

MAY 13-15,

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REZNICK GROUP'S

**8th Annual New Markets
Tax Credit Summit**

Loews Miami Beach Hotel, Miami, FL

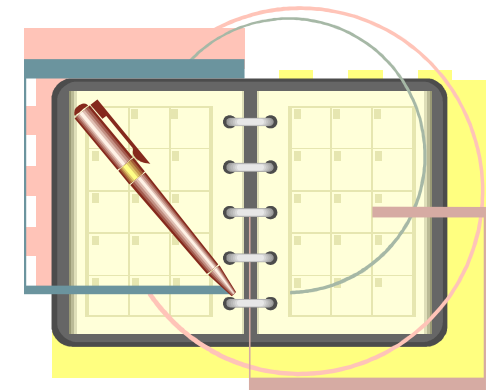


Pre-Conference NMTC Workshop
“The Nuts & Bolts of the NMTC Program”

Gary Perlow, CPA
Principal, Reznick Group

Overview of Today's Agenda

- Nuts and Bolts of Program Requirements
- Standard Transactional Structures (leveraged vs. non-leveraged)
- Basic Compliance Requirements (regulatory and program)
- Tax Credit Recapture Events
- Standard Fee Structures
- Pricing the Credit and Investor Benefits
- Reporting Requirements
- Negotiating a Transaction – What to Expect



Overview of Following Two Days

- Accessing Leveraged Debt in Today's Environment
- Why Have Some Deals Gone South
- Today's Need for a "Strong" Tax Opinion
- Tapping Other Subsidies
- Buyers Beware – "Addressing the Tough Issues Up-Front"
- Scoring/Preparing a NMTC Application – "The Do's and Don't's"
- Investor Marketplace – "Where Do We Stand Today"
- Accessing NMTC Funding – "What are the Steps"
- Legislative Update



Introduce Today's Instructors

- Gary Perlow – Nuts & Bolts of the Program and Negotiating a Transaction
- Deborah Rosier – Compliance Requirements
- Phillip Cornblatt – Tax Credit Recapture
- Scott Szeliga – Standard Fee Structures
- Don Nimey - Investor Benefits and Pricing the Credit

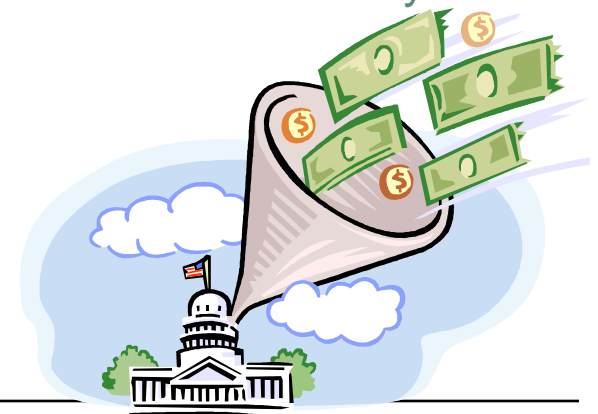


Industry Acronyms

CDFI	Community Development Financial Institutions Fund (arm of US Treasury that administers program)
CDE	Community Development Entity
QEI	Qualified Equity Investment (investment made in a CDE that triggers the credit)
QALICB	Qualified Active Low-Income Community Business (recipient of NMTC capital)
QLICI	Qualified Low Income Community Investment (loan/equity investment from CDE to business/real estate)
LIC	Low-Income Community
ATS	CDFI Fund's Automated Tracking System (QEI registration system)
CIIS	Community Impact Information System (system CDFI uses to recapture community impact information)

New Markets Tax Credit Program

- Enacted on December 21, 2000 as part of Community Renewal Tax Relief Act of 2000 (extended through 2008).
- Creates a tax credit for equity investments in Community Development Entities
- Investors receive a 39% tax credit on equity invested into CDEs awarded tax credit allocation. The credit is received over seven years (5% years 1-3 and 6% years 4-7).



New Markets Tax Credit Program

Federally allocated tax credits are used to induce equity capital into CDEs.

\$15 billion in investments will be generated by NMTCs from allocations through 2007, this creates almost \$6 billion in credits

- First Round- \$2.5 billion in investment authority issued.
- Second Round- \$3.5 billion in investment authority issued.
- Third Round- \$2 billion in investment authority will be issued Spring 2005.
- Additional \$1 billion GoZone Allocation in 2006.
- Fourth and Fifth Rounds- \$3.5 billion in investment authority each round (2006 and 2007).
- 2008- 1-year extension for \$3.5 billion with 20% non-metro set aside.
- 2009- Seeking extension (1,2 and 5 years)

Process Overview

Step 1: Entities apply to the CDFI Fund for CDE certification (rolling basis/non-competitive).

Step 2: Entities apply competitively to the Fund for a NMTC allocation (current round submitted in March).

Step 3: The Fund allocates NMTCs to CDEs (early Fall).

Step 4: CDE enters into Allocation Agreement with the CDFI Fund.

Step 5: CDEs (under mandated timeframe) use allocations to offer NMTCs to investors for cash.

Step 6: CDEs use proceeds to make QLICs (12-month rule).

How to Become a CDE

- Form an entity (or use an existing entity) that meets certain requirements below.
- Ascertain EIN#
- Form a Board/Advisory Board that meets 20% LIC representation criteria (accountability test).
- Primary mission (60%) of providing services or capital to LICs or low-income people (mission test).
- Complete CDE application and submit to CDFI Fund.
- Can certify multiple subsidiary CDEs on one application (subject to control provision).
- If existing CDFI no need to apply, just register.
- If LLC, must have 2 members or elect C-Corp. status.

Allowance of Credit

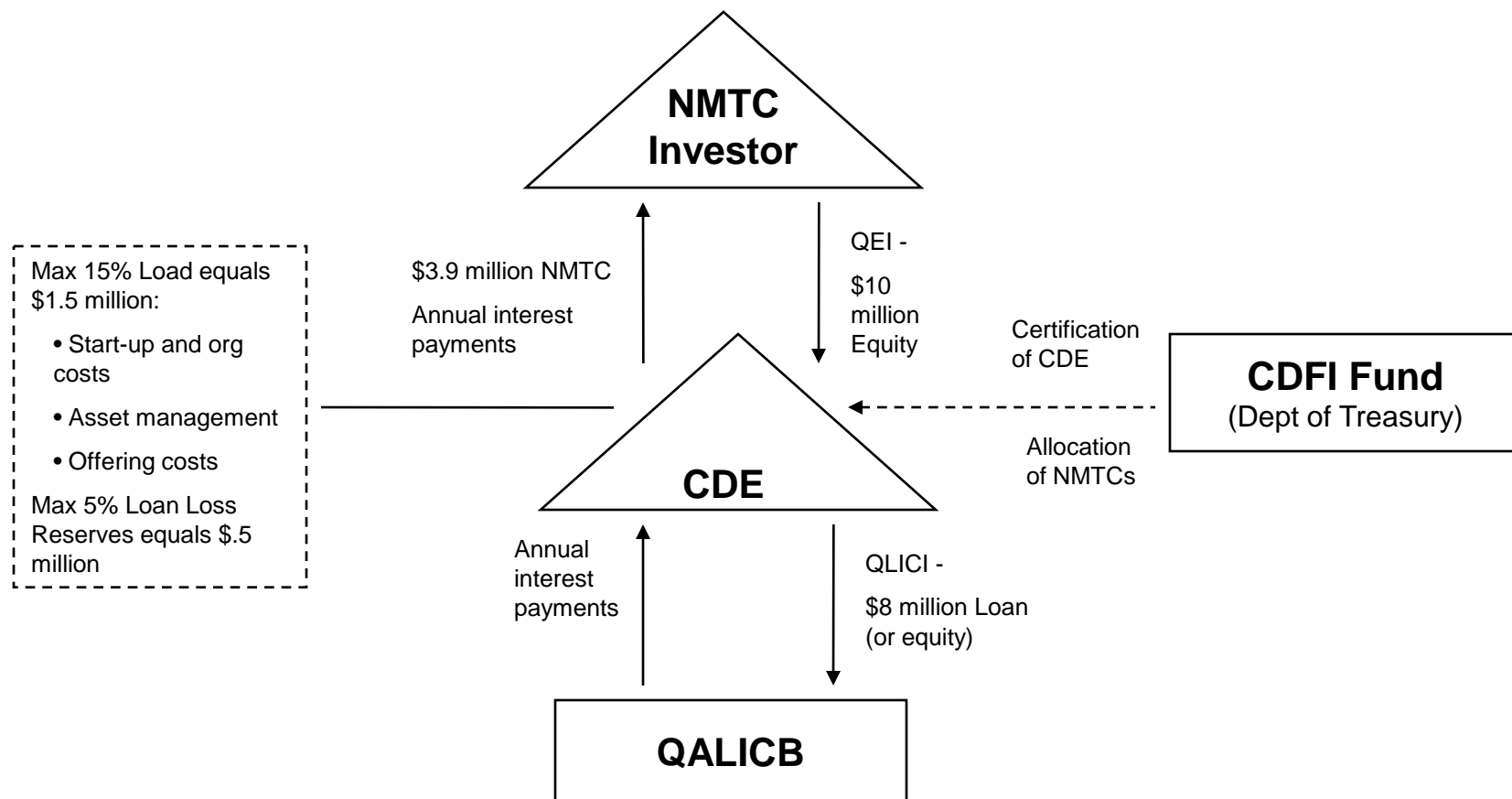
- General business credit under Section 38
- Claimed on “anniversary” date of QEI (credit allowance date).
- Credit can be sub-allocated to a subsidiary CDE.
- Subject to AMT & passive activity rules.
- Cannot be carried back, only forward.
- Can combine with other Federal and State subsidies and credits, except LIHTC.



Qualified Equity Investment (QEI)

- Investors' contribution to a Partnership or LLC or Purchase of Stock from Corp solely in exchange for cash.
- CDE (or applicant for NMTC) can be a non-profit, but cannot issue a QEI.
- Look back provision (when exercised) becomes QEI when CDE signs Allocation Agreement.
- Most QEI's funded to single purpose sub-CDE that invests in one business/real estate.
- QEI cannot be redeemed for 7 years (365x7).
- Who typically makes these investments?
- Can an investor sell his interest in a CDE during 7 year life?
- 5 year clock to issue QEI (subject to 60% threshold).

NMTC Vanilla Structure



Substantially All Investment Requirement

- Defined as 85% of QEI (includes up to 5% loan loss reserve)/reduced to 75% in year 7.
- Investment requirement- must be met for each year of 7-year compliance period.
- Year 1- have 12 months to invest so one test date.
- Years 2-7 (calculate twice at 6 month intervals and average the two)
- Two methods to calculate- Direct Tracing and Safe Harbor (flip back and forth)
- If fail this test triggers tax credit recapture.

Direct Tracing Method

- Meet 85% test if QEI is directly traceable to qualified low-income community investment (QLICI)
- Calculation as follows:
Amount invested or loaned to business (QLICI)/(divided by) QEI
- Almost always used when single purpose CDE invests in one business.



Safe Harbor Method

- Substantially all test met if 85% of aggregate gross assets of CDE invested in/loaned to QALICBs.
- Calculation as follows:
Amount invested or loaned to businesses (QALICBs)/(divided by) CDE's cost basis in its assets (often used for loan funds).



Sample Balance Sheet

CDE, LLC
BALANCE SHEET
December 31, 2007

ASSETS

Cash	\$	5,000
Loan loss reserve		50,000
Loans receivable		3,670,000
Loan cost, net of accumulated amortization of \$10,000		90,000
Organization fees, net of accumulated amortization of \$20,000		180,000
		<hr/>
Total assets	\$	<u>3,995,000</u>

LIABILITIES AND MEMBERS' EQUITY

LIABILITIES

Accrued interest payable	\$	25,000
Accounts payable		5,000
Accrued management fee		15,000
		<hr/>
Total liabilities		45,000

CONTINGENCY

MEMBERS' EQUITY

		<hr/>
Total liabilities and members' equity	\$	<u>3,995,000</u>

Safe Harbor Calculation:

Amount invested in QLICI plus loan loss reserve	3,720,000	/	4,025,000	= 92%
= 3,670,000 + 50,000				
Cost basis in Assets (add back amortization)				
= 3,995,000 + 10,000 + 20,000				

What Constitutes a Qualified Low-Income Community Investment (QLICI)

- Equity/capital investment or “loan” to a qualified business/real estate (QALICB).
- Purchase of loans from CDEs (subject to 30-day exception rule).
- Equity investment or loan to another CDE (subject to step in the shoes).
- Financial counseling and other services provided to LIC businesses or LIC residents (advice on organization and operation of business).

Flash- Principal loan repayments or equity distributions back to CDE are treated as invested in QLICI if recycle within 12 months (for Equity QLICIs) or for a loan the balance of year when loan is repaid plus 12 months.

What Constitutes a Qualified Active Low-Income Community Business (QALICB)?

First Test- Must be located in a LIC

Generally, Low-Income Communities are:

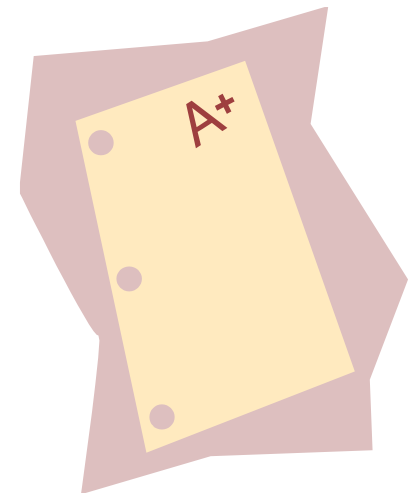
- Census tracts with at least 20% poverty rate, or
- Census tracts where the median family income is below 80% of the area family median income.

Exceptions created by the American Jobs Creation Act of 2004:

1. High out-migration rural counties (10% net out-migration over the past 20 years) may use a MFI threshold of 85% instead of 80% to determine eligibility.
2. Low populations census tracts (population less than 2,000) within an empowerment zone and contiguous to one or more low-income communities are eligible low-income communities.
3. The previous methodology of identifying "target areas" was replaced with a provision for identifying "target populations". This exception will not be available until the IRS prescribes regulations under which target populations will be treated as low income communities and procedures for determining associated issues such as how a QALICB relates to a targeted population.

Test #2 to be a QALICB

- Must be recognized as an “active business” (must reasonably expect to recognize income within 3 years of QEI, or if non-profit, actively engaged in activity that furthers purpose of non-profit).



Test #3 to be a QALICB

- Cannot be a business engaged in the following:
 - Developing or holding intangibles for sale or licensing as primary business.
 - Engaged in rental of residential rental property (80/20 rule).
 - Sin business (golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack/other gambling, package good liquor store).
 - Government owned property/business.
 - Real estate without "substantial improvements."
 - Real estate with disqualified tenants.

Test #4 to be a QALICB- Do you meet the Activity Tests?

- 50% or more of the total gross income is from active conduct of a qualified business in Low-Income Communities; and
- 40% or more of the use of the tangible property is located in Low-Income Communities; and
- 40% or more of the services provided by the business' employees are performed in Low-Income Communities; and

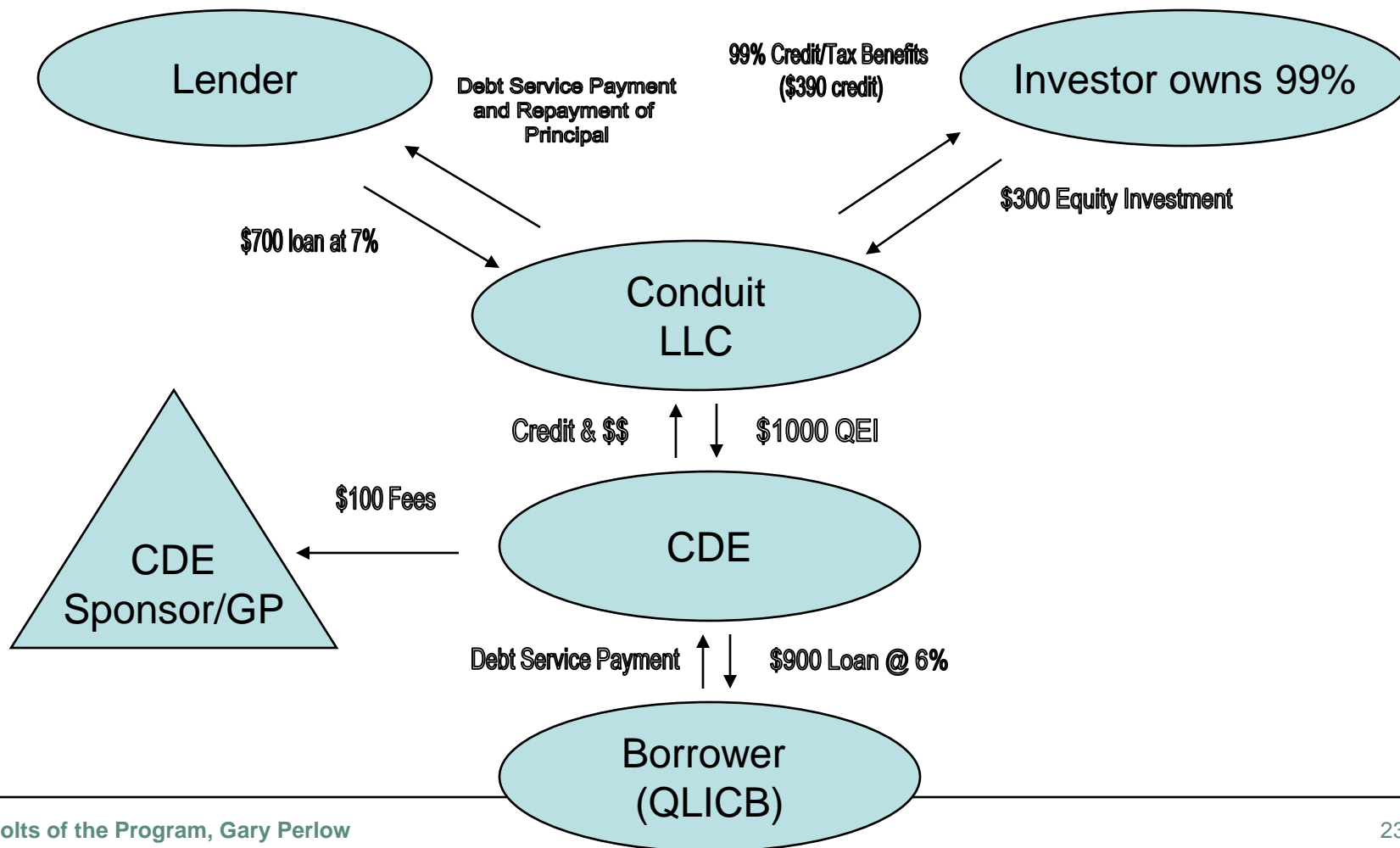
Exceptions:

1. The gross income test is met if either the tangible property or the services test is met at 50% or higher.
2. A business venture with no employees (e.g., real estate partnership) meets the services and gross income tests if it meets the tangible property test at 85% or higher.
3. "Active conduct" includes start-ups (for profit and not-for-profits) if the entity is reasonably expected to generate revenue (receive donations) within three years of the date of the QLICI.

Test #4 to be a QALICB- Do you meet the Activity Tests? (continued)

- Less than 5% of the average aggregate unadjusted bases of the property is attributed to:
 - Collectibles (e.g., art and antiques, other than for sale in the ordinary course of business), and
 - Non-qualified financial property (e.g., debt instruments with a term in excess of 18 months OR unreasonable levels of working capital in cash and cash equivalents [QLICI made to support construction activity within twelve months of investment is considered reasonable working capital]).
- Construction of Real Property Exception.

How Does Leveraging Work?



Portion of Business Rule

- A portion/division of a business is a QALICB if that portion would meet all the tests if portion was separately incorporated.
- Must be able to trace QLICI proceeds to that portion of business and maintain separate books and records.
- When is this rule utilized in the industry?



Reasonable Expectation Position

- If CDE does not control QALICB and CDE can demonstrate it “reasonably expects” the QALICB will remain a QALICB for 7 years at time of closing it will always be a QALICB!
- Control- ownership of more than 50% or control (based on voting rights or management rights) of more than 50%.
- Management rights defined as power to influence policies or investment decisions.



Establishing Your Reasonable Expectation Position

- Reps and Warranties.
- Review development budget/timeline.
- Review operating projections.
- Review existing leases/lease commitments.
- Review corporate minutes.
- Prepare reasonable expectations position memorandum.