Tax Credit Basics

- Tax credits provide a dollar for dollar offset to a taxpayer’s tax liability
  - A $100 tax credit reduces taxes by $100; thus a $1 of tax credit today is worth $1 to an investor

- Tax credit calculations include:
  - The basis for the tax credit (what it is based on)
  - The tax credit percentage (percent of the basis that is the credit amount)
  - Tax credit period – number of year for which a tax credit is received
  - Tax credit yield—the percentage of the tax credit value that investors will pay for the stream of tax credits

- Project/investment must meet applicable IRS rules to earn the tax credit
NMTC Yield: Investor Payment per $1 of credit

CDE Survey of 2015 NMTC Activity

Chart 4: NMTC Pricing, 2005-2015

Source: The above chart shows the range of pricing in various surveys of NMTC investors. It includes a blend of data from the Urban Institute, GAO Novogradac & Company, and 2014 data from the NMTC Coalition’s survey.

Courtesy of the New Markets Tax Credit Coalition.
Parties to Tax Credit Investment

- Project developer, property owner or business
- Tax credit investor
- Tax credit syndicator or intermediary
- Lawyers and accountants with tax credit expertise
- Other lenders and funders
Low-income Housing Tax Credit

• Project must develop new low-income housing
• Basis is the depreciable investment in the project
• Credit is 9% or 4% of depreciable investment, depending on use of other federal subsidies, the % of low-income units and other requirements
• Credit period is 10 years
  – Investor gets the 9% or 4% credit for 10 years
Historic Tax Credits

- Project must be a substantial investment to rehabilitate a historic property in accordance with Secretary of Interior’s standards.
- Tax credit basis is the rehabilitation investment in the building and related soft costs over a 24 month or 60 month period.
- Tax credit is 20% of the basis: 5% a year over four years.
- Tax credit period is four years.
New Market Tax Credits

- Federal program to expand private investment in low-income communities
- CDFI Fund certifies organizations as Community Development Entities (CDE)
- CDEs apply to CDFI Fund for an annual award of allocations set by law
- “Allocatees” commit their tax credits to specific projects (developer or business)
- Allocatee and/or developer/business secure investor to purchase tax credits
- Capital invested in a firm or project in a low income area consistent with IRS rules
Delivery of Tax Credits Varies by Program

**LIHTC**
- Federal Government
- State Government
- Developer
- Investor to supply capital

**NMTC**
- Federal Government
- CDE Intermediary
- Developer
- Investor to supply capital

**HTC**
- Federal Tax Entitlement
- Developer based on project type
- Investor to supply capital
New Market Tax Credits

- Project must invest via a CDE in a qualified business in a low-income area
  - $ > 20% poverty rate or $ \leq 80\%$ area med. income
  - Additional targeted areas or populations
- Tax credit basis is the CDE’s investment in the qualified business
- Tax credit amount is 39% (5% for first 3 years and 6% for next 4 years)
- Tax credit period is 7 years
- $43.5$ billion allocated to date in 12 rounds
- 5-year $17.5$ billion extension passed in 2015
Two Models of NMTC Financing

- Model 1: NMTC capital supplies direct below-market loan to real estate projects or businesses
  - Tax credit lowers investors required ROI and thus interest rate to borrowers

- Model 2: Leveraged Model: funds from NMTC investor are pooled with other financing sources into as a new “project CDE” to increase NMTC tax credit basis
  - Larger credits earned on pooled investment provide the bulk of return to investors
  - NMTC investment functions as a “near grant”
NMTC Leveraged Structure

Image by MIT OpenCourseWare.
Diagram of Leveraged Model: $10 Million Project

Range of NMTC Uses

- Subsidy for development projects
- Below market debt for real estate projects
- Below market business loans
- Business equity investments
- Hospital, education and other non-profit facilities
- Cultural facilities
- Land conservation and recreational facilities
- Infrastructure projects
Jamaica Plain Brewery Reuse

- Closed brewery complex acquired by CDC in 1983
- Renovated in phases over 25 years
- Final phase: difficult and costly
  - Interior demolition and entire reconstruction of 68,000 square foot
  - Reuse as fitness center, retail and office space
- Home to 50 small businesses

Courtesy of Ed Kopp on Flickr. CC BY-NC-SA.
### JP Brewery Project Final Phase:
68,000 sf Rehab of Brewery Complex

<table>
<thead>
<tr>
<th>Total Dev Costs</th>
<th>$12,105,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Debt (Life Ins. Fund)</td>
<td>$4,700,000</td>
</tr>
<tr>
<td>Historic Tax Credits (MHIC)</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>New Market Tax Credits (MHIC)</td>
<td>$2,160,000</td>
</tr>
<tr>
<td>City of Boston Loan</td>
<td>$150,000</td>
</tr>
<tr>
<td>Developer loan &amp; deferred fees</td>
<td>$1,095,000</td>
</tr>
</tbody>
</table>
Sources and Uses of NMTC Financing

- Financial institutions are main NMTC investors
- Expected investor returns in 6.5% to 8.5% range
- Under leverage model, NMTCs provide 15% to 20% “cash subsidy”
  - Leveraged structure dominates: 97% of QEIs in 2014
- High transaction costs favor large transactions
  - Mean QALICB investment of $8.1 million thru FY2012
- 65% of NMTC investment thru 2012 was for real estate projects; recently more business financing
- Emphasis on targeting “high distress” areas
  - 70% of NMTC investment thru 2013 were in high distress census tracts (poverty $>30\%$, UE $>1.5x$ nation, Median income $\leq60\%$ of area)
Most NMTC Dollars Thru 2012 Went to Real Estate Projects

<table>
<thead>
<tr>
<th>Project Type</th>
<th>N</th>
<th>$ Invested</th>
<th>% of N</th>
<th>% of $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Business</td>
<td>3,234</td>
<td>10,224 million</td>
<td>40.1</td>
<td>32.9%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>4,670</td>
<td>20,316 million</td>
<td>57.9</td>
<td>65.3%</td>
</tr>
<tr>
<td>Other</td>
<td>156</td>
<td>578 million</td>
<td>1.9</td>
<td>1.9%</td>
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<tr>
<td>Total</td>
<td>8,060</td>
<td>31,118 million</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Trend in More NMTC Business Investment

Chart 7: NMTC Industry Trends 2012 – 2014 – Manufacturing and Healthcare

Source: New Markets Tax Credit Coalition, survey of NMTC allocatee activity January 1, 2012 – December 31, 2014

Courtesy of the New Markets Tax Credit Coalition.
## NMTC Allocations, 2002-2014

<table>
<thead>
<tr>
<th></th>
<th>MI</th>
<th>ME</th>
<th>MA</th>
<th>CT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Allocations</strong></td>
<td>12</td>
<td>10</td>
<td>38</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total Amount of Allocation ($ million)</strong></td>
<td>$499</td>
<td>$913</td>
<td>$1,966</td>
<td>$85</td>
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<tr>
<td><strong>Number of Allocatees</strong></td>
<td>5</td>
<td>1</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td><strong>Largest Allocatee and Share of total</strong></td>
<td>Cap Fund (33%)</td>
<td>CEI (100%)</td>
<td>MHIC (37%)</td>
<td>Commerc ial &amp; Industrial CDE (100%)</td>
</tr>
</tbody>
</table>
NMTC Investments in Detroit Through 2010

- 15 projects
- $200 million in NMTC
- ~$650 million in total investment
- Concentrated along Woodward Corridor in downtown, Midtown and New Center

Map data courtesy of Google™.
### Argonaut Building, Detroit

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
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<tbody>
<tr>
<td>TDC</td>
<td>$145.3</td>
</tr>
<tr>
<td>NMTC ($69 in credits)</td>
<td>$14.4</td>
</tr>
<tr>
<td>Bank Loan</td>
<td>$51.1</td>
</tr>
<tr>
<td>Owner Equity</td>
<td>$36.0</td>
</tr>
<tr>
<td>State HTC &amp; Brownfield Tax</td>
<td>$11.6</td>
</tr>
<tr>
<td>Credits</td>
<td></td>
</tr>
<tr>
<td>Foundation Loan</td>
<td>$16.7</td>
</tr>
<tr>
<td>Deferred Developer Fee</td>
<td>$15.5</td>
</tr>
</tbody>
</table>
Detroit: NMTC to Finance New M-1 Light Rail Line

$16 million NMTC to investors

$31 million in loans

$9 million in cash equity

$40 million cash for project

"Leverage Entity" to create NMTC Basis

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11.437 Financing Economic Development
Fall 2016

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