



## USDA-Guaranteed Loans Can Now Be Used in NMTC Transactions

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The United States Department of Agriculture (USDA) business and industry loan guaranty program has been an important economic development financing tool for rural America. Under the American Recovery and Reinvestment Act of 2009 (ARRA), more than \$1.6 billion was authorized for the loan guaranty program. Similarly, the New Markets Tax Credit (NMTC) program, amended in 2006 to ensure that non-metropolitan communities were allocated a proportional share of qualified low-income community investments, has accounted for significant investment activity in rural communities. From 2003 to 2011, more than \$3.5 billion was invested in non-metro census tracts under the NMTC program. Unfortunately, until now these two programs could not be combined.

Charlie Spies, CEO of Coastal Enterprises Inc., a mission-driven lender and investor specializing in rural economic development throughout the United States with more than \$900 million in NMTC allocation awarded to date said the previous separation of the programs added a layer of complexity. “Restrictions under the loan guaranty program did not permit loans guaranteed by the USDA to be

used within an NMTC financing structure, despite a stated desire by the USDA to allow lenders access to the program,” he said. “This added complexity and cost to project financings that were forced to use both programs side-by-side rather than together, if at all.”

On June 3, the USDA published final regulations that, among other changes, permit loans guaranteed by the USDA to be used for NMTC projects. The clear goal of the NMTC provisions is to permit loans guaranteed by the loan guaranty program to be used:

1. In conjunction with an equity investment in a qualified active low-income community business (QALICB); and
2. To make a leverage loan to an investment fund which in turn makes a qualified equity investment in a community development entity (CDE) or its subsidiary (sub-CDE).

### Equity Investments

Although equity investments are relatively rare in practice, under the NMTC provisions, a CDE or sub-CDE lender is permitted to have an ownership interest in the borrower (which is generally prohibited under

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the loan guaranty program), provided that the following conditions are met:

- The lender does not have a pre-existing ownership interest in the borrower,
- The lender does not take a controlling interest in the borrower and the lender's ownership interest in the borrower is under 20 percent, and
- The lender provides a USDA-approved plan to address what occurs to the lender's equity interest in the project after the seven-year NMTC recapture period expires.

As intended, these rules permit CDEs and sub-CDEs participating in the loan guaranty program to make an equity investment in a QALICB. As reinforced by the preamble, the fact pattern that the USDA had in mind was to permit a guarantee on a loan from a CDE or sub-CDE to a QALICB when the lender also made an equity investment in the QALICB, subject to the conditions listed above.

### Leverage Loan

Of more significance, the NMTC provisions are also intended to permit a leverage loan to be guaranteed by the loan guaranty program. This intent is made clear in the preamble to the regulations, which state in a pertinent part that the final regulations: "has been expanded to include a lender's leveraged loan to accommodate the mechanics of the NMTC program."

"The ability to use the loan guaranty program for NMTC leverage loans could dramatically expand the number of business loans we are able to provide to our constituents," said Heidi DeArment of Montana & Idaho Community Development Corporation, a multiple-round NMTC allocatee which serves many rural communities in Montana and Idaho.

As in the implementation of any complex governmental program, let alone combining two, significant hurdles

remain in having the loan guaranty program and the NMTC program successfully mesh.

First, there is the language employed in the final regulations. Although the caption to the regulation refers to "loan guarantees for the leveraged lender," suggesting the rule is intended to apply to a loan made by a leverage lender to a leverage fund, the regulation itself indicates that the rule applies "when the eligible borrower is a sub-CDE," not when the borrower is a leverage fund. Sub-CDEs normally are capitalized solely by equity investments and therefore would not be borrowers. We understand that the USDA believes that these rules apply to leverage funds, and not just to sub-CDEs. However, because the NMTC provisions refers to a sub-CDE, it is not clear whether practitioners will be able to opine with sufficient certainty to satisfy NMTC transaction participants regarding whether the final regulations permit a leverage loan made to a leverage fund to be guaranteed by the loan guaranty program.

Additionally, there are a number of other key issues to be worked through, as pointed out by other CDEs regularly working with the loan guaranty program, notably financial reporting, loan terms, credit analysis/ratios, tangible balance sheet equity, collateral requirements and monthly reporting to the USDA.

The USDA Rural Business Cooperative Service, in conjunction with the White House, has gone to great lengths to promote the final regulations to stakeholders in an effort to expand the use of the loan guaranty program with NMTCs. Despite implementations challenges, we remain hopeful the new rules will expand funding for rural projects that would not have been possible in the absence of the guaranty program.❖

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*This article first appeared in the November 2016 issue of the Novogradac Journal of Tax Credits.*

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ISSN 2152-646X

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