profits because they're getting the tax credits as profits.

On the two bank applications that I was involved in, they asked how much of the money are you going to actually fund to qualified equity investments. Both of them said 99 percent, left just one percent for cushion against bad investment or something.

ROBERT McGILL: If you're negotiating a deal with the bank and the bank says they're not going to make any profit on the deal, run.

THOMAS TRACY: They're making it. They're making it in income -- interest income and tax credits.

SPEAKER: There's another question back here.

SPEAKER: You all talk about the possibility of doing loans and equity investments. Are any of the funds doing -- Tom, you just started to talk about this. Are any of the funds doing actual equity investments in qualified low-income businesses? And if so, what's the price on the credit?

THOMAS TRACY: Most -- the credit is -- the program right now as it stands, it's much easier to do it as loans as opposed to equity. And one of the reasons -- well, there's a lot of reasons. Some of them are complicated. If you think about the credit, the credit is a fixed amount regardless of risk. In other words, I can put my money into venture capital and expect 50 percent return, an all or nothing deal, and I get the same amount of credits.

So if you start to do equity investments, equity investments require equity returns, which would be probably 20 -- right now 20 percent and higher. The credit is not as big as an incentive for those investors as it is for investors who are making moderate loans, senior debt, or even some moderate mezzanine debt where the expected returns are only anywhere from 6 percent to 12 or 14 percent. There, it can have a 6 percent credit with a pre-tax -- pre-tax equivalent of 8 or 9 percent. That's a huge -- that's a huge incentive or subsidiary. That's probably the reason.

The other reason I think is most of the equity would be going into businesses. I think as opposed to real state. And there, the rules that the treasury came out with on their first round make it risky for investors to invest in businesses like venture capital for retax purposes than put it into a piece of real estate that's not going to move around or possibly use its qualified status.

LINDA SCHAKEL: I think, Will, you mentioned that part of your application was for equity.

WILL COOPER: Yeah, we have included a fairly broad spectrum of products that we can offer. We did that purposely because we knew this was a market that was emerging. It was dependent upon the transaction as well as the investor's needs. We have a significant group of investors that have different needs, as well as we recognize there are opportunities that may be unique. And we would be interested in pursuing an equity investment that made sense. It does come down to the return on the dollars and risk and rewards. Yeah, we would look at that.

DOUGLAS BYSTRY: I'll add real quick, we are not doing equity investment, but I've heard that 20 to 25 percent of the cost. And so what I think -- as was indicated, it's going to be expensive out there.

LINDA SCHAKEL: Again, if you check the Web site on the descriptions, it will tell you. And the majority of them are expecting to do loans rather than equity. But through that search, you can find the ones that are going to do equity.

SPEAKER: Okay. We have another question over here. You said that you were talking about homebuilders fund as one of the uses for your New Markets tax credits. I wanted to find out if, in your homebuilders fund, the affordable housing builder was using a lease purchase instrument, does that make them ineligible for your program?

THOMAS TRACY: Okay. What you have to do with home builders is in order to qualify -- well, actually take affordable housing, homeownership, and say how do we do a New Markets program that qualifies and direct it to affordable new homeownership. And one of our clients is Fannie Mae. So they had a great interest in trying to solve that, that challenge. The way you have to do it is you have to have the home builder qualify, set up a special -- a special little entity, purpose entity, and qualify that entity as a qualified business, which means that that entity will be strictly put together solely for developing this group of homes. This entity will meet all the requirements of a qualified business. So that probably has to have an employee right now until the treasury rates come out to clarify that and it has to do a substantial amount of tangible assets and a substantial of the servicing has to be in the communities. So we as a homebuilder formed this and represent back to us that they will do all their work in the low-income communities. So all the homes they're going to build out of this one little company will be there. We will then make the loan to the company, and then the company uses it to acquire the land and do all the predevelopment and, you know, start the building of the homes.

DOUGLAS BYSTRY: The lease purchase would not exclude -- would not be excluded as --

THOMAS TRACY: You could do that.

DOUGLAS BYSTRY: Yeah.

LINDA SCHAKEL: You would have to tread carefully because a qualified business does not include a business that's in the business of residential rental. So you would have to make sure that you were not receiving too much in rental income from dwelling units in order to --

DOUGLAS BYSTRY: I think the program you're talking about, you would get paid off. Your builder would get paid off. It would be their obligation to get it back from the community. You could, in fact, merge or marry those.

LINDA SCHAKEL: As long as this homebuilder was not renting the program.
DOUGLAS BYSTRY: I assume it's a Freddie Mac program?

SPEAKER: Yeah. It's called, I think, Get On Track Mortgage. And so, yeah, the mortgage -- there's around agency that purchases --

DOUGLAS BYSTRY: So there's a purchase involved there. So it would pay back the developer.

LINDA SCHAKEL: So his developer is not going to own.

DOUGLAS BYSTRY: Right.

THOMAS TRACY: Right. Some organization would acquire the home from the developer and then do a lease purchase with the tenant. You can do it that way. There's one other interesting thing I think is going to happen, just like it happened in the low-income housing tax credit world. That is, when you look to harder-to-develop or harder-to-do deals, the more challenging deals, the ingenuity of everyone -- and Will will testify to this -- the layers and layers of subsidiary that they call in the low income tax credit world can start to develop in the New Markets tax credit world.

I'll throw out an example in the second round, which is homeownership, which we were trying to go into in Detroit, Chicago, and Indiana, and provide homeownership where no one has gone before. To do that, it required 10 or 15 different players all giving something in the form of some subsidiary, either homeowners' assistance or grants to acquire the land or deeding the land over, the lots over to reduce costs. So you're combining that all with this New Markets money that's going in to make it work. I think you're going to see more of that, more creative types of programs as this -- as this whole program evolves.

LINDA SCHAKEL: The Low Income Tax Credit is actually a richer credit; you get more for the credit than the New Markets. If you've got all kinds of sources of funds being cobbled together for the Low Income Tax Credit that begins to give you a perspective on how they will be cobbled together for the New Markets.

SPEAKER: Using that same example for the residential homebuilder, how do you match that sort of example with your plan to have a seven-year term where your funds are out for seven years? The residential homebuilder isn't spending seven years on a project.

THOMAS TRACY: You can do one of two things. We can either give a seven-year line of credit to the homebuilder so we can roll the proceeds from one development to another one, hopefully over the seven-year period. A lot of that depends on the economy, the economics in the area, if there's going to be enough homes to be built during that period. Or we are going to have to face the reinvestment issue. And it's probably beyond the scope of today's seminar where we have a real nifty way of doing that, as long as you have one investor that's willing to give us a line of credit.

We kind of start -- we start with two CDEs instead of one. And the -- the investor will give us a line of credit for our other CDE. And that CDE will purchase or make the loan on the next -- on the next home project. And as this one starts rolling off, it will start purchasing participation inside that loan which is qualified --, which will be a qualified investment in the program. And we'll gradually move the money from our brother CDE. We call it junior into senior. That way, we have continuous movement and no reinvestment issues come up. But you will face that any time you have an activity that's going to be less than seven years and you have to reinvest up to the six years. You have to reinvest. In year six, you don't have to reinvest because you have up to a year to reinvest. So automatically you wouldn't have to. But you can't give it to the investors in year six.

SPEAKER: Do you get CRE credits for loans?

THOMAS TRACY: You mean as far as the program?

SPEAKER: Yes.

THOMAS TRACY: There's -- there are a couple of things that have happened. One, everyone thought that because New Markets program was primarily a redevelopment type of program, that congress intended it to -- to put private equity in or private capital into developing or redeveloping area that's would qualify for the CRE. They actually came out with -- with a revelation which was proposed, and I think it's final now, which says if you make an investment into a CDE and that CDE -- whatever that CDE does with the money, if it's -- if that activity is not a permissible activity for a bank, then it comes under what they call a part 24, which is a permissible activity for the bank to make that investment. And part 24 and part 25 are very, very close together in the requirements. There's very minor -- just a couple of minor differences. So once the OCC [Office of Comptroller of Currency] and the fed usually adopts the OCC's regs says that New Markets activities qualify as permissible activities under part 24, then they really qualify under CRE in part 25. So you're viewing it as a unit CRE type of activity.

WILL COOPER: Is it important to differentiate between a loan and an investment? You're looking at an investment from a bank to the CDE, which is not a loan. It would be considered an investment. So it's important to differentiate there even if you're a leverage participant.

THOMAS TRACY: The -- they haven't come out with anything that -- in the low income tax credit area, they came out with, I believe, the number of lending guidance.

LINDA SCHAKEL: It took them a while.

WILL COOPER: Our investors are looking at this as a qualified investment. Regardless of where it is, by definition, I think that's the definition that most of the major banks are using.

THOMAS TRACY: For Gary Wade, who is the director of the OCC group, he has been on the circuit a little bit. And every time I'm in Washington, I go and have lunch with him and try to figure out what's going on. And his opinion -- and it's only an opinion, so it's not official -- is that what they basically will do is they will look through the investments you make in the CDE, and look at the activities that the CDE itself is doing. So if -- in Barry's opinion at least, certainly a bank would go and ask for it formally if they wanted to know for sure, if you make an equity investment in the CDE, but the CDE is making the loans, his opinion is you could claim that under the lending text if you choose to do so rather than the investment test. It's sort of a look-through theory or pass-through theory. That's not official, though. If you want to do that, you would want to write to the OCC, if you're the federal reserve, and ask for clarification that.

SPEAKER: Thanks for the eloquent answers, all of you.

LINDA SCHAKEL: I wanted to do a little bit of clean-up here just to make sure that you don't walk out of here thinking that the only way you can participate in this program is if you go in and get an allocation. Once a CDE gets an allocation from -- from the treasury department, they have to turn around -- and we've been throwing out this 85 percent figure. They have to turn around and use 85 percent of the investor's dollars in qualified investments. And certainly qualified investments include making a loan or equity investment directly in a business within the low-income community. But you're also permitted to make a loan or an equity investment in another CDE or to purchase loans from another CDE. So if you have an entity within your municipality or within your renewal community or your empowerment zone that is making or has made loans to businesses in the low income community, you can in a sense replenish your loan pool by selling those loans to someone who has the credit.

THOMAS TRACY: Right.

LINDA SCHAKEL: And particularly, if it is one of these entities that will have a need for a pipeline of loans, that's a good way for a municipality or a CDE to get involved.

Now, what do you have to do to become a certified CDE? It's not the same extensive application that these gentlemen went through to get the credit, but you have to be certified by CDFI. Go to their Web site [www.cdfifund.gov/] to see how to do it. You have to establish that you have a primary mission of providing the low-income community for being a CDE. That allows you to be a player in this game too without going through the actual credit application process yourself.

Also, for those of you -- as a clean-up for those of you who have been sitting in on the sessions earlier, a qualified low-income business is going to have pretty much the same definition as an enterprise or renewal community definition, except you can look at not just separate legal entities, but you can kind of look at the activities that only within that activity. You don't have to meet the 35 percent employee requirement. Again, there probably would be some priorities that each one of these gentlemen expressed in making their investments. They would look to see that you're creating jobs, but you don't have the requirement of 35 percent. And also for commercial real estate, you don't have to have 50 percent of your rental income coming from a qualified business. So there -- it's a little bit easier definition to meet in many ways. But it still requires that you actually be in the community. That's where your tangible property is. That's where your employees are performing their services.

THOMAS TRACY: And I know of one -- what I call intermediaries. Intermediaries are those that got the awards for the purpose of purchasing loans from other community -- community banks or CFIs or other community lenders. The biggest -- the one example that comes to mind is Community Reinvestment Corporation out of Minneapolis. I think they got 160 or something like that. Mary Tingerthal's group. And they -- I think half of their allocation will be providing secondary market -- a secondary market for community loans. As long as those loans are made, as Linda mentioned, through the CDE -- the CDE network.

And another good source is if any -- if you're aware of any large banks that will give an allocation on the second round or, you know, the ones that got them on the first round, call the contact person and see if they earmarked any of their allocation for either purchasing loans from other community lenders or making investments in other CDEs. Because they might have. I know the two that I was involved with allocated a small portion when they did the percentages of what they wanted to use it for. They allocated a small piece to purchase loans from other community lenders. And so they're cognizant that they're not going to be able to make all of the types of community loans that they would like to make because of their size or facilities and that these community lenders are probably better suited to make these types of loans. It would tie them into the network. So when the banks come out on the second round in your -- in let's say you're a community lender in the trade area, give them a call and ask if they reserved any of that allocation for that purpose.

LINDA SCHAKEL: Any other questions. Okay. Well, I would like the panelists -- thank the panelists. They pretty much covered anything.

SPEAKER: We have one more question.

SPEAKER: When you said there were qualified businesses in the home for the -- for the loan for the home builders loan fund, if you were looking at that can a nonprofit developer still -- I know one of the guidelines was it could not be a nonprofit?

THOMAS TRACY: A qualified business can be nonprofit or for-profit.

LINDA SCHAKEL: The prohibition for the nonprofit was the wage credit, not for the CDE.

(The session was concluded at 4:55 p.m.)