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How does the federal New Market Tax Credit program work?

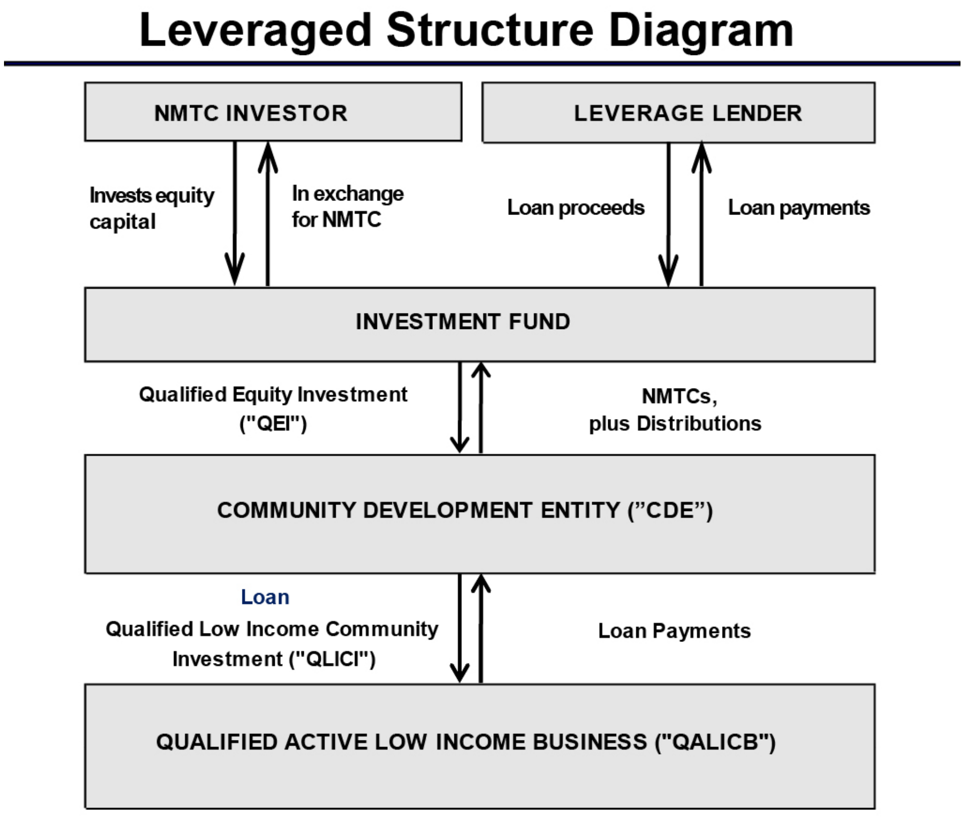
The federal New Market Tax Credit (NMTC) program has supported a wide range of for- and non-profit businesses, including education and childcare, which benefit low-income communities. Communities benefit from the jobs associated with these investments and the benefits of public facilities and goods and services.

Through the NMTC program, the US Treasury's Community Development Financial Institutions Fund allocates tax credit authority to Community Development Entities (CDEs) through a competitive application process. CDEs are fiscal intermediaries through which capital flows from an investor to a qualified business located in a low-income community. CDEs offer tax credits to investors in exchange for equity targeted at investments in low-income communities. With these resources, CDEs make loans to businesses operating in distressed areas. Qualified businesses can be for- or non-profit entities. The qualified business is usually the NMTC project "sponsor." To utilize NMTCs, public education institutions such as community colleges and school districts create special non-profit entities specifically for the purpose of building educational facilities.

In exchange for investing in CDEs, investors claim a tax credit worth 39 percent of their total investment in the CDE, which is claimed over a seven-year period. Unlike Low Income Housing Tax Credits (LIHTCs), NMTCs are generated by enhancing other project sources, specifically, debt from a leverage lender, rather than being based on project expenditures (see diagram, below). Also, unlike LIHTCs, NMTCs are a relatively shallow subsidy in a project. For example, a typical NMTC project will realize a net benefit of approximately 20% of the amount of the investment in the CDE. However, this subsidy can still be significant to a non-profit entity hoping to build a state-of-the art facility with constrained resources.

The overwhelming majority of NMTC investments involve more favorable terms and conditions than the market typically offers. Terms can include lower interest rates, flexible provisions such as subordinated debt, lower origination fees, higher loan-to-values, lower debt coverage ratios and longer maturity.

NMTC Leveraged Structure Diagram



The NMTC investor invests equity capital in an investment fund organized by a CDE. The investment fund also includes resources from a lender (called a "leverage lender"). Lenders often participate in these funds because they receive Community Reinvestment Act benefits for such investments. The leverage lender may also be an affiliate of the project sponsor and the leverage loan funded with other sources available to the sponsor, such as proceeds from a capital campaign or other borrowing.

The amount of resources in the investment fund is the amount that is leveraged for tax credits. So, an investor receives tax credits based on its investment as well as the proceeds of the leverage loan or other resources that will be used for a project.

The CDE takes the money that is pooled in the investment fund and loans it to a Qualified Active Low Income Business (QALICB). The QALICB can be a for-profit or non-profit entity created for the purpose of a business or real estate development that creates benefits for a low-income community.