New Markets Tax Credits: The Nuts and Bolts

Understanding If/How to Use the NMTC Program to Benefit Your FQHC Capital Project

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Capital Link Overview

- Launched in 1995, nonprofit, HRSA national cooperative partner
- Offices in CA, CO, AL and MA
- Leveraged $1.4 billion in financing for over 246 capital projects (about 10% of current health center facility space)
    - **Direct assistance** to health centers and complementary nonprofit organizations in planning for and financing operational growth and capital needs
    - **Industry vision and leadership** in the development of strategies for organizational, facilities, operational, and financial improvements
    - **Metrics and analytical services** for measuring health center impact, evaluating financial and operating trends and promoting performance improvement

Today’s Topics

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- **New Markets Tax Credits (NMTC):**
  - What are they? Why would you want them?
  - How do you get them?
  - Who does what? - Understanding the closing process
  - Understanding the ‘Unwind’

- **NMTC Preparation Program (NPP)**
  - Details and subsidy application

NMTC and Community Health Centers

Health center capital projects are a highly desirable asset type ("Community Facility") for NMTC investors

- **Geography:** CHCs are usually located in qualified low-income census tracts which are considered to be "severely distressed" due to higher poverty and/or lower median family incomes – rural (non-metro) census tracts are also desirable
- **Mission:** CHCs provide multiple positive community benefits – positive health outcomes, economic impacts, other related services
- **Compliance:** CHCs seen as low-risk for violating NMTC regulations, e.g. non-qualified businesses or uses
- **Financial Stability:** health centers are seen as stable and growing industry that can support long-term debt

What are New Markets Tax Credits?

- Federal economic development program administered by the US Treasury and authorized since 2000 (however, not permanently appropriated). Designed to drive private investment into low income areas.
- Utilized in over $4 billion of FQHC capital projects (you will not be the first!)
- **Once annually** the US Treasury awards a limited amount of tax credit authority to winning applicants, who are all approved "Community Development Entities" (CDEs) (you do not need to become a CDE – you just need to find one that really likes your project, and CL can help with that)
- Health center capital projects are ideal NMTC investments because they are usually located in "Highly Distressed" low-income census tracts (to be discussed) and provide multiple positive community benefits
- Best for projects of >$6M in total cost (including closing costs) due to fee/cost structure and amount of Management tie required.

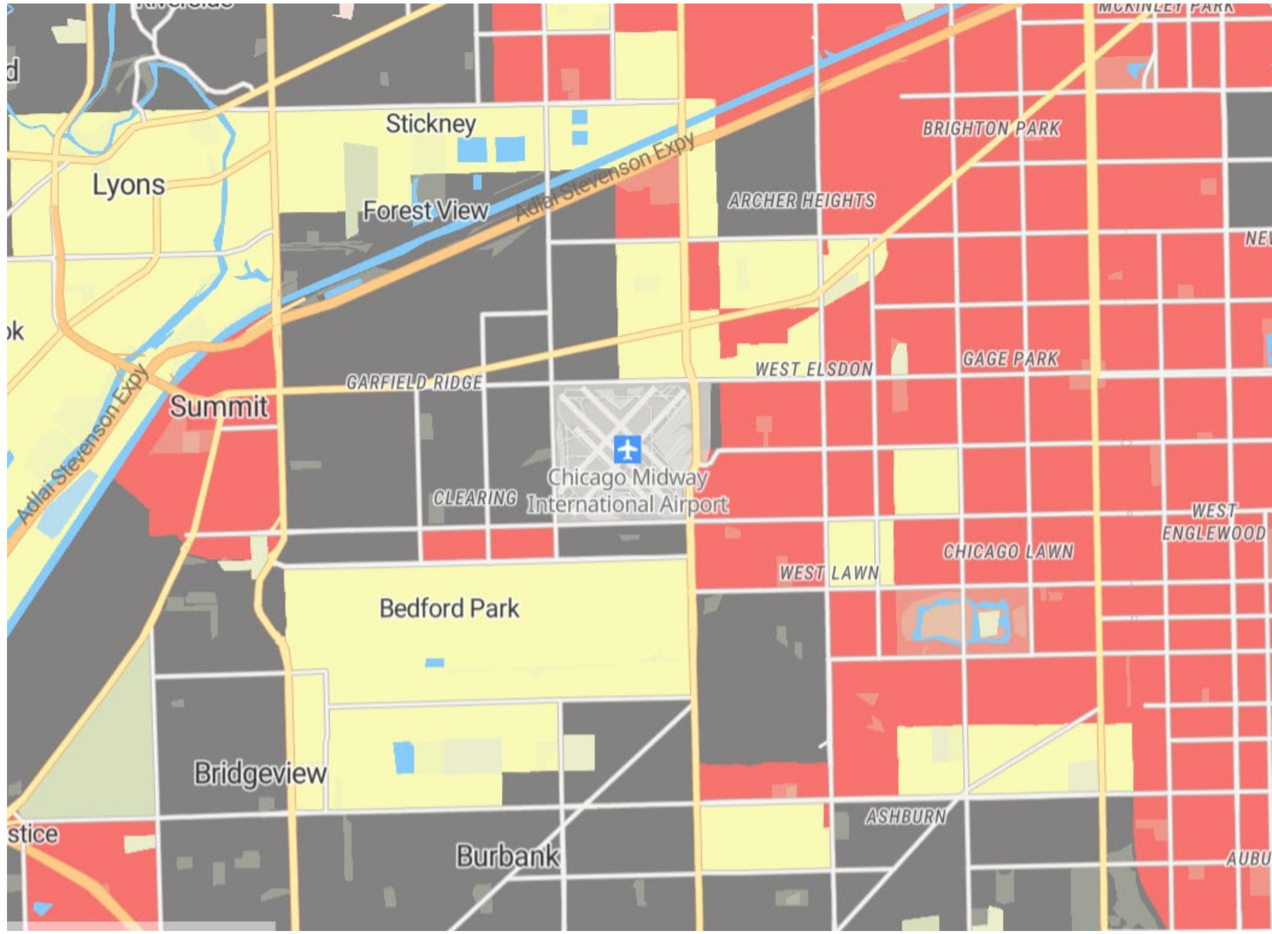
Why Use NMTC ?

- Tax credits provide **<u>net</u>** "equity" = <u>~18%-20% of total project cost</u> (Back of the envelope: Total Qualifying Project Costs x 39% at ~$.75 *<u>less</u>* associated closing costs/fees/reserves)
- An "Investment" is converted into a loan that isn't repaid (Got that?? I know, it doesn't make much intuitive sense, but the investor receives federal tax credits over seven years with every intention to "put" the investment back to the FQHC at the end of the tax credit period)
- Loans '**inside the structure**' are interest-only for 7 years, which conserves operating cash
- Structure allows leveraging of other financing sources: grants, loans, cash and <u>project expenses that you have already paid</u> up to 24 months prior to closing

How Do I Get Them: #1 – Your Location Qualifies ….or not

Insufficient Data
Severe Distress or Non-Metropolitan
Eligible
Not Eligible

Shaded by: Census Tract, 2010



https://www.novoco.com/resource-centers/new-markets-tax-credits/data-tools/nmtc-mapping-tool

Non-metropolitan

Not every area you think of as rural is 'non-metro' ☹; **And** While Non-metro designation helps get you from Eligible to Severely Distressed, it does **not** get you from Ineligible to Eligible

Targeted Populations

There are some exceptions to geographic eligibility – NMTCs can be allocated to benefit a targeted population but due to their complexity for qualifying it's better to discuss this possibility on a case by case basis.

- Generally requires annually 'income-qualifying' a fairly high percentage of your patients (60-70%) or your employees (40%-60%) – but because this is the 'hard road', you need a CDE willing to entertain the idea and apply their scarce allocation to your project. And you should know that some geographies are completely ineligible (>120% area MFI).

The 'Short-List' for a Long Process

FYI – All this needs to be done, but not necessarily sequentially….

- Determine eligibility (strange to say, but 'Severely Distressed is Best');
- Determine a realistic project schedule:
  - Goal is to determine when you can expect to be break ground (= that will be close to the date when you'll need all the money to complete the project):
    - **Board buy-in (Strategic Planning)**
    - **Site Control (clean environmental report, confirm appropriate zoning)**
    - **Program & space planning**
    - **Architecture plans**
    - **'Schedule of Values' - level of budgeting**
    - **Permits**
- Prepare and regularly update a 'Sources and Uses of Project Cash' table;
- Find a CDE (or CDE's) that is interested in your project:
    - **for their application pipeline (?), or**
    - **for allocation of credits in-hand**
- Find an Investor to buy the credits (generally, the easiest part of the process);
- Secure and sign Reservation Letters for NMTC allocation and investment;
- Find experienced Counsel and schedule closing calls (allow for 90 days)
- <u>Consultants can help with this</u> *(that's clearly self-serving, but also true ☺)*

How it Usually Works…(you wear three hats!)

The Health Center is the "**Sponsor**", the **"Leveraged Lender"** and the "**Lessee**"

- The **Sponsor** prepares the Sources and Uses of Project Cash table
- If bank debt is required, the **Sponsor** seeks commitments from lender(s) for two scenarios (**with, and without NMTCs**); The tricky part is that NMTCs are not committed far in advance and are not 'all or nothing'; meaning, for a large project you may need to find more than one CDE to participate and even then, collectively, they may not be willing/able to provide NMTCs up the maximum amount that you qualify for.
- For this reason, almost all transactions have **'inside the structure'** and **'outside the structure'** portions of the project financing;
- Even if your bank loves you, they may not immediately want to play along, because:
  - This is **NOT** a standard commercial real estate loan request;
  - You are borrowing $ from them for the project, but they are 'outside the structure'
  - They **DO NOT GET** a direct mortgage security interest on the project property until the end of the tax credit period; they get a security interest in collateral of some value (to be explained on a later slide), but it is not a Mortgage/Deed of Trust.
  - However, because they are outside the structure, they **CAN** get principal and interest payments during the tax credit period *(they like that part).*
- **Finally, unlike a standard commercial R/E loan you need to have all cash at closing!**

How it Usually Works…(you wear three hats!)

What/Who is the "**Leveraged Lender**"?

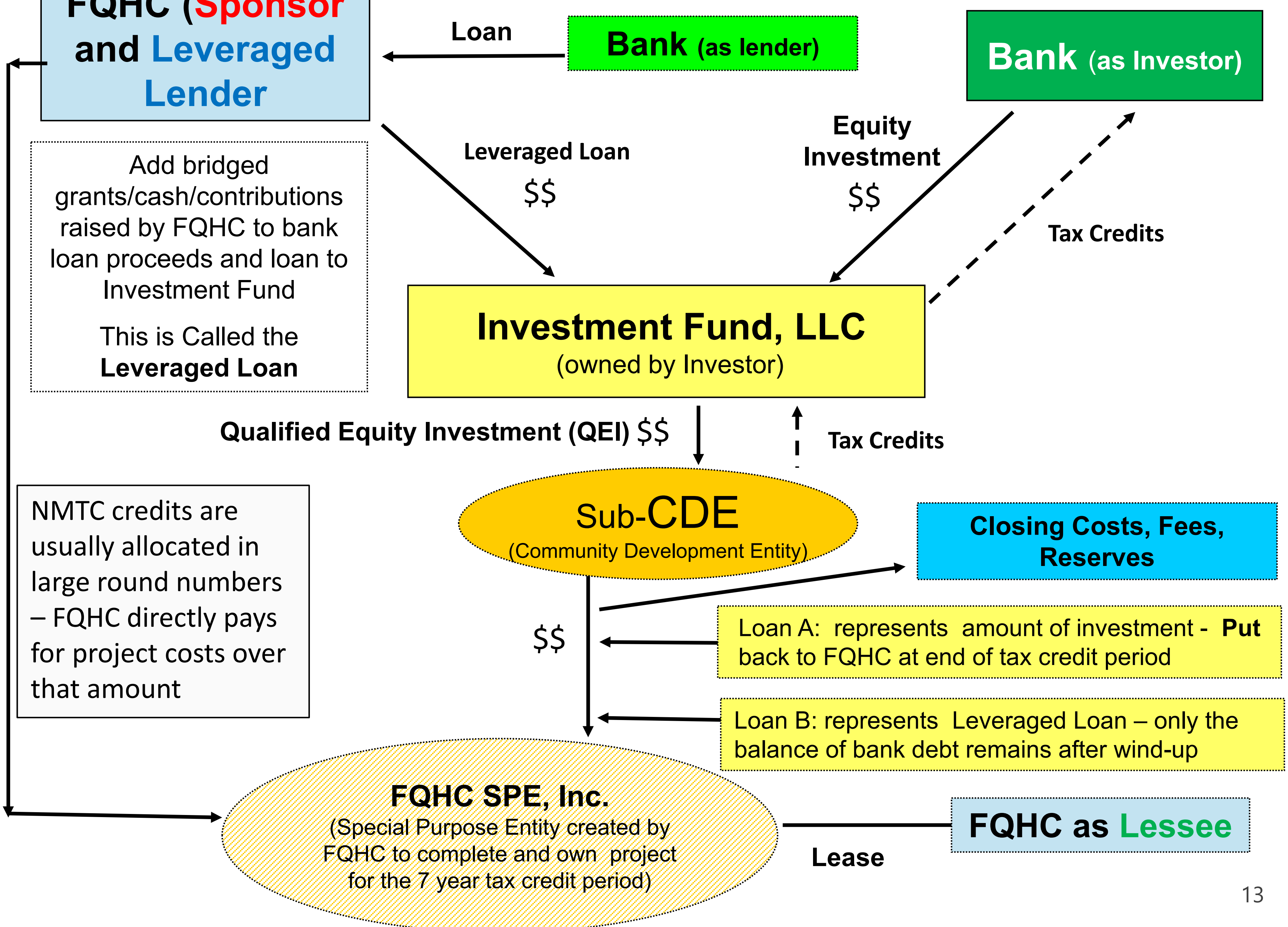
- Let's go back to the original idea – this is a tax credit program and you are a "Not-for-Profit" and don't pay taxes…so how/why does this program work for you?
- The 'structure' creates a for-profit entity (the "Investment Fund") that is owned by the Investor (usually a big bank with predictable taxable income for the next seven years). Like most companies, the Investment Fund is capitalized with Equity and Debt.
- The Equity comes from the Investor (remember the formula?: $ total allocation x 39% x tax credit price per $ of credits). That credit price is set by (sometimes negotiated with) the Investor.
- The Debt is all the other cash required (combined with the Equity) to equal the total NMTC allocation inside the structure. That Debt is provided by the **Leveraged Lender** (most often, that's you!).

Example: assume a $10M project, that generates gross tax credits of $2,925,000 (assuming a $.75 credit price). The Investment Fund then needs to borrow $7,075,000 from the **Leverage Lender.**

How it Usually Works…(you wear three hats!)

- For the Tax Credit period, the health center (aka: the **Sponsor** and **Leveraged Lender**) does **NOT OWN** the project property or the building on top of it! You lease it until the unwind, so you are also the **Lessee;**
- The NMTC law requires that the project be owned by a Qualified Active Low-Income Community Business (QALICB). Because that definition is fairly strict and the CDE and Investor do not want to risk tax credit recapture (that results from suddenly - and probably unintentionally - ceasing to qualify as a QALICB), they usually mandate the creation of a "Special Purpose Entity" (SPE) that is technically **NOT** you;
- So this SPE is formed by you, but has a board with a majority of members that are not currently affiliated with the Health Center (not current board members or staff);
- Typically there are five members – two from the health center and three nominally independent 'friends' of the health center (former board members, former staff, staff of other FQHCs, the PCA, being located out-of-state is OK).
- The QALICB can not conduct a 'sin business', nor accumulate un-related assets or a lot of cash – called nonqualified financial property. They simply build the facility, own it for seven years while they lease it to you. They get monthly (maybe quarterly) lease payments and make corresponding interest-only payments to the Sub-CDE….that's it.

Yes, It's Complicated



But When do I get the Equity/Grant?

All of this complication gets the <u>QALICB</u> the dollars required to finance the construction of the facility. But how does the Sponsor realize the net equity? How do these loans become the 'grant' you were promised?

- As part of the closing documents, one of the shortest (but arguably the most important) document is the **<u>Put/Call Agreement</u>**.
- As noted, the Investor owns the Investment Fund which in turn, makes the equity investment in (controls the majority of) the sub-CDE, which holds the mortgage on the property.
- At the end of the seven year tax credit period, the Investor has received all of the tax credit benefits it will get. The **Put/Call** Agreement provides for 2 options at that point:
  - For $1,000 (usually), the Investor can choose to **PUT** its interest in the Investment Fund to the **Leverage Lender,** (the health center) which then also transfers ownership of the sub-CDE to the health center so now it holds the mortgage and owes the balance on that loan to itself – so the whole structure can be rolled up, or
  - The Investor balks at **Put**ing its interest in the Investment Fund to the Leveraged Lender so the LL can **CALL** the ownership rights to it (<u>make</u> the Investor sell it to them) – the price is set by appraisal so it will be higher than $1,000). To my knowledge this has never happened, so it is unclear how much higher.

Example Transaction – Uses

Uses of Project Funds			
Real Estate Related Costs	**$**	**1,000,000**	Purchased with NMTC proceeds or within last 24 months
Total Building Hard Costs	**$**	**6,000,000**	Optimally you have a GMP
Total FFE Costs	**$**	**750,000**	
Soft Costs	**$**	**1,200,000**	Architect, engineers, permits, consultants
Capitalized Interest	**$**	**150,000**	During construction
Closing Costs & Reserves	**$**	**1,200,000**	seems high - lots of detail behind this number
Total Uses of Funds	**$**	**10,300,000**	

Example Transaction – Sources

Sources of Funds Inside Structure	Total	
New Markets Tax Credit Equity	$ 2,925,000	@ $.75/$ of allocation
Bank/CDFI Sponsor Loan	$ 1,500,000	net amount needed ASSUMING you get full allocation
Government Grant	$ 1,000,000	Usually reimbursable - needs bridge loan
Private Foundation Grant	$ 500,000	In-hand
Federal Earmark	$ 2,000,000	Reimbursable - needs bridge loan
Other Contributions & Grants	$ 75,000	can be part of health center cash
Capitalized Costs - (bridge equity	$ 250,000	'one-day loan' at closing
Capital Grants - HRSA C8E	$ 750,000	Reimbursable - needs bridge loan, NOFI complicates
Health Center Cash	$ 1,000,000	
Total Sources of Funds Inside Structure	$ 10,000,000	
Sources of Funds: - Outside Structure		
Health Center Cash Loan	$ 300,000	
Total Sources of Funds: - Outside Structure	$ 300,000	typically needs to be >=3%
Total Sources of Funds	$ 10,300,000	

The Line-up Card…

- Health Center representatives (CEO, CFO, staff accountant);
  - Health Center NMTC counsel (should be experienced, this is not a great place/time to have your local counsel learning the ropes);
- CDE(s) Representative(s) – federal (and possibly state?)
  - CDE Counsel (ask for fee estimate up-front and if they'll cap the fees)
- Investor Representative(s) – can include many staff for monitoring the details (pre-incurred costs, insurance, disbursements, etc.)
  - Investor Counsel (ask for fee estimate up-front and if they'll cap the fees)
- Sponsor lender representative
  - Sponsor lender counsel (try to <u>not</u> have them join every call if possible)
- NMTC accountant for financial projections
- Consultants, Owner's Representative

In the bullpen:

- Local counsel – usually for real estate issues
- Title agent (especially if construction has already started)
- Construction monitor
- Insurance evaluator

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U.S. Treasury recently announced awards of $5 Billion in New Markets Tax Credits!

"OK, but what does that mean for my health center?"

Chase New Markets Corporation	Chicago	IL	National	$55,000,000.00
Cinnaire New Markets, LLC	Lansing	MI	Multi-state	$55,000,000.00
Civic Builders, Inc.	New York	NY	National	$55,000,000.00
Civic Community Partners, Inc.	San Diego	CA	Local	$55,000,000.00
Clearinghouse Community Development Financial Institution	Lake Forest	CA	Multi-state	$60,000,000.00
Cleveland New Markets Investment Fund II, LLC	Cleveland	OH	Local	$35,000,000.00
Colorado Enterprise Fund, Inc.	Denver	CO	Statewide (or territory-wide)	$45,000,000.00
Colorado Growth and Revitalization Fund, LLC	Denver	CO	Statewide (or territory-wide)	$50,000,000.00
Community Health Center Capital Fund, Inc.	Boston	MA	National	$55,000,000.00

https://www.cdfifund.gov/sites/cdfi/files/2022-10/CY_2021_NMTC_Program_Award_Book%20_FINAL.pdf

NMTC Challenges

- Finding a Community Development Entity (CDE)
  - Timing of project vs. award announcements ("shovel ready")
- Complex structures
- Can take 60-120 days to close
- High transaction costs (but the NMTC-related costs don't come out of the CHC's pocket); many expert advisors needed
- Minimum recommended Total Project Budget $6 Million (However, some CDEs are looking at placing smaller allocations, though the net benefits may not be the same)
- Compliance: reporting requirements for 7-year period (it will take some back office time – but usually only for quarterly reporting and for annual audits)
- Takes great staff coordination and patience!

Community Health Center Capital Fund (CapFund)

is a

Certified Community Development Financial Institution (CDFI),

and a

Community Development Entity (CDE)

They can provide loans and New Markets Tax Credit (NMTC) allocation to eligible community health center capital projects nationally.

and

CapFund is partnering with Capital Link, to provide the **New Markets Tax Credit Preparation Program (NPP)**. The program's goal is to offset the cost of assisting health centers in preparing for and securing project financing using New Markets Tax Credits.

Program Process and Timing

- **Complete the NPP application.**

  https://www.chc-capitalfund.org/new-markets-tax-credits-prep-program

- Select applicants will be chosen (based primarily on feasibility/readiness) to receive grant funding from CapFund to support more in-depth assistance from Capital Link.

Regardless of whether awarded grant support, all applicants are eligible for:

- individual discussions with management about the NMTC program;
- assessment of project eligibility;
- development of a preliminary transaction structure and diagram;
- development of a project timeline to identify key milestones in alignment with expected NMTC allocation cycles.

NPP Project Deliverables

Common components of an overall NMTC financing process supported by grant funding may include:

- A transaction summary, detailing the proposed project and its expected community benefits to provide to CDE's;
- 7-year financial projections and associated Forecast Narrative/Business Plan
- NMTC structuring, including securing leverage debt (if needed);
- Guidance and assistance throughout the closing process.
- Upon successful completion of the program, participants will receive preferential consideration for any allocation held by Capital Fund. Capital Link will also utilize its well-established network of CDE contacts to seek additional allocation as necessary for each project.

NMTC Resources

- Written NMTC resources
- Case studies, including many FQHC NMTC financings
- Webinars, many on varying aspects of capital planning and financing
- Learning Collaboratives – Capital Link to again offer later this calendar year a free capital development learning collaborative.
- One-on-One Assistance - a Capital Link project consultant is available to schedule an initial call and project review.

Contact Us

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