

LIHC MONTHLY REPORT

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Why A New Markets Tax Credit Program?

By Carol L. Hough, Marketing Director, Novogradac & Company

Why a New Markets Tax Credit program? This was the question posed to the attendees of Novogradac & Company LLP's Urban Revitalization Conference held in Chicago, July 19-21, 2001. The answer – the program will bring whole new capital to urban and rural areas. In short, New Markets equals new investment capital.

New Markets program and the LIHC program

The New Markets Tax Credit program, created with the goal of building on the success of Low-Income Housing Tax Credit (LIHC), differs from the LIHC in one significant way. The New Market credits are a percentage of equity invested while LIHC credits are a percentage of qualifying project costs. This provides the New Markets program with access to venture capital funds and provides opportunity for banks, insurance companies and social investment funds to participate in meeting the need in distressed urban and rural areas.

The New Markets program builds on the success of the LIHC program by combining the discipline and efficiency of the capital markets with the community development goals of the New Markets program. Advocates believe this structure will attract much-needed new capital to low-income communities, rather than re-channeling existing investments.

Three factors will contribute to the success of the New Markets program and its venture capital approach, say experts: 1. the expertise and experience of community development entities 2. tax credit structuring and placement entities and 3. venture capital professionals.

New Markets Program and a CDE: How the investment works

The New Markets tax credits, which are provided in return for qualified equity investments, may be used to offset an investor's federal income tax. To meet the requirements for a qualified equity investment, the investment must be acquired by the taxpayer at its original issue; the investment must be made through a community development entity (CDE); and substantially all investment cash must be used by a CDE to make qualified low-income community investments.

Qualified community development entities (QCDE) are crucial to the New Markets program because they are the vehicle through which an investment is made to obtain the New Markets tax credits. "They play an important role in bridging the private equities markets with low-income communities," says Michael J. Novogradac, managing partner of Novogradac & Company. It is the QCDEs that obtain tax credit allocations from

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LIHC WATCH

Acknowledging that the definition of the Established Income Range (EIR) could do a better job of fostering deconcentration, the Department of Housing and Urban Development (HUD) has issued a proposed rule to amend the deconcentration component of the regulations for Public Housing Agency Plans. The proposal revises the definition of the EIR so that if a development has an average income of 30 percent of area median income (AMI) or less, it cannot be identified as a "higher income development." In some cases, EIRs are so low that developments at 30 percent AMI or below pencil out above the EIR. HUD seeks comments on the proposed rule by October 15.

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Why A New Markets

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Treasury and then invest and manage the private equity in qualified active low-income community businesses.

A QCDE is one whose primary mission is serving or providing investment capital for low-income communities or low-income persons. Additionally it maintains accountability to residents of low-income communities through its representation in the governing of the entity or on any advisory board. Finally it is certified by the Community Development Financial Institutions Fund, part of the Department of the Treasury, as a QCDE.

The equity investment consists of any stock or capital interest in the QCDE in which the investors will receive a stock or partnership interest.

A QCDE can be either a domestic corporation, partnership, limited liability company or limited liability partnership. Not-for-profit and for-profit entities may be certified as QCDEs but the Treasury has indicated that only for-profit QCDEs will be eligible to apply for and receive tax credits. That, says Novogradac, is an incentive for not-for-profit entities to form partnerships with for-profit entities to create CDEs that will qualify as QCDEs.

Perhaps the most important thing to remember, Novogradac says, is that it is not the investment in a QCDE that truly generates the tax credits. "It is what the QCDE does with the investment that is critical in determining whether it qualifies for federal tax credits." ❖

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