

NEW MARKETS TAX CREDITS:

POPULAR FINANCING MECHANISM DRAWING ATTENTION IN HEALTHCARE INDUSTRY

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The New Markets Tax Credit Program (“NMTCP” or “Program”) and the applicability of new markets tax credits (“NMTCs” or “tax credits”) as a financing tool for healthcare facilities is a new trend under discussion in many circles. The NMTCP may be used to finance various types of capital projects related to the healthcare industry (e.g., data centers, surgical units, clinics, expansions) if located in eligible jurisdictions. This article gives a general overview of how NMTCs may be used to help meet capital financing needs.

The New Markets Tax Credit Program was enacted as part of the Community Renewal Tax Relief Act of 2000 (which has been extended through 2011), which provides equity investors in qualified projects with a 39% tax credit for their investment if those investment proceeds are used to finance eligible projects. The Program is administered by the U.S. Treasury’s CDFI Fund and the mission of the Program is to increase economic opportunity and promote community development investments for underserved populations or in distressed communities (otherwise known as low income communities (“LICs”).

The NMTCs are generated when an investor invests its funds in a qualified community development entity that will use substantially all of the investment proceeds to invest in eligible investments designed to finance activities in LICs over a seven-year period. (*See Figure 1*) If all the legal requirements are satisfied, the tax credits received by the investor will be 5% of the amount invested for the first three years and 6% of the amount invested for the next four years, for a total of 39% of the amount invested.

The entity that provides the NMTCs is called a qualified community development entity (“CDE”). An entity becomes a CDE only after it is certified by the U.S. Treasury. The basic requirements to become a CDE are (a) form an entity (and obtain a Tax Identification Number), (ii) that has an advisory board for the entity that has 20% representation from low-income communities and (iii) whose primary mission is providing services or capital to low-income communities or low-income people.

Once certified and awarded an allocation from the CDFI Fund, a CDE will then look to investors to contribute cash to the CDE or an affiliate to help finance the project. Upon receiving the equity cash investment, the CDE is required to spend the funds within 12 months. Bank loans or affiliate loans are usually the other primary source of funds for a NMTCP project. (*See Figure 1*).

Low income communities are population census tracts that meet any one of the following relevant criteria:

- Census tracts with at least a 20% poverty rate;
- Census tracts where the median family income is at or below 80% of the statewide area median family income (for non-metropolitan areas only);

- Census tracts where the median family income is at or below 80% of the statewide median family income or 80% of the metropolitan area median family income (for metropolitan areas only), whichever is greater;
- Census tracts that have a population less than 2,000, contained in federally designated empowerment zone and contiguous to at least one other LIC;
- Census tracts where median family income is at or below 85% of statewide area median family income and is located in a high migration rural county; or
- Targeted populations (e.g., low-income persons if project is located in a census tract with median family income at or below 120% of applicable area median family income).

The CDFI Fund has a listing of all eligible population census tracts on its website, www.cdfifund.gov.

The borrower and its business must satisfy certain requirements to be eligible to obtain NMTCP financing, including:

- The borrower must be a corporation (for-profit or non-profit), partnership or sole proprietorship;
- At least 50% of the total **gross income** of the business is from the active conduct of an eligible business in LICs;
- At least 40% of the **use of tangible property** of the business is within LICs;
- At least 40% of the **services performed** by the business' employees are performed in LICs; and
- Less than 5% of the average of the aggregate unadjusted bases of the property owned by the business is attributable to **non-qualified financial property** (e.g., debt instruments with a term in excess of 18 months).

Special rules apply if the borrower is deemed to be a real estate development business. The following projects are ineligible to be financed with NMTCs: residential rental properties (with at least 80% of its gross income generated from dwelling unit rentals), golf courses, race track, gambling facilities, certain farming businesses, country clubs, massage parlors, hot tub facilities, suntan facilities and alcohol/liquor stores.

Figure 1 shows a schematic of a typical plain vanilla NMTCP transaction. Assume for this example the borrower is seeking to finance a clinic and needs \$9.7 million to meet its financing needs. The sources of funds are \$7.8 million from a lender (at a 5% interest rate) and \$2.2 million from an investor. The lender may be an affiliate of the borrower or an unrelated entity such as a bank. The source of the lender's loan may be grants and/or other loans it receives. The total of \$10 million is invested in an affiliate of the CDE and, after paying \$300,000 in fees to the CDE, the affiliate CDE makes two loans to the borrower totaling \$9.7 million at a below-market rate of 3.8%. The borrower will use \$9.7 million of loans to pay projects costs and other financing costs. The terms of the borrower loan require interest only payments for the first seven years and amortization on the loans commences after year 7. After the initial seven-year term of the loans, the investor will generally sell its equity interest in the affiliate CDE for a nominal amount (e.g., \$1,000) to the borrower or its affiliate. Figure 1 shows the NMTCP financing provided the borrower with below market financing and use of the investor's equity investment to finance the clinic.

The NMTCP is useful for projects in areas that are being developed or redeveloped (rural projects specifically are being sought by CDEs). Financing costs may make small financings unworkable. The Program can be attractive to non-profit borrowers, because many banks will treat the equity that the investor provides in return for the tax credits as equity in the project, reducing the amount of equity a non-profit borrower needs to contribute to get the project financed.

The NMTCP is viewed to be a large success and was recently named a Top 25 program with the Innovation in American Government award. From the Program's inception in 2002 through the end of 2010, the NMTCP will have awarded \$29.5 billion to be invested in low-income communities, which would result in \$11.505 billion in tax credits for investors. The Program has added more than 68 million square feet of real estate in low-income communities for projects from child care facilities to senior living facilities to manufacturing facilities and supermarket and shopping center developments. If you are interested in determining whether your capital projects financing needs may be met through the NMTCP, please feel free to contact Ronald A. Bell or Mary L. Groves at Peck, Shaffer & Williams LLP at 303-296-3996 for more information.

How Does Leveraging Work?

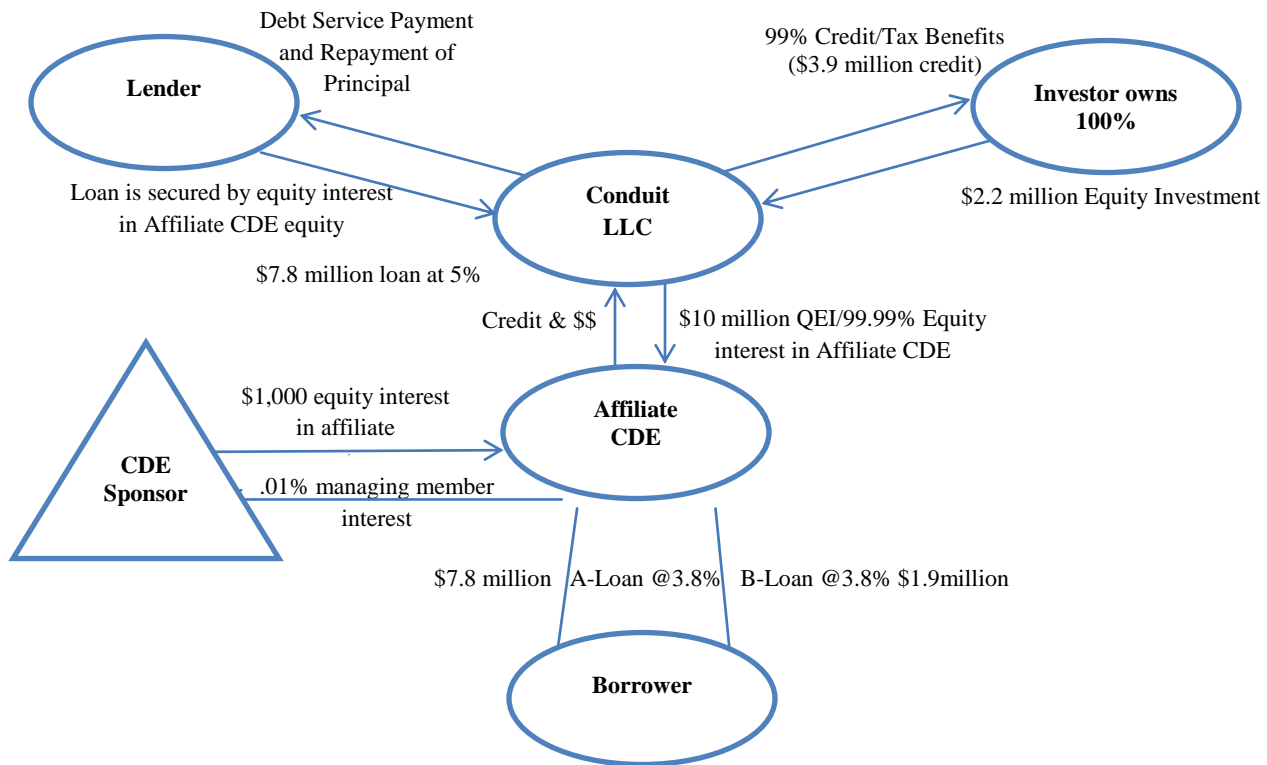


Figure 1. Typical NMTC Financing Structure