The New Markets Tax Credit: The Path for Financial Institution Participation

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In the United States, utilizing economic incentives to spur business growth and relocation are almost as old as the Country itself. The frequency of incentives to spur capital investment and job creation in low to moderate income communities has increased over the last 20 years. Congress established the New Markets Tax Credit (NMTC) program as part of the Community Renewal Tax Relief Act of 2000[1] to encourage investors to make investments in impoverished, low-income communities (LICs) that traditionally lack access to capital.[2] With the sunset of the program set for the end of 2010; investors, lenders and non-profits are coordinating intense lobbying efforts upon Capitol Hill to continue the program in its current format or to modify the program to insure continued support of financial institution and non-profit coordination. The key to the program's renewal is the relationship developed between financial institutions and non-profits that cater to the economic stability of LICs. The last several years of the program has seen a concentrated effort by program administrators to award program benefits to those Applicants that coordinate LIC efforts in an attempt to revitalize and stabilize each local economy.

Based on the historical awards of the NMTC, financial institutions (especially those that coordinate efforts with local non-profits that cater to the economic stability of LICs) continue to maintain an advantage in receiving an award (directly or indirectly). With the pending extension of the NMTC program with additional compliance requirements, it appears financial institutions will continue to grab the lion's share of NMTC allocations. Those financial institutions that partner with local or regional non-profits in pursuit of sustainable lending opportunities in LICs will be at a distinct advantage.

This article addresses program background, the application process to receive a NMTC award and favorable conditions for financial institutions' receiving a NMTC award.

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[1] Pub. L No. 106-554(2000)

[2] GAO Report to Congressional Committees, January 2010

Background

After debating various proposals to spur investment capital to LICs, Congress created the NMTC to assist LICs that lack conventional access to credit and investment capital for developing small businesses, creating and retaining jobs, and revitalizing neighborhoods.

Generally, a LIC is defined as a census tract (1) in which the poverty rate is at least 20% or (2) outside a metropolitan area in which the median family income does not exceed 80% of median statewide family income or within a metropolitan area in which the median family income does not exceed 80% of the greater statewide or metropolitan area median family income. *Based on current census figures, approximately 30% of census tracts qualify for the NMTC program.* In essence, the NMTC provides investors (individuals, financial institutions, other corporations, etc.) with a tax credit as an offset for the associated risk and reduced fees for loans/investment into LICs.

The NMTC program is administered by the Community Development Financial Institutions Fund (the Fund), a unit of the Treasury Department. The Fund has devised a complex annual Application process to review requests for NMTC allocations. The Fund allocates tax credit authority - the amount of investment which investors use as the base for determining the amount of tax credits they are eligible to claim (39% of an award allocation) - to Community Development Entities (CDE) that apply for and obtain allocations. On an annual basis, each Applicant may submit an application for an allocation of credits up to the annual maximum award ($150 million). As of January 2010, the Fund had allocated $26 billion (original legislation earmarked $15 billion) in total available NMTC allocations. The NMTC expired following the 2009 allocation round. Based on the current recession and economic hardships facing LICs, it is anticipated Congress will extend the NMTC program for future years (the program has been extended multiple times since its inception).

As an example, the Fund may award $10 million to a CDE. The CDE, in turn, may offer tax credits to ten investors who each invest $1,000,000 in the CDE. The credit that each investor can claim would be calculated as follows:

Year	Percentage Claimed	Credit Claimed
1	5%	$50,000
2	5%	$50,000
3	5%	$50,000
4	6%	$60,000
5	6%	$60,000
6	6%	$60,000
7	6%	$60,000
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Total	39%	$390,000

Unlike traditional tax credit programs, NMTCs are awarded via an extensive Application process (Application round). Over the program's history, a predominate portion of NMTC allocations were awarded to financial institutions (directly and indirectly). As Congress considers extending the NMTC program, CDEs associated (wholly owned subsidiaries of financial institutions or associated with a financial institution) appear to have a distinct advantage over CDEs which are neither funded nor associated with financial institutions. Therefore institutions with significant Community Reinvestment Act (CRA) activities should consider funneling CRA activities through an approved CDE in order to seek a NMTC allocation (potential 39% tax credit for activities required by another federal regulatory program).

Who Administers the Program?

The Fund administers the NMTC program in coordination with the Internal Revenue Service and the Treasury Department's Office of Tax Policy. The Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities across the United States and its territories.

In connection with the Fund's mission, financial services can include activities such as help in developing a business plan, assistance with business financials, and operating assistance to nonprofit organizations. Financial services do not include traditional personal financial advisory services.

Application Process

The NMTC program is intended to encourage new equity investment to help spur economic growth in LICs. The NMTC program permits taxpayers to receive a credit against their federal income taxes for making qualified equity investments in eligible CDEs with expertise in and successful track record of promoting economic development in LICs. A CDE with an approved NMTC allocation is granted a 39% NMTC to be claimed over a seven-year credit allowance period for qualified equity investments into the CDE. The tax credit provided to the investor (either the original holder or a subsequent purchaser) is claimed over a seven-year credit period. In each of the first three years, the investor receives a tax credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the tax credit is six percent annually.

The Fund certifies CDEs on an ongoing basis, and allocates NMTC allocations annually to select CDEs through a competitive application process. Thus, applicants that wish to participate in the NMTC program must successfully navigate a two-step application process. The first stage requires the proper establishment and approval of a CDE (the proper conduit for NMTC activities) by the Fund. The second stage requires an approved CDE to submit a formal allocation application (business plan) on their proposed LIC activities for which the CDE would like to receive a NMTC award. The first step can be done at any time, while the second step (submission of an allocation application) must be submitted during designated application round.

CDE Certification - Step 1

Step one of the two step process may seem complex, but in reality its implementation is quite easily accomplished. To be eligible to request a NMTC allocation, an entity must be an approved CDE. An eligible CDE is

(1) any duly organized entity treated as a domestic corporation or partnership for federal income tax purposes;
(2) has a primary mission of serving, or providing investment capital for, low-income communities or low-income persons;
(3) maintains accountability to residents of low-income communities through their representation on any governing board of the entity or any advisory board to the entity; and
(4) has been certified as a CDE by the Fund.

The Fund will review potential CDEs to determine if the CDE is a domestic corporation or partnership (profit or non-profit). In addition, the Fund will applicant CDEs to determine if the CDE has a primary mission of serving or providing investment capital to low-income communities or low income persons. Furthermore, the Fund will review applicant CDEs to determine if the CDE maintains accountability to residents of LICs it serves or intends to serve through appropriate LIC representation on its governing or advisory board.

Qualified CDEs include community development financial institutions (CDFIs), community development venture capital funds, small business investment corporations, community loan funds, specialized small business investment companies, and similar entities. Generally, CDFIs are private-sector banks, thrifts, and credit unions with a primary mission of community development. CDFIs also include housing and small-business loan funds and community development funds. These specialized financial institutions work in market niches that have not been adequately served by traditional financial institutions. CDFIs and “specialized small business investment companies” automatically qualify as CDEs. Each such entity must register with the Fund, however, in order to be certified as an approved CDE.

For Profit / Non-Profit Corporation or Partnership

Both nonprofit and for-profit CDEs may apply for NMTC allocations. However, nonprofits may not take on investors. Thus, a nonprofit CDE will have to set up a for-profit affiliate for potential NMTC investors. If the nonprofit CDE were to receive a NMTC allocation, the nonprofit CDE would transfer its NMTC allocation to its for-profit affiliate (based on prior approval from the Fund).

Primary mission

Under the primary mission test, the Fund will examine the CDE’s organizational structure through documents that should indicate the CDE’s purpose or objectives. These documents can include bylaws, articles of incorporation or organization, partnership agreements and board resolutions.

As part of the Fund’s certification form, a CDE must submit a “Certification of Authorized Representative,” declaring that the CDE will at all times direct at least 60% of its activities (including loans, investments, and related technical assistance) to low-income persons, to persons or organizations located in LICs, or to other organizations serving such persons or residents. An "authorized representative" is an officer or any other individual who has authority to sign for and make representations on behalf of the applicant CDE.

Accountability

Under the accountability test, the CDE should be able to demonstrate and identify its service area. Examples of service areas include local areas (neighborhoods, cities, counties, metropolitan areas, Indian reservations, etc.), statewide areas, multiple states, particular regions of the country, or a national area. A certified CDE can restate its service areas and submit the revision to the Fund for approval.

The "Certification of Authorized Representative" also must attest to the CDE's maintenance of accountability to the residents of the service areas through their representation on its governing board or advisory board. The applicant CDE must demonstrate that at least 20% of its board members are representative of LICs in the designated service area. To be deemed a representative, a board member must either live in the LIC or represent the interests of residents in the LIC. For example, a small business owner whose business is located in the community, an employee or board officer of a local charitable organization, or an employee of a government agency that provides services to the LIC may be deemed to represent the interests of local residents and will help the CDE achieve a passing score in this segment of the application.

For a CDE that serves a statewide or other larger-than-local area, the applicant must demonstrate that at least 20% of its board members are representative of a cross-section of low-income communities in the state or states that it serves. For this purpose, multiple advisory boards are allowed; a separate accountability chart for each board must be submitted with the application, however. Alternatively, the CDE may select board members from organizations that represent the interests of a cross-section of low-income communities (e.g., a statewide organization or a nationwide nonprofit community service development organization).

Where the accountability test is fulfilled through local resident representation on an *advisory board,* the applicant CDE must provide a written narrative describing:

(1) how advisory board members are selected;
(2) how often the advisory board convenes (which must be at least annually);
(3) how the board solicits feedback from the community it serves, and how often such information is collected; and
(4) how the board will use the information to inform the actions of the governing board in developing the organization's policies (e.g., an advisory board representative sits on the governing board, an advisory board member presents reports to the governing board, etc.).

Allocation Application – Step 2

Once a year, the Fund for a limited time period accepts NMTC allocation requests from eligible CDEs. Each year, the Fund receives requests in excess of the approved Allocation monetary cap. Historical awards indicate financial institutions have received the bulk of NMTC allocation awards via subsidiary CDEs or investment partner with CDEs.

The Fund will analyze and evaluate allocation requests based on a competitive review process to identify those CDEs best suited to have the greatest community development impact. Under the review criteria, a maximum of 110 points are scored on an application. Up to 25 points can be awarded under each of the following four sections:

(1) Business investment strategy;
(2) Capitalization strategy;
(3) Management capacity; and
(4) Community impact.

An additional ten “priority” points can be earned under the business investment strategy section by applicants that can (1) outline a prior successful track record in providing capital or technical assistance to disadvantaged businesses or communities (five points), or (2) demonstrate the intent to invest in businesses whose majority owners are unrelated parties to the CDE (five points). In most instances, a CDE (associated or subsidiary) of a financial institution with a strong Community Reinvestment Act (CRA) history is capable of earning the bulk of review points.

Each application typically goes through a three step review process. The first step requires three independent reviewers to evaluate each application. The reviewers usually include private sector professionals with strong credentials in community development finance, federal agency staff working in other community development finance programs, and Fund staff. Reviewers are selected on various factors such as their knowledge of community and economic development finance and experience in business or real estate finance, business counseling, secondary market transactions, or financing of community-based organizations. The Fund screens each reviewer to identify any potential conflicts of interest with applications. The Fund provides each reviewer with detailed descriptions of what constitutes a conflict of interest, and each reviewer is required to sign a certification that all conflicts of interest to the Fund have been disclosed. In addition, reviewers are required to sign a confidentiality agreement stating that they will not reveal any information obtained from the Fund during the review process.

Once selected, the reviewers undergo on-site training to prepare for the review process, including training on how to review applications based on Fund guidelines to scoring each application. Reviewers are required to evaluate and score each application independently from the other reviewers assessing the same application.

In scoring each application, reviewers rate each of the four evaluation sections (Business Strategy, Community Impact, Management Capacity, and Capitalization Strategy,) as follows: Weak (0-5 points); Limited (6-10 points); Average (11-15 points); Good (16-20 points); and Excellent (21-25 points). In addition, reviewers rate applicants with respect to the two statutory priority point sections: (i) up to 5 points for demonstrating a track record of serving disadvantaged businesses or communities; and (ii) 5 points for committing to invest substantially all of the proceeds from its qualified equity investments in unrelated entities.

In addition to evaluating and scoring each application, reviewers are required to recommend an allocation amount based on the information provided in the application. Reviewers are instructed to recommend both two-year and five-year allocation amounts, based on the amount of capital the reviewer determined the applicant could reasonably raise and deploy over these time periods (highest priority given to those CDEs that can place amounts in the marketplace within the shortest timeframe). To help ensure consistency with Fund review and scoring guidelines, and to ensure a high quality of reviewer comments, each reviewer recommendation form was reviewed by Fund staff personnel before final award.

Once all reviewer comments have been received and reviewed by Fund staff personnel, an Allocation Recommendation Panel comprised of Fund staff reviews each evaluation and recommendation made by reviewers in Step 1, with respect to the "highly qualified" applications. In order to be considered "highly qualified" and eligible for an allocation, an application had to achieve:

1) an aggregate base score (without including priority points) of at least 216 points (out of a total of 300 feasible points), which approximates the middle of the "good" range based on a scoring scale of weak, limited, average, good and excellent; and
2) an aggregate base score of at least 48 points in each of the four application evaluation criterion, which approximates the low end of the "good" range.

Thus, an application with scores in the "good" range in three of the four criteria, but an "average" score in the fourth criterion, would not advance to the panel phase of the review process. Thus, applications must receive an overall sufficient high score but must be well balanced.

Annual applications that meet the necessary ranking criteria by the independent reviewers are forwarded to the Recommendation Panel in descending order of their aggregate scores under the Business Strategy and Community Impact application sections, inclusive of priority points. For each highly qualified application, panelists reviewed the comments and recommended allocation amounts provided by each of the first phase reviewers. Due to the large number of annual applications ranked highly by first phase reviewers, and given the Fund's desire to expedite the flow of capital into LICs, the Recommendation Panel determines an allocation amount for each highly qualified applicant that reflects an amount that the applicant could reasonably raise and deploy over a 2-year period, as opposed to the maximum 5-year period. This 2-year allocation amount is then used as the basis for the final award amount. The Fund determines that awarding allocations based upon the 2-year recommended allocation amounts would be the most effective way to ensure a fair distribution of allocations to as many of the most qualified candidates as possible.

The Fund also reviews a variety of compliance, eligibility, due diligence and regulatory matters. Included in this review are:

(i) checks to determine whether any applicants that have been awarded funds through other Fund programs were compliant with the award requirements and disbursement eligibility requirements;

(ii) checks to determine whether prior-year allocatees successfully issued the minimum requisite amount of Qualified Equity Investments from prior NMTC Program awards, as specified in the previous award agreement; and

(iii) an analysis of transactional-level data submitted by prior-year allocatees. In limited circumstances, points may actually be deducted from scores if Applicants failed to meet reporting deadlines in either of the past two fiscal years.

Generally applicants with high minimum allocation requests have to demonstrate that they are able to:

a) raise investor capital within two years;
b) deploy the capital within 3 years; and
c) utilize the credits to provide innovative products or achieve significant community impacts.

In order to receive a score in the “excellent” range in each of the four review criteria, applicants generally needed to demonstrate certain characteristics by section.

Business Strategy

The Fund’s evaluation of a certified CDE’s business investment strategy will include an analysis of the CDE’s eligible activities (called “qualified low-income community investments”). Eligible activities include loans to or capital or equity investments in “qualified active low-income community businesses”; purchases of eligible loans made by other CDEs; certain financial counseling and related services to businesses and residents in low-income communities; and any equity investment in, loans to, or counseling of other qualified CDEs.

Under IRC Section 45D(d)(2), a “qualified active low-income community business” (QALICB) is a corporation, partnership or a business carried on as a sole proprietorship that would meet the tests requirements if it had been incorporated met all the following requirements:

(1) At least 50% of the entity’s total gross income is derived from the active conduct of a qualified business in a low-income community. In applying the gross income test, the Fund will consider income derived from products that are either manufactured or sold in a LIC.

(2) A substantial portion (at least 40%) of the use of the business’s tangible property (whether owned or leased) occurs in a low-income community.

(3) A substantial portion (at least 40%) of the services provided by the business’s employees are performed in a low-income community. The Fund will interpret the tangible property test so that a business that is located in a qualified area but provides services elsewhere will adequately satisfy this standard. If a project is spread over eligible and ineligible census tracts, the Fund will consider the QALICB requirements for the portion of the project that is within the eligible census tract.

(4) Less than 5% of the average of the aggregate unadjusted bases of the business's property is attributable to collectibles (e.g., art and antiques), other than those held for sale in the ordinary course of business (i.e., inventory).
(5) Less than 5% of the average of the aggregate unadjusted bases of the business's property is attributable to nonqualified financial property (e.g., debt instruments with a term in excess of 18 months)

The NMTC program guidelines indicate that activities deemed ineligible to be treated as QALICBs include:

(1) residential rental property deriving 80% or more of its income from residential dwelling units;
(2) businesses operating golf courses, race tracks, or gambling facilities;
(3) certain farming businesses; and
(4) stores where the principal business is the sale of alcoholic beverages.

To earn an "excellent" review rating for the Business Strategy section, the applicant must summarize how applicant products will be significantly more flexible or non-traditional than industry standards. For all applicants, except those solely offering financial counseling services or purchasing loans from other CDEs, the applicant must indicate that 100% of its qualified LIC investments will be provided in the form of equity; equity-equivalent financing; debt with interest rates at least 50% below-market; or debt that is otherwise considered flexible or non-traditional (rates and terms). Applicants investing in other CDEs must demonstrate a high likelihood that they will pass these favorable rates and terms along to the ultimate borrowers; and applicants purchasing loans from other CDEs must commit to require the selling CDE to re-invest at least 90% of these proceeds.

In addition, an applicant must demonstrate an excellent track record of providing, during each of the past 5 years, products and services (including non-qualified LIC investments activities that are relevant to its business strategy) similar to those it intends to deploy. This track record should reference significantly lower delinquency/default rates for each product line based on industry standards.

Furthermore, the applicant must demonstrate an ability to close at least 80% of its activities over the subsequent three years, and that it is highly likely that it will achieve the projections outlined under its Community Impact section.

Moreover, the applicant must demonstrate that NMTCs will add significant value to the applicant's products and services, by:

a) expanding the volume of its activities;
b) expanding the types of products and services offered;
c) targeting areas of greater economic distress; or
d) using the allocation to achieve other benefits for residents of LICs.

In summary, the applicant's business investment strategy section will score favorable points if:

- It involves products and services that are flexible and non-traditional in form.
- It can demonstrate a high leverage rate for its borrowers or investees.
- Applicant has a successful track record of providing products and services similar to those it intends to deploy.
- It has a strong pipeline of proposed projects.
- It can demonstrate that its NMTC strategy will add substantial value to the proposed activities (without the NMTC the projects would be infeasible).

<u>*Community Impact*</u>

The Fund's analysis of community impact will have a great effect impact on the entire application because this area embodies the overall goals and objectives of the NMTC. To score favorably under this part of the application, the CDE should demonstrate that a high percentage of its qualified LIC investments will be made in areas of higher distress as opposed to areas of normal activity. Also helpful would be the CDE's ability to articulate a credible detailed and quantifiable impact on the community it intends to serve. The CDE should demonstrate that it has a strategy that will impact or energize other investments in the LICs that will be served.

Due to the high likelihood of exposure to potential LIC projects, there is a distinct advantage for financial institution CDEs to highlight community impact. The CDE can highlight potential pipeline projects being bypassed by traditional financing methods and only with the NMTC benefits subsidizing risk could the CDE be able to finance the LIC project. Non financial institution CDEs struggle to find sufficient projects to cannibalize an allocation award within the placement period (within 60 months). However, financial institution CDEs can typically highlight LIC projects in excess of the maximum annual allocation award ($150 million) with a shorter placement period (typically within 24 to 36 months).

To earn an "excellent" point ranking under the Community Impact section requires that at least 80% of its activities will be provided to geographic areas of high distress (example above average unemployment). The applicant must demonstrate that it will be highly likely to achieve this numeric goal based on its track record and/or strategy for targeting these types of communities (most CDEs reference parent financial institution CRA activities).

In addition, applicants should demonstrate it has historically achieved significant community impact per dollar invested, and that its past financing activities were intricately connected to a strategy of creating significant benefits to low-income persons and/or communities. Based upon the applicant's overall business strategy, its proposed product offering(s), its track record and the size of its overall request, there must be high confidence that the projections are attainable and suggest significant impact. The applicant's methodologies for deriving these impact projections must be clearly articulated and well supported, and the applicant must demonstrate that it will collect relevant data for its impact measures going forward. In addition, the applicant must demonstrate a high likelihood that its strategy is being coordinated with local community plans and will help to catalyze other non-NMTC investments in the LICs.

<u>*Management Capacity*</u>

The Fund reviews the qualifications of the CDE's board members, management team, and other essential staff. To receive favorable scoring in this area, an applicant CDE should emphasize its staff's relevant experience, particularly in LICs that are being targeted. The CDE should point to its track record of raising capital, especially from profit-motivated investors (via parent financial institution as well as history management group). In addition, the CDE should confirm that it has the capacity to manage the addition of NMTC-approved activities to its current portfolio of projects. The CDE should demonstrate a meaningful involvement with the LIC decision makers and show that it can coordinate with local community plans.

The historical data of the parent financial institution may be utilized by the CDE to highlight the qualifications of management. As such, CDEs associated with a financial institution having a strong CRA history have a distinct advantage with this section.

To earn an "excellent" rating under Management Capacity, the applicant must demonstrate that it has assembled a team of personnel capable of achieving the deployment projections outlined in the Business Strategy (again CDEs typically reference parent financial institutions since such a history is available). Reviewers consider if key personnel have extremely high qualifications in locating, underwriting, and approving investments, and/or providing Financial Counseling and Other Services, to LICs. In addition, reviewers highly rate those applicants capable of successfully managing the addition of NMTC activities into its current portfolio.

Reviewers highly rank those applicants that can demonstrate key personnel have extremely high qualifications with respect to raising capital from profit-motivated investors. Applicants with key personnel with the wherewithal to manage investment proceeds and subsequent activities receive high marks. As result, reviewers seek information to determine:

a) key personnel have extremely high qualifications with respect to managing the applicant's assets and controlling its overall risk;
b) the applicant is highly likely to successfully manage the addition of NMTC investments into its current portfolio;
c) the applicant's infrastructure capacity (e.g. management information systems) will highly likely support its asset and risk management procedures; and
d) the reviewer has high confidence in the applicant's ability to operate successfully as a going concern.

The applicant must demonstrate that it and its key personnel will be able to ensure compliance with the NMTC program requirements by showing:

a) key personnel have extremely high qualifications with respect to managing programmatic compliance requirements; and
b) the applicant is highly likely to remain in compliance with NMTC program rules based upon its description of its systems and procedures (e.g., portfolio monitoring, reporting, investment / reinvestment strategies).

In addition, the applicant must demonstrate a high likelihood that its community representatives will provide meaningful feedback and that such feedback will be utilized in investment decisions. If the applicant or Controlling Entity is an insured financial institution and its most recent CRA rating was less than “outstanding,” the applicant must provide a very credible case suggesting that it is highly likely to secure an “outstanding” CRA rating in the future.

Capitalization Strategy

In evaluating a certified CDE’s capitalization strategy, the Fund’s scoring criteria will take into consideration the CDE’s prior performance in securing equity investments from investors and its plan for doing so in the future, including a demonstration that the CDE will issue qualified equity investments in the near term. Most financial institutions set up the CDE as a wholly owned subsidiary with the ability to fully fund the CDE if and only if it receives an allocation award.

The CDE should illustrate that a majority of the economic benefits of the allocation will be passed along to borrowers and investees. In addition, the CDE should demonstrate that it intends to deploy more than 85% of its allocation proceeds in qualified low-income community investments. The Fund will examine whether the CDE is offering products and services that are substantially different from those of its investors (below market loans, below market origination fees, etc.). The Fund is looking to determine how the NMTC benefits are being passed on to LIC users.

To earn an excellent rating under Capitalization Strategy, the applicant must demonstrate that it has raised capital over the past five years equivalent to at least 80% of its requested allocation amount (again an easy item for CDEs associated with financial institutions), and that 70% or higher of this amount was raised as equity at market or near-market terms.

Applicant must list investors that will provide funding. Applicants that can list investments totaling at least 80% of the applicant’s allocation request (via receipt of funds, the commitment of funds, or the letter of interest/intent) rate highly. Financial institutions associated CDEs generally meet this requirement by providing a letter of commitment indicating the parent financial institution will fund the subsidiary CDE only upon receipt of a NMTC allocation award.

CDEs associated with financial institutions are favorably looked upon by reviewers if the CDE indicates it is offering products with more favorable rates or terms than those currently offered by the investors (parent) and/or targeting its activities to areas of greater economic distress than those currently targeted by the investor. Financial institutions satisfy this requirement by indicating the parent would not otherwise make the below market interest transaction if it were not for the NMTC benefits subsidizing the risk associated with such a transaction in a LIC.

<u>*Some additional requirements for the successful CDE applicant*</u>

The law requires that a certified CDE meet certain time requirements in carrying out its activities. For example, a CDE must offer NMTCs to its investors within five years of receiving an allocation. A CDE must invest "substantially all" (generally 85%) of its qualified equity investment proceeds in qualified low-income community investments within 12 months. In addition, during the first six years of the NMTC credit period, CDEs that receive a return of capital have 12 months to reinvest those funds in qualified low-income community investments. Reinvestment is not required in the final year of the seven-year credit period.

To demonstrate that it has properly invested "substantially all" of its qualified equity investment proceeds, a CDE may employ either of two tests:

> (1) Under the "direct tracing" method, a CDE is required to trace the qualified equity investment allocations to specified qualified low-income community investment projects. This approach typically will involve substantiation through the accounting records.
> (2) Under the "safe harbor" method, a CDE must demonstrate that 85% of its aggregate gross assets are invested in qualified low-income community investments and deployed in qualified activities.

The NMTC may be subject to recapture during the seven-year credit period if the CDE ceases to be qualified; if the qualified equity investments fail the "substantially all" requirement; or if the CDE redeems the investments from the investors. A CDE's filing for bankruptcy is not an event that triggers credit recapture.

As a result, reviewers are trying to determine if the applicant CDE has the capability to gather sufficient investment funds, enough projects to utilize the NMTC allocation as well as the ability to monitor program compliance over the life of the credit.

Conclusion

The process by which NMTC equity investment allocations are made ultimately will rest on the scoring methodology employed by the Fund review panel. Thus, the successful strategies a CDE can articulate in its application will substantially increase the chances of securing an allocation. By comparison, the CDE certification process is not where the emphasis should be placed. That is not to say applying for the CDE certification should be taken lightly. Rather, the Fund apparently has placed its emphasis on the allocation application sections.

The NMTC program objectives are to promote rapid and meaningful economic development to LICs. To date, the NMTC program has proven to be viable subsidy for financial institutions seeking to increase or diversify their CRA activities.

While, on the surface, the application process may seem daunting and confusing and not very user-friendly, one should keep in mind that financial institutions that partner with LIC mission based non-profits have an advantage in securing the allocations available. Thus, as additional ammunition in the arsenal of economic development in LICs, the NMTC is worth consideration, as the benefits can often outweigh the procedural effort.

With historical experience and data of the CRA program, financial institutions can easily calculate the potential benefits of the NMTC award if an allocation was to be received. Almost every financial institution I speak with regarding the program instantly references past projects that were bypassed due to risk of return. The powers to be realize with the NMTC program benefits, the bypassed projects would have been able to move forward.

With the pending reinstatement of the program, interested financial institutions should review historical lending information, consider the viability of potential LIC projects and find non-profit LIC organizations in which to recruit / partner for the NMTC program. History has indicated this program continues to be a cost effective methodology to subsidize risk associated with LIC investments. Proposed renewal of the program will increase application scrutiny to award funds to financial institution Applicants that partner with local or regional LIC mission based non-profit agencies, have sufficient funding to move forward and have a lending history. All signs indicate financial institutions will continue to grab the lion's share of awards.