ANALYSIS OF SELECTED NEW MARKETS TAX CREDIT PROJECTS

Final Report

June 2007

Prepared for:

U.S. Department of the Treasury
Community Development Financial Institutions Fund

Prepared by:

The Urban Institute
2100 M Street, NW ● Washington, DC 20037

Analysis of Selected New Markets Tax Credit Projects

Final Report

June 2007

Prepared By:

Martin Abravanel
Nancy Pindus
Brett Theodos

The Urban Institute
Metropolitan Housing and Communities
Policy Center
2100 M Street, NW
Washington, DC 20037

Submitted To:

U.S. Department of the Treasury
Community Development Financial Institutions Fund
601 Thirteenth Street, NW
Washington, DC 20005

Contract No. GS-23F-8198H, Task Order TPD-CDF-06-K-00011
UI Project No. 08003-000-00

TABLE OF CONTENTS

ACKNOWLEDGEMENTS

This report would not have been possible without the voluntary cooperation and forthright comments of the Community Development Entities (CDEs), investors, borrowers, and other key participants who were interviewed as part of the study. We also thank the following staff of the CDFI Fund for their guidance and thoughtful input throughout the project: Jim Greer, Linda Davenport, Matt Josephs, Chris Stever and Trefor Henry; as well as Donna Fabiani, formerly of the CDFI Fund. Consultants John Caskey, Julia Sass Rubin, and Sean Zielenbach provided valuable and insightful advice at many points during the study, and Margery Turner of the Urban Institute offered important comments on an initial draft of the report.

EXECUTIVE SUMMARY

In the early 2000s the U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund began to administer the New Markets Tax Credit (NMTC) program, which targets debt and equity capital to businesses or organizations situated in low-income, economically distressed communities. It works through specialized Community Development Entities (CDEs) that offer federal tax credits in exchange for investments in projects ranging from commercial, industrial, retail, manufacturing, or mixed-use ventures to community facilities. This is a report on a diverse sample of five such projects utilizing tax credits allocated in 2002 and 2003—early in the program's history. Its substantive purpose is to describe the characteristics, evolution, financial arrangements, and anticipated community impacts of the projects, while its methodological purpose is to explore the strengths and limitations of using in-depth, semi-structured telephone interviews with key project actors and stakeholders as a basis for generating data for a future program evaluation. The information in this report was provided voluntarily by CDEs, with the expectation that the report would be available to the public.

Project evolution. All of the CDEs or their parent organizations had some type of previous experience in aspects of community development prior to their use of NMTCs. Although the evolution of the relationships that brought together the particular CDEs, investors and recipients of the investments (as well as their legal/accounting support teams) varied by project, preexisting relationship networks played some role in each instance. Where CDE officials believed a proposed project met the locational criteria of the NMTC program, they generally proposed its use to a prospective investment recipient as a possible part of the project's financing. Most such businesses or organizations had either not heard of the NMTC program or knew little about it when the investments were initially considered—given that the program was relatively new at the time. All projects were completed on schedule, although there were overruns in one of them due to unanticipated increases in the cost of construction materials. Two of them faced some early challenges in making loan repayments but these have subsequently been overcome. No delinquencies or other financial problems have arisen in any of the projects.

Financial arrangements. One CDE invested in each of the five projects. Two of them were subsidiaries of national non-profit organizations, two were subsidiaries of regional banks, and one was a certified Community Development Financial Institution (CDFI). While the regional banks were also the investors in their projects, either a national or local bank not affiliated with the CDEs was the investor in the remaining three. One project also included an individual investor. Besides NMTC-stimulated investments, four of the projects attracted conventional investments either from the CDE or an outside bank, one received private donations, and two received additional support from public sources—in the form of Community Development Block Grants, state energy conservation grants, or Rehabilitation Tax Credits. Projects varied from small, straightforward investments to large, complicated arrangements. The smallest, in terms of total project costs, was $819,000, and the largest was $36,295,000. NMTC funding as a share of total project financing varied considerably, from 5.5 percent to 83.7 percent.

Role of NMTCs. As is often the case in real estate or business transactions, time was of the essence for one reason or another in all of the projects; absent the use of NMTCs, therefore, financing was considered insufficient or only available on less favorable terms. All of the CDE investments offered at least one type of better-than-standard rates and terms, and one offered as many as ten different types of better rates and terms. After the fact, however, the case for NMTCs being essential to projects was not entirely evident in all instances, with indications that some of them might have come to fruition without the credits.

Anticipated community benefits. Conditions immediately surrounding the various project sites ranged from quite deteriorated to moderately blighted to not especially blighted but also not improving. The poverty proportions of the census tracts in which projects were located ranged from 17 percent to 30 percent for individuals—although two of the sites were in core downtown areas with limited residential composition. Although some CDEs have paid particular attention to project benefits and to documenting such outcomes, the benefits to communities and low-income persons deriving from the investments were not well articulated in every project, nor did community benefits always appear to be a primary concern. The investments of these and of the other CDEs also indicate a wide range of outcome possibilities—including leveraging or stimulating other investment, creating or retaining jobs, adding to local tax bases, stemming blight, reinvigorating neighborhoods, or expanding services—and, therefore, a need for multiple measures in order to capture them.

I. BACKGROUND

The U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund administers the New Markets Tax Credit (NMTC) program, which targets debt and equity capital to businesses or organizations situated in low-income, economically distressed communities.[1] Intended to address the lack of available capital for business and economic development ventures in such places, the program provides federal tax credits to those who would invest in Community Development Entities (CDEs)[2] that, in turn, invest in qualified businesses. Each business or economic development initiative supported by the NMTC program, termed a project,[3] involves at least three key parties:

- **A CDE** that has been competitively awarded an allocation of tax credits by the CDFI Fund and, then, sells them to investors;
- **Individuals or corporate investor entities** (that may or may not be affiliated with a CDE) that use the tax credits in return for making an equity investment in a CDE,[4] which the CDE subsequently uses for making loans or equity investments in projects;[5] and
- **The recipient of the investment**, termed a Qualified Active Low Income Business (QALICB).[6]

---

[1] The program was enacted as P.L. 106-554, Community Renewal Tax Relief Act of 2000, and signed into law on December 21, 2000. The legislation defines low-income communities as consisting of census tracts with a poverty rate of at least 20 percent, a median family income of less than 80 percent of the metropolitan areas or statewide median (whichever is greater) or, for non-metropolitan census tracts, a median family income of less than 80 percent of the statewide median. Census tracts typically contain between 1,500 and 8,000 people, with an average size of about 4,000 people.

[2] CDEs are domestic corporations or partnerships whose primary mission is to serve or provide investment capital for low-income communities or low-income persons. Certified by the Treasury Department, they are required to maintain accountability to residents of low-income communities through representation on their governing or advisory boards.

[3] Projects may consist of one or more transactions (investments or loans); of 234 projects initiated under the program as of 2004, 201 consisted of one transaction, 21 consisted of two transactions, and 12 consisted of three or more transactions.

[4] A CDE may also use NMTCs to purchase a qualifying loan from another CDE.

[5] A qualified equity investment consists of stock or a similar equity interest acquired directly from a CDE for cash. Substantially all of the cash received by CDEs in exchange for tax credits must be used: to make loans or investments to businesses located in low-income census tracts; for development of commercial, industrial and retail real estate projects (including community facilities) in low-income census tracts; development of for-sale housing in low-income census tracts; to invest in or loan to other CDEs; to purchase qualified loans from other CDEs; or to provide certain financial services to business and residents in low-income communities.

[6] QALICBs may be pre-existing or newly established businesses or organizations in which (a) at least 50 percent of the total gross income is from the active conduct of a qualified business in low-income communities, (b) at

There is considerable flexibility with respect to the types of projects that can be supported by NMTC-stimulated investments. They can include for-profit and non-profit businesses for commercial, industrial, retail, manufacturing, and mixed-use projects, for example, as well as community facilities such as childcare or health facilities or charter schools.[7]

II. PURPOSE AND METHOD

This is a report on a small but diverse sample of projects in which CDEs, using a portion of their Round 1 (2002) or Round 2 (2003) NMTC allocations, have invested.[8] It has two purposes—one primarily substantive and the other primarily methodological.

The substantive purpose is to provide a more complete picture of the characteristics, evolution and financial arrangements of selected projects than is available in either the CDEs' applications for NMTC allocations, the allocation agreements they have with the CDFI Fund, or the CDFI Fund's data tracking systems. Although applicants for NMTCs are required to describe their plans for using the credits (including the geographic areas and communities to be served, the types of projects to be undertaken, and the kinds of financial products to be provided), they cannot initiate specific projects until they have received an allocation. Once CDEs have an allocation and begin projects, the reports they submit to the CDFI Fund provide detailed data on the financial aspects of each transaction but limited descriptive information about the projects themselves. This report, therefore, describes specific NMTC projects and reports on how they came about, the roles played by CDEs and investors, why NMTCs were used, and what community impacts were intended.

The methodological purpose is to explore the strengths and limitations of using a particular approach to assessing the NMTC program—as preparation for designing a subsequent, more comprehensive evaluation plan.[9] The approach involves:

---

least 40 percent of the use of tangible property of the business is within low-income communities, (c) at least 40 percent of the services performed by the businesses' employees are performed in low income communities, (d) less than 5 percent of the average of the aggregate unadjusted bases of the property is attributable to collectibles (e.g., art and antiques) other than those held for sale in the ordinary course of business (e.g., inventory), and (e) less than 5 percent of the average of the aggregate unadjusted bases of the property is attributable to nonqualified financial property (e.g., debt instruments with a term in excess of 18 months).

[7] New Markets Tax Credit Fact Sheet, prepared for the New Markets Tax Credit Coalition by Rapoza Associates, www.newmarketstaxcreditcoalition.org/reportsETC/newfiles/fact&figure.pdf.

[8] To date there have been five rounds of NMTC allocation competitions, the last of which is currently in process; awards are expected to be made in fall 2007. For this study projects were limited to allocation Rounds 1 and 2 given the probability that these were more likely to have been completed than those from later rounds. As of FY 2004, there had been a total of 292 transactions, 42 of which were in Round 2 and the remainder in Round 1.

- Focusing on individual projects as the units of analysis;
- Gathering qualitative information about them through in-depth, semi-structured telephone interviews with key actors and stakeholders (CDE officials, investors, investment recipients, attorneys, accountants or others);[10] and
- Assembling other information contained in CDE applications to the CDFI Fund, allocation agreements, documents provided by project stakeholders, and financial transaction data reported in the CIIIS and ATS.[11]

Although akin to classic case study methodology, the intent is not to provide detailed, stand-alone descriptions or reports on each project but, instead, to assemble a body of information that can be categorized across projects (or project types) and analyzed using standard descriptive or inferential statistics. The approach allows for gathering a rich and textured body of information at the project level, viewing each from diverse perspectives, triangulation of information and, then, aggregate-level analyses.

Based on a review of CIIS and ATS data and discussions with CDFI Fund staff, five projects were selected for preliminary study. Five was considered a small enough number to facilitate testing the telephone interview approach but large enough to be able to include diverse types. While every possible project type could not be represented among the five, they were selected to reflect a range of characteristics with respect to:

- **Participants**—whether for-profit or not-for-profit organizational structure, investor type, and QALICB type (real estate or not real estate);
- **Projects**—number of transactions per project, project purpose (such as business, commercial, real estate, etc.), business description, transaction type, investment amount, type of QEI Investor (self-funded or not), whether there was a single or were

---

[9] It was done as one component of a preliminary assessment of the program by the Urban Institute. The other components consisted of compilations of (a) data culled from CDE applications for tax credit allocations and (b) administrative information on NMTC transactions routinely collected through the Community Investment Impact System (CIIS) and Allocation Tracking System (ATS) of the CDFI Fund. See Rosso *et al*., *Analysis of the New Markets Tax Credit Program Applicant Pool* (February 2007, the Urban Institute) and Theodos *et a/., New Markets Tax Credit Program Initial Data Assessment (*December 2006, The Urban Institute).

[10] Across the five projects, 13 interview sessions were held with a total of 27 persons.

[11] This included: market studies; business plans; sources and uses of funds documents; *proforma* income statements; descriptive information (e.g., project profiles, newspaper articles, and organizational information available on the Websites of the CDEs, their controlling entities, banks, and other project stakeholders); data on all outstanding loans, investments and advance commitment loan purchases for NMTC allocations (as of fiscal year 2004) by allocation round; information on investors and the structure of their investments in CDEs; census tract data summaries for each project location; and other material, including the *Annual Progress Reports* of the New Markets Tax Credit Coalition.

multiple investors, whether the financing involved a leverage model or not, and use of historic tax credits or not; and

- **Locations**—region of the country, urban or rural, and community distress indices.

The specific CDEs and projects that were selected are discussed later in this report. The information was provided voluntarily by CDEs, with the expectation that the report would be available to the public. Note that while the CDEs are identified by name, establishing relationships or assessing program outcomes does not require knowing the identities of individual projects. Hence, to both respect the privacy of investors and QALICBs and encourage their voluntary participation in the study, projects are described in general terms but not otherwise named.

In addition to the fact that five projects is a relatively small number given the size and diversity of the NMTC portfolio, there are additional limitations to the method described above. These are not critical with respect to what has been learned from the information that was gathered, but are worthy of note nonetheless.

- The projects were initiated early in the development of the NMTC program and, as such, may not represent adequately the kinds of investments and projects that have emerged as the program has evolved since then.

- The preliminary effort did not allow for particularly detailed reviews of some of the documents (such as business plans and *proformas*) and did not permit identification of, or interviews with, persons other than the primary stakeholders.

- To the extent the interview method relies on respondent recall, the accuracy of the information provided about how these projects were initiated and evolved could have been compromised by time or hindsight.

- There is some disadvantage in not having visited a project or met in person with stakeholders, which would have allowed for direct observation of the physical site and facilitated identification of a network of other interested or affected parties. This limitation does not apply to understanding the financial details of the projects, however, since these are reasonably well communicated via other means.

- In view of the above, there was limited opportunity to evaluate, empirically and independently, either the projects' impacts on low-income persons, neighborhoods, or communities or the extent to which NMTCs contributed to such impacts. These issues are considered later in the report, but surely require more rigorous and extensive study in the future.

The following sections: provide a picture of the CDEs (and their parent organizations) that invested in the selected projects; portray the projects in terms of their characteristics and evolution; consider the projects' financial arrangements; offer some general, cross-site observations regarding what was learned about the need for tax credits in different projects and their intended impacts; and present some stakeholder perspectives on the NMTC program. Brief profiles of the five projects are provided in the Appendix.

III. FIVE CDEs AND THEIR CONTROLLING ENTITIES[12]

The selected projects used NMTC allocations from five of the 50 CDEs (39 in Round 1 and 13 in Round 2) that had reported Round 1 or Round 2 transactions as of the end of fiscal year 2004. The five CDEs are as follows:

- The Oak Hill Banks Community Development Corporation
- Rural Enterprises of Oklahoma (REI) New Markets Investment, LLC
- The National Development Council (NDC), HEDC New Markets, Inc.
- The National Trust for Historic Preservation, National Trust Community Investment Corporation (NTCIC)
- Zions Community Investment Corporation (ZCIC)

Table 1, which summarizes some of their key characteristics, shows that the selected CDEs included those with a primarily local perspective as well as those with a statewide, regional or national scope, and those whose controlling entities include banks, a certified CDFI,[13] and national non-profit organizations.[14]

All of the controlling entities had experience in aspects of community development prior to their use of NMTCs. The two banks, for example, had been involved with both the Community Reinvestment Act (CRA) and small business lending, with one of them serving primarily rural, low-income communities. The two non-profit organizations—the National Trust for Historic Preservation and the National Development Council—were established in 1949 and

---

[12] These are entities that control a CDE, with control defined as: ownership, control, or the power to vote more than 50 percent of the outstanding shares of any class of voting securities of any entity, directly or indirectly or acting through one or more other persons; control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of any other entity; or the power to exercise, directly or indirectly, a controlling influence over the management policies or investment decisions of another entity, as determined by the CDFI Fund.

[13] Community Development Financial Institutions are private sector financial intermediaries whose primary mission is community development. Nationwide, there are over 700 such institutions certified by the CDFI Fund.

[14] See Thoedos et al., *New Markets Tax Credit Program Initial Data Assessment*.

1968, respectively, with missions that included community revitalization and economic investment in low-income areas. Rural Enterprises of Oklahoma was established as a CDFI in 1982 to provide economic development services. Four of the five CDEs were established by their controlling entities specifically to permit them to carry out their business objectives or missions using the NMTC program, and one was established shortly before the NMTC program.

In their applications for NMTC allocations, four of the five CDEs planned to use the investment capital they would obtain by selling NMTCs for both business and real estate financing, although one of them had planned to support primarily businesses. The fifth CDE planned to limit its investments to real estate. Two of the CDEs intended to use NMTCs only for making loans, while the others planned to make both debt and equity investments.

Each of the controlling entities and their CDEs is described briefly in Table 1 and below.

Table 1: Key Characteristics of Selected CDEs

CDE Characteristics	Oak Hill Banks Community Development Corporation	REI New Markets Investment, LLC	HEDC New Markets, Inc.	National Trust Community Investment Corporation (NTCIC)	Zions Community Investment Corporation (ZCIC)
Location	Jackson, OH	Durant, OK	New York, NY	Washington, DC	Salt Lake City, UT
Allocation years and amounts	2003: $20M	2002: $56M 2005: $80M	2002: $30M 2003: $135M 2006: $121M	2002: $127M 2006: $53M	2003: $100M
Geographic scope	Local	State-wide (2002); Multi-state (2005)	National	National	Regional
Organization structure	For profit	For profit	Non-profit; for-profit subsidiaries established for individual projects	For profit	For profit
Structure of controlling entity	Thrift bank or bank holding company	Certified CDFI	National non-profit	National non-profit	Thrift bank or bank holding company
CDE uses of NMTC	Loans for business and real estate; financial counseling	Loans & equity to businesses, especially in rural communities in Oklahoma.	Loans & equity in real estate and non real estate, limited partnerships	Equity & loans for historic rehabilitation, including for pre-development or construction; often combined with federal & state historic tax credits	Loans for business and real estate
Relationship to controlling entity	Subsidiary formed by controlling entity specifically for NMTC	Subsidiary formed by controlling entity specifically for NMTC	Subsidiary formed by controlling entity specifically for NMTC	Subsidiary formed by controlling entity (in 2000) to advance its historic-preservation based economic development initiatives in low-income communities	Subsidiary formed by controlling entity specifically for NMTC

Oak Hill Banks, a community bank serving rural southern Ohio, is over 100 years old, and has $1.3 billion in assets. A full-service banking institution, it provides investment funding to business and also offers a variety of lending products to residents within its service area—including residential loans and home equity lines of credit. Over the period 1998-2002, almost 60 percent of Oak Hill Banks' real estate and non-real estate business loans were to businesses in disadvantaged communities.

Oak Hill Banks CDC, a CDE in which Oak Hill Bank is the sole investor, was formed specifically for the NMTC program. It has one Advisory Board member from each of the 12 counties it serves. Because of its location in a low-income area, it has experience in other community development financing and federal business/community investment/support programs beyond NMTCs, including equity investments in CDFIs, Small Business Administration (SBA) 7(a) and 504 guaranteed loans, and State of Ohio small business deposits, agriculture, and economic development funds. In Round 2 of the NMTC allocations, the CDE requested an allocation of $50 million and was awarded $20 million, which it used to finance projects and, later, re-invest the interest and payments that were received. Loans ranged from about $140,000 to just over $4 million. Although the CDE had five years in which to invest its NMTCs, it did so within two years—a reflection of demand within its area. In addition to loans to businesses, the funding stream was used to provide financial counseling and for contracting out the provision of formal business workshops on QuickBooks, Financial Management, Marketing and Communications, and Business Technology (e.g., various Microsoft tools).

Rural Enterprises of Oklahoma, Inc. (REI) is a certified CDFI that provides economic development services within the State of Oklahoma. A large packager of SBA (504, 7(a), MicroLoan programs) and Rural Development (USDA), it also: receives funds from the Oklahoma Department of Commerce (used to match federal grants and contracts for economic development) and the Oklahoma Department of Agriculture (used to match federal rural development funding); hosts an extension engineer to work with fledgling manufacturers; and is a rural housing financer. REI is one of the largest rural development entities in the country—having been awarded funds of $11.5-12 million and maintained a $50 million portfolio of rural development projects—and is committed to making 60 percent of its investments in rural areas. It does not offer any conventional financing and does not compete with the lending institutions (banks) with which it works, instead, concentrating much of its outreach on working with banks that historically have been partners for SBA and other programs.

REI New Markets Investment, LLC, a CDE, is a wholly owned subsidiary of Rural Enterprises of Oklahoma, Inc., formed specifically for the NMTC program. The NMTC program is the first tax credit program with which it has worked. All of its previous experience with public programs involved debt financing. Since it was formed, the CDE has also begun working with state tax credits. It uses NMTCs to support businesses, especially in rural communities, by providing loans and equity. As of March 2007, the CDE had $694,000 of NMTCs that had not yet been committed from its Round 1 allocation. It also received a Round 3 allocation (2005) and is presently funding projects out of that round.

The National Development Council (NDC) is a nationwide non-profit organization dedicated to economic development finance and housing. Begun in 1968, NDC's initial mission was to be a catalyst to stimulate investment in communities of color. Today it attempts to stimulate investment in low-income areas, create jobs for the unemployed, and provide quality affordable housing for low-income families. NDC has 55 employees in 26 offices across the country, and a network of partners, social service providers, housing providers, and units of state and local governments with which it works. It has client relationships in 38 states, and provides technical assistance and training to 100-150 clients at any point in time. It provides: technical assistance to communities to develop and finance economic development and affordable housing projects; professional development in economic development and affordable housing for practitioners; and direct small business lending in low-income communities. NDC has used most economic development tools—including Low Income Housing Tax Credits (LIHTCs), Rehabilitation Tax Credits (RTCs) for historic properties, U.S. Department of Housing and Urban Development (HUD) Section 108 loans, SBA guaranteed financing, tax exempt debt, and HUD's Urban Development Action Grants (UDAGs) in the past.

HEDC New Markets, Inc., a CDE, is a new non-profit entity created by NDC specifically to implement a NMTC program in the communities in which NDC works. Although the CDE operates on a nationwide basis, in its initial application for a NMTC allocation it anticipated focusing most of its activities in the states of California, Maryland, New York, Washington, Illinois, Indiana, and Pennsylvania. It applied for a NTMC allocation in three of four rounds and was awarded an allocation each time. The CDE has closed $62M of its Round 4 allocation and committed the balance, and has subsequently applied for a Round 5 allocation. HEDC makes loans and investments in business and real estate projects.

The National Trust for Historic Preservation was founded in 1949 as a private, nonprofit membership organization dedicated to saving historic places and revitalizing America's communities. For the past 25 years, the Trust has implemented a revitalization strategy in older Main Streets and residential neighborhoods, focusing on building preservation and on cultivating locally owned businesses. The Trust operates three community revitalization programs: the National Main Street Center that provides training and technical assistance in small business development; Community Partners, which offers a range of low-interest loans and consulting to preservation projects; and Preservation Development Initiatives that conducts comprehensive assessments of communities' historic resources and helps them maximize their economic potential.

The National Trust Community Investment Corporation (NTCIC), a CDE, was established in 2000 to advance the Trust's historic preservation-based economic development initiatives in low-income communities, focusing on each community's distinctive character. NTCIC has a nationwide service area, but has focused most of its activities in the states of North Carolina, New York, Texas, California, Michigan, Oregon, and Maryland. NTCIC initially proposed a NMTC strategy that consisted of five different products involving loans and equity for historic rehabilitation projects—including short-term, small real estate predevelopment construction and bridge loans, and combining NMTC with federal and state historic tax credits for eligible projects. Its more recent applications for allocations of NMTCs, however, have focused on providing equity and equity-like loans for rehabilitating strategic vacant properties for reuse as office, retail, mixed-use or community and cultural facilities in conjunction with federal Rehabilitation Tax Credits (RTCs).

Zions Bancorporation (ZBC) dates to 1873 when Zion's Savings Bank and Trust Company was incorporated in the Utah Territory under the direction of Brigham Young, becoming Utah's first chartered savings bank and trust company. In 1957 it merged with two other banks to form Zions First National Bank. In 1987, the name of the investment company changed to Zions Bancorporation. It now includes affiliate banks in ten states—Arizona, California, Colorado, Idaho, Nevada, New Mexico, Oregon, Texas, Utah and Washington, which operate under their own names. In addition to a wide range of traditional banking services, Zions offers an array of investment, mortgage and insurance services, and has a network of loan origination offices for small businesses nationwide. The company also provides electronic banking services, including electronic municipal bond trading, and is the only primary government securities dealer headquartered west of the Mississippi River. ZBC places a premium on: having strong local bankers in the communities it serves; being involved in those communities; and having personal relationships with its customers. In addition, it specializes in government-backed lending to small and emerging businesses, is a large SBA lender, and serves low- and moderate-income and underserved communities to meet Community Reinvestment Act (CRA) requirements (including loans in "Hot Zone" census tracts).

Zions Community Investment Corporation (ZCIC), a CDE, is a for-profit subsidiary of ZBC. ZBC provides the sole source of funding for ZCIC. Affiliate banks send potential projects to ZCIC, which consist primarily of loans ranging in size from under $500,000 to $25 million. The CDE's Round 2 application for an NMTC allocation indicated plans to focus on smaller businesses because the procedures for drafting loan documents and other procedures are already set up so that the bank can afford to do smaller loans.

IV. PROJECT CHARACTERISTICS AND EVOLUTION

This section describes five projects in which the above CDEs have invested. Two of them involve use of NMTCs from the Round 1 allocation and three involve use of credits from the Round 2 allocation. One of the five was initiated in 2004 and completed in 2005, while the remaining four were initiated in 2004 and completed in either 2005 or 2006. In each instance, these were either the first or among the first projects in which the respective CDEs used a portion of their NMTC allocations.

Project characteristics. While it is possible for multiple CDEs to invest in the same project, in the vast majority of instances only one CDE has been involved in each project, and that is the case for all of the projects described in this report. In two of them the CDEs are subsidiaries of regional banks, which also are the investors and, in the remaining three, either a national or local bank not affiliated with the CDE is the investor. One of the projects also involved an individual investor. In none of the cases did the QALICBs receive formal financial counseling from the CDEs, although one of them received guidance with respect to locating accountants and attorneys to help structure their financial package. The five projects are as follows:

- **The Oak Hill Bank Community Development Corporation**, as CDE and sole investor, provided debt financing to a start-up small business located in a rural area in the Midwest. The business supplies parts to construction contractors. Its loan was for the purposes of purchasing and rehabilitating a vacant commercial property that is used as a warehouse and for distribution purposes.
- **REI New Markets Investment**, as CDE, sold tax credits to an investor bank and an individual investor and, in turn, provided debt financing to expand a business located in a medium sized city in the South. The business, which supplies a service for the health and hospitalities industries, needed a loan for the purpose of building a new facility and purchasing highly specialized equipment.
- **HEDC New Markets, Inc.**, as CDE, sold tax credits to an investor bank and, in turn, provided debt financing to a private development company for construction of an office, hotel, and retail complex in a medium-sized city in the Northeast. The major employer in the city, located away from the downtown area, is a large university. The university initiated the project so that it could rent office space for some of its staff as a way to support downtown revitalization.
- **The National Trust Community Investment Corporation (NTCIC),** as a CDE, sold tax credits to an investor bank and, in turn, made an equity contribution to a partnership established with the parent organization of a nonprofit network headquartered in a large community in the South. The nonprofit organization, which offers specialized services to

predominantly low-income minority clients, had obtained a vacant, boarded-up, historic property for use as its headquarters. The equity investment contributed to the extensive rehabilitation that was required.

- **Zions Community Investment Corporation (ZCIC),** as CDE and sole investor, provided debt financing to an existing large private medical practice for the construction of a new office facility that provides outpatient services in a medium-size city in the West.

Key characteristics of the projects are summarized in Table 2.

Table 2: Project Characteristics

	CDE (Allocatee)				
Project Characteristics	Oak Hill Banks Community Development Corporation	Rural Enterprises of Oklahoma, Inc. (REI) New Markets Investment, LLC	National Development Council (NDC), HEDC New Markets, Inc.	National Trust for Historic Preservation, National Trust Community Investment Corporation (NTCIC)	Zions Community Investment Corporation (ZCIC)
Timing					
Allocation round	2	1	2	1	2
Year initiated	2004	2003	2001	2004	2004
Year completed	2005	2004	2005	2005	2006
QALICB or QALICB Parent Descriptors					
Scale/size (based on payroll, employees, etc.)	Very small	Small	Medium	Medium	Medium/large
For- or non-profit	For profit	For profit	For profit	Non profit	For profit
Minority, low-income, or women owned/managed	None	None	None	Minority managed	None
Location					
Region	Midwest	South	Northeast	South	West
Metropolitan or non metropolitan	Non-metropolitan	Metropolitan	Metropolitan	Metropolitan	Metropolitan
Community size	Small	Medium	Medium	Large	Medium
"Downtown " site	No	No, residential/ industrial area	Yes	Yes	No
Project Descriptors					
Business, commercial real estate, residential real estate	Commercial real estate—rehabilitation	Commercial real estate—new construction & equipment purchase	Commercial real estate—new construction	Commercial real estate—rehabilitation	Commercial real estate—new construction
New or existing entity	New	Existing	Existing	Existing	Existing
Percent poverty of census tract	16.60%	19.60%	30.10%	43.80%	20.50%
Percent of Median Family Income[15]	61.70%	58.50%	74.80%	73.50%	64.40%
Nature of project	Establish wholesale parts distributorship for the construction trades	Expand business serving health & hospitality industries, established as a separate business	Develop office, hotel & retail complex	Rehabilitate headquarters building for a social services provider	Develop/expand private-practice medical offices complex

[15] These data are drawn from the CDFI Fund Information and Mapping System (CIMS). The NMTC median family income is defined as the *greater* of the statewide median family income or the metropolitan median family income.

Project evolution. Although the evolution of the relationships that brought together the particular CDEs, investors and QALICBs (as well as their legal/accounting support teams) varied by project, preexisting relationship networks played some role in each instance. In three cases, for example, the QALICBs—either the existing businesses or some of their principals—had previous customer relationships with either the CDEs and/or the investors that became involved in the projects. In one of the remaining projects, pre-existing relationships also existed that brought together the sponsor, the QALICB, the investor, and the legal support team—even though the investor, QALICB and CDE had not previously done business with one another. And, in the fifth case, the CDE was referred to the QALICB by another CDE based on the latter's knowledge of the particulars of the proposed project. The former CDE had an existing arrangement with a major national bank that, then, became the investor.

NMTCs were presented to QALICBs as one possible means for obtaining debt or equity financing by the CDEs or investors to whom they had come for assistance. In some cases, the QALICBs had not previously been involved with a public program that encouraged economic development but, in others, there was familiarity with, and previous use of, other such programs—such as Small Business Administration (SBA) loans, Community Development Block Grants (CDBGs), or state economic development programs. Most, however, either had not heard of the NMTC program or knew little about it given that the program was relatively new at the time. Where CDEs, therefore, believed a proposed project met the locational criteria of the NMTC program, they generally proposed its use to the QALICBs as a possible part of the project financing. The financing circumstances were different from project to project.

- **The Oak Hill Banks CDC project** involved several partners looking for financing to start a new business that required a warehouse and distribution building. The partners looked at a handful of properties before settling on one they considered being best suited for their needs. Since it was expected to take some time to establish and grow the new business, the partners sought the most favorable loan terms possible so as to cushion any potential early start-up challenges. The building was located in a qualified low-income census tract in a relatively depressed area and, therefore, was eligible for NMTC investment.
- **The REI New Markets Investment project** involved several partners seeking to expand their business, which required the kind of specialized equipment that, if the business failed, would have poor resale value. Having been turned down for conventional financing multiple times for this reason, the partners sought a loan from a bank with which they had a previous relationship, which also was a Small Business Investing Company (SBIC). The bank, which had informal links to a CDE, recommended that the partners consider use of NMTCs, and the CDE provided the partners with a list of census tracts that qualified under the program. The partners went from tract to tract to

search for land on which to construct a new facility and, when they found an appropriate site, took advantage of the NMTC program.

- **The NDC HEDC project** involved a major university that was looking to sponsor development of off-campus office space, some of which it intended to rent, as a means of supporting the downtown area of its community. The university's partner in this endeavor (a large regional real estate, development and management company—ultimately the QALICB) conceived of the project as involving construction of Class A office space, an upscale, mid-priced hotel and retail space. The lease it obtained for the land on which the complex was to be built contained preconditions requiring project completion by a certain date. Given the time constraints imposed on the development, the developer bought the land, commissioned an architectural design, and began to move forward on construction in anticipation that a state economic development grant would be forthcoming. When the grant did not materialize and cost overruns began to mount as a result of unanticipated increases in materials costs, the developer sought help from a CDE to fill the financing gap that existed between projected completion costs and the conventional financing it had obtained. NMTCs were proposed to fill the gap inasmuch as the project's downtown location was in a qualified census tract.
- **The NTCIC project** involved a nonprofit organization looking to obtain funding beyond the CDBG funds and private donations it had received to completely rehabilitate a building it had acquired for use as its headquarters. Recognizing the historic character of the building, NTCIC worked with the organization to syndicate and obtain federal Rehabilitation Tax Credits (RTCs). To fill the remaining financing gap between anticipated rehabilitation costs and funds already obtained, the CDE proposed use of NMTCs, in conjunction with RTCs, because the building was located in a qualified census tract.
- **The ZCIC project** involved a partnership consisting of a large number of physicians who owned a medical office facility. The practice was growing in size and the partners were engaged in a multi-phase expansion of the facility. Looking for the best financing possible, the partnership approached two banks. ZCIC, which was a CDE allocatee, was able to offer the partnership better terms and rates with use of NMTCs than the competing bank because of the facility's location in a qualified census tract.

As is often the case in real estate or business transactions, time was of the essence for one reason or another in all of these projects. And, in all cases, available financing was either not sufficient or was available on less favorable terms than could be offered in conjunction with NMTCs. In one case, development was already underway and costs were accumulating and, in others, land, a building, or other funding was available in the short term that might no longer be available if a complete financial package could not be put together in a timely fashion. The

CDEs were able to assemble investors and process their investments within the needed time parameters and on terms that made the projects feasible with respect to scale and timing.

The projects ranged considerably as to the extent of their involvement with local government or planning agencies. Although in none of the cases did a government agency or official initiate or spearhead the project, they did play at least some role in three of them. One of the CDEs, for example, met with municipal officials while they were identifying promising project sites; the officials were eager to attract possible new business because of the local tax and utility revenues it would generate. Another was in close contact with city officials to encourage and facilitate development of a municipal parking structure in concert with the project. In that instance, the project was coordinated and consistent with the city's long-term redevelopment plans. In a third instance the QALICB had received city approval for a special construction waiver and had also received CDBG funds for the project, suggesting some degree of coordination with local community development activities. The project also required, and received, certification from the National Park Service. In the remaining two projects, however, there appears to have been no special role played by a government or planning agency.

Conditions immediately surrounding the various project sites ranged from being quite deteriorated to being moderately blighted to being not especially blighted but also not improving. The poverty proportions of the Census tracts ranged from 17 percent to 30 percent, for individuals—although two of the sites were in core downtown areas with limited residential composition.

All projects were completed on schedule, although there were overruns in one of them due to unanticipated increases in the cost of construction materials. Two of the businesses faced some early challenges in making loan repayments but these have subsequently been overcome. No delinquencies or other financial problems have arisen in any of the projects.

Key elements of the histories of the five projects are summarized in Table 3.

Table 3: Project History

	CDE (Allocatee)				
	Oak Hill Banks Community Development Corporation	Rural Enterprises of Oklahoma, Inc. (REI) New Markets Investment, LLC	The National Development Council (NDC), HEDC New Markets, Inc.	The National Trust for Historic Preservation, National Trust Community Investment Corporation (NTCIC)	Zions Community Investment Corporation (ZCIC)
History of the Relationship between the QALICB (or its parent), CDE and Investor					
The CDE is the controlling entity of the investor	Yes	No	No	No	Yes
The QALICB (or its parent) had a pre-project relationship with the CDE and/or investor	Yes	Yes	No	No	Yes
Who sought whom—how did initial contact between the QALICB, CDE and/or investor occur?	One of the partners in the new venture had a previous relationship with Oak Hills Bank. The venture was looking for financing to establish a business.	Investor is informally linked to REI (CDE). The QALICB came to the investor for financing to expand its business. Having had a previous relationship with the investor, QALICB came to them because they had been turned down for conventional financing and knew the investor made SBIC investments.	A university, looking to develop office space off-campus to support the downtown, selected a development partner (QALICB), which later came to HEDC (CDE) for assistance when the project experienced a funding gap partially associated with failure of a state program to deliver grant funds.	QALICB parent was looking for additional funding to rehabilitate a building it had acquired, for use as its headquarters. NDC referred the QALICB parent to NTCIC (CDE) because of the historic character of the building. The CDE collaborated with an investor bank.	QALICB came to the CDE/investor for financing for redevelopment/construction of its facility as part of a larger expansion of the facility. The CDE offered better financing than competitor investors, in part because of NMTCs.
Who first presented the idea of NMTCs to the QALICB (or its parent)?	Bank (CDE)	Investor	Law firm for QALICB suggested NDC (CDE)	NDC (CDE) referred the QALICB to NTCIC (CDE)	CDE
QALICB received financial counseling	No	No	No	Not formal, but selection of lawyers/accountants from CDE list	No
QALICB had previous experience with public economic development programs—including NMTCs	No	No	Yes, including state economic development program, SBA, CDBG, Energy Conservation grants	Yes, with CDBG and RTC (historic tax credits)	No

	CDE (Allocatee)				
	Oak Hill Banks Community Development Corporation	Rural Enterprises of Oklahoma, Inc. (REI) New Markets Investment, LLC	The National Development Council (NDC), HEDC New Markets, Inc.	The National Trust for Historic Preservation, National Trust Community Investment Corporation (NTCIC)	Zions Community Investment Corporation (ZCIC)
Site History					
Pre-project investment and economic development conditions in the target neighborhood/ property	Deteriorated, limited development potential	Not blighted, but no new investments	Some previous redevelopment had taken place.	Deteriorated, limited development potential	Somewhat blighted
Investor's Relationship to NMTCs and Site					
Investor had used other economic development programs prior to the project	Yes	Yes	Yes	Yes	Yes
Project the investor's first use of NMTCs	Yes	Yes	Yes	No	Yes
Investor subsequently used NMTCs	Yes	Yes	No	Yes	Yes
Investor previously made investments in the target or similar areas	Yes	Yes	Yes	No	Yes
Investor made subsequent investments in the target area	12 subsequent investments in Jackson County, OH	Uncertain	Uncertain	Uncertain	Uncertain
Project Follow-on					
Project completed on schedule/budget	Yes	Yes	Some initial budget and schedule overruns, cushioned by NMTCs	Yes	Yes, ahead of schedule and under budget
Any delinquencies or other problems; how is QALICB doing?	No. Some early challenges making payments; doing better since then	No. Some early challenges making payments, cushioned by NMTCs; doing better since then.	No. Hotel doing better than expected, office space doing somewhat less than anticipated	No	No. The practice has grown.

V. FINANCIAL ARRANGEMENTS

The underwriting process, financing, rates and terms, and investor configurations for the five projects are discussed below.

Underwriting. Underwriting consists of the process investors use to evaluate loan and investment applications. How the process works with respect to NMTC projects varied across organizations, with some patterns emerging.

For projects where institutional investors are distinct from the CDEs or their controlling entities, and where an outside institutional investor claimed the tax credits, underwriting was done by *both* the institutional investors (often banks of other financial institutions) and the CDEs. The way the process worked tended to vary somewhat across organizations but, in projects where a CDE and institutional investor had a longstanding working relationship, the underwriting guidelines had become somewhat standardized. In cases where CDEs are a self-financed subsidiary of a controlling entity that claims the tax credits, projects were underwritten only once—by the CDE staff. However, they were underwritten according to the controlling entity's standards and, depending on the CDE's relationship to the controlling entity, there may have been a loan review committee or some similar entity also involved. Of the five projects, one was underwritten by three separate entities, two were underwritten by two entities, and two were underwritten by one entity—the CDE. One of the five projects attracted an individual investor; also an NMTC claimant. That investor did not undertake formal underwriting review, but was involved with the QALICB through a previous relationship.

Projects were underwritten using standard practices, including income statements, a balance sheet, and *proforma* projections. Underwriters generally took into account applicants' cash flows, credit history, operating histories, collateral, character, equity contributions, and qualifying NMTC credits. The CDE and investor underwriters used all of the above information to determine if an applicant was an acceptable credit risk. CDEs and investors typically also evaluated the credit histories and assets of principal owners for smaller and younger businesses. While underwriters examined the credit histories of the QALICBs and the principal owners, they did not perform automated credit scoring underwriting, which is to be expected as credit scoring underwriting is typically restricted to loans under $250,000.[16] CDEs and banks reported that their NMTC projects used standard underwriting processes.

Financing. In addition to differences in projects' investment purposes, the five ranged greatly in size, transaction type, as well as with respect to the rates and terms involved. They varied from small, straightforward investments to large, complicated arrangements. The smallest, in terms of total project costs, was $819,000 and the largest was $36,295,000. NMTC financing ranged from $326,000 to $15,000,000. Likewise, NMTC funding as a share of total project financing varied considerably, from 5.5 percent to 83.7 percent. Other aspects of financing were as follows:

- Three projects exclusively involved debt financing, one involved an equity investment, and one consisted of both equity and debt financing. This is consistent with the full

---

[16] Temkin, Kenneth and Roger Kormendi, *An Exploration of a Secondary Market for Small Business Loans,* Small Business Administration, Office of Advocacy, 2003.

range of NMTC projects in fiscal year 2004, where equity investments comprised 14.8 percent of NMTC financing.[17]

- Of the four projects that involved some debt financing, two had loans that were fully amortized with terms of 240 and 258 months and two had partially amortized loans that were originated with terms of 84 months each.
- The NMTC financing in four of the projects was originated as one transaction, while the remaining project consisted of four separate transactions occurring over a several month period.
- Three projects had fixed interest rates starting at an average of 4.22 percent, and one had an adjustable interest rate starting at 7.09 percent, though rates may fluctuate.
- Two CDEs took the first lien position on the debt financing and two took the second lien position.
- Three of the debt-financed projects had zero points attached to the loan, while one had 3.5 points.
- One project contained convertible debt options.
- Three of the debt-financed projects had no origination fees, while the fourth represented less than one-tenth of one percent of the loan amount. CDEs reported that other fees were in line with their conventional financing.

In addition to NMTC financing, four projects also received conventional financing. Of these, two received conventional funding from the CDE itself. Oak Hill Banks CDC offered the construction supplies contractor a short-term loan, vehicle loan, and line of credit, totaling over $400,000 in additional financing. The medical office practice received roughly $27 million in traditional debt financing. A third project—the service supplier to the health and hospitalities industries—received over $1.2 million in new financing from the NMTC investor. One QALICB (the developer of the office, hotel and retail complex) received financing from a non-NMTC lender on the order of $23 million.

Two of the five projects received additional support from public sources. The office, hotel and retail complex received $700,000 in non-repayable Community Development Block Grant (CDBG) funding through the state, and $400,000 in state energy conservation grants. The non-profit provider of services to predominantly low-income minority clients received over $1.4 million in CDBG funding and nearly $500,000 in RTCs.

[17] Theodos *et al*.

Better rates and terms. While not required by statute, CDEs indicate that they generally offer better than standard rates and terms to QALICBs as a part of their NMTC financing. For reporting and evaluation purposes, the CDFI Fund has identified 13 types of better rates and terms (ranging from preferable equity terms to lower fees and rates to increased underwriting flexibility), and CDEs are required to record which of these, if any, they offer borrowers. The number of types of better-rates-and-terms varied substantially across the five projects, ranging from one to 10—averaging 5.4. As a group these five projects are somewhat more likely than the average NMTC investment to offer types of better rates and terms.[18]

The specific types of better rates and terms that were offered to QALICBs varied across projects. However, of the four with debt financing, all offered below-market interest rates and three offered lower-than-standard origination fees and longer-than-standard periods of interest-only payments. The presence of these three categories is consistent with the full range of NMTC transactions. As shown in Table 4, below, 79 percent of all transactions offered below-market interest rates, reported as of the end of fiscal year 2004; 62 percent offered lower-than-standard origination fees; and 39 percent offered longer-than-standard period of interest-only. These better rates and terms offered are an indication of the increased flexibility available for lenders under the NMTC program. One borrower for example, reported that the interest rate was lowered by one percent, which, when combined with a lower down payment, resulted in lower monthly payments. Another reported having received a seven-year fixed rate loan in a situation where a five-year adjustable rate loan would have been more typical.

[18] NMTC investments for fiscal year 2004 averaged 3.9 types better rates and terms offered. Theodos *et al.*

Table 4: Number and Percent of Transactions Recording Better Rates and Terms

Better Rates and Terms Category	Number	%
Below Market Interest Rates	231	79.1
Lower Than Standard Origination Fee	181	62.0
Longer Than Standard Amortization Period	114	39.0
Longer Than Standard Period Interest Only	113	38.7
Loan To Value Ratio Higher Than Standard	86	29.5
More Flexible Credit Standards	86	29.5
Subordinated Debt	70	24.0
Equity Products	69	23.6
Loan Loss Reserve Requirements Less Than Standard	49	16.8
Debt Service Coverage Ratio Less Than Standard	46	15.8
Non-Traditional Collateral	41	14.0
Debt With Equity	38	13.0
Equity Equivalent Terms	30	10.3

Source: Urban Institute analysis of NMTC data.
Note: Includes all transactions that had been initiated as of FY end 2004.
Better rates and terms categories are as reported by CDEs.

Lenders typically require that the debt service coverage ratio (DSCR), which is calculated by dividing the applicant business' net operating income by annual debt service (including the requested financing), meet a certain target—often 1.20. Two CDE lenders reported that they offered a lower DSCR than standard through NMTC financing. In addition, although most lenders do not make loans for projects with a loan-to-value (LTV) ratio greater than 80 percent, two CDE debt lenders reported that they accepted a higher LTV than standard for the projects in which they invested.

In addition to the above criteria, CDEs and investors evaluated the types of collateral that were used by QALICBs to secure debt financing. In this regard, loans used to purchase unique or specialized equipment generally represent a higher level of risk than loans to purchase non-specialized business equipment, as the former is more difficult to sell in the event of a foreclosure. Two of the four debt lenders recorded accepting non-traditional collateral, such as in the case of the business supplying services for the health and hospitalities industries, which required purchasing highly specialized equipment with few transferable uses.

Of the remaining types of better rates and terms, one of the four debt lenders offered debt with equity and one offered equity equivalent terms, which included convertible debt/warrants. With respect to credit standards, which are used by lenders to establish repayment histories, two were more flexible using NMTCs than is typical. For two of the four debt-financed projects, the CDE offered subordinated debt, accepting a second lien position. And, finally, unlike what normally occurs in SBA loan-guaranty programs, lenders in three of the four debt-financed projects did not provide longer loan terms (longer-than-standard amortization period), possibly because the NMTC is only claimable for seven years.

Investor configurations. To provide debt and equity financing to qualified businesses in low-income communities, CDEs obtain funds from investor entities that, in turn, acquire federal tax credits worth 39 percent of their original investment. Investors can be any person or organization with a federal tax burden. They are able to claim the credits over a seven-year period—a five percent claim for each of the first three years and a six percent claim annually for the four subsequent years.

CDEs have enormous flexibility in attracting investors and establishing investment vehicles. Those seeking outside investors can invite either general pooled investments or project-specific investments. Conversely, some CDEs are established by an investor such that all of their investments are self-funded by that entity.[19] The projects studied here reflect both of these investment structures. Three CDEs received investments from outside investors who subsequently claimed the tax credits. These were either local or national banks. The remaining two CDEs are self-financed subsidiaries of their controlling entities—local or national banks—that claimed the credits. And, one of the five projects also attracted an individual investor, who was also a NMTC claimant, in addition to an institutional investor.

Besides NMTC investments, the four debt-financed projects also attracted conventional investments, either from the CDE or an outside bank.[20] Predominantly, however, the conventional investments came from the CDE or the CDE's investor. Three projects received conventional financing in this manner. The project that did not receive conventional financing from the CDE or its investor was the office, hotel and retail complex. It first received funding from a conventional investor and, then, obtained a NMTC investment when overruns and failure to receive a state economic development grant threatened further development. In two cases, conventional investments were made subsequent to the NMTC financing and, in the remaining two cases, conventional financing was concurrent with, or prior to, the NMTC investment. This investment is explicitly incorporated into the underwriting process.

VI. CROSS-SITE OBSERVATIONS

Inasmuch as the fundamental purpose of the NMTC program is to increase the flow of private capital to low-income communities in need of investment, a primary evaluation question involves whether private investments have, indeed, been directed to such places and, beyond

[19] Most typically, banks act as controlling entities in establishing and financing a CDE.

[20] Loans of investments financed without NMTC tax credits are referred to as "conventional financing."

that, to places with the greatest need. Obviously, this study of five projects cannot address this question other than to say that all of the projects were located in census tracts that met the program's eligibility criteria, as is statutorily required. There are, however, several important questions beyond that regarding the minimum statutory threshold that will warrant consideration in future evaluation efforts.

Within the program's basic statutory and regulatory framework there is considerable flexibility as to what kinds of investments are made as well as with respect to their scope, purpose, and desired impacts. Although the CDFI fund formally certifies CDEs and competitively awards NMTC allocations to a portion of them, it does not review individual projects or become involved in underwriting decisions. Individual CDEs are responsible for project selection and, therefore, for considering which investments are made, the need for NMTCs in these projects, and prospective project impacts. This flexibility means that, except for compliance with core CDFI Fund and Internal Revenue Service (IRS) regulations, there is no single standard that determines whether a project is the "best choice" for the use of tax credits. While this is entirely in keeping with the notion that low-income communities and investors in those communities should be making such decisions, it presents a challenge for program assessment. Simply put, to what standards should the program be held when it comes to evaluating projects, the importance of NMTCs to them, and their benefits? Though addressing these issues is beyond the scope of this report, it is nonetheless important to reflect on what has been learned from the five projects that can inform subsequent program evaluation design with respect to them.

Each project in which there has been NMTC-supported investment can be characterized, separately, with respect to the degree to which it depended on that investment to move forward and the kinds and extent of benefits that followed from it. Although such determinations were not principal priorities for this report, discussions were held with diverse stakeholders regarding both. With respect to the former, the questions asked were: if the credits had not been available, would the project have proceeded—at about the same time and at about the same scale—as it did with the credits? Note that, regardless of the answer, such determination is not a statutory or regulatory requirement of the program. However, if the answer is "yes," the credits may simply have substituted for other types of investment, including private investment such that there would not have been a need for the federal subsidy. If there were no such need, then the purpose of the program—to encourage private investment in low-income areas—would not have been served. While this is an important issue, it should be clear that because timing and circumstance are so crucial when putting projects together (in order to seize what may be fleeting market opportunity), it is not always possible to explore alternative sources of financing or predict what would have happened in the absence of the tax credits at the time that financing was assembled; and, it is equally difficult to reassess this question of need after the fact.

With respect to the latter, the question was whether there were positive impacts—i.e., those that improved low-income communities or the circumstances of low-income persons. Impact indicators need to be tailored to the purposes and situations of individual projects, thereby complicating cross-project analyses. For example, impacts can include those on low-income neighborhoods or areas (e.g., less blight), new jobs generated or retained for low-income persons, service-type benefits for low income persons, tax revenues for communities, and new investments generated or new investors attracted to low-income communities—among others. For numerous reasons, both determinations are difficult to make from interview data, and can depend on different kinds of evidence across projects.

It was clear from the interviews that some CDEs have paid particular attention to the issues of the need for tax credits and of project benefits. For example:

- As NTCIC's NMTC activities have evolved over time, the CDE began using a financing model developed by others to estimate the extent to which tax credits were needed, as well as to direct their allocation to the most difficult projects in the most distressed communities. NTCIC also began to focus on the formal identification, quantification, and monitoring of community benefits, now requiring all QALICBs in which they invest to sign Community Benefit Agreements in advance. These are tailored to each project and may include such impacts as: job generation and low-income jobs; job benefits; community revitalization; and project-specific impacts such as affordable rents on housing or for businesses owed, serving, or hiring low-income or minority residents, or outreach and improved access to facilities for low-income or minority residents.[21]
- Using a different approach, REI contracted with a consulting firm to estimate the broader economic impacts of 10 NMTC investments it had made through 2005.[22] With expenditure data on each project, the firm used input-output multipliers developed by the Bureau of Economic Analysis to estimate an aggregate value for economic output, new jobs, and additional earnings—based on assumptions about the structure of the regional economy, not actual observed impacts.

NTCIC's and REI's efforts, then, show some institutional interest among CDEs in assessing the need for NMTCs and/or documenting outcomes—even beyond those annually reported through the CIIS. Their investments and those of the other CDEs also indicate a wide range of outcome possibilities—including leveraging or stimulating other investment, creating or

---

[21] See www.NTCICfunds.com.

[22] Economic Impact Group, LLC, *Estimating the Economic Impact of REI's New Market Tax Credit Investments, 2003-2005,* July 2006.

retaining jobs, adding to the local tax base, stemming blight, reinvigorating neighborhoods, or expanding services—and the need for multiple measurement approaches to capture them.

With respect to the five Round 1 and Round 2 projects, discussions with stakeholders and a review of relevant documents suggest that the case for NMTCs being necessary is not strongly evident in every situation. In some instances, there is reason to believe other financing arrangements may have been available or feasible to bring the project to fruition without the credits. Likewise, the benefits to communities and low-income persons deriving from the investments are not well articulated in every project, nor was this always a principal focus. The main point to be made here is that even across a small number of projects there can be considerable variation with respect to the kinds of performance criteria that might be applied to the NMTC program beyond the criterion that investments be directed to low-income communities. The highest level of performance, presumably, is where NMTCs support projects that (a) need assistance in order to move forward and (b) demonstrate desirable benefits. Absent a legislative history or requirement that any criteria be applied to the program beyond its obligation to target investment to low-income communities, it will be necessary both to consider what additional performance criteria should apply and to prioritize them prior to undertaking a comprehensive program evaluation.

VII. STAKEHOLDER PERSPECTIVES ON THE NMTC PROGRAM

The interviews conducted for this report did not systematically survey stakeholders' opinions about the NMTC program, but the common theme that emerged across interviews was decidedly positive. The stakeholders associated with the five projects, all of whom had been involved with NMTCs since the earliest allocation rounds, uniformly viewed the program as providing an additional and flexible financing tool that meets the needs of borrowers and investors while also supporting projects consistent with their objectives and missions.

Community accountability. One stakeholder noted that a selling point he uses when describing NMTCs to prospective investors is that their uses are determined locally and, as such, that the community, not a federal agency, determines what the benefits should be. Indeed, by statute and regulation, CDEs are expected to be accountable to the residents of the low-income communities they serve and must demonstrate to the CDFI Fund that a proportion of their governing or advisory board is representative of that service areas. It is not clear from the discussions, however, how much of a role, if any, non-CDE staff played with respect to the project selection process. Although the topic of board involvement was broached in one instance during stakeholder discussions, it did not relate to the project under consideration. This topic, therefore, warrants further consideration in future program assessment efforts.

Advantages and disadvantages of using NMTCs. Reported advantages of the NMTC program are: they are faster than the SBA 504 program; they are better than the conventional terms that are offered; they are especially helpful to business start-ups; larger transactions are more feasible than those possible in certain other programs, such as IRP (USDA) loans that have a maximum of $150,000; that equity requirements are flexible, unlike those involved in SBA loans; and that NMTCs can be used in combination with most other tax credit programs. Borrowers were pleased with the financial terms that were offered and did not find the process to be overly burdensome. All of the stakeholders interviewed said they would use NMTCs again.

On the other hand, as reported by one banker, there are cases where businesses or organizations need to move very fast, prefer as little paperwork as possible, and want to avoid large attorneys' fees. Some of his customers, therefore, prefer conventional financing if they can qualify and turn to NMTCs or other community development programs only when they cannot finance conventionally.

Growing awareness of the NMTC program. Since the projects discussed with stakeholders were initiated early in the NMTC program, it was reported that knowledge of the program has grown in the economic development community through articles in newspapers, chambers of commerce, and CDEs' own efforts to inform local economic development agencies, bankers, and businesses.

Uses of NMTCs. Some CDEs have not made, nor plan to make, substantial changes in their uses of NMTCs over time, although others have made some changes. In the program's first several years, all of them had to figure out how to approach NMTCs in light of their controlling entities' objectives and missions. At that point, all of them learned the regulations and, then, over time, began to improve their processes and, in some cases, specialize in areas where they believed they could operate most effectively.

All of the stakeholders noted that there had been a significant "learning curve" involved in working with NMTCs as a new program, although their prior experiences with community development financing (such as SBA loan programs), historic tax credits, and Low Income Housing Tax Credits had been helpful. They also reported that the time and paperwork required for NMTCs were comparable to these of the other programs.

One CDE official reported that, for the organization's first NMTC project, there were many documents that had to be created and negotiated from scratch, and that they had to learn the regulations as they went along. This experience, however, has helped with subsequent projects. The board of another CDE decided that $500,000 would be the minimum size for a project using NMTC because of the legal and transaction costs. A third CDE has not made any changes in its planned strategy for using NMTCs, with loans continuing to be their primary emphasis. However, the organization plans to focus on smaller businesses in the future; it can afford to do smaller loans since their parent bank has already set up and absorbed the cost of drafting loan documents and other required paperwork. A fourth CDE did not make any changes in their plans in their two rounds of NMTC allocations. And an official of the fifth CDE described how the organization has narrowed its focus over time. Its Round 1 application included both debt and equity product lines, but almost all of its Round 1 projects turned out to be equity rather than loans. The CDE surmised that it could make more of an impact with equity; so, as it evolved, the CDE consolidated what it did into equity products, going from five financial products in Round 1 to primarily a single equity approach involving rehabilitation of properties in Round 4.

Complexity and reporting burdens. Stakeholders acknowledged that the NMTC program is complex, with additional reporting requirements. This did not, however, emerge as a significant concern in the interviews. With respect to putting the financing package together, it was noted that there are a few, but not many, additional hurdles with NMTCs. For example: the address has to qualify; the type of business has to qualify; and there are other requirements, such as the time frame for claiming the credit, that have to be enforced. For CDEs and banks with community development experience, NMTCs require similar staff skills and procedures as other programs or products they have used for accessing capital.

Three stakeholders distinguished between the requirements for completing a deal and the ongoing reporting and compliance requirements, which were described as more burdensome than other programs. In particular, stakeholders commented on the extensive reports and records that CDEs have to maintain for compliance purposes and the frequency of reporting.

Geographic targeting. CDEs reported using the mapping tool on the CDFI Fund's web site and, when possible, steering potential projects to sites in qualifying census tracts. Stakeholders in rural areas noted some difficulties, however. The mapping system can be a problem in very rural areas because sometimes there is no address. Also, it can be difficult to find qualifying census tracts in rural areas using either the 20 percent poverty criterion or the 80 percent of average monthly income criterion, due to small population numbers even though an area may be poor. Such stakeholders were pleased that the CDFI Fund would be addressing the concerns of rural areas in upcoming allocation rounds.

Suggestions for program improvement. The stakeholder interviews focused on the development of specific projects and did not elicit recommendations for program changes or improvements. One stakeholder, however, suggested reducing the frequency of transaction reporting. Another suggested the need for *more* government regulation of NMTCs to prevent over-subsidization, promote consistent standards, and improve the efficiency of the market. This stakeholder also suggested regulation of fees and more visibility with respect to fees, and supported the CDFI Fund's addition of a question on fees in the Round 5 application.

APPENDIX: PROJECT PROFILES*

***Source: FY 2004 Community Investment Impact System (CIIS), or updates provided by CDEs.**

CDE		Oak Hill Banks CDC
Investor		
	NMTC investor(s)	Local Bank
	Conventional investor(s)	Local Bank
Project Description		
	Debt financing to a start-up rural small business that supplies parts to construction contractors. The	
Borrower Characteristics		
	Minority Owner	No
	Female Owner	No
Financing Terms		
	NMTC financing	$685,000
	Total project financing	$819,000
	Percent NMTC	84%
	Transaction Type	Term Loan
	Interest Rate	6.60%
	Term	240 months
	Amortization type	Fully amortized
	Lien position	First
	Better Rates and Terms	Below Market Interest Rates
		Lower Than Standard Origination Fee
		Debt Service Coverage Ratio Less Than Standard
	Other local/state/federal financing	No
Community Characteristics		
	Census Division	East North Central
	Metropolitan or non-metro	Non-Metropolitan
	Families below poverty (%)	15%
	Owner-occupied housing (%)	69%
	In labor force (%)	59%
	High school graduate or higher (%)	64%
	White (%)	98%
	Black (%)	1%
	Hispanic or Latino (%)	1%
Low-Income Community Definition		
	Census tract with >=20% of individuals in poverty, **or**	No (16.6%)
	Census tract where the median family income is at or below 80% of the area median family income	Yes (61.7%)
Areas of Higher Distress Indicators		
	SBA Designated HUB Zone	
	Unemployment Rates 1.5 Times National Avg (=8.7%)	
Outcomes and Impact		
	Jobs projected to be created	6

CDE	REI New Markets
Investor	
NMTC investor(s)	Local Bank
Conventional investor(s)	Local Bank
Project Description	
Debt financing to expand a business that supplies a service for the health and hospitalities industries. The	
Borrower Characteristics	
Minority Owner	No
Female Owner	No
Financing Terms	
NMTC financing	$3,210,000
Total project financing	$4,210,000
Percent NMTC	76%
Transaction Type	Term Loan, Equity Investment
Interest Rate	7.10%
Term	84 months
Amortization type	Partially amortized/balloon
Lien position	Second
Better Rates and Terms	Equity Products
	Equity Equivalent Terms
	Debt With Equity
	Subordinated Debt
	Below Market Interest Rates
	Longer Than Standard Period Interest Only
	Loan To Value Ratio Higher Than Standard
	More Flexible Credit Standards
	Non-Traditional Collateral
	Loan Loss Reserve Requirements Less Than Standard
Other local/state/federal financing	No
Community Characteristics	
Census Division	West South Central
Metropolitan or non-metro	Metropolitan
Families below poverty (%)	22%
Owner-occupied housing (%)	25%
In labor force (%)	77%
High school graduate or higher (%)	90%
White (%)	42%
Black (%)	47%
Hispanic or Latino (%)	5%
Low-Income Community Definition	
Census tract with >=20% of individuals in poverty, **or**	No (19.6%)
Census tract where the median family income is at or below 80% of the area median family income	Yes (58.5%)
Areas of Higher Distress Indicators	
None	
Outcomes and Impact	
Jobs projected to be created	60

CDE		HEDC New Markets / NDC New Markets Investments LP
Investor		
	NMTC investor(s)	Local bank
	Conventional investor(s)	Regional bank
Project Description		
	Debt financing to a private development company for the construction of an office, hotel, and retail complex in a medium-sized city.	
Borrower Characteristics		
	Minority Owner	No
	Female Owner	No
Financing Terms		
	NMTC financing	$6,600,000
	Total project financing	$30,000,000
	Percent NMTC	22%
	Transaction Type	Term Loan
	Interest Rate	3.60%
	Term	84 months
	Amortization type	Partially Amortized/Balloon
	Lien position	Second
	Better Rates and Terms	Subordinated debt
		Below market interest rates
		Lower than standard origination fee
		Longer than standard period of interest only
		Longer than standard amortization period
		More flexible credit standards
		Non-traditional collateral
		Debt-service coverage ratio less than standard
		Loan loss reserve requirements less than standard
	Other local/state/federal financing	Yes
Community Characteristics		
	Census Division	Middle Atlantic
	Metropolitan or non-metro	Metro
	Families below poverty (%)	23%
	Owner-occupied housing (%)	5%
	In labor force (%)	62%
	High school graduate or higher (%)	96%
	White (%)	78%
	Black (%)	9%
	Hispanic or Latino (%)	4%
Low-Income Community Definition		
	Census tract with >=20% of individuals in poverty, **or**	Yes (22.1%)
	Census tract where the median family income is at or below 80% of the area median family income	Yes (74.8%)
Areas of Higher Distress Indicators		
	Designated for Redevelopment by Govt Agency	
	Poverty Rates Greater Than 30 Percent	
Outcomes and Impact		
	Jobs projected to be created	535

CDE		National Trust Community Investment Corporation
Investor		
	NMTC investor(s)	National bank
	Conventional investor(s)	None
Project Description		
	Equity contribution to a partnership established with the parent organization of a nonprofit network headquartered in a large city. The nonprofit organization, which offers specialized services to predominantly low-income minority clients, obtained a vacant historic property for use as its headquarters and the equity investment contributed to the rehabilitation that was required.	
Borrower Characteristics		
	Minority Owner	No
	Female Owner	No
Financing Terms		
	NMTC financing	$327,000
	Total project financing	$5,935,000
	Percent NMTC	6%
	Transaction Type	Equity Investment
	Interest Rate	.
	Term	.
	Amortization type	.
	Lien position	.
	Better Rates and Terms	Equity Products
	Other local/state/federal financing	Yes
Community Characteristics		
	Census Division	West South Central
	Metropolitan or non-metro	Metropolitan
	Families below poverty (%)	37%
	Owner-occupied housing (%)	27%
	In labor force (%)	21%
	High school graduate or higher (%)	45%
	White (%)	70%
	Black (%)	11%
	Hispanic or Latino (%)	78%
Low-Income Community Definition		
	Census tract with >=20% of individuals in poverty, **or**	Yes (30.1%)
	Census tract where the median family income is at or below 80% of the area median family income	Yes (73.5%)
Areas of Higher Distress Indicators		
	Designated Empowerment Zone, Enterprise Community, or Renewal Community	
	Designated for Redevelopment by Government Agency	
	Encompassed by HOPE VI Redevelopment Plan or in Hot Zone (CDFI Fund Designation)	
	Median Income Less Than 60 Percent of Area Median Income	
	Poverty Rates Greater Than 30 Percent	
	SBA Designated HUB Zone	
	Unemployment Rates 1.5 Times National Average (=8.7%)	
Outcomes and Impact		
	Jobs projected to be created	24

CDE		Zions Community Investment Corporation
Investor		
	NMTC investor(s)	National bank
	Conventional investor(s)	National bank
Project Description		
	Debt financing to an existing large medical practice for the construction of a new medical office facility that provides outpatient services in a medium-size city.	
Borrower Characteristics		
	Minority Owner	No
	Female Owner	No
Financing Terms		
	NMTC financing	$15,000,000
	Total project financing	$36,295,000
	Percent NMTC	36%
	Transaction Type	Term Loan
	Interest Rate	2.60%
	Term	258 months
	Amortization type	Fully amortized
	Lien position	First
	Better Rates and Terms	Below Market Interest Rates
		Lower Than Standard Origination Fee
		Longer Than Standard Period Interest Only
		Loan to Value Ratio Higher Than Standard
	Other local/state/federal financing	No
Community Characteristics		
	Census Division	Mountain
	Metropolitan or non-metro	Metropolitan
	Families below poverty (%)	14%
	Owner-occupied housing (%)	37%
	In labor force (%)	70%
	High school graduate or higher (%)	82%
	White (%)	81%
	Black (%)	1%
	Hispanic or Latino (%)	20%
Low-Income Community Definition		
	Census tract with >=20% of individuals in poverty, **or**	Yes (20.5%)
	Census tract where the median family income is at or below 80% of the area median family income	Yes (64.4%)
Areas of Higher Distress Indicators		
	Encompassed by HOPE VI Redevelopment Plan or in Hot Zone (CDFI Fund Designation)	
Outcomes and Impact		
	Jobs projected to be created	50