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The Washington Legislative and Regulatory Update

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NMTC Investors Describe 'Stabilized' Equity Marketplace in 2023, Predict Busy First Quarter of 2024

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The new markets tax credit (NMTC) had a strong year for investment activity in 2023, with investors predicting more than $4 billion in qualified equity investment (QEI) issuance by year-end. Looking ahead at 2024, investors expect another busy year for the NMTC as demand for the community development tax credit continues to outpace supply. That was the consensus at the Oct. 26 Investor Insights panel of the Novogradac 2023 Fall New Markets Tax Credit Conference in New Orleans, moderated by Novogradac partner and conference chair Brad Elphick, CPA.

Deadline-Driven Activity

Kathleen Galvan, acquisitions manager for National Trust Community Investment Corporation, described the first few months of 2023 investment activity as a "sprint" for prior-year allocatees pushing to meet the May 4 deadline for meeting QEI and qualified-low-income community investment (QLICI) requirements.

Drew Hammond, vice president and business development officer for U.S Bancorp Impact Finance, said his company closed nearly 60 individual investments for about $300 million in NMTCs earlier this year before the May 4 deadline. Hammond said Impact Finance projects it will invest 10% more in 2024 than in its investment total in 2023, which was a 33% increase from 2022.

"I think it's pretty amazing, for lack of a better word, just because we used to have only $3.5 billion in the award cycle," said Hammond. "The fact that the industry as a whole was able to close more than that year-to-date is great for the program."

Investors anticipate a similarly busy first quarter of 2024 as prior-year NMTC allocatees push to meet the March 21, 2024, deadline for meeting QEI issuance and QLICI requirements.

"Clearly there'll be a huge dynamic push, which is good to see, with robust appetite, generally speaking, on the investor side," said James D. Howard, president of Dudley Ventures. "I think that's all very positive for the industry."

An important factor in NMTC closings this year is the condensed timeframe between allocation rounds. The Community Development Financial Institutions (CDFI) Fund announced the calendar year (CY) 2022 allocation awards Sept. 22 and opened the CY 2023 round Oct. 23, just four weeks later.

"Traditionally, the CDFI Fund would make the award and then it was about two to two-and-a-half months between when those awards were announced and the next round's application opened," said Elphick. "Last year, we saw a three-week turnaround, which I think caught everybody by surprise. So when people were asking me this year what I thought, I said, 'Well, we might as well just assume three weeks.'"

The shorter window between allocation rounds is a challenge for some CDEs trying to close transactions under the prior allocation round, while trying to apply for an award under the next allocation round.

"We had a lot of active closings that we were hoping to get done before the new award," said Chris Leutzinger, senior vice president and NMTC relationship manager for Truist Community Capital. "At Truist, we write our own application every year, so it is a really difficult time to manage the resources it takes to apply for a new award, while also managing a potential tranche of new closings by year end. So, I think some of those year-ends might end up being the first half of January, but before the next round that's going to try to meet that March 21 deadline."

The shorter turnaround between allocation rounds poses important decisions for CDEs to make. "There's way more demand for this subsidy than $5 billion can really satisfy, so CDEs are having to make choices on what deals they invest in," said Elphick.

Howard agreed. "What you end up with in this compression is more deals that are probably self-leveraged, more deals that are equipment in nature, maybe deals that are non-real estate in nature just because everybody is trying to look at the simplicity of the close," said Howard, who said he expects real estate transactions that have longer timelines will still happen, but in a second wave of closings.

Tax Credit Equity Pricing

Many factors affect NMTC equity pricing, such as supply and demand of credits, historic inflation, higher interest rates, accounting guidance, Community Reinvestment Act (CRA) considerations and yield thresholds.

"Coming out of the pandemic, a lot of investors came back to the market and there was a pretty quick ramp up in pricing with interest rates rising at the same time," said Hammond. "I think, like with the rest of the economy, it takes a little while for those interest rates to churn through and feel the effects, and we're seeing that now with yield demands increasing across the board in all of the tax credit programs we're investing in."

"There's kind of a ceiling on what tax credit investors can pay because of all this economic uncertainty–uncertainty abroad, uncertainty with CRA–so those all have to be factored in when we're making decisions," said Leutzinger.

Another recent development that may affect the tax credit equity marketplace more broadly is issuance of final regulations for renewable energy investment tax credit transferability.

"We have yet to see the breadth of the dynamic of that marketplace and it will be interesting to see if new investors jump into tax credits," said Howard. "I think this is a little bit of a wait and see in 2024 where we wind up in that marketplace. … I do think there are some tax credit dynamics that are new and unique where we haven't seen that brought to bear yet." Howard said it remains to be seen how equity pricing for the renewable energy tax credit marketplace stabilizes in 2024 and how that could affect other tax incentives.

Finding Creative Financing Solutions

The panel commended the NMTC community for finding creative ways to fill financing gaps amid economic challenges. "What we've learned throughout the history of the New Markets Tax Credit program is that CDEs and [qualified active low-income community businesses] are all very creative in identifying and using available sources," said Elphick. "The beauty of the program is how flexible it is."

Galvan agreed. "CDEs have stepped up–we have a couple of projects where there was a gap and each one of us put in a little bit more allocation to make it happen," said Galvan. "Having these great investor partners to put in that extra million or two million makes a huge deal to these nonprofits that are getting these hugely impactful deals done."

John Chamberlain, managing director of Capital One, noted that more CDFIs are providing gap financing and at larger loan sizes. "We've also seen having multiple CDFIs come in and share the loan, because the loan size may be a little bit more than one can do by itself," said Chamberlain. "Sometimes it's filling that last piece—it's not necessarily taking on the entire project, but filling in necessary gaps in the capital stack system."

Hammond said that U.S. Department of Agriculture-backed loans are also useful to a growing number of NMTC transactions.

"One of the unsung heroes of the CDFI Fund program base is this bond guarantee program," said Howard. "If you look at the utilization of the bond guarantee program–we haven't done it, but some of the money-center banks have done it–where they go to the marketplace for the loan guarantees and are funding in a major way some of these CDFIs for much bigger initiatives. I think that's a trend that's just beginning to start, and you certainly saw it with a number of CDEs, CDFIs and not-for-profit organizations tapping the [Paycheck Protection Program] marketplace and so forth. That's a trend that 10 years ago hadn't even begun to start, and now the balance sheets of many of the larger CDFIs begin to equal many of the smaller community banks. That's an incredibly impressive trend given mission and not-for-profit status."

One caveat that Elphick shared with attendees with respect to having multiple financing sources is that many CDEs and investors assess NMTC investments based on their ability to close in a timely manner. Elphick said that adding multiple capital sources can complicate transactions and delay closings, which could affect a project's ability to compete for allocation and equity. "Before you start throwing everything on the wall to see what sticks, know that that's also going to have an impact on your ability to close and may cause you to have to wait a bit longer to be able to find allocation because there are other deals that may not have as many moving pieces that can close and meet some of these deadlines that the industry has to deal with," said Elphick.

NMTC Permanence

One of the main areas of opportunity for the NMTC is permanence. Ever since its original enactment through the Community Renewal Tax Relief Act of 2000, the NMTC has been subject to multiple and sometimes retroactive extensions.

Uncertainty about the future of the incentive makes it difficult for participants to plan, especially for smaller CDEs with limited resources. "Unpredictability makes it really hard to attract permanent players in the market due to significant time and staff commitments," said Galvan.

"With the lack of permanency–until we get that–I think that will always be the case," said Howard. "What you wind up with is resources stretched thin in a lot of different ways, trying to meet multiple objectives."

Panelists said it's a familiar challenge with an obvious solution: permanence.

"We've seen this with the five-year extension," said Elphick. "It creates some certainty. It allows people to invest in their own resources to better administrate the program. All of that creates efficiency in the markets, which should ultimately lead to greater subsidy and greater benefit making its way to the project or business."

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