HICKORY GROVE CAPITAL

New Markets Tax Credit Overview

NMTC PROGRAM SUMMARY

- Congress created the New Markets Tax Credit program as part of the Community Renewal Tax Relief Act of 2000, to encourage investment in low-income communities. The New Markets Tax Credit Program (NMTC) helps economically distressed communities attract private investment capital by offering federal tax credits to fill project financing gaps, enabling investors to make larger investments they would otherwise not make. The NMTC Program provides investments to low-income community businesses and non-profits including the likes of community facilities, manufacturing, technology and mixed-use projects creating greater access to housing, healthcare, education, and community goods and services.

- Through the NMTC Program, the Department of Treasury's CDFI Fund allocates tax credit authority to certified Community Development Entities (CDEs) by a competitive application process. CDEs are financial intermediaries through which investment capital flows from an investor to a qualified business in a low-income community. CDEs use their authority to offer tax-credits to investors in exchange for cash to make interest only loans and investments to non-profits, developers and businesses operating in distressed areas that have more competitive terms and flexibility than current market-rate products.

TYPICAL NMTC PROJECTS

Manufacturers, processors, distributors, health care facilities, community centers, child care providers, mixed-use real estate facilities, charter schools, supermarkets, museums, hotels, performing arts centers, pharmacies, convenience stores, trucking companies, printing companies, waste management, renewable energy, sporting goods, office buildings, shopping centers, substance abuse treatment facilities and more

COMMON NMTC INDUSTRIES

Manufacturing, Accommodation and Food Services, Mixed-Use Real Estate, Healthcare and Social Assistance, Educational Services, Retails Goods and Services, Entertainment and Recreation, Forestry and Fishing, Utilities, Telecom, Broadcasting

PROGRAM NOTES

- ***Congress has approved $61 billion of tax credit authority since 2000***
- ***CDFI Fund has made 1,254 awards to CDEs since the program's inception***
- ***In the most recent allocation round awarded in 2020, CDEs applied for $14.5 billion of the $3.5 billion of allocation available***
- ***Certain states began creating their own NMTC programs in 2008***
- ***Since the program inception, every $1 of NMTCs has spurred an additional $8 of private investment in LICs***
- ***Approximately 5,799 NMTC projects have been completed - 59% were operating business projects and 40% were real estate projects***

Who are the participants?

Investors (buyers of the tax credits):

Investors who make qualified equity investments (defined below) reduce their federal income tax liability by claiming the credit. Investors buy the credit at a discount, receiving a built in return and more incentive to part with their cash. The tax credit value is 39% of the cost of the qualified equity investment ("QEI") and is claimed over a seven-year credit allowance period. **This is an exciting program that provides tax incentives to investors to make investments in distressed communities and promotes economic improvements through the development of successful businesses in these communities.**

Who are the Investors?

The number and type of investors still tends to be very concentrated, however, with a large percentage of QEIs coming from large banks, and a significant portion of that investment coming from a limited number of large financial institutions. These investors have traditionally had a strong appetite for NMTCs and a high degree of familiarity with the program's structures, making these investors an easy first choice for many Community Development Entities ("CDEs"), however, any entity or person can be eligible to claim the tax credits.

What are some Investor motivations?

- Generate reasonable returns for the risk profile of these transactions
- Receive Community Reinvestment Act (CRA) credit for investing in Low-Income Communities (LIC)
- Making impacts to the communities they serve
- May be an opportunity to provide the leverage loan in addition to the QEI
- May be an opportunity to win a new client

Community Development Entities (CDE):

What is a CDE? Qualified investment groups apply to the U.S. Department of the Treasury's Community Development Financial Institutions Fund (CDFI) for an allocation of New Markets Tax Credits. The investment group is known as a Community Development Entity (CDE). A CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investment funding, or financial counseling in low-income communities (LICs). These groups tend to be mission driven lenders, mainstream financial institutions, and quasi-government entities.

How to become a CDE: An organization must submit an application to the CDFI that demonstrates that it meets three criteria: (1) it is a domestic corporation or partnership duly organized under the laws of the jurisdiction in which it is incorporated, (2) it has a primary mission of serving low-income communities, and (3) it maintains accountability to residents of these low-income communities.

How the CDE receives cash: Treasury Department's CDFI reviews NMTC applications submitted by CDEs, issues tax credit authority to those CDEs deemed most qualified, and plays a significant role in program compliance. After the CDE is awarded a tax credit allocation, the CDE is authorized to offer the tax credits to institutional investors in exchange for cash. The CDE then takes the tax credit sale proceeds and makes an equity investments or loans to low-income communities and low-income community businesses, all of which must be qualified under the program.

CDEs are the intermediaries between the potential low-income community investments and the CDFI during the application process. CDEs also present investors with investment opportunities and provide the CDFI the majority of its compliance data.

CDEs can have a service Area that is national, regional, multi-state or local (city our select counties).

Qualified Active Low-Income Community Business (QALICB)

This is usually a for-profit business, non-profit or developer who sponsors a capital project or business operation and receives the loan or equity proceeds from a CDE. This entity must be in qualified Low-Income Community and meet several other tests to be deemed eligible for the NMTC financing. **A project's address is mapped to determine its location eligibility within a Low-Income Community.**

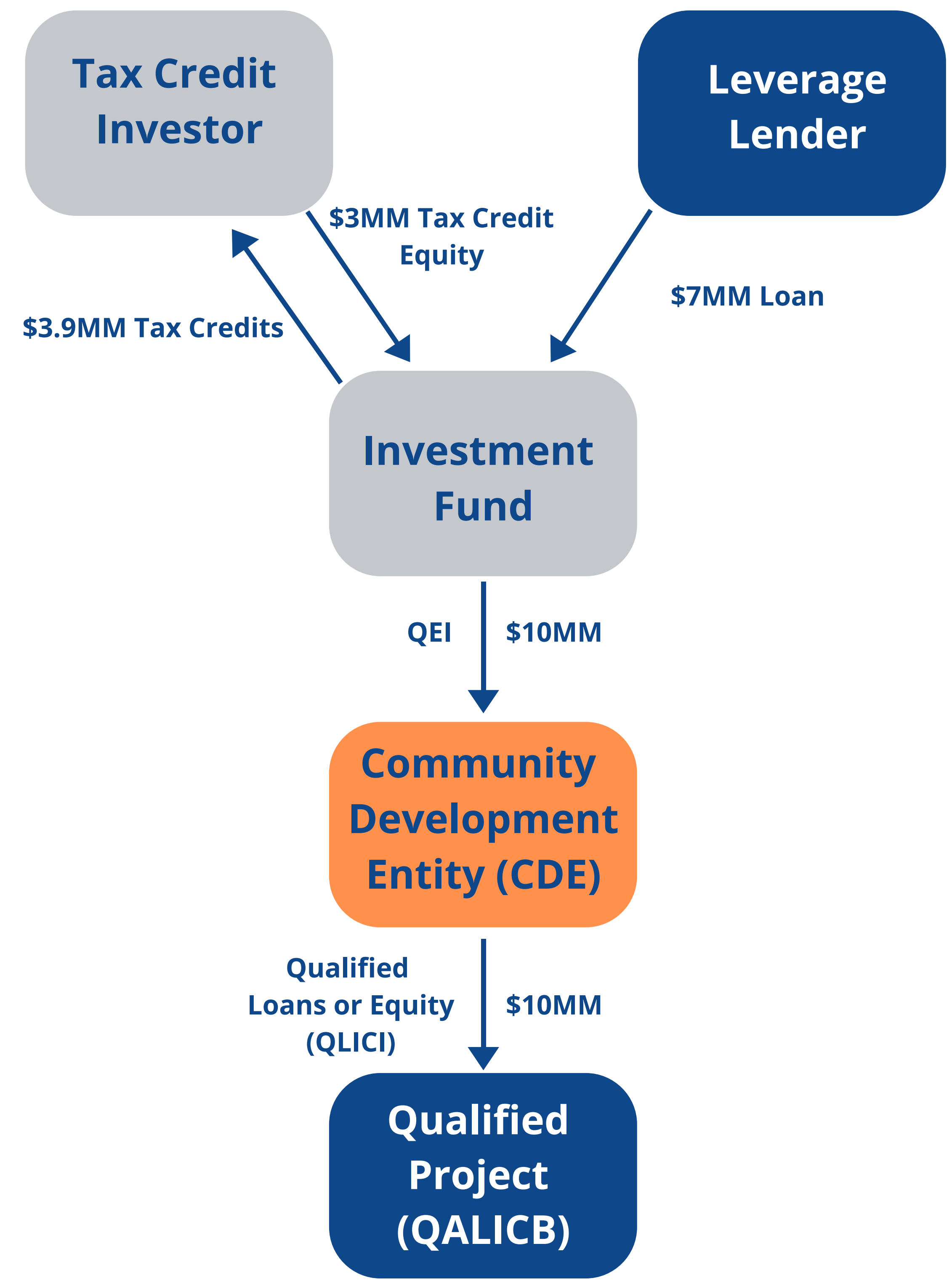
In a traditional NMTC transaction, a QALICB will need to demonstrate they have raised roughly 75% of the project sources of funding. These sources can come from bank debt, balance sheet cash, capital campaigns, grant funding, other local and state incentives.

Transaction Process

After the CDE is awarded a tax credit allocation, the CDE is authorized to offer the tax credits to institutional investors through their CDE. CDEs look for institutional investors (usually large banks) to make QEIs in the CDE. The CDE then takes the equity investments and makes a loan to low-income communities and low-income community businesses, all of which must be qualified under the program.

In practice, CDEs tend to have long standing relationships with traditional NMTC investors, so raising equity is not usually a challenge. There are a variety of CDEs across the country with different missions and strategies. CDEs are consistently reviewing deal flow to identify projects located in low-income communities and align with their mission, making their next application to the CDFI stand out. Strategies can include but are not limited to investing in: affordable housing, charter schools, rural geographies, manufacturing facilities, minority businesses, community facilities, urban geographies, healthcare facilities, tribal geographies, and mixed-use real estate. Once a project has been qualified by a NMTC professional a project Sponsor must provide verification they have arranged the leverage in a transaction, which traditionally accounts for 70-75% of the total project costs. These funds are usually made up of other public subsidies and private sector funds. The diagram below details how the funds are aggregated and flow through a NMTC structure.

$10MM Leveraged NMTC Example



NMTC Impacts and Community Benefits

Many project Sponsors will be NMTC eligible, but to attract a CDE its important for project Sponsors to articulate the community benefits and impacts of their project. NMTC financing tends to be competitive with many project Sponsors chasing a finite resource in NMTCs. While determination of impact is not an exact science, demonstrating how a respective project will create high-impacts in some of the following ways will help to obtain financing and begin preliminary diligence with a CDE:

- Creating and retaining quality jobs with above average wages for the area and strong fringe benefits
- Providing jobs that are accessible to low-income people
- Impacts to minority business owners
- Promoting investment in rural locations
- Addressing income inequality
- Providing goods and services to low-income community residents

In addition to impacts a project Sponsor must show a need for NMTCs. This is accomplished by crafting a strong "But For" narrative. Some example include the following statement: "But For NMTC subsidy, this project:

- Could not move forward due to a capital shortfall;
- Would be delayed without NMTC financing;
- Would not make economic sense to pursue (often used for manufacturing or real estate in highly speculative and stressed areas);
- Would not have the same social/community/economic impacts;
- Would not be located in a distressed, low income community.

Benefits to projects who are successful in obtaining NMTCs

The NMTC program helps businesses with access to flexible and affordable capital. As long term, patient capital, project Sponsors traditionally receive benefits including lower interest rates on loans, debt forgiveness on principal, interest-only payments for seven years, subordinated debt, low to no origination fee, higher LTVs, lower debt service coverage ratios, access to a reduced cost of capital, and more.

The NMTC program has largely been capped at $3.5 billion annually since 2005, but Congress recently increased its allocation for NMTC credits to $5 billion beginning in 2021.

To learn more about how you can take advantage of the NMTC program contact Ryan Congrove at (614) 407-4786 or ryan.congrove@hickorygrovecapital.com.

Key NMTC Terms

NMTC – The New Markets Tax Credit – a 39% credit taken in installments over 7 years; (5% for the first 3 years and 6% for the last 4 years adds up to 39%).

CDFI Fund – The Community Development Financial Institutions Fund – a division of Treasury tasked with, among other things, overseeing NMTC program and awarding NMTC allocation to CDEs.

CDE – A “Qualified Community Development Entity” certified by the CDFI Fund. This is a mission based financing institution aimed at helping low-income people or communities. CDEs are eligible to receive NMTC allocations through the CDFI Fund.

Low-Income Community - Census tract with poverty rate >20% and/or annual median income (AMI) that is <80% of statewide average. Allocatees have the option to commit to serve areas of high distress. Census tracts with poverty rate >30% and/or <60% of AMI and/or a unemployment rate 1.5x the national average.

Allocation Agreement – The Agreement pursuant to which the CDFI Fund grants the CDE the authority to “designate” NMTCs to an investor.

Allocatee – A CDE which has received an allocation of NMTCs from the CDFI Fund.

Leverage Lender - Provides the required leverage into a NMTC structure to generate tax credit equity from the NMTC Investor. The source of proceeds can come from both the private sector or other public subsidies. Some examples include: bank debt, balance sheet cash, capital campaign proceeds, state or federal grants, TIF proceeds and more.

QEI – “Qualified Equity Investment” – Investment into a CDE in the form of either stock or capital interest. The CDE designates the investment as a QEI, and the investor is then able to take a NMTC in an amount equal to 39% of the QEI.

QLICI – a “Qualified Low-Income Community Investment” Generally a loan or investment by the CDE to/in a QALICB.

Sub-CDE – a “subsidiary” of the CDE, which itself also qualifies as a “Qualified Community Development Entity,” also known as a “subsidiary allocatee.” "Substantially all" (85%) of the QLICI must remain invested in the QALICB during first 6 years and drops down to 75% in year 7.

QALICB - “Qualified Active Low-Income Community Business” Business, Non-Profit, Developer which is geographically located in a low-income community as determined by census data. “Sin” businesses (golf course, country club, massage parlor, hot tub facility, suntan facility, gambling, liquor store) are excluded.

Professional Service Providers - Legal counsel and accountants necessary to ensure the structure and transaction are documented in accordance with the NMTC.