

New Markets Tax Credits: Putting them to Work

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New Markets Tax Credits

- Federal tax credit to spur private investment in low income communities
- Investors get tax write down
- Businesses and projects get equity or below market loans
- Primarily for economic development but can be used on housing development projects

New Markets Tax Credits

- Investor gets 39% of their investment as tax credit over 7 years

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
5%	5%	5%	6%	6%	6%	6%

- A substantial portion of this investment reaches businesses or projects as equity or low interest loans

Pacific Plaza, Bremerton, WA

- Commercial building located in downtown Bremerton
- Rehab of 2 story building
- 10,000 sq. ft. commercial space
- Tenants include a dentist and a naval information services company
- Developed by B.M., LLC
- Tenants are also owners of the building



Pacific Plaza – Why NMTC?

- Two displaced commercial tenants needed new space
 - Dentist's office
 - Naval intelligence company
- Both wanted to own their own building, and were considered relocating outside of Bremerton
- NMTC loan enabled them to stay in Bremerton
- The dentist and naval intelligence company expect to create 10 new full time jobs by the end of 7 years



NMTC and Housing

- Mixed-use projects with less than 80% of revenue from residential
- Mixed-use projects, with separate commercial condo
- Homeless shelters
- Economic development components to larger residential projects (e.g., HOPE VI redevelopments)
- Homeownership deals

Albers Mill Lofts, Tacoma, WA

- Located on Thea Foss Waterway on former brownfield site
- Developed by Heritage Properties
- Rehab/new construction
- 10,000 sq. ft. commercial (art gallery and café)
- 36 residential units (market rate)
- Utilized Historic Tax Credits



Albers Mill Lofts – Why NMTC?

- Converting historic mill into residential lofts was expensive
- Difficult to find traditional investors interested in former Superfund site in Tacoma
- Projected rents left financing gap



Compass Center, Seattle, WA

- Located in Pioneer Square
- Developed by Compass Center
- New construction component of new/rehab development
- Social service space
- New offices for Compass Center
- 78 transitional housing units for homeless men



Compass Center – Why NMTC?

- New construction portion was \$9.4M
- Over 10 different funding sources
- Included \$3.2M owner equity
- Cost increases at 75% completion created funding gap of \$850k



LaSalle Hotel, Seattle, WA

- Located in Pike Place Market
- Developed by Pike Place Market Preservation & Development Authority
- Rehab/new construction
- 36,500 sq. ft. commercial
- New senior center
- 64 residential units



LaSalle Hotel – Why NMTC?

- Total commercial development costs of \$3.89M
- Raised \$1.46M of grant money and \$664K of equity
- Because of subsidized rent for senior center, new rents could afford only \$900K of debt
- Left with \$850K financing gap



Morrier Hotel, Yakima, WA

- Located in downtown Yakima
- Developed by Morrier Hotel LLC
- Rehabilitation
- 86-unit hotel with retail space
- Utilized Section 108 loan from City of Yakima



Morrier Hotel – Why NMTC?

- Restoration of vacant department store to hotel use
- Combined Loan To Value requirements for hotel projects limited to 70%
- Project needed Section 108 loan and significant owner equity
- Remaining gap of \$800k



NMTC Terms

- LIC: Low-Income Communities
- CDFI Fund: U.S. Treasury Community Development Financial Institutions Fund
- CDE: Community Development Entity
- QEI: Qualified Equity Investment
- QALICB: Qualified Active Low Income Community Business
- QLICI: Qualified Low Income Community Investment

LIC

- Low-Income Communities
- Eligible census tracts
 - Poverty level above 20%, or
 - Median income below 80% of state or metro median income, whichever is greater
 - Census tracts with population less than 2,000 located in empowerment zones and contiguous to other eligible tracts
- Rural counties that lost > 10% of population between 1980 and 2000
- Targeted populations designated by Treasury Secretary

CDFI Fund

- Allocates New Markets Tax Credits through national competition
- \$15 billion appropriated for program
- \$8 billion allocated in first 3 rounds
- \$3.5 billion available in round 4, applications due September 21, 2005

CDE

- Community Development Entity
- Certified by CDFI Fund
- Eligible to apply for NMTC allocation from CDFI Fund
- Sells NMTC to investors
- Must reinvest money from investors in Low-Income Communities

QEI

- Qualified Equity Investment
- Amount of equity invested into CDE by investor or investors
- Basis for calculating tax credits: 39% of QEI over 7 years
- Equity cannot be a loan and cannot be collateralized
- Investment must remain in CDE for 7 years

QALICB

- Qualified Active Low Income Community Business
- Business (or project) must have substantial connection to Low Income Community, measured by percentage of gross income, tangible property and/or services
- Real estate deals in LIC qualify

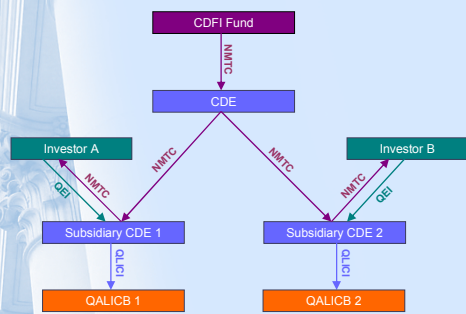
QALICB (continued)

- Ineligible business
 - Residential real estate (>80% of income from residential)
 - Rental property w/o substantial rehab
 - Golf courses
 - Country clubs
 - Massage parlors
 - Hot tubs or tanning facilities
 - Gambling facilities
 - Farming businesses
 - Liquor stores
 - Rental to non-qualified businesses

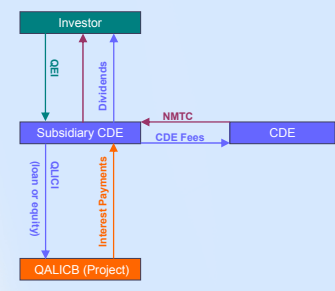
QLICI

- Qualified Low-Income Community Investment
- Loan or equity investment by the CDE into QALICB
- CDE must invest substantially all (85%) of QEI in QLICI
 - Additional 5% may be kept in reserves
- CDE Fees: may be up to 15% of QEI, typically range from 3 – 6% of QEI
- QLICI = QEI – CDE holdbacks

NMTC Program Structure



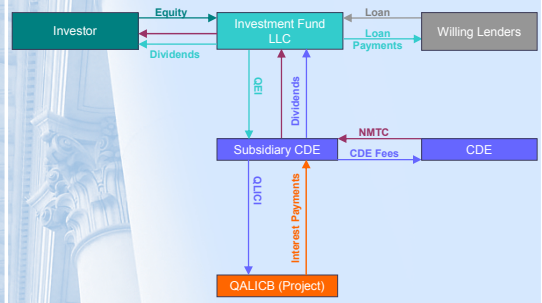
NMTC Structure – Project Level



Leveraged Investment

- Investors receive New Markets Tax Credits on other people's money
 - Conventional loans
 - Historic Tax Credits
 - Government loans
 - Philanthropic grants
- Loans used as leverage cannot be secured by real estate for 7 years
- Money flows through upper tier investment fund (typically LLC)

NMTC Structure – Leveraged Investment



More Terms

- **A Loan**
 - The portion of QLICI that investor expects to get back after 7 years
- **B Loan**
 - The portion of QLICI that is related to the net benefit of NMTC
- **C Loan**
 - The portion of QLICI related to leveraged sources. C Loan terms reflect terms of leveraged sources.

Calculating the Benefit – Factors

- **Amount of Leverage**
 - Without leverage, benefit limited to interest savings
 - Benefit grows as leverage grows
- **Investor IRR**
 - Currently ranges from 7% to 12%
- **Transaction Costs**
 - CDE Fees: typically 3 – 6% of QEI
 - Reserves required by investor
 - Attorney fees for investor, CDE, QALICB: can range from \$25,000 to \$150,000
 - Annual asset management fees to CDE

Calculating the Benefit

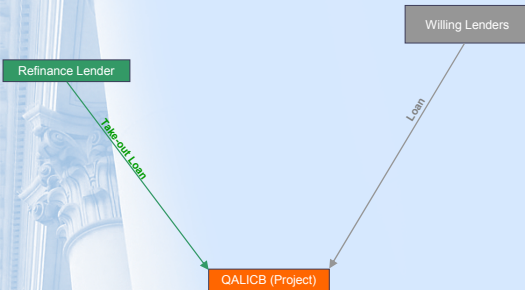
Investor IRR	Net NMTC Benefit per \$1.00 of Leverage		
	@ 3% Fees	@ 4% Fees	@ 5% Fees
7%	\$0.38	\$0.37	\$0.35
8%	\$0.36	\$0.35	\$0.33
9%	\$0.34	\$0.33	\$0.31
10%	\$0.32	\$0.31	\$0.30

Note: These calculations do not take into account the cost of attorneys' fees and required reserves.

NMTC Exit Strategy

- CDE dissolves after year 7
- Non-leverage deals
 - Loan refinanced, investor repaid
- Equity deals
 - Put/call provision similar to Historic Tax Credits
- Leverage deals
 - A Loan refinanced
 - B Loan assigned to investment partnership who can then forgive loan
 - C Loans assumed by leverage lenders

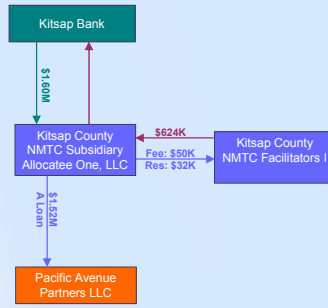
NMTC Structure – After 7 Years



Project Examples

- Pacific Plaza
- Albers Mill Lofts
- LaSalle Hotel
- Compass Center
- Morrier Hotel

NMTC Structure – Pacific Plaza



Pacific Plaza- NMTC Benefit*

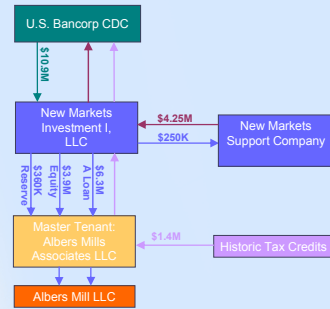
- Market interest rate was 8% at that time
- For a \$1.50 million loan, the interest savings on a 2.5% below market rate loan is:
 - \$37,500 interest savings per year
 - \$262,500 total interest savings for 7 year period
- The Borrower saved a total of \$262,500 in interest through the NMTC program

* Approximate values were used

Pacific Plaza – NMTC Issues

- Kitsap County NMTC Facilitators needed \$100K of CDBG to cover costs of setting up CDE
- Start up costs for this first deal were substantial
- Took 6 months to close
- A lot of time was spent on educating the borrower and the investor on NMTC regulations

NMTC Structure – Albers Mill Lofts

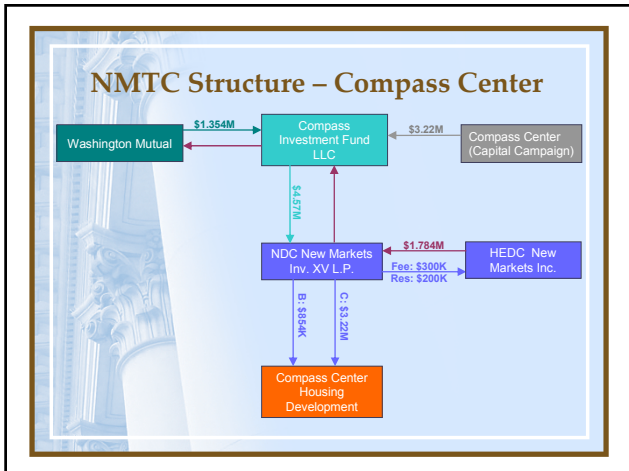


Albers Mill NMTC Benefit*

U.S. Bancorp CDC QEI	10,855,000
Less Fees & Expenses	(250,000)
Less Reserves	(360,000)
QLICI	10,245,000
Less A Loan	(6,300,000)
Less Equity attributable to Historic Tax Credits	(1,400,000)
Net NMTC Benefit	2,545,000
Total Project Cost	10,245,000

* Approximate values were used

- ### Albers Mill – NMTC Issues
- One of first NMTC projects closed (first in Washington)
 - Commercial revenue reserve
 - Master tenant lease for Historic Tax Credits



Compass Center NMTC Benefit*

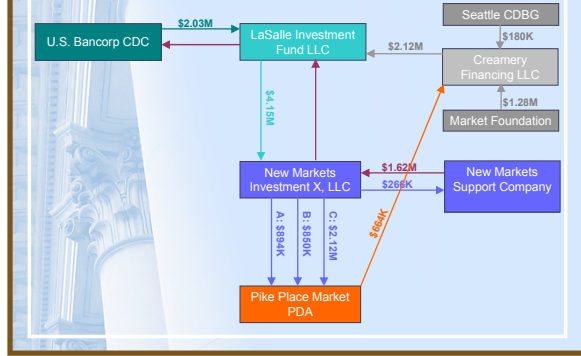
Compass Center Capital Campaign	3,221,000
WaMu Equity	1,354,000
QEI	4,575,000
Less CDE Organization Expense, Syndication & Placement Fees, Legal Fees	(300,000)
Less Capitalized Reserve (for 7 yrs of Audit & Asset Management)	(200,000)
QLICI	4,075,000
Less original leverage funds	(3,221,000)
Net NMTC Benefit	854,000
Total Project Cost	9,400,000

* Approximate values were used

Compass Center – NMTC Issues

- Related Party issue with leverage source
- Residential rents as % of Gross Building could vary
- Created two separate leases

NMTC Structure – LaSalle Hotel



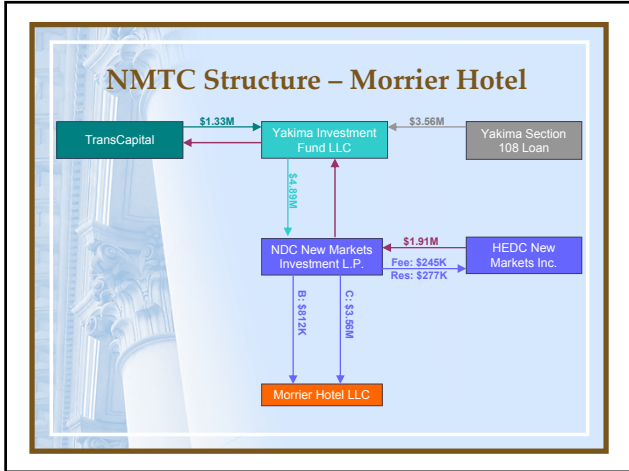
LaSalle Hotel NMTC Benefit*

Total Leverage	2,124,000
U.S. Bancorp CDC Equity	2,027,000
QEI	4,151,000
Less Fees & Expenses	266,000
QLICI	3,885,000
Less Leverage	(2,124,000)
Less A Loan	(894,000)
Net NMTC Benefit	867,000
Total Project Cost	3,885,000

* Approximate values were used

LaSalle Hotel – NMTC Issues

- LIHTC equity in residential
- Leveraging owner equity
- Leveraging public funds
- Wine shop



Morrier Hotel NMTC Calculation*

HUD Sec. 108 Loan from City of Yakima	3,560,000
TransCapital Equity	1,334,000
QEI	4,894,000
Less CDE Organization Expense, Syndication & Placement Fees, Legal Fees	(245,000)
Less Capitalized Reserve (for 7 yrs of Audit & Asset Management)	(277,000)
QLICI	4,372,000
Less original leverage funds (108 Loan)	(3,560,000)
Net NMTC Equity	812,000
Total Project Cost	9,500,000

* Approximate values were used

- ### Morrier Hotel – NMTC Issues
- HUD 108 loan used as leverage
 - No direct security in property for 7 year compliance period
 - Cannot repay principal of QEI during compliance period
 - Sized interest-only payments at project level to match/exceed 108 terms to top tier LLC

- ### Other Washington NMTC Deals
- Housing-related deals
 - Third & Pine
 - Rainier Vista Center
 - Seabrook
 - Non-profit deals
 - Shoalwater Bay Wellness Center
 - Cadillac Hotel
 - Community Capital Development
 - For-profit deals
 - Everett Mall
 - King Square
 - Medical Dental Building
 - Corixa Equipment Purchase

Third & Pine, Seattle, WA

- **Developer:**
A.F. Evans
- **CDE:**
Key Community Development New Markets LLC
- **Investor:**
Key Bank



Third & Pine, Seattle, WA

- Commercial investment in mixed-use building
- 65 LIHTC units in residential space
- Separate condominium ownership for commercial space



Rainier Vista Center, Seattle, WA

- **Developer:**
Neighborhood House, Inc.
- **CDE:**
Key Community Development New Markets LLC
- **Investor:**
Key Bank



Rainier Vista Center, Seattle, WA

- New 10,000 square foot building for social service provider
- Part of Seattle Housing Authority's HOPE VI redevelopment



Seabrook, Pacific Beach WA

- **Developer:**
Seabrook Holdings LLC
- **CDE:**
ShoreBank Enterprise Pacific Coast I LLC
- **Investors:**
Wells Fargo Bank, Sterling Savings Bank, Bank of Astoria



Seabrook, Pacific Beach, WA

- 400-home market rate homeownership project
- Rural mapping issue
- Phase 1 development financing
 - QLICI will be paid back before 7 years and reinvested
- CDE leveraged community benefits
 - Use of local businesses (70% of construction)
 - 3% impact on County property tax base
 - 1% fee for local foundation assessed on resales
 - New approach to coastal development



Shoalwater Bay Wellness Center, Tokeland, WA

- **Developer:**
Shoalwater Bay Indian Tribe
- **CDE:**
ShoreBank Enterprise Pacific Coast I LLC
- **Investors:**
Wells Fargo Bank, Sterling Savings Bank, Bank of Astoria



Cadillac Hotel, Seattle, WA

- **Developer:**
Historic Seattle
- **CDE:**
Key Community Development New Markets LLC
- **Investor:**
Key Bank



Community Capital Development, Seattle, WA

- **Developer:**
Seattle Economic
Development Fund
- **CDE:**
Key Community
Development New
Markets LLC
- **Investor:**
Key Bank



Everett Mall, Everett, WA

- **Developer:**
Steadfast
Commercial
Properties
- **CDE:**
Paramount
Community
Development Fund
LLC
- **Investor:**
GMAC



King Square, Seattle, WA

- **Developer:**
King Square
Enterprises LLC
- **CDE:**
Key Community
Development New
Markets LLC
- **Investor:**
Key Bank



Medical Dental Building, Bremerton, WA

- **Developer:**
Medical Dental
Building Investor
Group LLC
- **CDE:**
Key Community
Development New
Markets LLC
- **Investor:**
Key Bank



Corixa Equipment Purchase, Seattle, WA

- **Business:**
Corixa Corp.
- **CDE:**
HEDC New Markets
Inc.
- **Investor:**
Wells Fargo



Good NMTC Resources

- CDFI Fund
 - www.cdfifund.gov
- New Markets Tax Credit Coalition
 - www.newmarketstaxcreditcoalition.org/info/info.frameset.htm
- Novogradac & Company LLP
 - www.novoco.com/NMTC/index.shtml

Great NMTC Resources

- Kitsap NMTC Facilitators
 - Roger Waid, (360) 337-7219
 - Jenny Byers, (360) 337-7186
 - byersj@kccha.org
 - www.kitsapnmtc.com
- National Development Council
 - Michelle Morlan, (206) 624-0338
 - mmorlan@nationaldevelopmentcouncil.org
 - www.nationaldevelopmentcouncil.org
- Common Ground
 - Dan Landes, (206) 461-4500, ext. 115
 - DanL@commongroundwa.org
 - www.commongroundwa.org