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How the Pandemic Has Affected NMTC Equity Pricing and Investments

Q&A

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Question: How has the COVID-19 pandemic affected new markets tax credit (NMTC) equity pricing and investment types?

Answer: The COVID-19 pandemic is affecting NMTC equity pricing and which transactions are being financed in a number of ways, as investors and syndicators discussed in a panel at the Novogradac 2021 New Markets Tax Credit Virtual Conference in January.

Pricing

Novogradac recently conducted an NMTC pricing survey, which showed average NMTC equity pricing among survey respondents dropped significantly from an average price of about 87 cents per credit in 2017 to 74 cents per credit to date in 2021. While the average for 2021 was 74 cents, newer transactions that are working toward a closing appear to indicate this average price per credit may decrease further. At the height of the Great Recession in 2010, average NMTC equity pricing declined to as low as 69 cents per credit. Whether we've seen the tax equity pricing floor yet this time around will likely depend on a variety of factors:

- **NMTC permanence:** The NMTC incentive was established as part of the Community Renewal Tax Relief Act of 2000 and has been reauthorized several times over the years, sometimes retroactively. Community development advocates, including the Novogradac-led NMTC Working Group, have called for the NMTC to be a permanent or indefinite part of the tax code. "Permanence, from a syndicator perspective, can help bring in new investors," said Laura Vowell of U.S. Bancorp Community Development Corporation. A permanent NMTC would encourage participants to ramp up their NMTC staffing and capacity, which could lead to greater efficiencies and allow them to offer better equity pricing on transactions.
- **Financial Accounting Standards Board (FASB) accounting rules:** Under current guidance, reporting entities must present the depletion of NMTC investments as an expense in their pretax income, while recognizing the economic benefit of the investment below pretax income as a reduction to income tax expense. PNC Financial Services Group submitted a letter to FASB in February asking the board to consider expanding current accounting guidance on low-income housing tax credit (LIHTC) investment to apply to all tax credit investments, including NMTC investments. As it did for LIHTC investors, simplified FASB guidance would make the tax credit a more attractive investment leading to greater appetite. With greater appetite for NMTCs, investor pricing would be expected to increase absent any other factors.
- **Social outcomes:** Panelists reported that social outcomes can factor into both an investor's interest in doing an investment and in the tax credit equity pricing offered. For example, Scott Pinover of Wells Fargo Community Lending & Investment shared that he recently held pricing at 89 cents per credit for an investment in a minority-owned fledgling company because the transaction could not have moved forward with lower pricing. Other investors have created or are in the process of creating a policy that allows them to offer higher pricing to transactions that meet certain racial equity initiatives.

- **Community Reinvestment Act (CRA):** While investor panelists said project strength and impact are important, CRA motivation has and will continue to impact pricing that can be offered. Typically, CRA-motivated investors are willing to pay a premium for transactions that will meet their CRA needs.

Lower equity pricing doesn't mean transactions aren't getting closed. Spencer Gagnet of Capital One said that while equity pricing declined due to lower appetite impacted by banks' profitability and uncertainty about losses in 2021, Capital One still had a strong year for 2020.

In the Feb. 10 NMTC Qualified Equity Investment Report published by the Community Development Financial Institutions (CDFI) Fund, the amount of qualified equity investments finalized had increased by more than $1.1 billion since its Jan. 5 report. Much of this activity was likely fueled by the CDFI Fund's eligibility requirements for prior awardees to apply for allocation in the calendar year 2020 allocation round.

Investment Types

Risks associated with the COVID-19 pandemic have played a significant factor for many investors in deciding which investments to pursue in 2020 and 2021. For example, one panelist described deciding not to move forward with an investment in a theater that was on track to open in 2021 because of questions around when the theater could realistically open and generate revenue. Investors are also considering uncertain demand in the immediate future for certain building types, such as retail, office space and hospitality, when making decisions.

"There are sectors out there that are going to be impacted where lenders, both ourselves and others, are taking a green/yellow/red category for difficulty," said Gagnet. "Retail and hospitality are red."

Conclusion

It is clear that the pandemic has had a meaningful impact on NMTC transactions, affecting tax credit equity pricing and types of transactions. The NMTC Working Group has advocated for years for many of the changes being discussed that would help mitigate this impact. To learn how you can become part of the NMTC Working Group and get involved in the discussion, please contact us. ❖

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