National Trust Community Investment Corporation
a subsidiary of the National Trust *for* Historic Preservation

Tools of the Trade:
Tax Credits 101

What is tax credit financing and how does it work?

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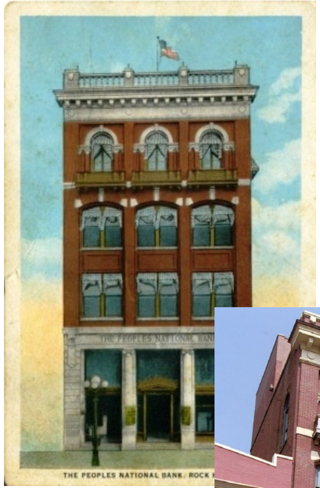
Q&A: WILLIAM FIEDERLEIN | PROJECT MANAGER

INTRO: MERRILL HOOPENGARDNER | PRESIDENT

Who is NTCIC?

- **NTCIC** finances sustainable economic development in communities nationwide by providing **tax credit syndication**, **technical assistance & advocacy** for the preservation of historic properties, especially in **low-income communities**, and the production of renewable energy

- **NTCIC** is governed by a 10-member board of directors comprised of current or former National Trust for Historic Preservation trustees, low-income community representatives, and industry experts



NTCIC's 1st Project was the Dalton Building in Rock Hill, SC (Before)

Dalton Building (After)

Who is NTCIC?

Definition

- Low-Income Community (LIC)
  - Any population census tract that meets 1 of the following criteria (1) Poverty rate is at least 20% or (2) Median Family Income for the tract does not exceed 80%

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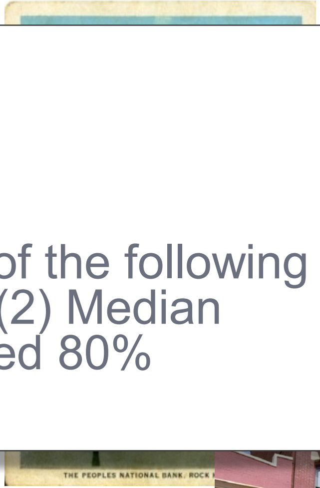

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Dalton Building (After)

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Who is NTCIC?

- National Trust Subsidiary formed in 2000 to take advantage of the newly created New Markets Tax Credit Program
  - Community Development Financial Institutions Fund (**CDFI Fund**)
  - Internal Revenue Service (IRS)
- Qualified Community Development Entity (**CDE**)
  - CDFI Fund only AWARDS New Markets Tax Credits (NMTCs) to CDEs
- Tax Credit Syndicator
  - Connect private investor capital with developers rehabilitating historic buildings

What are Tax Credits?

How do you get them? How do you use them?

Tax Credit Basics

- Generally designed to encourage or reward certain types of investment and development that are considered beneficial to the economy, the environment or to further any other purpose the government deems important
- Tax credits reduce the amount of income tax **dollar-for-dollar** that individuals or companies owe to federal and state governments
- Investors with a large tax liability want to buy tax credits to lower taxes – e.g. large banks
- Historic restoration projects need inexpensive capital
- Tax credit syndicators connect investors with projects that qualify for tax credits

Tax Credit Basics

- Investment Tax Credit (**ITC**) or Solar tax credit
  - Received for installing solar energy systems
- Low-Income Housing Tax Credit (**LIHTC**)
  - Used to finance construction and/or rehabilitation of affordable rental housing
- Historic Tax Credit (**HTC**)
  - Encourages rehabilitation and re-use of historic buildings
- New Markets Tax Credit (**NMTC**)
  - Provides an incentive for investment in low-income communities

Not All Credits are Created Equal

Historic

- Encourage redevelopment of historic buildings
- Federal since 1976 and 35 state programs
- FHTC is administered by the National Park Service
- Credit is earned by the developer for qualified rehabilitation expenses
- 20% credit taken over a single or five year period with a 5 year compliance and recapture period

New Markets

- Encourage investment in low-income communities
- Federal since 2003 and 14 state programs
- Administered by the CDFI (Dept. of Treasury)
- Credits are awarded to a community development entity (CDE)
- 39% credit taken over 7-year compliance and recapture period

Low Income Housing

- Provide affordable rental housing for low-income individuals
- Federal since 1986 and 16 state programs
- Administered by HUD
- Credits awarded to developers
- 10% or 4% credit taken over a 10-year compliance and recapture period

Example: Main Street Development, LLC

Historic Tax Credits 101

What are they? How do you get them? What can they do?

History of HTCs

- The National Historic Preservation Act of 1966 authorized the National Register of Historic Places. The National Register coordinates and supports public and private efforts to identify, evaluate, and protect America's historic and archeological resources.
- The **HTC** was enacted in 1978 to preserve and rehabilitate historically significant properties
- The **HTC** became a permanent part of the tax code in 1986
- The **HTC** was saved from being eliminated from the Tax Cut and Jobs Act in 2017

Post 2017 HTC Basics

- **Types of HTCs**
  - **Federal HTC:** **20 percent** credit for certified historic structures
    - Buildings listed on the National Register of Historic Places
    - Buildings that contribute to a National Register-listed Historic District
  - **State HTC:** Available in **35** states
- **Administration of HTCs**
  - Preservation aspects jointly administered by **National Park Service** and **State Historic Preservation Offices**
  - Tax Aspects Administered by the **IRS**

How HTCs Work

- To generate HTCs, property owners or developers must undertake the **substantial rehabilitation** of a **certified historic structure** with an **eligible end use**

How HTCs Work

Am I Eligible?

- **Building must be a “Certified Historic Structure”**
  - Individually listed on the National Register <u>or</u>
  - A contributing building in a National Register Historic District
- **Project must be a “Certified Rehabilitation”**
  - Renovation adheres to the *Secretary of the Interior’s Standards for Historic Rehabilitation*

How HTCs Work

Am I Eligible?

- **Property must be income producing**
  - Apartments, Hotel, Office, Retail, Theatres, etc.
  - Owner-occupied residences **do not** qualify
- **Project must be a “Substantial Rehabilitation”**
  - Spend > $5,000 or the “Adjusted Basis” of the building
  - This test must be met within 2 years (5 if phased)

How HTCs Work

Adjusted Basis Calculation

- **A – B – C + D = Adjusted Basis**
    - A. Purchase price of the property (building & land)
    - B. Cost of the land at time of purchase
    - C. Depreciation taken for an income-producing property
    - D. Cost of any capital improvements made since the initial purchase

How HTCs Work

- To generate HTCs, property owners or developers must undertake the **substantial rehabilitation** of a **certified historic structure** with an **eligible end use**

- To qualify for certification, developers must complete a **3-part application** that is approved by the state **SHPO** and the **NPS**

How HTCs Work

NPS Application Process

- **Part 1:**
  - Presents information about the significance and appearance of the building
- **Part 2:**
  - Describes the condition of the building and the planned rehabilitation work
  - Proposed work is based upon the *Secretary of the Interior's Standards for Rehabilitation*
- **Part 3:**
  - Submitted after the project is complete and documents that the work was completed as described in part 2
  - Typically awarded when the project is "placed in service"
  - Officially when the HTC credits are awarded

How HTCs Work

- To generate HTCs, property owners or developers must undertake the **substantial rehabilitation** of a **certified historic structure** with an **eligible end use**
- To qualify for certification, developers must complete a **3-part application** that is approved by the state **SHPO** and the **NPS**
- Tax credits are equal to **20%** of the qualified rehabilitation expenditures (**QREs**)

How HTCs Work

What are QREs?

- Qualified Rehabilitation Expenditures (**QRE**) are tax credit eligible development costs on which the **HTC** is calculated

What counts?

- **Hard Costs**
  - Construction, Electrical, Plumbing, HVAC, etc
- **Some Soft Costs**
  - Architectural Fees, Insurance, Construction Period Interest, Taxes, Application Fees, Project Management Fees, etc

What doesn’t count?

- Acquisition costs
- Demolition costs
- Leasing expenses
- New construction
- Some non-historic construction

How HTCs Work

- To generate HTCs, property owners or developers must undertake the **substantial rehabilitation** of a **certified historic structure** with an **eligible end use**
- To qualify for certification, developers must complete a **3-part application** that is approved by the state **SHPO** and the **NPS**
- Tax credits are equal to **20%** of the qualified rehabilitation expenditures (**QREs**)

If project is eligible, the building owner is able to attract capital from investors in exchange for these credits

Calculating the Value of HTC

- **QRE x 20% = Credits**
- **Investors typically pay less than $1/credit to realize benefit**
  - QRE > $10MM – low to mid $.90s
  - QRE < $10MM – mid $.80s or lower
- **Credits x investor pricing = HTC equity**

The Compliance Period

- **Credit delivery**
  - The HTC is generated when the building is placed in service (PIS), receives its Certificate of Occupancy
  - Credit is earned 4% per year over 5 years, but investors will typically schedule the equity payments over the development and construction period
    - **NTCIC's typical pay schedule:**
      - 30% at closing
      - 45% at PIS
      - 15% when the project receives their NPS Part 3
      - 10% at "stabilization" – when the project begins to generate income
- **5-year compliance period**
  - Period in which credits are subject to recapture
  - Cannot make material alterations to the building
  - Cannot transfer ownership via sale or foreclosure
  - Recapture amount decreases by 20% each year

New Markets Tax Credits 101

History of NMTCs

- The New Markets Tax Credit (NMTC) Program was established with support from a bi-partisan Congress in 2000 and is administered by the CDFI Fund, a department of the U.S. Treasury
- There have been 15 application rounds of the NMTC Program, however it is NOT a permanent part of the tax code and must be extended by Congress
- PATH Act of 2015 extended the NMTC program for 5-years
- The NMTC Program is set to sunset in 2019
- The House (H.R. 1680) and Senate (S.750) have introduced bipartisan bills to make the NMTC Permanent

Terms and Acronyms

- **LIC** = Low-Income Community
- **CDE** = Community Development Entities
- **QEI** = Qualified Equity Investments
- **QLICI** = Qualified Low-Income Community Investment
- **QALICB** = Qualified Active Low-Income Community Business

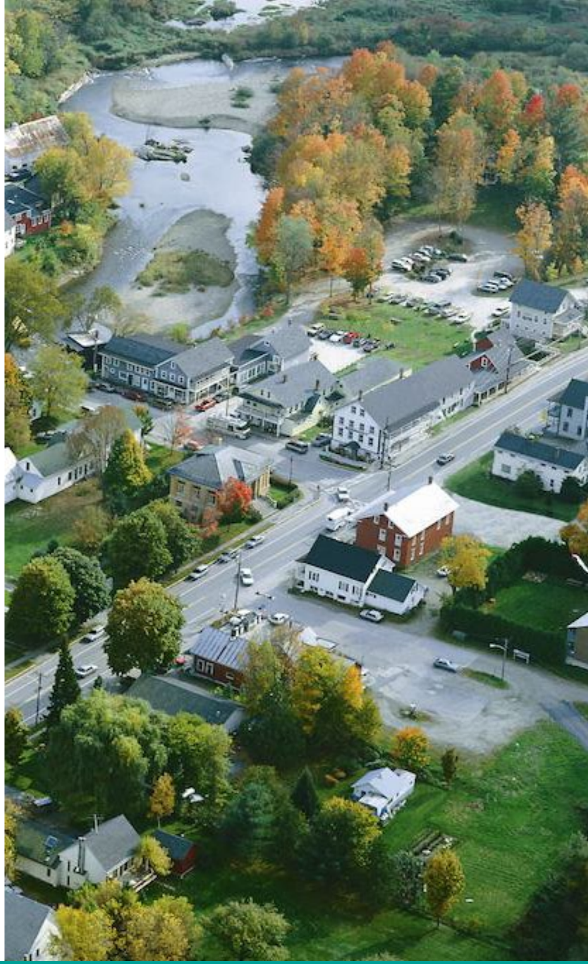
Basically, a CDE uses a QEI to make a QLICI in a QALICB located in a LIC.

NMTCs

- Encourages investments in low-income communities that traditionally have had poor access to debt and equity capital
- CDFI Fund only AWARDS tax credit allocation to Qualified CDEs
- CDEs have annual compliance reporting to the CDFI Fund
- Projects or Qualified Active Low-Income Community Businesses (QALICBs) must report community impacts at the project to the CDE on an annual basis
- Projects must certify annually that they remain a QALICB

How NMTCs Work

- CDFI Fund announces **NMTC allocation availability** for a Calendar Year Allocation Round



How NMTCs Work

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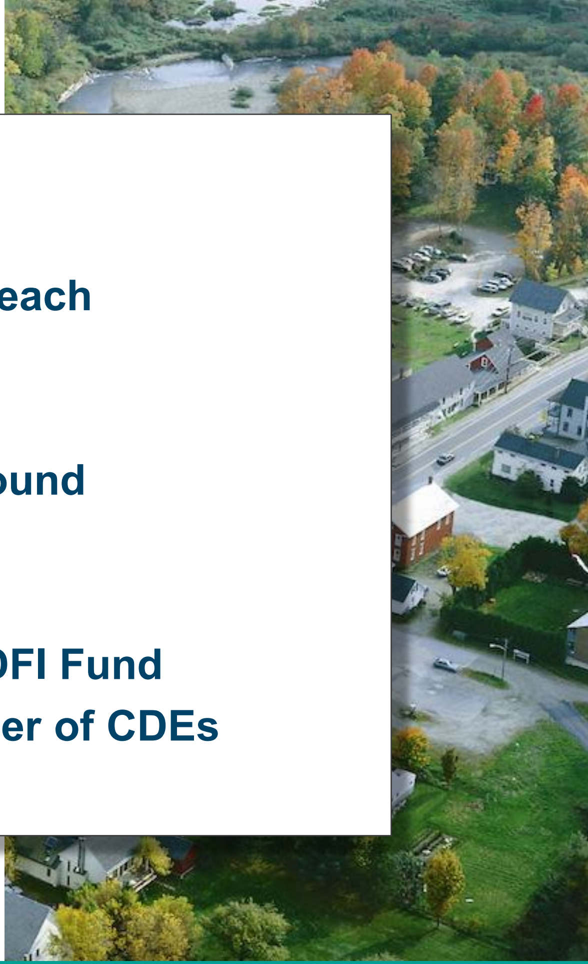
CDFI Fund

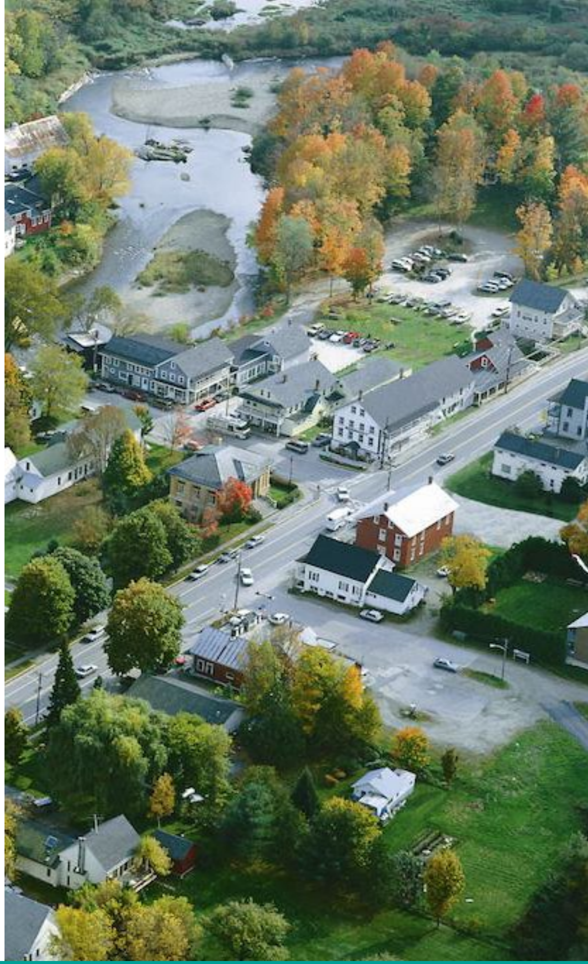
- $3.5 billion of tax credit authority is available for each Allocation Round (currently)
- Applications are usually due within 60 days of Round announcement
- After a competitive review of applications, the CDFI Fund awards an allocation of NMTCs to a limited number of CDEs



How NMTCs Work

- CDFI Fund announces **NMTC allocation availability** for a Calendar Year Allocation Round

- CDEs must apply through a **competitive application** process to be considered for NMTCs



How NMTCs Work

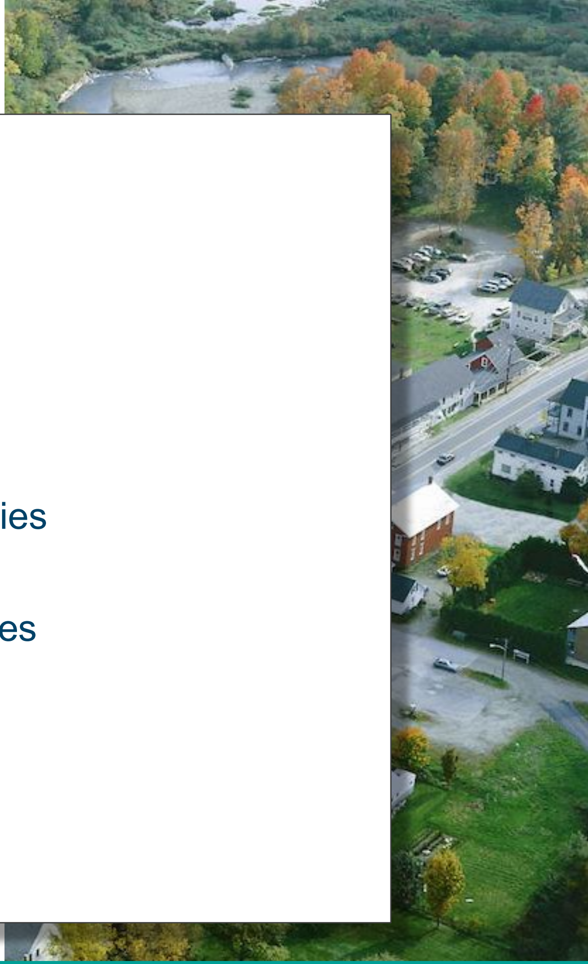
Application

- **Part 1 Business Strategy**
  - **Activities and Uses**
    - Real Estate Activities
    - Operating Businesses
  - **Innovative Investments**
  - **Financial Products**
    - Equity
    - Debt
      - 50% below market interest rates
      - Longer than standard interest only periods

How NMTCs Work

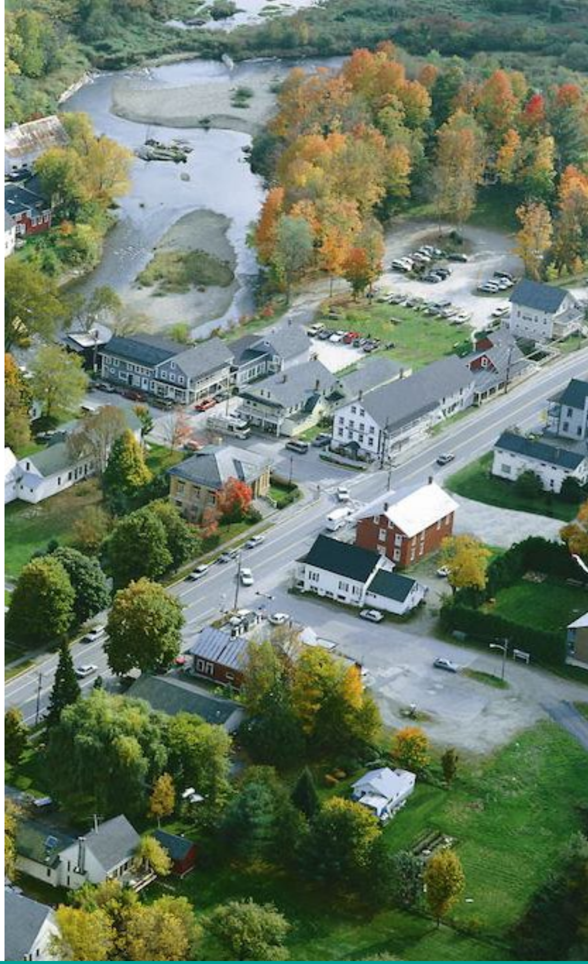
Application

- **Part 2 Community Outcomes**
  - Job creation / retention
  - Quality Jobs
  - Jobs accessible to low-income persons
  - Commercial goods or services to low-income communities
  - Healthy food financing
  - Community goods or services to low-income communities
  - Financing minority businesses
  - Flexible lease rates
  - Housing units
  - Environmentally sustainable outcomes



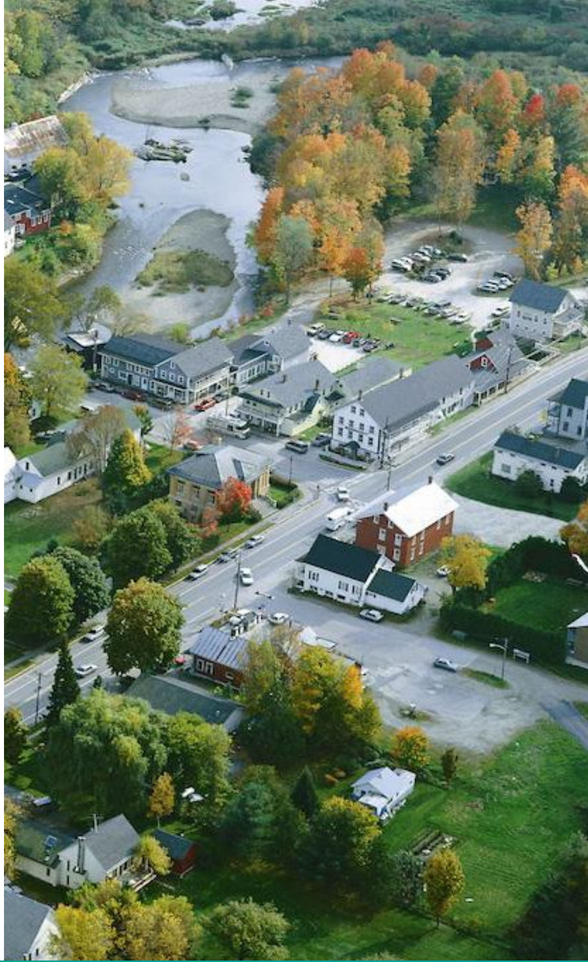
How NMTCs Work

- CDFI Fund announces **NMTC allocation availability** for a Calendar Year Allocation Round
- CDEs must apply through a **competitive application** process to be considered for NMTCs
- Once a CDE has been **awarded an allocation** they must complete an **Allocation Agreement** with the CDFI Fund



Project Evaluation / Selection

- Is the project located in a **NMTC-eligible census tract**?



Project Evaluation / Selection

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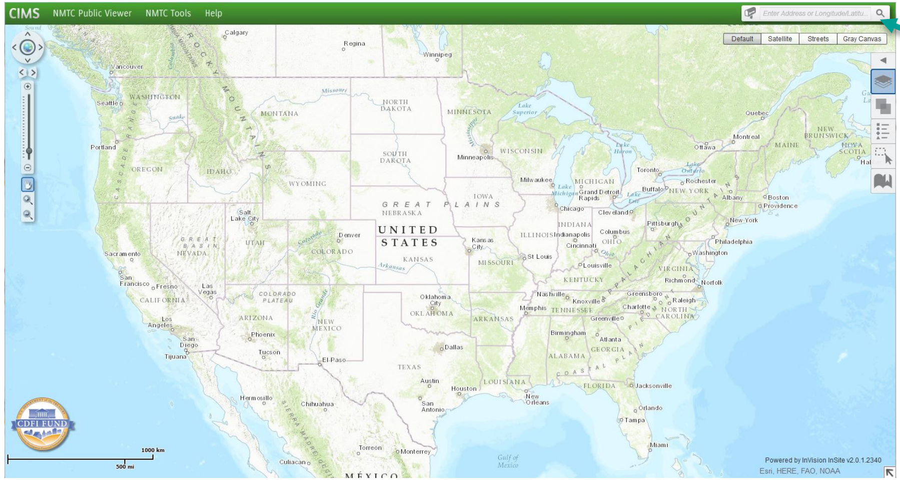
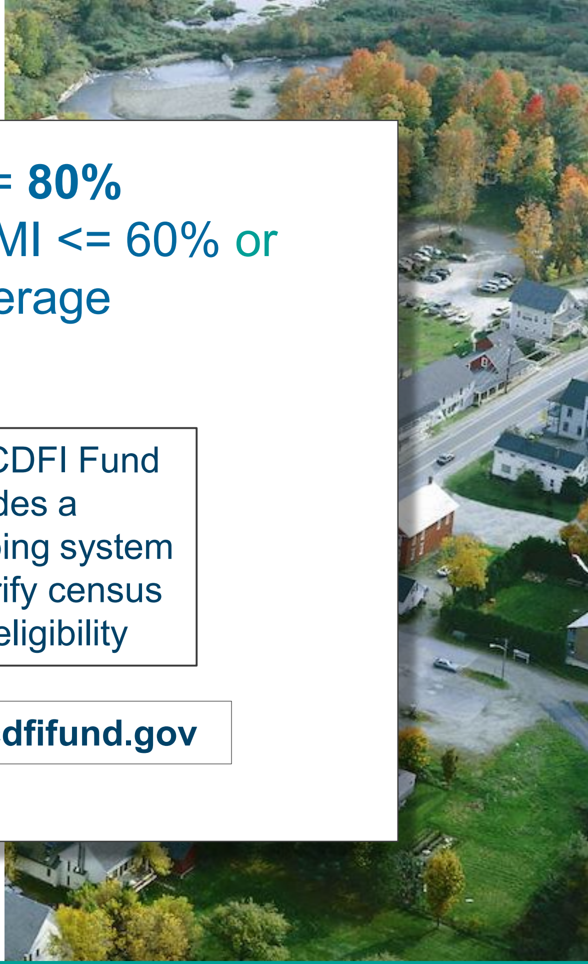
- **LIC**: Must have a poverty rate >= **20%** or AMI <= **80%**
- **Severely distressed**: poverty rate >= 30% or AMI <= 60% or unemployment rate at least 1.5x the national average



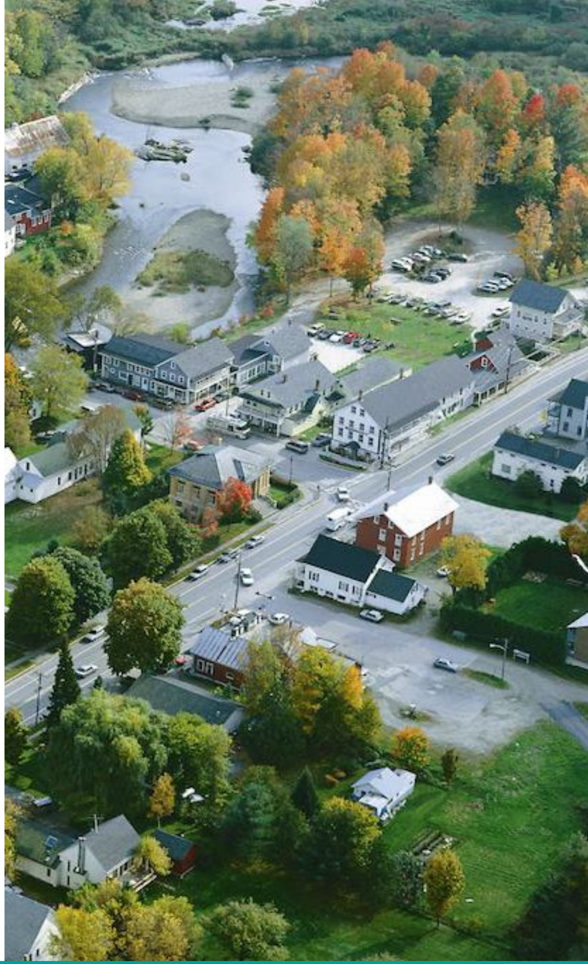
The CDFI Fund provides a mapping system to verify census tract eligibility

www.cdfifund.gov



Project Evaluation / Selection

- Is the project located in a **NMTC-eligible census tract**?
- What **types of** tenant **businesses** will be at the Project?



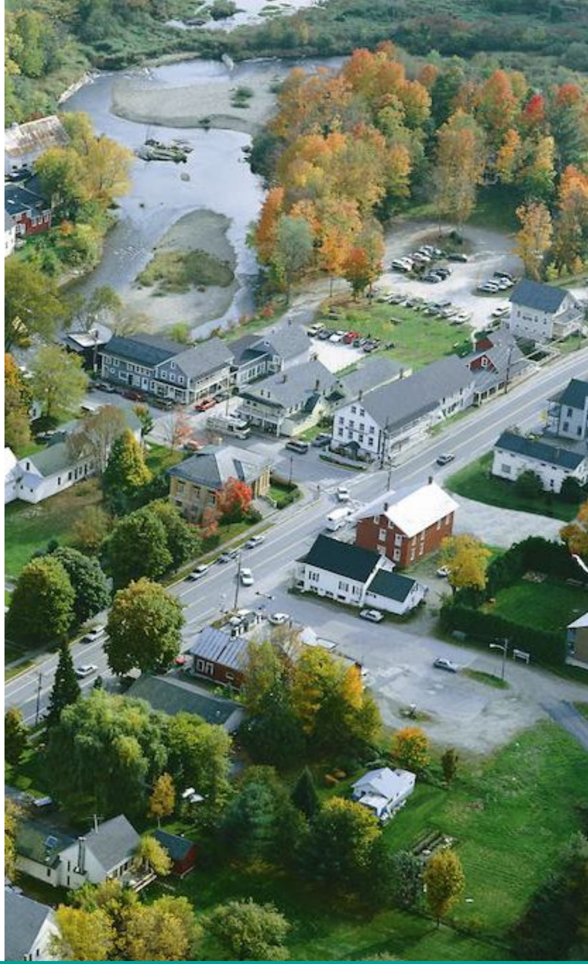
Project Evaluation / Selection

Excluded Businesses

- Golf courses
- Race tracks
- Gambling facilities
- Certain farming businesses
- Country clubs
- Trades or businesses involving intangibles
- Massage Parlors
- Hot tub facilities
- Suntan facilities
- Stores where the principle business is the sale of alcoholic beverages for consumption off premises

Project Evaluation / Selection

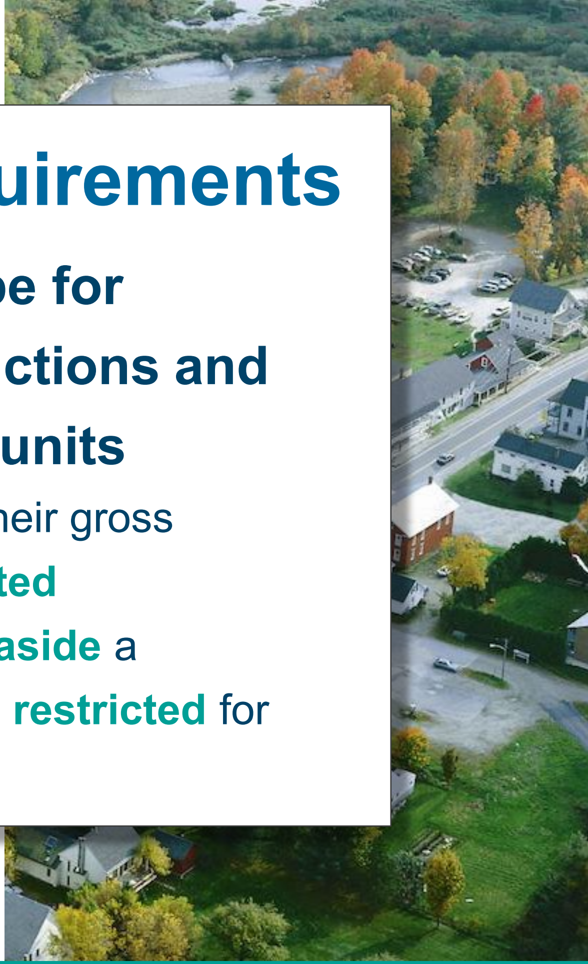
- Is the project located in a **low-income community**?
- What **types of** tenant **businesses** will be at the Project?
- Will the project have a **residential** component?



Project Evaluation / Selection

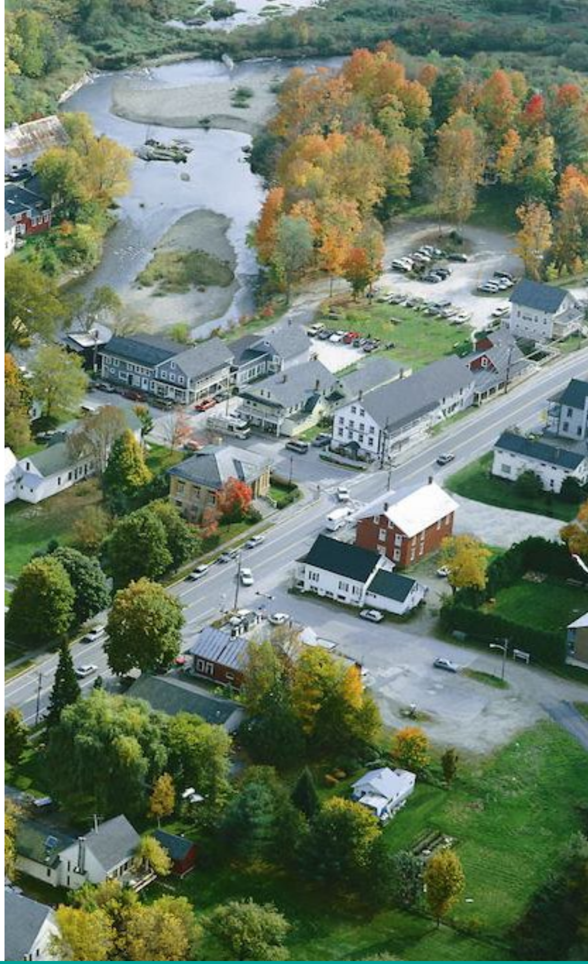
Residential Restrictions & Requirements

- **New Markets Tax Credits are intended to be for commercial businesses so there are restrictions and requirements for projects with residential units**
  - Buildings or structures that derive **80% or more** of their gross income from **residential rental income** are **prohibited**
  - Properties with residential units are **required** to **set aside** a minimum of **20% of units** as **both income and rent restricted** for households earning **80% or less AMI**



Project Evaluation / Selection

- Is the project located in a **low-income community**?
- What **types of** tenant **businesses** will be at the Project?
- Will the project have a **residential** component?
- What are the anticipated **community impacts**?



Project Evaluation / Selection

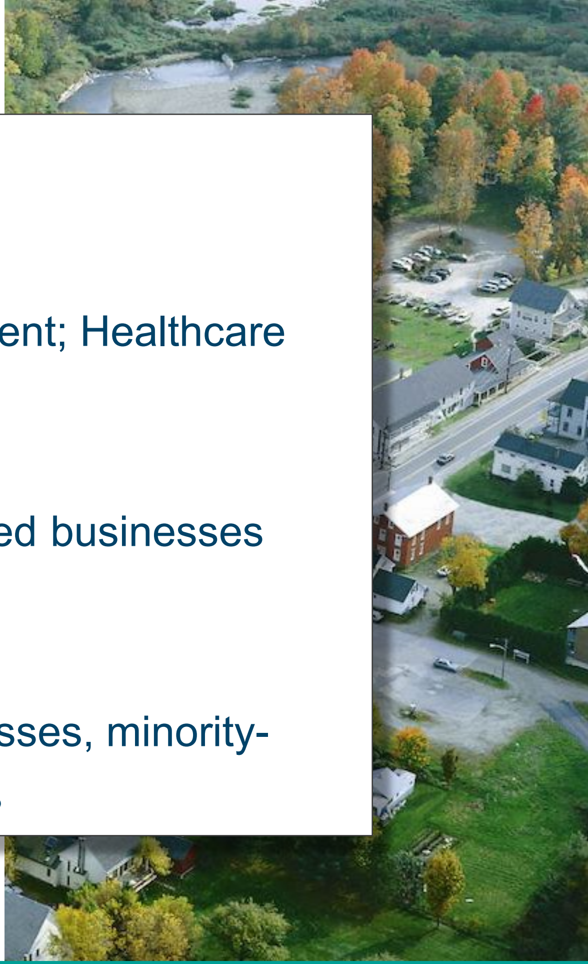
Community Impacts

- **Job Creation / Retention**
  - How many construction jobs will be created?
  - How many permanent jobs will be created?
- **Quality of Jobs**
  - Pay a Living Wage? www.livingwage.mit.edu
  - Offer benefits: health insurance; paid time off; retirement
- **Accessible Jobs**
  - Minimum education or skill level

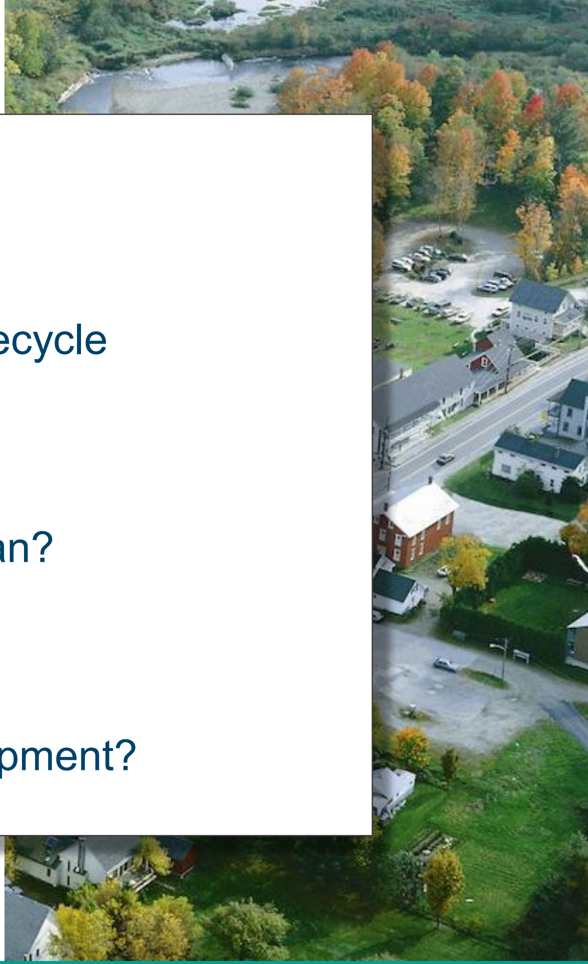
Project Evaluation / Selection

Community Impacts

- **Goods and Services**
  - Community goods or services: Workforce Development; Healthcare
  - Commercial goods or services: Grocery; Pharmacy
- **Minority Representation**
  - Contracts or sub-contracts awarded to Minority-owned businesses
  - Jobs filled by Minority individuals
- **Flexible Lease Rates**
  - Flexible lease rates & terms to locally-owned businesses, minority-owned, women-owned, and/or non-profit businesses



Project Evaluation / Selection

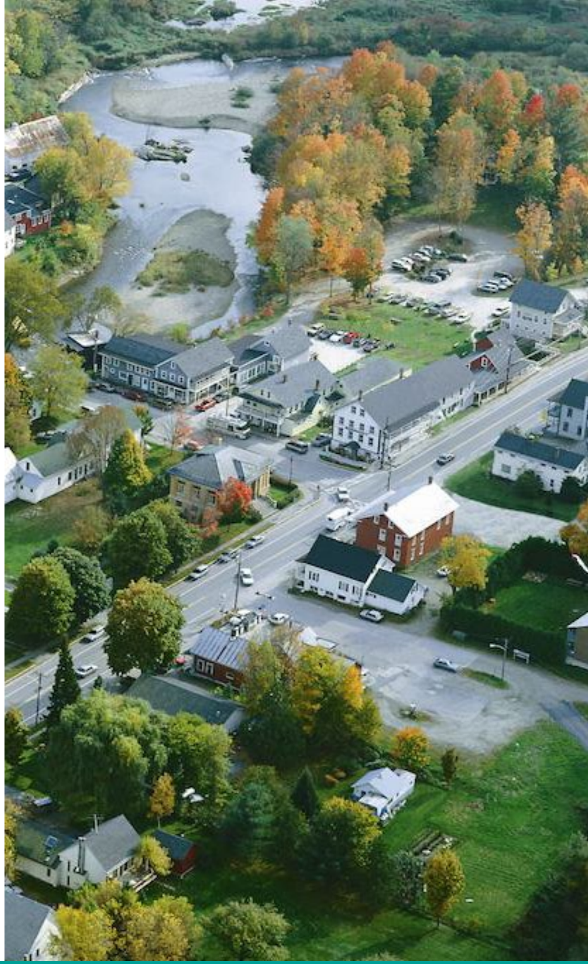


Community Impacts

- **Environmentally Sustainable Outcomes**
  - Construction waste management plan: Reuse and Recycle
  - Green Energy Technologies
- **Community & Economic Plan**
  - How does the project fit into a broader community plan?
  - Community engagement during project planning
- **Additional Non-NMTC Investment**
  - How will the project help catalyze additional redevelopment?

Project Evaluation / Selection

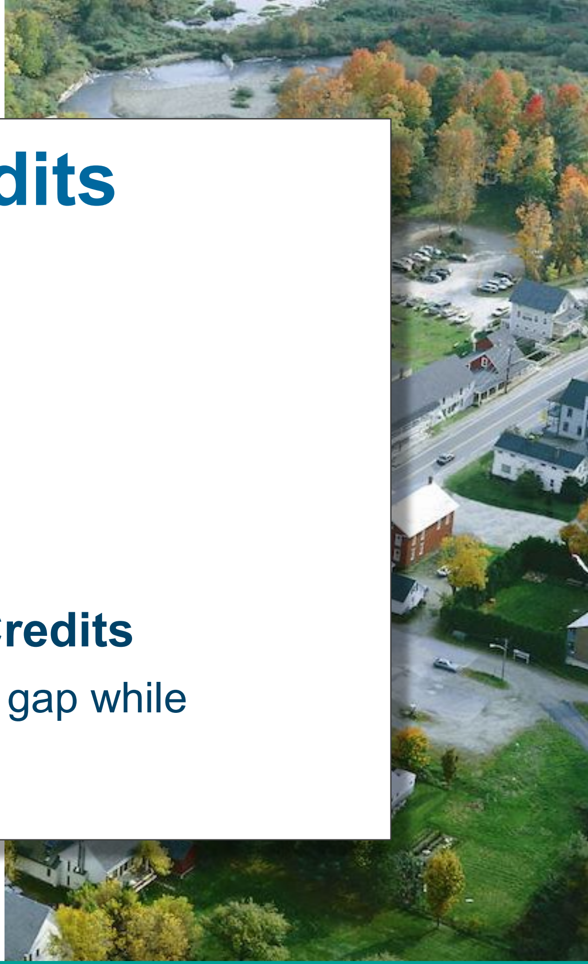
- Is the project located in a **low-income community**?
- What **types of** tenant **businesses** will be at the Project?
- Will the project have a **residential** component?
- What are the anticipated **community impacts**?
- What are the current or anticipated **sources of financing**?



Project Evaluation / Selection

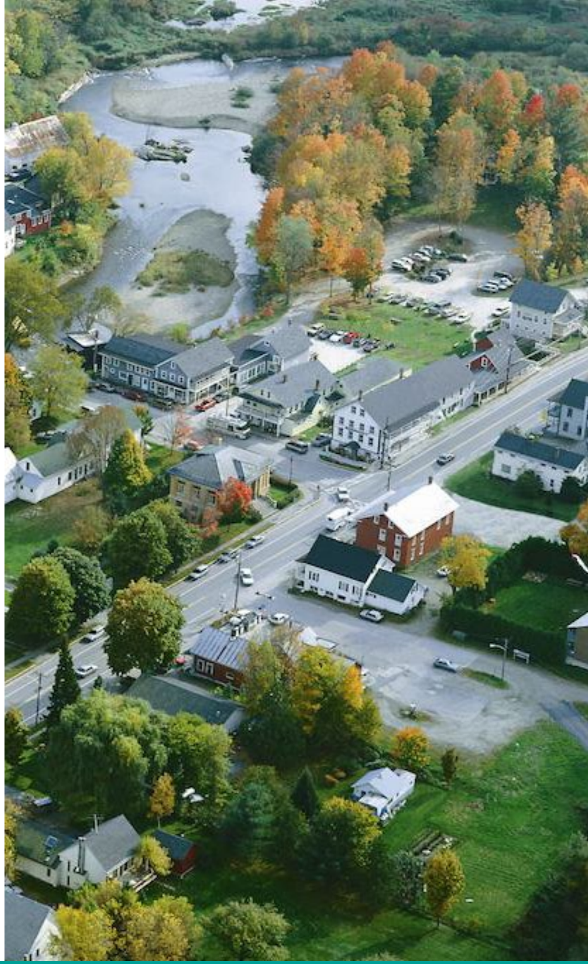
“But for” New Markets Tax Credits

- **What are the other capital sources?**
  - Bank debt
  - Capital Campaign (non-profit sponsors)
  - Grants
  - Historic Tax Credit Equity
- **Evidence for the need of New Markets Tax Credits**
  - Existing funding sources can not fill the financing gap while achieving the community impacts



Project Evaluation / Selection

- Is the project located in a **low-income community**?
- What **types of** tenant **businesses** will be at the Project?
- Will the project have a **residential** component?
- What are the anticipated **community impacts**?
- What are the current or anticipated **sources of financing**?
- How close to being shovel-**ready** is the Project?

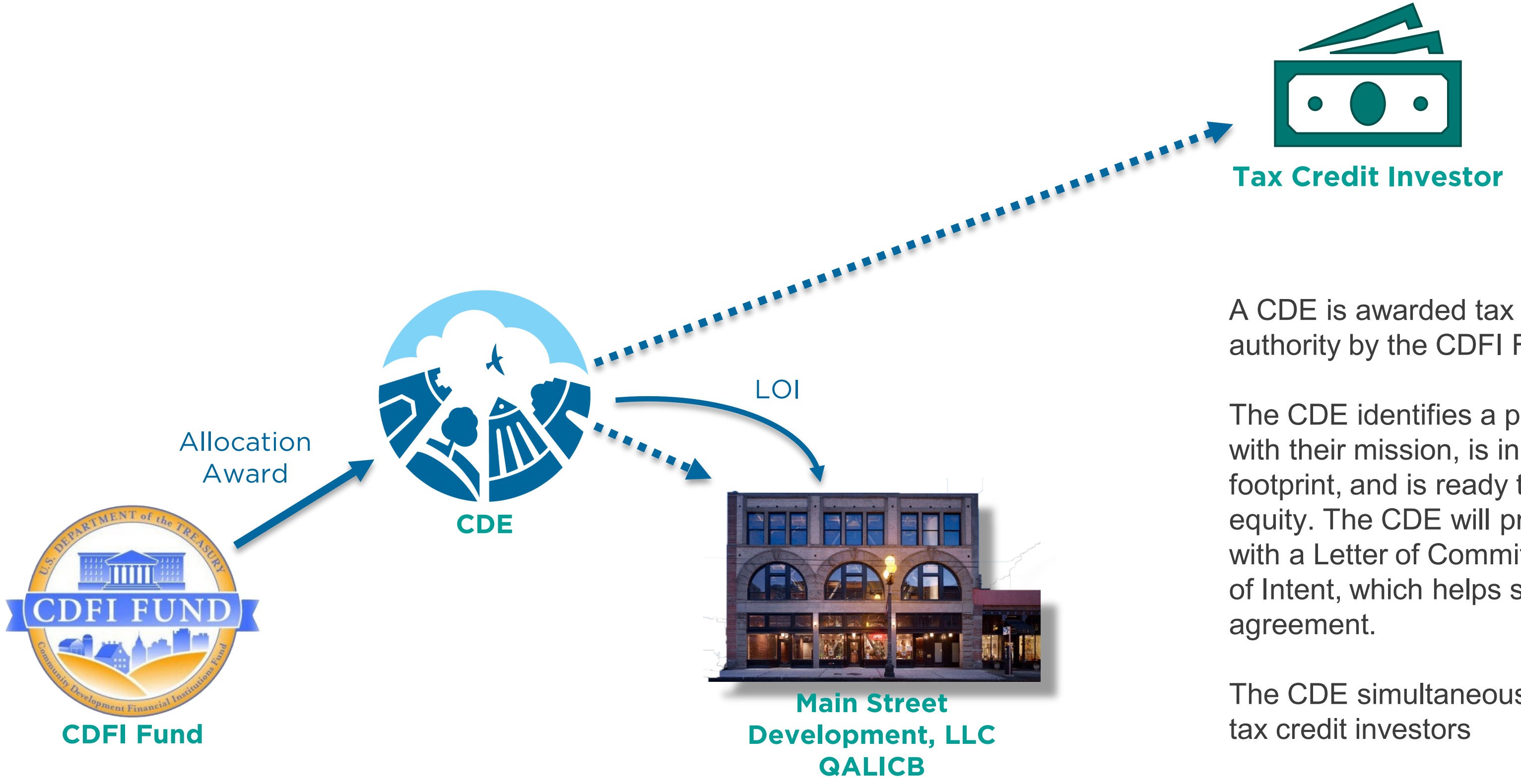


Project Evaluation / Selection

Readiness

- **Site control status**
- **Status of entitlements and permits**
- **Environmental status**
- **NPS process status**
  - Part 1
  - Part 2

New Markets Award Process

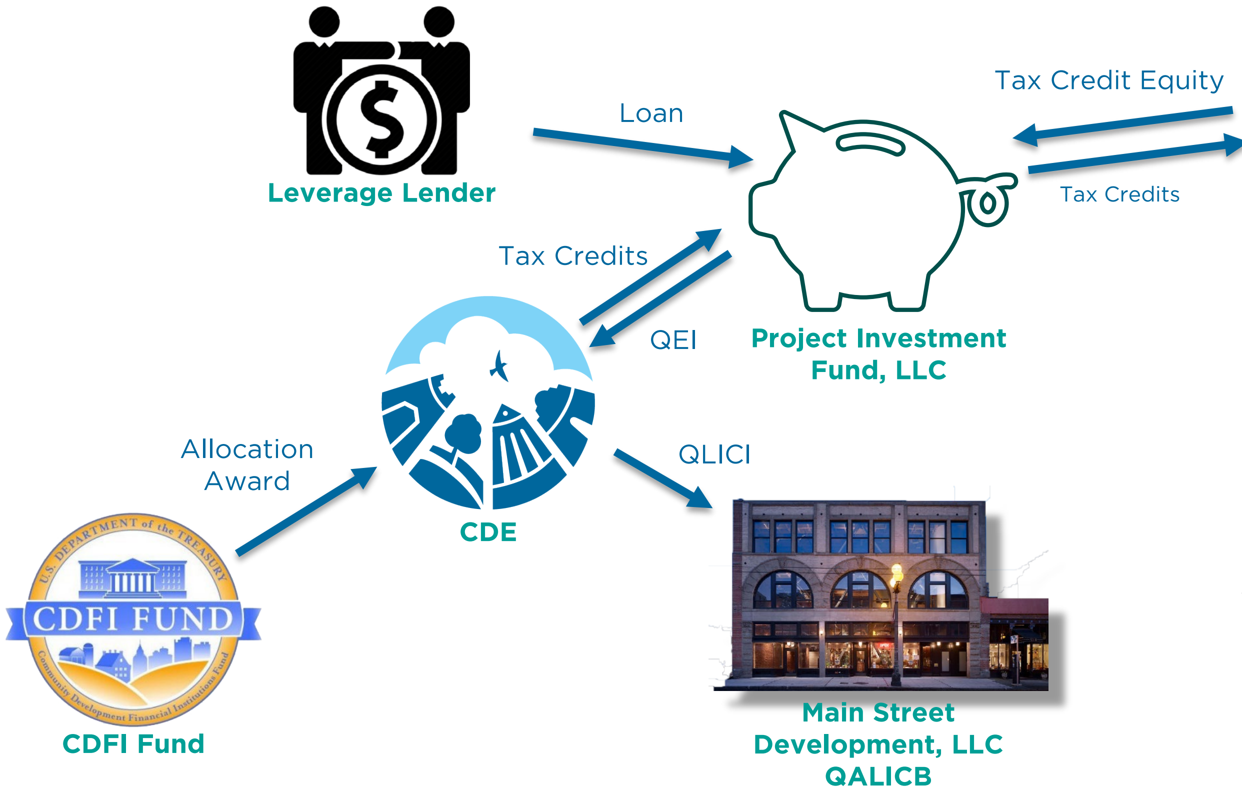


A CDE is awarded tax credit allocation authority by the CDFI Fund.

The CDE identifies a project that aligns with their mission, is in their geographic footprint, and is ready to receive tax credit equity. The CDE will provide the project with a Letter of Commitment, or a Letter of Intent, which helps solidify the agreement.

The CDE simultaneously works to identify tax credit investors

New Markets Award Process



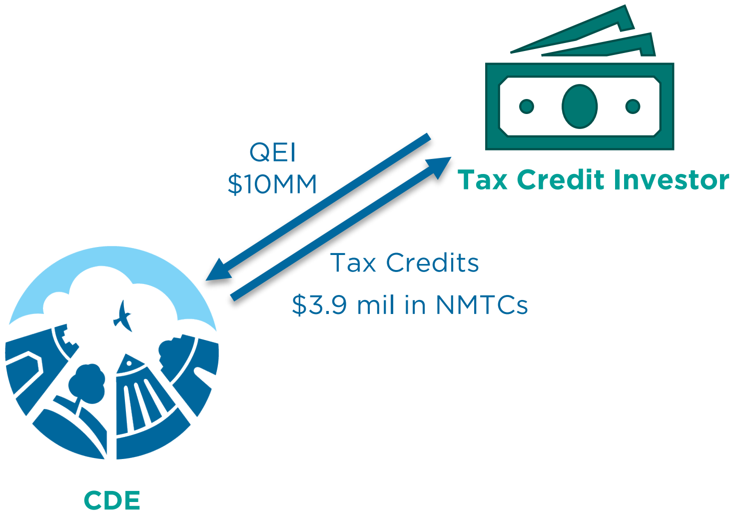
Now that the financing parties are identified, the closing process can begin. This complex financial transaction involves multiple things happening simultaneously within the same deal in order for all parties involved to receive the credits or equity they are seeking. Once these groups have agreed on every legal decision required for this process, of which there are many, the financing will close and the transaction will commence.

With this, the CDE can transfer the tax credits to a jointly owned investment fund. Meanwhile, the Investor will transfer the agreed upon QEI. The lender will also be compiling the other sources of funding for the project and passing it into the investment fund. Now, the investment fund has within it the full amount of the QLICI loan. This is passed back through the CDE to the project.

Calculating the Value of NMTC

- **Qualified Equity Investment (QEI)** – Is determined by how much tax credit allocation the **CDE** will put toward the Project or Qualified Active Low-Income Community Business
- The New Markets Tax Credit is taken over the **7-year** compliance period
- Investor receives **5%** of the **QEI** in tax credits during Years **1-3**
- Receives **6%** of the **QEI** in credits during Years **4-7**
- This results in a tax credit that is approximately **39%** of the **QEI**

Calculating the Value of NMTC

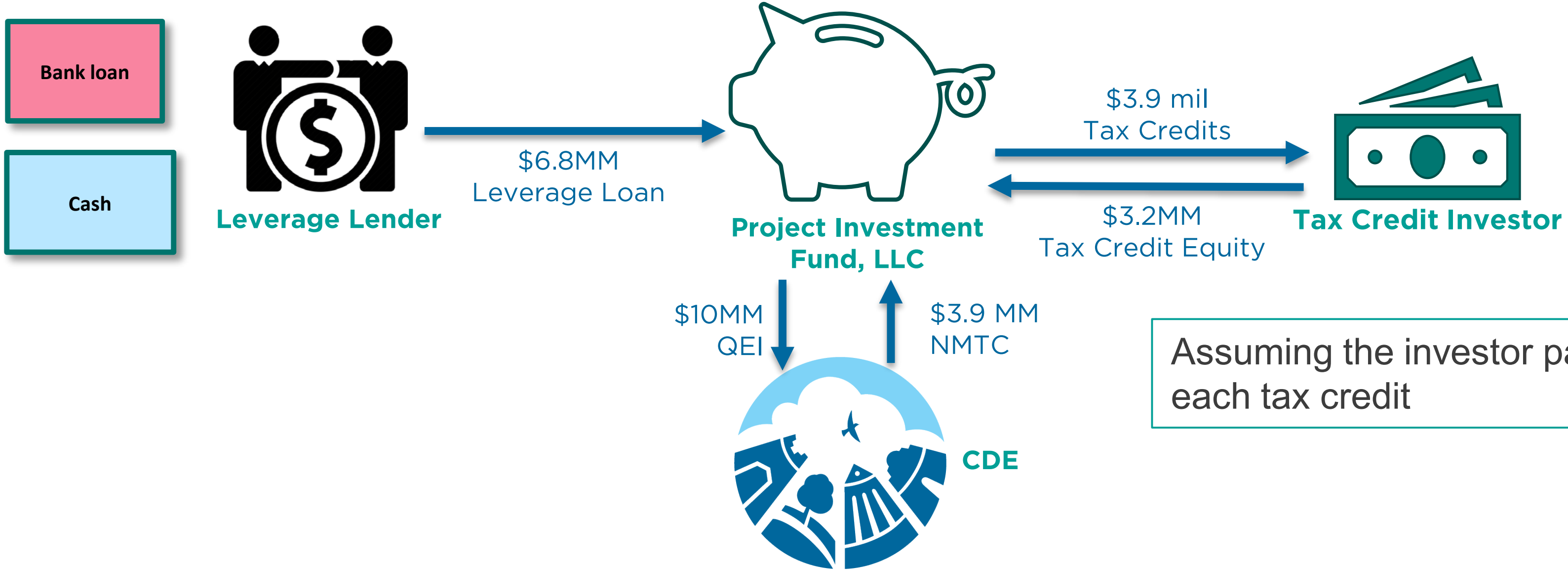


Year 1	5% of QEI	$500k
Year 2	5% of QEI	$500k
Year 3	5% of QEI	$500k
Year 4	6% of QEI	$600k
Year 5	6% of QEI	$600k
Year 6	6% of QEI	$600k
Year 7	6% of QEI	$600k
Total		**$3.9 mil**

Calculating the Value of NMTC

- **QEI x 39% = New Markets Tax Credits available**
- **Tax Investors will pay for the amount of tax credits received**
- **Similar to HTCs this is typically less than $1/credit to realize benefit**
  - Low to mid $.80s
- **Credits x investor pricing = NMTC Equity**
- **What about the $10 million QEI?**

NMTC Leverage Structure



Assuming the investor pays $0.82 for each tax credit

Requirements of QEIs

- Original issue solely in exchange for cash
- In exchange for stock or capital interest
- Investment must be designated as a **QEI** and reported to the **CDFI** Fund and **IRS** within **60** days of investment
- **CDE** must use “substantially all” of the QEI to make a Qualified Low-Income Community Investment (**QLICI**) in a Qualified Active Low-Income Community Business (**QALICB**)
  - “Substantially all” means **85%**
  - Most CDEs pledge to invest around **95%** or higher to be competitive in the application

Calculating the Value of NMTC

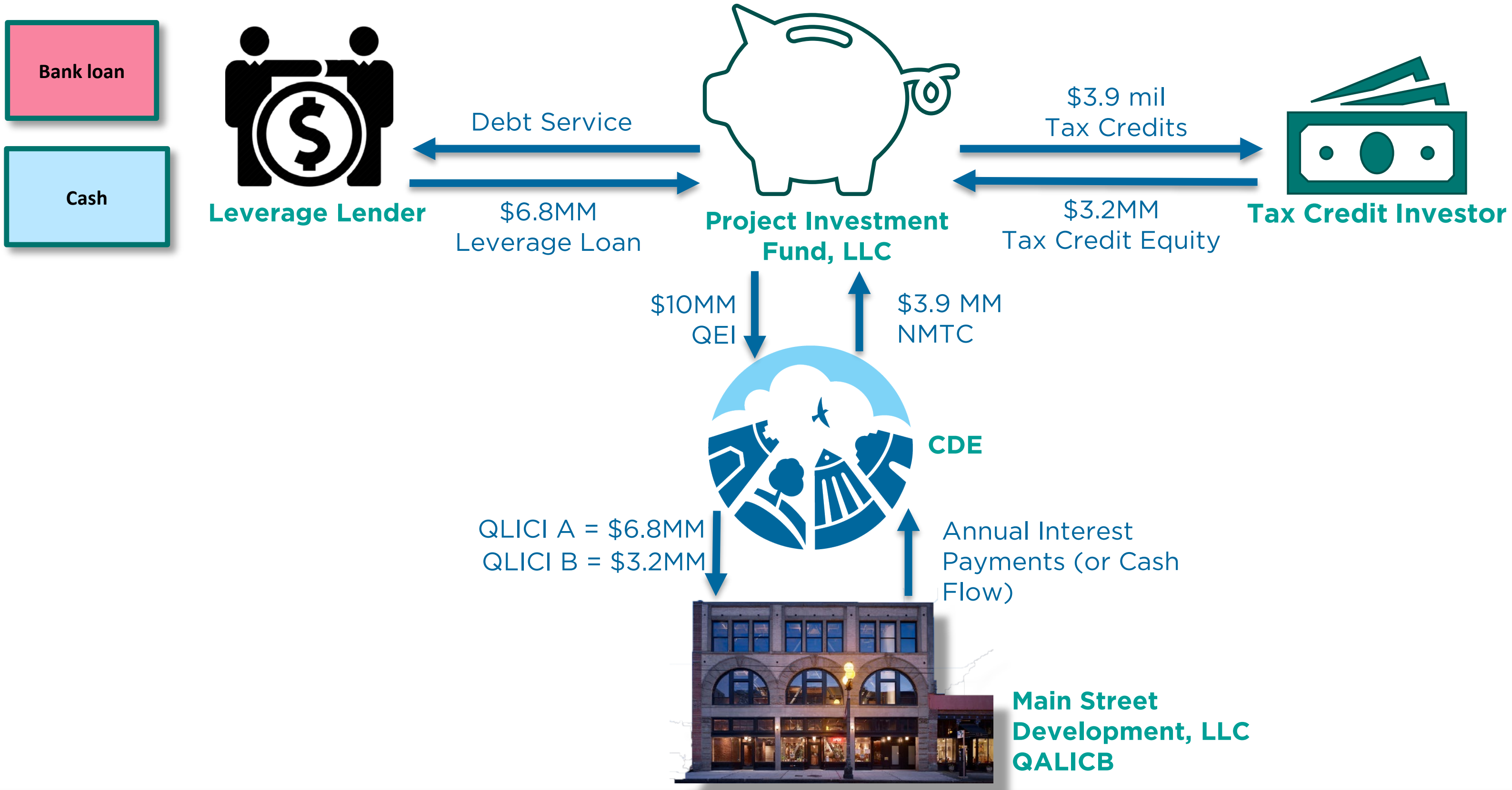
- What about the value to the Project or **QALICB?**

- Typically **CDEs** make two debt **QLICIs** to the **QALICB**
  - QLICI A reflects the Leverage Loan
  - QLICI B reflects the tax credit equity

- Both **QLICIs** typically have below market interest rates and flexible financing features

- The interest rates for both **QLICIs** are calculated based on the debt service payments needed for the Leverage Loan

NMTC Leverage Structure



Qualified Active Low-Income Community Business (QALICB)

A **QALICB** must meet these requirements:

- Generate revenue within 3-years
- At least 50% of the total **gross income** is from the active conduct of a qualified business in **Low-Income Communities (LICs)**; and
- At least 40% of the **use of tangible property** of the business is within LICs; and
- At least 40% of the **services performed** by the business' employees are performed in LICs; and
- Less than 5% of the average of the aggregate unadjusted basis of the property is attributable to **collectibles** (e.g. art and antiques), other than those held for sale in the ordinary course of business; and
- Less than 5% of the average of the aggregate unadjusted basis of the property is attributed to **non-qualified financial property** (e.g. debt instruments with a term in excess of 18 months)

Value of the NMTC to the QALICB

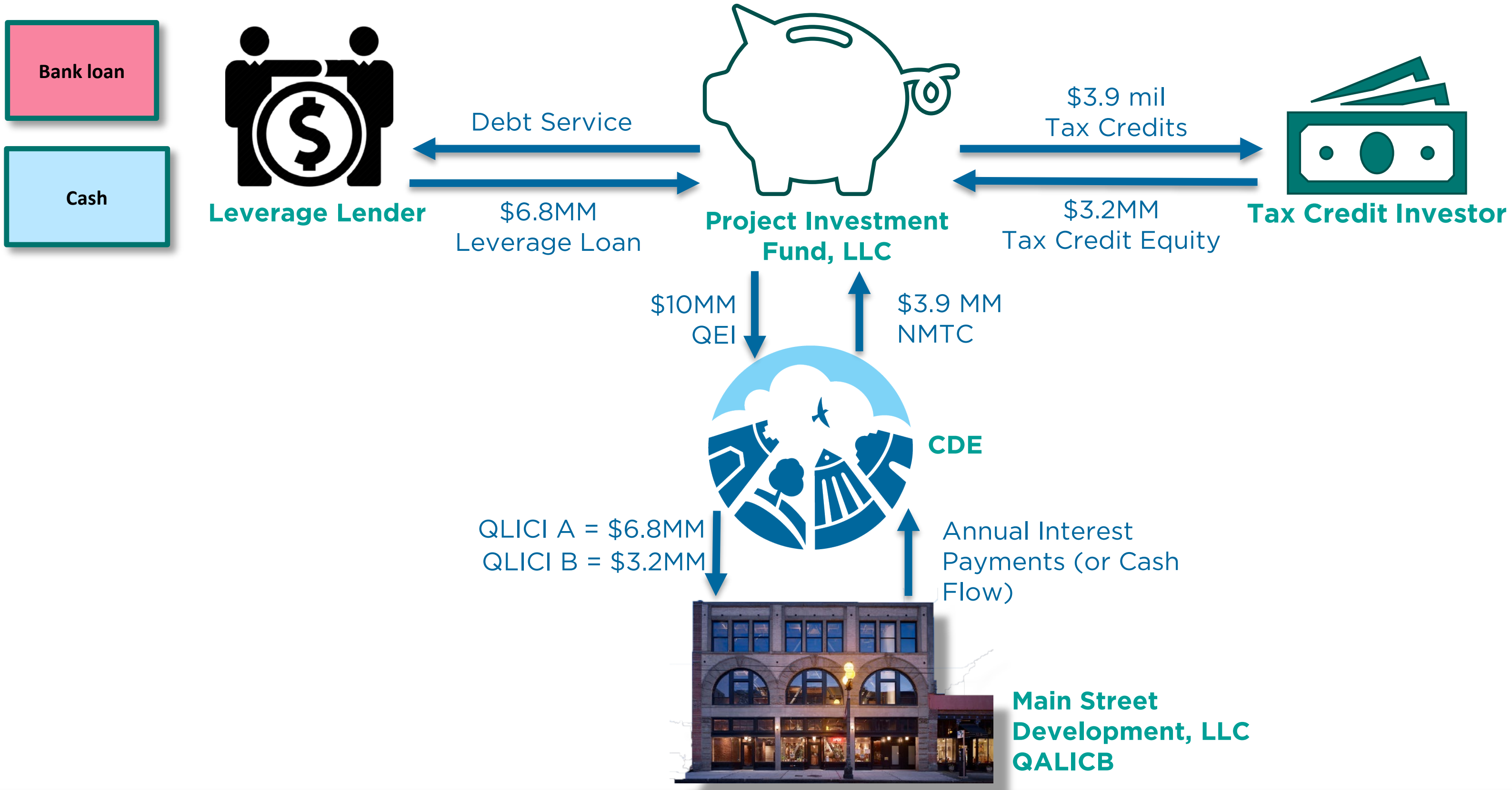
NMTC Investments Require:

- 7-year compliance period
- Much stricter compliance requirements
- Risk of recapture for the full tax-credit amount
- Annual Community Impact reporting requirements

What the QALICB receives for the NMTC Investment:

- Below market interest rates for 7-years
- Flexible financing terms
- At the exit of the NMTC transaction the QLICI B loan can be converted into QALICB equity for a nominal amount.

NMTC Leverage Structure



Community Investing 101

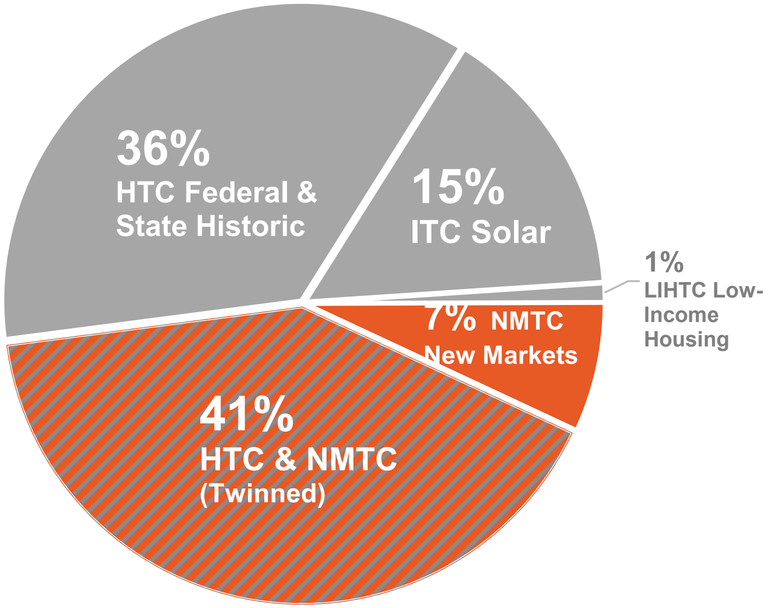
How organizations like NTCIC can assist historic preservation and community development in your Main Street communities

NTCIC's Tax Credit Role

- **As a Tax Credit Syndicator**
  - Provide guidance to developers and individuals seeking tax credits for historic rehabilitation
  - Evaluates specifics of development projects and identifies additional sources of capital available
  - Connects individuals to investors actively seeking historic projects to support and finance
  - Supports projects through their ongoing compliance periods from financial closing to exit

NTCIC's Historic Tax Credit Experience

- NTCIC has syndicated HTCs since 2000
  - **62** HTC-only projects; **$319MM** in tax credit equity
  - **69** multi-credit projects; **$657MM** in tax credit equity
- National footprint with investments in 35 states
- Range of investment sizes
  - Investment amounts from **<$1MM - >$20MM**
  - Average equity: **$8MM**
- Asset class variety:
  - Market-rate and affordable multi-family, mixed use, community facility, hospitality, office and industrial

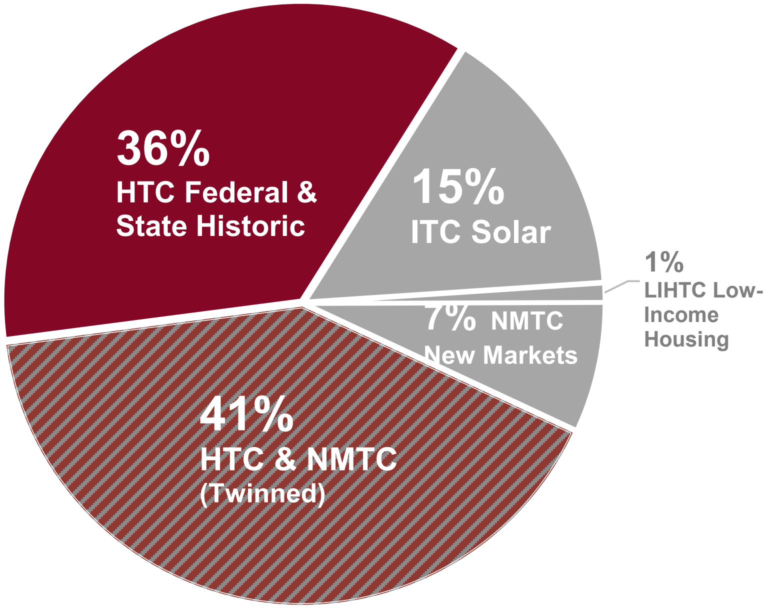


NTCIC's Tax Credit Role

- **As a Community Development Entity**
  - Is actively seeking projects looking for New Markets Tax Credits
  - Guides projects through the allocation process
  - Offers products that directly support smaller-scale real estate development projects located in Main Street Communities
    - The Irvin Henderson Main Street Revitalization Fund is actively seeking projects to support

NTCIC's New Markets Tax Credit Experience

- Allocatee since Round 1 of the NMTC Program
  - Winner in **11** rounds
  - Pioneer for "twinning" of HTCs with NMTCs
- **$583MM** in Allocation
  - **13** NMTC-only projects
  - **69** NMTC investments combined with state or federal HTCs
- National footprint with current investments in **27** states
- Asset class variety:
  - Market-rate and affordable multi-family, mixed use, community facility, hospitality, office and industrial



Questions?

For any questions we are not able to answer during the presentation, be sure to reach out to us and we will be happy to help!

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NEW WEBINAR SERIES

INVESTING IN YOUR MAIN STREET

How to Use Tax Credits in Your Main Street

APRIL 11, 2019 AT 1PM EDT

Main Street Now Conference 2019

Merrill Hoopengardner
President, NTCIC

MAIN STREET Now CONFERENCE
— SEATTLE, WA —
MARCH 25-27, 2019

Tax Credit Financing: Show Me the Money!
Tuesday March 26
1:45pm – 3:00pm

The Land of OZ: Pulling Back the Curtain on Opportunity Zones
Tuesday March 26
1:45pm – 3:00pm

The NTCIC
Community Impact Survey

www.surveymonkey.com/r/mainstreetsurvey

MAIN STREET
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