

NMTC MONTHLY REPORT

A MONTHLY PUBLICATION ON THE NEW MARKETS TAX CREDIT INDUSTRY

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NMTC: Charting the Course

By Mary Tingerthal, Community Reinvestment Fund

When the New Markets Tax Credit (NMTC) program was initiated, we knew it wouldn't be easy to implement. Landmark initiatives such as this one rarely are. Still, we felt that the potential impact of this program in communities across the nation would far outweigh our efforts.

Like any innovative program, NMTC has had its share of implementation challenges, but the fact that lenders across the country are beginning to make loans is proof that it can be done. We feel very positive about our recent strides to put NMTC dollars into action. Investments have been obtained for most of CRF's first-round allocation of \$162.5 million. In fact, 97-percent either has been funded as qualified equity investments or is bound by investor subscriptions.

It's About Structure

For CRF, the first challenge was turning the NMTC, an entity with few instructions for implementation, into a workable and attractive vehicle for community lenders and investors. CRF structured its allocation in order to serve different types of lending partners by creating two sub-allocatees. Commercial Lending LLC was set up to provide funding for large loans, ranging from \$2 million to \$50 million. Bear Stearns is the sole investor for Commercial Lending and five projects (ranging from \$3.8 million to \$38 million) have been funded.

Business Loan Conduit LLC is the second sub-allocatee, and is structured to provide funding for smaller business loans (ranging from \$50,000 to \$2.5 million) that are originated by local community development lenders. In addition to the standard required program documents, CRF also provided its lending partners with marketing materials to help them identify potential borrowers. Most recently, CRF funded two loans. Working through its lending partner, New Jersey Community Capital, CRF purchased a loan made to a not-for-profit

charter school in New Brunswick, N.J., allowing the school to purchase and renovate a building. CRF also purchased a loan from Bay Area Employment Development Company and provided funding to the owner of a small business that manufactures tortillas in Hayward, Calif. The loan allowed the owners to purchase a warehouse closer to its main site, permitting the business to operate more efficiently.

Lessons Learned

With the successes of NMTC come additional challenges. One of the biggest obstacles has been investors' credit committees. CRF went into its first-round NMTC implementation oversubscribed with investors. We found that various program-related challenges resulted in some investors foregoing participation. Investors, who were on board with NMTC from the beginning, found it more difficult than originally anticipated to pass through transactions to their credit committees. However, as investment partners are becoming more comfortable with what their credit committees want, they are better able to evaluate an opportunity from its conception.

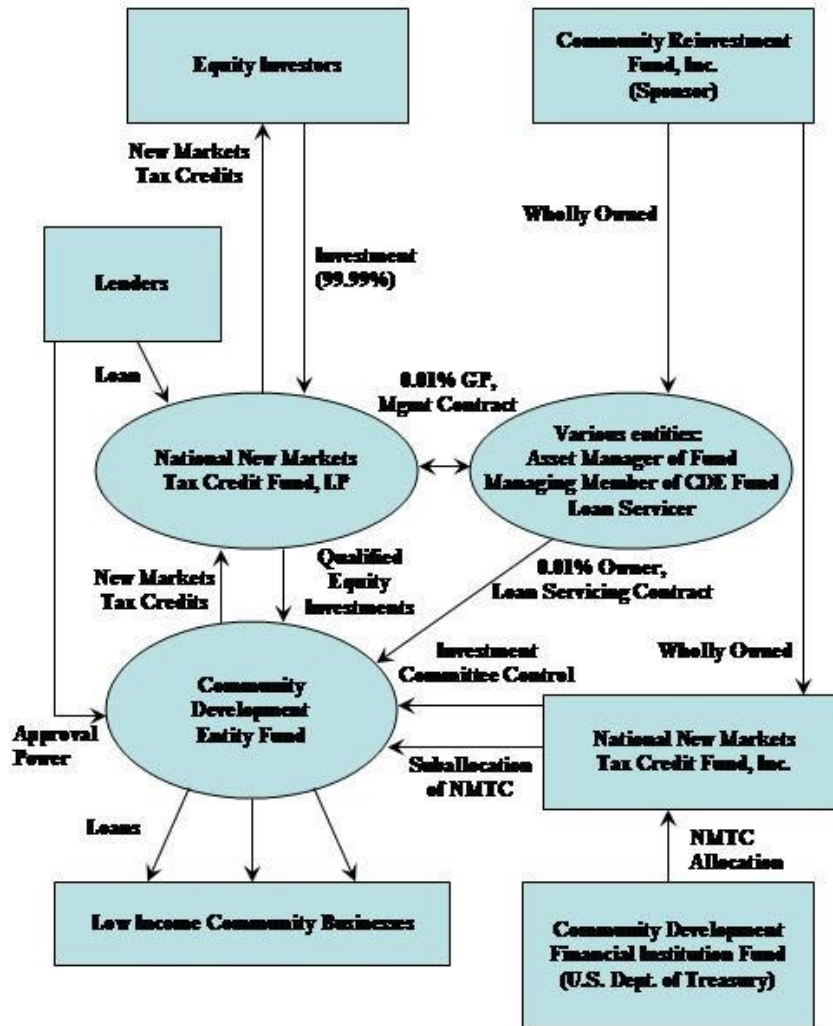
CRF used a leveraged transaction structure in which one group of investors is primarily getting the benefit of tax credits, while another group is primarily benefiting from the interest earnings from the loans. Two years ago, we thought this would be a powerful mechanism. Today, we have learned it is an important, but difficult model. Because equity investors have different hot buttons than debt investors, there were many conflicts to work through. For instance, the tax structure of the NMTC makes it impossible for CRF to pledge the underlying properties directly to debt investors as security for its loans. The inability to do that made it difficult for some investors to pass transactions through their credit committees.

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NMTC: Charting

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Structure of Leveraged Funds



(Source: Community Reinvestment Fund)

Another lesson learned – administration of the NMTC program is expensive. The cost of attorneys, tax accountants and extensive financial modeling has made the price of early implementation high. We expect that as we continue working through transactions, the process will become more streamlined and efficient.

Reaching Small Businesses

The complexity of NMTC financing has discouraged many local lenders from participating in the program. At CRF, we have spent a great deal of time, effort and money to make sure that small business borrowers are not

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left behind. Through Business Loan Conduit, we can fund business loans as small as \$50,000.

Despite the challenges, the results of NMTC are rewarding. The NMTC provides the opportunity to bring less-expensive capital to our lending partners, allowing them another resource to help businesses improve, grow and add economic vitality to their communities. The NMTC program is an industry effort that has overwhelming potential. The more we can do to share our challenges and learn from each other, the more successful we will be in building stronger communities. ❖

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