Rural Development

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TO: State Directors
Rural Development

ATTN: Community Programs Directors

FROM: Richard A. Davis /s/ ***Richard A. Davis***
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SUBJECT: Leveraging the New Markets Tax Credit Program with the Community Facilities Loan Programs

There has been an interest in utilizing Community Facilities direct and guaranteed loan financing in projects that also include leveraging the New Markets Tax Credit (NMTC) Program. This memorandum will provide guidance to determine whether a proposed NMTC structure when combined with Community Facilities (CF) Guaranteed or Direct Loan Programs financing meets the requirements of an eligible applicant, use of funds, test of credit elsewhere and other requirements of the regulations. It is important to note when leveraging NMTC with CF financing, program regulations are not amended.

A BRIEF OVERVIEW OF THE NMTC PROGRAM:

Congress authorized the NMTC program under the Community Renewal Tax Relief Act of 2000, to bring capital to communities that have traditionally had inadequate access to capital. The NMTC program encourages investors to make investments in low-income communities and will provide a tax credit to them for making the investments in a designated Certified Development Entity (CDE). The tax credit is equal to 39% of the investment and is spread over a 7-year period. The transaction, under the NMTC program, is complete at the conclusion of the 7-year period.

The Department of Treasury administers the NMTC program through the Community Development Financial Institution (CDFI) Fund and will upon successful application by a legally established organization, designate it as a "Certified Development Entity". Sometimes the CDE will establish sub-CDEs to carry the investment. The organization's primary mission must be to serve low-income communities or low-income people.

EXPIRATION DATE:
May 31, 2018

FILING INSTRUCTIONS:
Community/Business Programs

More specifically, funding is awarded annually by the CDFI fund to a CDE through a competitive process. The CDE has five years to raise Quality Equity Investments (QEIs) from investors. Once the CDE has the QEIs available, the CDE has twelve months to place the QEIs into Qualified Low Income Community Investments (QLICIs). This is accomplished by providing loans to or investments in qualified active low-income community businesses (QALICB); providing loans to, or investments in, other CDEs; the purchase of qualifying loans originated by other CDEs or other loans that qualify as a QLICI; and providing counseling to low-income community businesses.

These investments are expected to result in the creation of jobs and material improvement in the lives of residents of low-income communities. Examples of expected projects related to improving essential community facilities include daycare centers, schools, medical clinics, and food banks to name a few.

Additional information about the NMTC program and CDEs can be found at the U.S. Department of Treasury's Community Development Financial Institutions Fund website (www.cdfifund.gov) or the Internal Revenue Service website (www.irs.gov/businesses/new-markets-tax-credit-1).

BENEFITS OF LEVERAGING CF FUNDING WITH THE NMTC PROGRAM:

Leveraging CF funds through public private partnerships, such as the NMTC program, provides the opportunity to strengthen investments in rural community infrastructure spurring economic growth, job creation and access to improved health care, education and other critical services. NMTC transactions, paired with a CF direct loan or loan guarantee, can reduce the long-term debt obligation of a QALICB developing a community facility project. Reducing long-term debt increases cash flow and equity resulting in a financially stronger QALICB. The QALICB may qualify as the Agency's applicant or in some NMTC structures the QALICB benefits as a lessee from a lease provided by an applicant of the Agency. This structure is presented only as an example and is not meant to limit other models. It is emphasized that CF financing proposals that include NMTC leveraging should clearly define the benefits to the applicant, QALICB, community, Agency, and affiliate organization when applicable.

CF projects that leverage the NMTC program with CF funding, allow the Agency to spread its funding footprint farther and to reach more critical infrastructure projects that benefit Rural America. CF applicants that submit a project proposal that includes a NMTC structure are subject to all applicable program regulations, and the same underwriting and due diligence requirements as projects without NMTC.

UTILIZING THE NMTC PROGRAM WITH THE CF GUARANTEED LOAN PROGRAM:

A CF guaranteed loan proposal utilizing the NMTC program will follow the regulations outlined in 7 CFR Part 3575. CDEs applying for an Agency guarantee must meet the requirements of an eligible lender pursuant to §3575.27. Eligible lenders must be subject to credit examination and supervision by an appropriate agency of the United States or a state that supervises and regulates credit institutions. An eligible lender must also have the capability to adequately service loans for which a guarantee is requested. The appropriate agencies are the Federal Deposit Insurance Corporation, the Office of Comptroller of the Treasury, the Office of Thrift Supervision, the Federal Reserve Bank, the Farm Credit Administration, the National Credit Union Administration, or a state banking commission. Eligible traditional lender types can be found at §3575.27 (a) (1) – (5).

When a CDE does not meet the requirements of a traditional lender as noted above, then the requirements of §3575.27 (a) (6) must be met:

> "Other lenders that possess the legal powers necessary and incidental to making and servicing guaranteed loans involving community development-type projects. These lenders must also be subject to credit examination and supervision by either an appropriate agency of the United States or a State that supervises and regulates credit institutions and provide documentation acceptable to the Agency that they have the ability to service the loan. Lenders under this category must be approved by the National Office prior to the issuance of the loan guarantee."

It must also be understood that if the parent entity of a CDE has regulatory oversight, it usually does not extend to its subsidiary CDE. Evidence must be provided that a CDE/sub-CDE, being considered as a CF guaranteed lender, has the requisite regulatory oversight. Under the CF guaranteed loan program, which may be different from other Rural Development loan programs, non-traditional lenders without the required regulatory oversight are ineligible.

Holder Participation Model

The CDE can become the holder/participating lender of the guarantee through: (1) a sale of the Loan Note Guarantee; (2) purchasing a participation in the loan; or (3) the purchase of the Loan Note Guarantee and participation in the non-guaranteed portion of the loan. All program rules relating to participation or sale to a holder must be followed and the CDE must be in compliance with 7 CFR Part 3575.

In this manner the relationship between the CDE/sub-CDE and the Agency is completely outside of the NMTC structure. Participation with the CDE/sub-CDE is conducted in the normal course of business by the commercial lender.

UTILIZING THE NMTC PROGRAM WITH THE CF DIRECT LOAN PROGRAM:

The CF Direct Loan Program involves a direct disbursement of loan funds from the Agency to the borrower. The use of proceeds is limited to construction, renovation, improvement of a community-type project or the purchase of equipment. The CF direct loan regulation at 7 CFR Part 1942, Subpart A, does not authorize disbursement of loan funds to flow through an investment pool, to flow from the borrower through the CDE and back to the borrower, or other such configuration. A CF direct loan may be leveraged with the NMTC program, if a CDE provides construction financing, and the CF direct loan is used to take out the construction financing. Again, the CF direct loan funds would not flow through the NMTC structure in any way and our funding would be completely outside that model.

It is the policy of the National Office that we should not enter into any type of a forbearance agreement for the seven year tax credit period. Entering into this type of forbearance agreement would deny our rights and remedies under the loan documents, should the loan go into default.

NATIONAL OFFICE CONCURRENCE REQUIRED ON FINANCING NMTC PROJECTS:

National Office concurrence of the NMTC structure is required on all CF direct and guaranteed projects leveraging the NMTC program.

STATE OFFICE RESPONSIBILITIES:

A NMTC loan leveraged with another loan program is a transaction that includes several participants such as: investors, an investment pool, parent organizations, a CDE, a sub-CDE, a QALICB; and, for our purposes, a government guarantee or direct loan program. To fully understand the transaction and each party's role, you should always request a diagram of the financing structure when considering CF participation in the NMTC program. The diagram should clearly indicate who our applicant is and in the case of a guarantee, who is the lender making application for the guarantee. The following information should be submitted to the National Office for concurrence:

- The NMTC diagram
- A project summary to include at a minimum a project description, source and uses of funds, proposed security and any special circumstances
- A summary of benefits provided to the applicant, QALICB, community, Agency, and affiliate organizations when applicable
- Verification the CDE/sub-CDE is active and has received certification.

The National Office will review the NMTC financing structure and issue a written concurrence or non-concurrence to the State Office.

For direct loans, the approved NMTC financing structure diagram and National Office written concurrence should be provided to your Office of General Counsel (OGC) at the time you request an applicant eligibility review or at the latest, when requesting loan closing instructions. Your OGC is not responsible for issuing an opinion on the NMTC structure.

Since NMTC are routinely utilized as a funding mechanism for low income community businesses, you must insure that an applicant utilizing the NMTC program, is an eligible applicant financing an eligible community facility project pursuant to program regulations. It may be mutually beneficial to all parties, if an applicant and project eligibility determination is completed first, then obtain concurrence in the NMTC financing structure prior to the complete application stage.

We encourage you to gain a general knowledge of the NMTC program before reviewing a CF project application that includes a NMTC structure. A good summary is provided in the IRS document New Markets Tax Credit, Chapter 1: Introduction to the New Markets Tax Credit found at www.irs.gov/businesses/new-markets-tax-credit-1.

If you have any questions, please contact Karla Peiffer, Asset Risk Management Specialist, Community Facilities Programs, at karla.peiffer@wdc.usda.gov.