

Novogradac Report on Tax Credits **Summary: June 29, 2010**

Michael J. Novogradac, CPA, shares and update on tax extenders legislation, reviews the NMTC Coalition's Progress Report 2010, announces new guidance for the Section 1603 renewable energy tax credit cash grant program, reviews news about a series of public hearings that will be held on the Community Reinvestment Act, updates listeners on state tax credit news from New York, Illinois and California, and summarizes items of note in the Financial Reform bill.

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TAX EXTENDERS BILL TABLED

Introduction

- Last week on Thursday, June 24th, the American Jobs and Closing Tax Credit Loopholes Act, also known as the extenders bill, was defeated by a vote of 57 to 41 in the Senate.
- The bill would have extended unemployment benefits for millions of Americans, and it also included a package of provisions to extend various tax credit programs.
- The latest version included provisions to:
 - extend for one year the Section 1602 low-income housing tax credit cash grant exchange program,
 - expand the Section 1602 program to make GO Zone LIHTCs and Disaster LIHTCs eligible for the program,
 - extend for one year the New Markets Tax Credit program, and
 - allow the NMTC to offset the alternative minimum tax with respect to qualified investments made between March 15, 2010 and January 1, 2012.
 - The bill would also have funded the National Housing Trust Fund (NHTF) and extend by two years the placed-in-service date for GO Zone LIHTCs.

The Vote

- The vote last Thursday was on a version of H.R. 4213 that Senators Max Baucus and Harry Reid had introduced the day before on June 23rd.
- The revised legislation would have cost \$109 billion and \$33.3 billion to the deficit, according to reports from the National Association of Home Builders.
- Republicans and one Democrat filibustered the bill during a procedural vote, leading to the loss.
- Opponents' main objection to the bill was not to the tax extenders provisions but rather that the bill would add to the deficit.

What's Next?

- It is unclear what the next step will be for the extenders legislation.
- In the short term, the Senate is turning away from the extenders bill and concentrating on the small business lending bill and financial reform bill.
- It is doubtful that an extenders bill would pass before the July 4th recess, but it will likely be considered when Congress reconvenes on July 12th.
- Stay tuned.

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NMTC COALITION 2010 PROGRESS REPORT ON THE NEW MARKETS TAX CREDIT

Introduction

- Last month the New Markets Tax Credit Coalition released its 2010 New Markets Tax Credit Progress Report.
- This sixth annual report provides a snapshot of how the NMTC is working in the current economic climate and is organized into two sections:
 - Part 1: Findings from the Coalition's most recent CDE allocatee survey from Rounds 1 through 6.
 - Part 2: Stories of several high-impact projects that illustrate how CDEs are using the NMTC.

Key Findings

- The Coalition sent a survey to every CDE that received at least one allocation from 2003 to 2008.
- Of the 70 CDEs that responded, the smallest allocation award reported was \$2 million, the largest was \$150 million, the median was \$55 million and the average was \$58.7 million.
- This year's survey revealed that CDEs have issued or committed most of their allocations as qualified equity investments after three years.
- Nearly 89 percent of the CDEs surveyed had secured all or some of their QEIs from regulated financial institutions, 23 percent from private corporations and 17 percent from unregulated financial institutions.
- CDEs revealed that it was taking longer to find investors in this credit environment, particularly leveraged debt lenders.
- Respondents also indicated that investors were putting more stringent underwriting requirements in place.
 - Fifty-four percent of CDEs surveyed reported difficulty securing leveraged debt over the last year.
 - Seventeen percent reported to have had an investor pull back from a commitment.

Notable Trends

- Forty-seven percent of CDEs surveyed said they deploy their capital in less than a week after issuing a QEI, up from 36 percent in the 2009 survey.
- CDEs responding to this year's survey had deployed a higher percentage of their allocations as qualified low income community investments than last year's respondents.
 - As of the end of 2009, respondents had collectively made 2,082 qualified low-income community investments (QLICIs) totaling \$8.8 billion, approximately 86 percent of the total allocations awarded to survey respondents.
 - Last year CDEs had deployed approximately 79 percent at the time the annual report was compiled.

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- The survey shows an increase in the average size of loans and investments in non-real estate businesses over the last three years.
 - 35 percent of the QLICIs were made in non-real estate businesses in the Coalition's 2008 survey, 40 percent in 2009 and now 43 percent in this survey.
- Consistent with previous years' findings, more than 57 percent of respondents indicated that providing debt with below market interest rates is the CDEs' most used product.
- On average, CDEs reported that 47 percent of a project's total cost was covered using NMTC financing.
 - 31 percent of CDEs reported that they are increasingly being called upon to use NMTCs to finance a larger percentage of a project's overall costs as other financing sources have become tight.
- For the last three years, the survey results indicated that the average size of NMTC investments in urban and rural areas has been relatively similar despite an overall lower level of investment in rural areas.
 - The survey demonstrated a steady increase in NMTC activity in rural areas, rising from 11 percent of QLICIs in 2008 to almost 15 percent in 2010.
- CDEs reported that 93 percent of their total QLICIs were made in communities with an average of two or more high economic distress factors. These results signify a trend to target more investment to economically distressed areas.

More Information

- Rapoza Associates prepared the study for the New Markets Tax Credit Coalition, which will post the full report on its web site at www.nmtccoalition.org.

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**TREASURY DEPARTMENT'S NEW GUIDANCE ON START OF
CONSTRUCTION FOR THE SECTION 1603 PROGRAM**

Introduction

- The Section 1603 program provides cash grants in lieu of tax credits for solar, wind and biomass energy tax credit projects.
- The program expires at the end of 2010.
- There are efforts to extend the program, namely by Senator Maria Cantwell, but absent an extension projects would have to be under construction by the end of this year in order to be eligible for the Section 1603 program.
- As a consequence, the definition of “under construction” is of great significance to a number of projects currently under development.

New Guidance

- On June 25th, the Treasury Department posted additional guidance regarding the beginning of construction and eligibility for the Section 1603 renewable energy tax credit cash grant program.
- The new guidance is provided in the form of 25 frequently asked questions and answers regarding the beginning of construction for the Section 1603 program.
 - The guidance is available online at www.energytaxcredits.com.

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PUBLIC HEARINGS TO BE HELD ON COMMUNITY REINVESTMENT ACT REGULATIONS

Introduction

- Last week the federal bank and thrift regulatory agencies announced a series of upcoming public hearings on modernizing the regulations that implement the Community Reinvestment Act or CRA.
- The agencies consist of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Office of Thrift Supervision.

Modernizing CRA

- The agencies say they will consider
 - how to update the regulations to reflect changes in the financial services industry,
 - changes in how banking services are delivered to consumers today, and
 - current housing and community development needs.
- The agencies want to ensure that the CRA remains effective for encouraging institutions to meet the credit needs of communities.
- Interested parties will have the opportunity to provide testimony and written comments.
- While the agencies recognize public comments may discuss matters requiring statutory changes, the agencies' focus is on potential regulatory changes.

How to Comment

- The public will have the chance to provide oral or written testimony on potential changes to the CRA regulations at four hearings to be held around the country.
- The planned hearing dates and cities are:
 - July 19, 2010 in Arlington, Virginia;
 - August 6, 2010 in Atlanta, Georgia;
 - August 12, 2010 in Chicago, Illinois; and
 - August 17, 2010 in Los Angeles, California.
- Anyone wishing to submit testimony or attend the hearings must register five business days in advance.
- Hearing details are available online at www.ffiec.gov.
- In addition to offering an opportunity for testimony at the hearings, the agencies are encouraging interested parties to provide written comments on the CRA regulations to any of the agencies through August 31st, 2010.
- While the agencies encourage public comments on any CRA topic, they say they are particularly interested in receiving comments specifically about:
 - Geographic coverage
 - CRA performance tests, asset thresholds and designations
 - Affiliate activities
 - Small business and consumer lending evaluations and data
 - Access to banking services

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- Community development
- Ratings and incentives
- Effect of evidence of discriminatory or other illegal credit practices on CRA Performance Evaluations, and
- CRA disclosures and Performance Evaluations

On a Related Note

- Separately, the agencies also announced that they are proposing a change to the CRA rules to encourage depository institutions to support the Neighborhood Stabilization Program funded by the U.S. Department of Housing and Urban Development or HUD.

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STATE TAX CREDIT NEWS

NEW YORK

New Threat to Historic Tax Credit in New York

- It's been a rollercoaster ride for New York's historic rehabilitation tax credit.
- The state tax credit, which the Preservation League of New York State estimates would provide a 12-fold return on the state's investment, cleared a significant hurdle on June 16th, but now faces another battle.

Legislative Victory

- As reported in the March 30th podcast, imprecise language in the original legislation led to the New York State Department of Taxation and Finance ruling that the historic tax credits could not be used to offset banks' or insurance companies' franchise taxes. This severely limited the credit's usefulness, as it limited investor demand.
- On June 16th, the legislature passed S. 7556 and A. 10839.
- These bills amending the credit to allow banks and insurance companies to use the credits to offset their franchise taxes.
- When Governor David Paterson signs the legislation, it is expected to expand the investor pool and jumpstart stalled developments across the state.

Possibly Problematic Budget Bill

- However, celebration in the preservation community may be short lived if the governor's budget bill makes it through the legislature.
- The bill, introduced in April, calls for a three year deferral of 30 tax credit programs, including the historic tax credit.
- Other programs in danger include the state's low-income housing tax credit, brownfield credit and green building credit.
- The proposal would defer 50 percent of allowable credits that accrued by projects undertaken between 2010 and 2013 for three years, until 2013 to 2016.
- Tax credits carried forward from previous years would also be deferred.
- The deferrals are still being discussed, so the historic tax credit and other tax credits may not be included in the final budget proposal.

Reaction

- Organizations, including the Preservation League of New York State, the New York State Association for Affordable Housing and the Business Council of New York State, have been speaking out against the deferrals, which they predict will negatively affect development in the state.
- The preservation league predicts that historic rehab projects will halt because investors would not be assured of a timely return on their investment.
- The league also believes that a deferment of the tax credits could cause irreparable harm to the state's credibility as an economic development partner.

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- The ups and downs of the New York State historic tax credit will be discussed in greater detail in the History and the Hill column in the August issue of the Novogradac Journal of Tax Credits. So stay tuned.

ILLINOIS

New Tax Credit Approved for a Hotel in Illinois

- Last week Governor Pat Quinn signed a bill into law that will create a pilot program to provide a state tax credit for the renovation of the historic Hotel Pere Marquette in downtown Peoria, Illinois.
- The Hotel Pere Marquette was built in 1927 and its last major renovation occurred in 1981.
- Supporters say the project will generate 1,000 jobs.

About the Tax Credit

- The tax credit was created by Senate Bill 2534, which was sponsored by Senator David Koehler and Representative Jehan Gordon.
- The new law provides a state tax credit of 25 percent of the amount of the eligible expenditures for the renovation and expansion of the Hotel Pere Marquette.
- It's estimated that the tax credit could amount to an estimated \$8 million in tax credits for the hotel, which is slated for a \$40 million renovation.
- The pilot state program is administered by the Illinois Historic Preservation Agency.
- The Illinois Historic Preservation Agency reports that historic renovations yield one of the highest ratios of jobs per dollar as compared to other construction projects.
- Historic preservation groups see the pilot program as a positive step toward the ultimate implementation of a state historic tax credit.

CALIFORNIA

California Senate Bill 1316

- Senate Bill 1316 passed out of the Senate Revenue and Taxation Committee last week.
- This bill would create a California new markets tax credit program.
- The bill now will go to the floor of the Senate, where it is expected to pass.
- After that it would go to the Assembly and if it passed the Assembly, it would rely on the governor's approval to become law.

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FINANCIAL REFORM BILL

Introduction

- Last week the Financial Reform bill was released from a House-Senate conference where it was sent to resolve differences between the two existing versions of the legislation.
- Now it must be returned to both the House and Senate to be voted on again.
- Both the House and Senate must vote on and pass the same version of the bill before it can be sent to the president.
- There is some hope that the bill could be passed and sent to the president before the July 4th recess but it's unclear whether there will be sufficient votes for it to pass in the Senate.

About the Bill

Among other things, the bill would:

- Create a Consumer Financial Protection Bureau to be operated within the Federal Reserve and regulate consumer financial products,
- Provide the FDIC the right to liquidate failing firms,
- Create a 10-person Financial Stability Oversight Council that's designed to monitor systematic risk in the entire financial system and make recommendations,
- Require financial institutions to separate derivative activity from the federally guaranteed portion of their asset base.
- Place limits on the types of derivatives that financial institutions would be allowed to participate in.
- Implement the Volker rule, which in an earlier iteration would have prevented financial institutions from investing in private equity funds but has been adjusted to allow some stronger firms to invest up to 3 percent in private equity funds.
 - There is an exception to the Volker rule for investments designed to promote the public welfare, which should allow institutions to continue to invest in items such as the low-income housing tax credit.
 - There is also a carve out for federal and state historic tax credit investment.
- The bill does not address Fannie Mae or Freddie Mac. It is expected that issue would be address in the next 16-18 months.