How to Close NMTC Transactions Successfully in the Current Economic Climate

The new markets tax credit (NMTC) allocation awards announcement is expected soon, with the next allocation round opening soon after. Well-informed and well-positioned businesses have a great opportunity to secure NMTC financing, even if they were not originally in a community development entity's (CDE's) pipeline. In this week's Tax Credit Tuesday podcast, Michael Novogradac, CPA, and Novogradac partner Matt Meeker, CPA, discuss how to successfully close an NMTC transaction in the current economic climate. They cover how rising interest rates, growing inflation and supply chain issues are affecting NMTC transactions. They also discuss how to prepare a business for NMTC financing. They close with some common challenges faced in closing NMTC transactions and how to address them.

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Transcript

[00:00:12] **Michael Novogradac, CPA:** Hello. I'm Michael Novogradac. And this is Tax Credit Tuesday. This is the Sept. 20th, 2022, podcast. Today's episode is the third part of our new markets tax credit trilogy.

The first episode of the trilogy, our Sept. 6 podcast focused on two key points. First, how a business can qualify for new market tax credit financing. And second, how qualifying businesses can attract such financing from community development entities or CDEs, which provide the new markets tax credit financing.

The second episode, our Sept. 13 podcast continued that discussion by helping qualified businesses in search of project or business financing to better understand the key players in new markets tax credit financing. We also discussed how qualified businesses leverage different sources of financing to optimize the tax credit financing they can generate from a CDE.

Now today's episode concludes the trilogy with a discussion that focuses on closing new market tax credit transactions. But before beginning our discussion about closing new market tax credit financing, let me remind businesses and project developers that are serving low-income communities that now is a great time to seriously consider seeking new markets tax credit financing. I say that because the awards announcement for the current new markets tax credit round is expected very soon. Furthermore, the opening for CDEs to apply for the next round of allocations is likely just a few months away. Now you may think that if your business is not currently in a CDE's investment pipeline, that you don't have a chance to secure NMTC financing, that is not the case.

Many CDEs developed their current pipelines about eight months ago, around January of this year. Since then, many businesses and projects that these CDEs were interested in are no longer financially viable or otherwise aren't prepared to receive new markets tax credit financing in the coming months. This means that well informed and well positioned businesses have a great opportunity at securing new markets tax credit financing, even if they weren't originally in a CDE's pipeline.

Now, as I said, our topic today is how to close new markets transactions successfully. We're going to break our discussion into three parts. First, we'll review the current economic climate and how the environment is affecting new markets tax credit financings. Second, we'll discuss the steps you can take to get your project or business ready to apply for and receive new markets tax credit financing.

And third we'll discuss some common challenges faced in closing new markets tax credit transactions and some of the solutions to those challenges.

Now I'm very pleased to share that my guest today is my partner, Matt Meeker from Novogradac's Dover, Ohio office. Matt has several areas of tax credit expertise, including the federal and various state new markets tax credits, renewable energy tax incentives, historic tax credits, low-income housing tax credits and opportunity zones investments.

Matt does serve as a technical editor of the Novogradac Journal of Tax Credits magazine, and has worked on more than a thousand tax credit transactions. Particularly relevant to today's topic, Matt provides financial modeling and other consulting services to CDEs, businesses and their consultants to help them access and structure new markets tax credit financings, and work towards a successful closing.

As I say, each week, if you're ready, let's get started.

Current Economic Climate

[00:03:57] **Michael Novogradac, CPA:** Matt, let me say welcome to Tax Credit Tuesday. It's your first time on the podcast.

[00:04:02] **Matt Meeker, CPA:** Happy to be here, Mike. Just 750 more to go and I'll catch you.

[00:04:09] **Michael Novogradac, CPA:** So, looking at the current economic environment nationally, we're seeing rising interest rates, seeing high inflation and we're seeing supply chain issues among other challenges. If you could describe for our listeners how this current economic environment is affecting the new markets tax credit community.

[00:04:32] **Matt Meeker, CPA:** Yeah, unfortunately, the new markets tax credit community and particularly the low-income communities where the program is really designated to provide this benefit is seeing the exact same issues. Like you said, higher interest rates, inflation, supply chain issues. I would say these issues a lot of times are magnified in these low-income communities.

For example, there's been a big push to fund non-metro or rural transactions. We've been seeing a lot longer lead time on deliverables for supplies on the supply chain. There are constant delays that you have shipping issues that we've seen across the nation. And then additionally, you're talking about getting on a truck or a train, and these rural communities have always seen some delays and they're just really magnified this time.

So construction timelines that may have been six to eight months are now 10 to 12, 10 to 14 months. And sometimes these delays are unexpected. I think they're becoming expected now, but I believe earlier this summer folks were really thinking, "Hey, we'll give an extra month or two." And they realized, "No, we really need to give an extra three or four, five months, or don't even have an end date in mind."

And so the construction scheduling can really provide a burden on these projects as they try to underwrite and think about a completion date when these projects will be ready the on the lending constraints. Obviously higher interest rates has a big impact on everyone. We're seeing those same constraints on these new markets tax credit projects, particularly when you're dealing with a lender who's not familiar with the client, it's always a unique kind of marriage, almost going back to Nicolo's podcast that have talked about the four stages of dating.

And when you go through this underwriting, sometimes you're using a lender who's familiar with new markets, but they might not be familiar with the client, the actual underlying borrower. And in this environment, we're seeing sometimes a premium put on those interest rates as part of their underwriting risk.

As they look at the risk perspective, we're also seeing smaller loan, the value ratios, shorter memorization periods on top of the higher interest rates. But I think all of this plays into the fact of the need for new market tax credits and more of them, in my opinion the new market tax credits work as a gap financing to help projects get completed that typically would not be financed with traditional debt and equity.

And I think all these constraints increase in pricing increase in financing cost puts even more premium on obtaining these new market's important themselves in financing for these transactions.

[00:07:23] **Michael Novogradac, CPA:** Now thank you for that. That's an excellent point about all the challenges in the current economic environment and even greater challenges as we do head into a recession, further exacerbate the need for new markets tax credit financing to close financing gaps. And speaking of that, speaking of closing financing gaps and needing more new markets tax credit financing, it is a very competitive market out there for new markets tax credits, CDEs, themselves, compete for allocation authority.

And as I noted in the introduction, we do expect an awards announcement out in the coming weeks. And then once the CDEs are notified of their receipt of an award, in turn, there'll be businesses competing for agencies financing from those CDEs. So if I'm a business listening in right now, or a consultant to a business listening right now or a proposed project developer, what steps would you recommend I take to prepare to access new markets tax credit financing.

Preparing a Business for NMTC Financing

[00:08:28] **Matt Meeker, CPA:** It might to add on that. As you mentioned with the allocation being submitted over eight months, there's a lot of projects that were part of a pipeline. The economy has changed so much over the last eight months that there's projects are not going to be just viable at the moment. And so I think for people not in a pipeline, looking at their projects, the one term people folks use, especially I know CDE a lot of CDE clients of mine will use as shovel ready projects.

So lot people are like, what’s shovel ready? Do I need to have a shovel in my hand? And a lot of times for shovel ready, it's really about having all your ducks in a row. You have your other sources of financing. You know, again these are complicated projects by nature because there's a lot of different sources of financing's being pulled together for one project.

We'll have senior debt, subordinate debt, local grants, soft loans from local municipalities, trying to help out any way they can. You have economic equity, might have opportunity zones equity. There's just a lot of different pieces being put together. So CDEs want to see that you have this, at least in the works, you know, they don't want to hear, “Ooh yeah, I'm really good with my bank. They'll lend me 10 million next week.”

When I ask them they, they want to see the paper trail, they want to see that there's a commitment letter, a term sheet that you started. Those discussions. There might be an appraisal in the works. Are you getting construction bids in yet? This all just lets the CDE know that you truly have a project that is kind of ready to go or in the process of being ready to go.

Because a lot of times, like you said, it's very competitive. So these CDEs are entertaining dozens and dozens of projects that all on paper look great and have the impacts that they're looking for. Maybe they're creating jobs, you know, just whatever the economic impacts environmental impacts that CDEs are looking to use and utilize for these credits, but they need to make sure these projects can get built.

And so they're really sensitive on, can you put everything together in regards of financing, your project, understanding what your costs are going to be? One of the biggest items we're seeing now on the inflation is construction costs. We're seeing a lot of folks maybe not understand exactly that the implications that inflation has had on their construction.

A quick example, we have a project that we're working on right now started in the spring and they felt pretty comfortable with their construction estimates, both hard costs, soft costs. They had some drawings put together, were working very closely with an experienced architectural firm and another construction consultant. And they thought they had $15 million budgeted. They felt really good about that number. They knew they were still a month or two from out from going out to bids, but they felt really comfortable and had their financing in place. They finally went out to bid two months later and that $15 million budget turned into $25 million. And that was with three different bids all in that range.

And so now they immediately have a $10 million financing gap. And so they've been working really hard between value engineering, raising additional sources, trying to find more allocation to fill in that gap. But again, just being in this economy that we're in, they really didn't understand what their project was going to cost.

We're seeing that. And that's just not the big one project. We're seeing that on multiple projects here where it's not just a five or 10% increase what they're expecting, but you know, 25-30% more than the original cost estimates.

And then the last part is the going to be the but-for test. That's a little easier to meet in this economy. Things are getting a little tougher, but CDEs really want to understand why do you need these credit. You know, it's not that you want the credits, but you really need them. And so there's a little emphasis there when you first approach a CDE. In my experience, they like to know this is why we need the new markets. Here's our financing. Here's the gap. Here's what we can do with the new markets tax credit subsidy when it's provided for us, how we can finish our project and the impacts for our project. And sometimes that can take a couple different approaches in regards of maybe they can add on they can do a larger project or they can have more impacts by being in two locations versus one location.

So there's a couple different ways. I know some folks have reached out to me concerned with this, but for saying, I think we can find a way to get it financed. But if I got new markets, I'm going to A, B and C. Well, you've got to make sure the CDEs know that, so it's also letting them know what impacts you're really having, not just from economic standpoint, your business tax credit allocation for your project.

[00:12:57] **Michael Novogradac, CPA:** So I'm really glad you emphasized the but-for test and how the but-for test, you know, needs to be viewed in the right dimensions. And I definitely hear a lot of the but-for as a binary question of, but-for new markets tax credit financing the project would, or would not move forward? Which isn't really the test as I think of the, but for test, I think it has, but for new markets tax credit financing, the community wouldn't have seen these impacts.

[00:13:28] **Matt Meeker, CPA:** Absolutely.

[00:13:29] **Michael Novogradac, CPA:** So it's not it's not just binary. Does the development or business go forward or not? It's what, to what extent can the business serve the low-income community by way of the addition of new markets tax credit financing, which is, I think is what you're focus on there.

[00:13:41] **Matt Meeker, CPA:** Absolutely, Mike. And even another example there, we had a project that was a charter school and they were really working to, you know they were optimistic on getting a new markets tax credit allocation, but they weren't sure. So they really wanted to have a plan B in case they couldn't receive allocation.

Cause it was still important to get this school built in this community. It was a really dire need for it. And part of the cost cutting they found a way to make the numbers work, but they had to leave out an auditorium. They couldn't do a playground. They had it cut out a lot of technology if they went through it.

So yes, you could have financed and built this school without new markets tax credits. But without new markets, you couldn't do all these other amenities that were so important to the school and for the children's development attending that school. So I think that's, you know, people sometimes get caught up on, well, can you build the building without new markets? That's not necessarily,

[00:14:32] **Michael Novogradac, CPA:** Right. And maybe you can touch on readiness. Cause we hear a lot about readiness for the financing. And how CDE are looking for businesses that are ready to receive the financing. Maybe you can explain to the listeners why CDEs are so focused on readiness to receive financing.

[00:14:57] **Matt Meeker, CPA:** I think part of it is just even just timin because a CDE doesn't—it's time and effort from a CDE to get involved with the project, you know, they're committing resources, they have employees, they have professionals that they're going to hire to work through this financing. It's typical for a financing to take several months.

Kind of looking back to Nicolo's podcast, it's the engagement phase that he discusses and that's often two to three months, but that's, if you kind of have your financing in place, you have at least site control or the ability to exercise options to purchase the property that you can truly look to move forward because CDEs understand.

Yeah. We're going to spend a couple months, you know, two to three months working through the documentation, the underwriting, and they plan on doing that simultaneously a lot of times with your other financing sources, but they don't want to be spending in working through their new market financing, have that documented.

And then wait six months for you to go get your senior loan approved or for you to get construction bids in. Cause they, they really want to kind of keep this on a nice tight timeframe just to keep things efficient. They know time is money. They don't want to waste the project's time and their consultants working through this underwriting process.

And so by having, you know, bids in on construction contracts permitting in place again, I mentioned site control is a big one. If you're doing some equipment financing purchase orders or at least working through those contracts. And so kind of having those items together, whether or not they're signed and committed, but at least working through that process, it gives that CDE knowing that it's almost like a good use of their time, that it's just an efficient use of their time is a better way to put that as they work through that process.

[00:16:42] **Michael Novogradac, CPA:** And if you're not ready at that point or the CDE, if something comes up and you're not ready, a CDE is more likely to say, "We're going to look at another funding, another business, and maybe we'll put you in our application for next year."

[00:16:58] **Matt Meeker, CPA:** Absolutely Mike we see that quite a bit, like you said, it's a very competitive both, not only to obtain the allocation, but then to be deployed allocation to you. So if you're not ready, if you don't have all these items set up today, or you won't in the next month or two, it can still be helpful to get in front of the CDE to let them know about your project.Because of like you mentioned, there's going to be another application filled out soon and each hope to fill out their pipeline all over again.

We've also had deals that weren't quite ready. They were hoping to be ready, hoping the CDE would be a little flexible in timing. It just didn't work because CDEs do have their own deadlines they have to meet at the CDFI Fund with deployment.

We've had deals in front saying, "We're not going to be ready quite yet. It might take us eight months, six." We've had CDEs say, "Well, it's not quick enough for us. We have some deadlines, but if something falls apart or doesn't work out, right, we'll get back to you." And what I've seen, it was like a boomerang effect in regards of getting in front of the CDE, the timing wasn't right.

The CDE was going, working on another deal that deal fell apart. For whatever reason other financing factors didn't come through until the city would just back out say, "Hey, it's been six months. You thought you might be ready in six to eight months. Are you? Cause if not, if you are ready, then we are too."

We have this allocation that has freed up. So that happens quite a bit again, more so in the last two or three years with the economic conditions and maybe the previous 15, but that's kind of the world we're working in today.

[00:18:26] **Michael Novogradac, CPA:** So when I'm thinking of this timeline or the closing of a new markets tax credit financing, what are some of the key points on the path to closing? What would you say the average closing timeline is earlier? You mentioned two to three months. I'm not sure how typical that is. How average the average is.

[00:18:45] **Matt Meeker, CPA:** Yeah, I think that you know, we're accountants, we like to put numbers and percentages out there. So I would say a majority more than 50% of deals close in that two to three month window. The quickest I have seen is probably a month. I'm not sure I know of any investor CDE or tax council that would be willing to sign up knowing it has to close in a month, but we've done it when we run into some deadlines.

There's a lot of sleepless nights and long weekends involved with doing that one-month turnaround. You still have to get the amount of hours of work done. You just doing it in less days. Some deals do drag on. Unfortunately, you know, I would say I have a deal a year that does take more than 12 months.

We've got a few that are pushing 24 months right now. Just obviously there's a lot of uncertainty out there in the economy. We've had a lot of debt that had to be restructured over the last two years on some larger projects. Again, those are usually involving three to four different types of subsidy that you're trying to pull in together and maybe condo out in a different projects, but a large majority are in that two to three weeks, but that's often with a, of discussed regarding some commitments from well construction bids.

[00:20:07] **Michael Novogradac, CPA:** Well, given how many transactions you work on? Saying there's one that's 24 months. I'm sure. Percentage wise. It's extremely low.

[00:20:16] **Matt Meeker, CPA:** And extremely though I would say as a percentage wise, we're talking about 1% of the deals take more than 12 months.

[00:20:23] **Michael Novogradac, CPA:** Right. So we've talked about the current economic climate. And how it's the challenge of the current economic climate only exacerbate the need for new market cash financing for so many businesses and development projects. And we've also talked about project and what they steps they can take to be ready to receive new market cash credit financing.

Now let's talk about the third topic, the central focus of the podcast, and that's some of the challenges to closing a transaction and more importantly than identifying the challenges is discussing possible solutions that you've seen work in terms of overcoming certain hurdles. So maybe you could start by broadly speaking, discuss categories or groups.

I like to put things in categories in groups. If you could talk, maybe share some of the top categories or groups of challenges to closing.

Challenges to Closing an NMTC Transaction and How to Address Them

[00:21:16] **Matt Meeker, CPA:** Absolutely Mike. Yeah. When I think through a closing and the various items, hurdles obstacles that we need to get through to have a successful closing. Kind of put in three different buckets. First is just the general business underwriting and that's going apply to a senior lender, local local governments be loans, economic business partners, just general underwriting by from the market parties.

Second is going to be the tax analysis. We are talking about a tax credit. So there is a tax analysis that needs to be done on the transaction as a whole and make sure we're compliant. We're following what we have from Treasury and the IRS and the tax code. And there's an analysis just to work through there to make sure we're compliant.

And finally, it's making sure that the end structure that the financing as a whole makes sense for your business, you know, the new markets tax credit. I've really enjoyed working in this program because it's got this unique flexibility. Not only does it help low-income communities and it has a lot of economic impact.

But it also is a flexible credit in my opinion, that you can use it for a lot of different types of projects and a lot of different types of financing to pair with it. But because of those options, you got to make sure as a project, you understand how this project, how you're financing is working. There's often extra entities, additional entities that you put together and form as a part of this financing and understand what implications are going to be from the tax and potential tax standpoint.

[00:22:44] **Michael Novogradac, CPA:** So thank you for putting this into three buckets and let's take a closer look at each of those three. And let's start with underwriting. What are some of the common underwriting constraints that you see with current new markets tax credit financings?

[00:22:57] **Matt Meeker, CPA:** So starting off first with debt, we talked about debt a little bit, obviously higher interest rates lower LTVs, shorter analyzation periods, but then the also concern that you have, there is just collateral issues. You have forbearance that you need to work through. There's a lot of banks out there that have worked with new markets transactions, and those are great, but a large majority of the transactions we're working with, the underlying product has a banking relationship typically with a local regional bank that has not worked with new markets tax credits before.

And so there's just an education process there to work through on the business side. For those of you not familiar with the new markets tax credit structure, there's this need for a leverage loan. Which you couple with the new markets tax credit equity to then make the qualifying investment. And that leverage loan can be sourced from a multitude of different financings.

A lot of times we'll see if you have some senior debt bank debt involved, that the loan that bank loan will go through this leverage loan, be part of financing, this leverage loan or funding, the leverage loan. This is unique though for the lender because they're lending to a business who doesn't own the underlying assets.

And so it's a different collateral package for them. And again, in my experience, a lot of times when you can work through with these banks to help them understand why it needs to be this way. So the project can use this new market tax credit allocation, and the subsidy is so important to the overall underwriting.

We do see a lot of success working with banks, even for the first time on some of these collateral issues. And it's just an education process. And again, something to start sooner rather than later on the next on the economic equity side, that was kind of the next business underwriting. We still often see a lot of projects with equity, whether it's the developer putting in their own money, not just sweat equity, but actual cash into the transaction.

We see a lot of deals now that because we're talking about communities, it could be tough to put together financing. We'll see a lot of parties co-develop with other developers in the area or bring in some third-party equity as investment equity. We've seen some success with the opportunity zones program, pairing up with new markets tax credits.

The opportunity zone can be tough to use in the leverage structure. It's very complicated. So a lot of times we'll see opportunity zones equity come in side by side with the new markets financing to provide.

Now, there are some considerations there you need to work through on the business underwriting. One of the big things we run into is just the overall sources and uses. And what I mean by that is you have the new markets tax credit allocation. And in addition to that, you're bringing your opportunity own equity. We actually had a project where we had to resize our new markets tax credit allocation in order to fully utilize all the opportunity zones equity that was available to the project through its various business partners that had it was interesting.

There was a week or so of conversations behind the scenes when it was brought to my attention from the project that we have X amount of opportunity zones investments available to us, we really want to be able to utilize all this because we have a good relationship with these investors, but we don't have enough project uses to spend the new markets tax credit investment and the opportunity zones investment.

And they were really concerned going back to the CDE. They knew it was really hard to get this allocation. They were nervous going back to the CDE. And I was like, I think we just have to have an honest conversation with them. So we scheduled a call. They were quite nervous going into it and they brought it to the CDE and they're, well, isn't a simple solution just for us to reduce our allocation a little bit.

You just need knock down a million dollars or so. And they’re like, “Are you willing to do that?” And they go, “Absolutely we can do that. We actually had a project that was asking for an extra million of allocation. This is perfect timing.” And so again, a lot of stuff, is it just communication, you know, talking to all the parties involved, but when you're using different equity sources, again, if you have multiple partners involved, some of their money might be need to use for leverage.

Some of that might be equity directly into the project. How does that impact cash waterfalls? Because you're going to have an operating business maybe at one side or a real estate business on another side and working with your investors, help them understand where their money's going into the finance.

And what would be the actual economic sharing arrangements you might need to work out? Cause again, it's not necessarily just one partnership that you're putting, you might have multiples money's moving through. And so that can just be again, sometimes an education process. Sometimes just working through that little bit of brainstorming.

One thing that I'm, that we can provide a service for our financial modeling work is we can work through different scenarios with these closings a main product that we do provide here for all these new market tax credit financings is a financial model that works through all these cash flows, the tax calculations and loan schedules and fee schedules for the investment fund, the CDEs, the qualifying business, and the leverage lender and sponsors involved with the transaction.

We can use that financial model. It's a very flexible working, almost living, breathing, Excel. That we build to add flexibility to us. We can quickly run analysis for you if you want to move money around, if you want to share change sharing arrangements. And we do this a lot, especially when there's multiple investments involved from different parties to show how we can maybe change the sharing ratio at the qualified business level versus the cash waterfall to leverage lender level in order to hit those economics that all the parties were agreeing to when they first got involved with the deal, but didn't necessarily realize new market tax credits was involved.

[00:28:34] **Michael Novogradac, CPA:** So if I'm a business, that's, you know, hearing this podcast thinking, okay, I see these stricter underwriting requirements. What can I do to prepare for those?

[00:28:45] **Matt Meeker, CPA:** I think the biggest item is early and often communication. You know, a lot of these parties, I've been very fortunate to be involved with over 800 tax credit financings today and 90% or more of them are for, with folks doing their first new markets tax credit financing. And so there's a lot of education involved from a lot of the parties and, you know, working through the financing, not just the actual projects themselves, but again, their local banks, their lenders.

We see a lot of support from local governments, providing grants or soft loans to these projects because they see the importance that this project will have on the local communities. And so just getting in early involved I feel like it's never too early to call a new market professional. You know, someone here at Novogradac or tax counsel, we can help identify some of these key issues.

We can be part of conversations, working with your bank, your lenders, your investors, and help explain how this works. We've actually developed what we call a concept model. I think most of us has kind of coined the term or a mini model. So my partners use that term as well, where it's just a snapshot.

It's a couple pages to walk folks through how these financing work. What the net benefit looks like on the upfront and how this will look over the next seven years. And it's been a very helpful tool early on. That's very efficient way to walk these different financial parties through a transaction, help them get comfortable.

Then obviously we, everyone gets their council involved and work through the documentation, but a lot of it just comes into one getting educated early on with these different parties. But two is kind of having a contingency plan. Like I think it's also very important. You know, you always are going to have some hiccups on the road.

Again, seems like in today's economy, there's always surprises. Unfortunately, there are surprises are usually not for the good either, but just kind of going in with a plan, be a contingency plan. And sometimes it's simple. Just hi, having a higher contingency in your budget when you're working through the numbers, it's like, okay, I can get a loan of X amount.

I've got Y I'm out in the bank. And my local township and municipality is willing to give a grant of Z. But do I need to plan on a little bit more than that? Cause if I have all my eggs in one basket in that regard, it can be pretty tough. When I have a surprise when I have an extra cost pop up, I wasn't expecting, again, a higher interest rate, a low amortization period, a longer construction timeline, which means my financing costs have increased on me.

So just a lot of that, that just having that contingency plan goes a long way as well.

[00:31:21] **Michael Novogradac, CPA:** So we've talked about the first hurdle underwriting. The second hurdle you mentioned was tax analysis. Maybe you could describe for our listeners, some of the key challenges that you're seeing on that.

[00:31:33] **Matt Meeker, CPA:** Yeah. So we're working through the tax analysis, so again three different categories as well. One is ensuring your business qualifies. It's very important. There's no credits if you don't have a qualified business, the next is true lease, which is a very common tax issue we see, and the other, and probably one of the biggest items is true debt.

And so on the ensuring you have a qualified business, we've talked earlier on the previous podcasts about what the businesses, what you, what businesses do qualify. Again, this is a flexible program. A lot of the projects that we end up financing, I would fall into two buckets. We call a real estate transaction or an operating business.

And so there's this qualified business that's formed to take into qualified investment from the CDE. A lot of times we will finance just the real estate. You know, that's your real upfront cost. For most projects, you're either rehabbing a building or doing new construction. You'll take this new market qualified investment in use those proceeds to construct your building.

And then you're going to, and a lot of times you're either going to have an actual leasing transaction or you're going to operate a business within that facility, but we will structure a lease to a related party entity that you also control. So a lot of times in these transactions, you'll have two entities involved.

Perhaps your parent company, that's going to operate the business and a special purpose entity. You've created to own the real estate and to obtain the new market tax, the financing. That's what we call the real estate transaction. There are some CDEs involved that in their allocation agreement, so they're operating businesses or non estate transactions.

And so they're looking to finance a manufacturing facility or an equipment facility, and it doesn't necessarily have to be manufacturing or creating widgets. It could be something along the lines of you're doing an expansion for a plant and we want to finance the equipment for that plant. And so we'll create a special purpose entity.

To own the equipment and then equipment will be leased to an operator, which you also control as the project. And so again, you're creating two different partnerships, one to own the equipment, one to operate the project. And again, with that, we can provide some flexibility on financing, maybe collateral And there's some transactions where we get to creating additional entities is a hurdle. There's a lot of nonprofit. Sometimes we'll have issues or constraints on if they can create a subsidiary or to create another nonprofit. And the new market tax credit roles have kind of given us an I, my opinion, a gift, what we call a portion of business roles.

And so there's a structure that we can use where we use a portion of your business or your company. And that can be the qualifying business. And there's usually some document, there's some documentation around this and you almost treat it like a standalone business within the actual legal formation of your actual parent company.

Considers almost like a subsidiary without creating a subsidiary on paper. It just exists in the accounting world and these different flexibilities allow for a lot of projects to qualify for the new market tax credits. And so just working through with your professionals to understand what's the best structure for you.

It can go a long way doing that front versus trying to figure out on the fly. When you're working with your CDE can be very beneficial on the next tax issue on the true lease issue. Again, a lot of these transactions involve creating two different entities. One that's going to own the asset and then lease it to another business to operate that asset, whether it's equipment or real.

And you it's important that tax analysis, that, that lease is respected as a lease often, attorneys will call that the lease test. And this is a very important element to the tax analysis ensure the qualified business is deemed to be the owner of those assets for purposes. There's some very complex and quirky rules, both in, in, under the IRS, but also in gap accounting where a financing, leasing, transaction financing make, we don't rules, especially on the side qualified that's taking in the qualified investment owns these assets for tax purposes.

And so there's always a lot of scrutiny around this from the attorneys for good reason, cause we want to make sure that's that analysis is respected by the IRS. And part of that is also looking at the rates that we're charging. And so we'll often bring in a local broker or a professional to look at these leasing arranges that understands the asset releasing.

And that goes a long way with helping determine whether or not this lease is kind of respected and that we don't have any issues with the IRS down the road on, on reclassifying, who's actually running the equipment under these leasing arrangements. Finally, we have the true debt analysis and a lot of folks feel this might be one of the more important that have out there on the true debt analysis.

The qualified investment from the CDE to the project can be in the form of loan or equity. And in my experience, 99% of these investments are done in the form of a loan. And there's a lot of court history out there regarding what constitutes a loan. So it's important how that loan is structured in the legal agreements and the documentation.

It's respected as a loan, because if it's not respected as a loan by the IRS, it could be construed as a grant, which is not an eligible investment. You wouldn't be able to receive new markets tax credit as the investor in the project.

[00:37:18] **Michael Novogradac, CPA:** So thank you for that. That was a good summary of some of the tax analysis work that you do, as well as some of the solutions. I wouldn't say solutions, but some of the parameters within which the tax analysis is performed and some of the structuring advice that you end up providing along with legal counsel to help navigate the tax rules.

So let's move now to the third challenge. The closing that you mentioned, which was using a structure that works for a qualified business. If you could explain in a little more detail what you meant by choosing a structure that works for a qualified business.

[00:37:51] **Matt Meeker, CPA:** Yeah, Mike. So I mentioned earlier that the new markets tax credit provides a lot of flexibility and structure. We talked about using operating businesses, using a real estate business and even portion of a business. And with that, I think there's really two main aspects of companies should be focused on when looking at the structure, being utilized on the new markets financing and one that is income tax considerations. And the second is going to be GAAP considerations of that structure.

[00:38:23] Michael Novogradac, CPA So what are some of those income tax considerations or GAAP considerations that a business needs to consider?

[00:38:27] **Matt Meeker, CPA:** You want to make sure that again, that this project is going to work for you, the outcomes you want to achieve often partnerships again, will create at least one, if not two additional what we call a special entity or additional entity play a role in this new market financing and are creating a different additional entities.

It's important to know the tax consequence of those entities whether you want to create a partnership or an S Corp or a C Corp, if you're a nonprofit, it could be creating a supporting corporation. And then thinking through those tax implications as a nonprofit, one of the number one tax implications is going to be UBI.

You know, is this going to be actual unintentional business income to them and are they going to have any taxable income and actually have a tax payment owed because you’re not meeting your original mission statement? Or if you’re creating a new nonprofit, how will that mission statement and nonprofit purpose could be together how it's formed and when you're submitting to the IRS for its purpose.

On the taxable side, for an example, we were working with an entity a couple years ago and they were creating a special purpose entity partnership that was going to act as a qualifying business. And it was an equipment financing transaction. So the qualified business was going to own equipment and then lease it to the original parent entity to run their business and to run their operations. As we worked through the financial forecast and was talking to the client, we were educating them on with some passive activity loss rules, which is a pretty technical topic.

We won't get into all those rules today. Mike, that might be—

[00:40:09] **Michael Novogradac, CPA:** No, we will not.

[00:40:10] **Matt Meeker, CPA:** In the future. But there were tax implications. They realized they cannot use the losses on the depreciation of all this equipment, which was millions and millions of dollars of losses they had planned on using for their business.

But because we had stuck it, put this equipment under a different partnership. And that equipment was solely used for leasing. It changed the characterization of that loss. Now working with the client and their accountants, we realized they had another subsidiary. They had already formed that had very little activity in it anymore.

That was a corporation. And they thought, okay, we can work through some of our tax issues by putting the corporation there as our qualifying business. And we don't lose the benefit of the depreciation. Cause there's some other income we can use offset that corporate structure. Again, just one, one example of really looking through the different entities you're creating in the tax implications from each on the side.

The biggest item we typically see is consolidation. Again, you're creating another entity and for a private partnership for a private entity, usually their gap financial statements are not a major concern unless you have some loan coverage, you might be concerned with there's. When I mentioned the consolidation, a lot of times when you're creating this quality entity or creating a leverage lender, parties feel more comfortable.

If they can consolidate both those entities into one or roll them both up into one parent company and kind of collapse this new market transaction on their financial statements, it can impact their asset ratios or their loan to value ratios on their financial statements. And a lot of times when that is a concern, we have found it been very advantageous to bring up these concerns with the attorneys, drafting, the documents and the new market investor and CDE involved.

We had one, for another quick example: We had a project a few years ago where they, a nonprofit brought in their auditor to analyze the documents in the transaction to make sure they could consolidate. This transaction for cap purposes. And there were a few provisions in the leverage loan agreement in the investment fund agreement that created some pause on the consolidation of the market, new market structure for this sponsor nonprofit.

And it was actually resolved quite quickly. There was just a call was, it was put together. And a couple of these provisions in the documents themselves were just some standard language that had been left over for probably a dozen deals or so just when some carryover language that no one really was too concerned with that was in there, but it created a lot of concern for the auditors here and the attorneys and the investor was, were very quickly to agree to change.

You know, they asked for the proposed language, they're able to run it through. It had no impact on the tax side. The attorneys were happy. It was again, just kind of some boiler plate language that was in there that was quickly. So again, getting professionals involved, looking at these transactions can help identify even big issues to have some pretty simple solutions.

[00:43:15] **Michael Novogradac, CPA:** So thank you for that, Matt. And as you've noted, sort of throughout the podcast, it's so important to be identifying these issues early and when they get identified to be discussing them with the key participants affected by the issue and most issues when identified early can be resolved.

You always want to avoid the issue that is identified late, then so much can have happened, that it can be a greater challenge to resolve it. So besides these top three areas that we've talked about so far, you know, namely kind of underwriting tax analysis and identifying that the structure works for the borrower, are there any other words of advice that you'd have for our listeners that are potential borrowers or investee with respect to new markets tax credit financing?

[00:44:09] **Matt Meeker, CPA:** Like I would say that the biggest bit of advice to add is don't shy away from this program just because you don't understand it at first. I know there's a lot of acronyms that we throw out you, when we talk about new markets. We have CDEs, QEIs, QLICIs, QALICBs.

We even have conversations on how to pronounce those acronyms at times. But there's a lot to learn on this program, but part of that extra aspects that are part of the program is to create this flexibility discussed earlier in order to make it viable for a lot of business or a lot entities that need this benefit.

And so, get professionals involved. I mean, you might hear this podcast you might have done some research online and it might just feel like this is too complicated. It's not worth my time and effort. I would really encourage folks to reach out. To myself, to someone at Novo to tax professional that, you know, that's familiar with the program and really just have at least have a conversation to try to understand.

Cause it's one of those things that once you're going to get through those initial barriers of understanding the logistics of the program, the terminology that we use, you'll realize that with a little bit education, you can go a long way in understanding how this program works and how it can benefit your project.

So that probably be my number one, additional bit of advice. Mike is just not to get scared off too easily. Cause there's a lot of folks out there that want to help, that can help. And it's because we do care and we just see the good that this project does for a lot of different communities. And we'd like to see how it can impact your community as a developer.

[00:45:47] **Michael Novogradac, CPA:** Great. Thank you, Matt. There's a lot more questions I'd love to ask you, but we're getting to the end of our time here. I appreciate you making yourself available today. I'm sure that many of our listeners will want to contact you with questions. I will include your contact information. Today's show notes, which will be posted on our website, www.novoco.com/podcast.

And Matt do stick around for the Off-Mike portion of the podcast, where I get to ask you for some off topic, advice, and words of wisdom to our listeners.

Be sure to tune into next week's podcast, especially if you work with the low-income housing tax credit, or more broadly of affordable rental housing.

I posted a poll on Twitter recently asking my followers what kind of low-income housing tax credit topics they'd like us to cover on Tax Credit Tuesday. The winner in the low-income housing tax credit category was Year 15. The low-income housing tax credit has a 15-year tax credit compliance period, after which owners have various courses of action available to them.

Even if Year 15 is several years away for your development, it's never too early to start planning for Year 15. I actually encourage clients to plan for Year 15 while they're planning the development phase. My partner, Kevin Wilson would join me next week to discuss challenges and options for Year 15. You can make sure that you're notified of that episode and each week's episode, by following the subscribing to the Tax Credit Tuesday podcast, go to www.novoco.com/podcast to subscribe to and stream the show on our website.

You can also follow or subscribe to Tax Credit Tuesday on iTunes, Spotify, Google Podcast, Stitcher, and Radio Public.

Off-Mike

[00:47:35] **Michael Novogradac, CPA:** Now I'm pleased to reach our Off-Mike section where listeners can get some off-topic advice and words of wisdom from our podcast guests. So Matt, one of my favorite questions to ask guests, and it's probably reflects a bit about my own character in terms of trying to be more efficient and there's a variety of ways to describe becoming more efficient.

And I certainly try to be expansive in my own self-perception of efficiency, but linked in with efficiency is productivity. So what is a habit that you'd suggest listeners add to their daily routines to increase their own personal productivity?

[00:48:15] **Matt Meeker, CPA:** Well, Mike as partners of a CPA firm that provides services to clients, this may surprise you, but I'm going to say learning the word, “No.” And what I mean by that is that there's just not enough time in the day for everything that gets thrown at us. And that's just not professionally, that's in life with friends and families and other commitments we have. It just forces you to really prioritize your day, the task at hand that you have in front of yourself. This was something I took way too long to learn. I wish I would have learned this, you know, probably 10, 15 years earlier than what I did, but I eventually have someone getting there and still perfecting it.

But just the ability to look at what's being requested of you. A lot of folks refer to this as the Eisenhower Matrix. For those of you who are familiar with it where you look at on a scale of urgent and important and you make a little four-square matrix box. And if it's important and urgent, that's going to be your top task that you do.

But on the topic of saying no is if it's not important and it's not urgent, it kind gets put on the back burner. It might never get done, but it kind of works back through. And so being able to prioritize it. So I summarized it quickly as just saying, learn to say no, but there's a lot more to it than that.

It really comes down to prioritizing your tasks, your, and again, understanding your abilities, what you can get done. I just feel like understanding what needs to go on the back burner or maybe what never gets done allows you to focus more time on what is urgent and important. That helps you be more productive with your day.

[00:49:50] **Michael Novogradac, CPA:** I really like that focusing on “no,” because it is so important because there's so many demands on one's time and over the course of a day and I myself do find myself often getting caught up in non-important urgent, trying to catch myself and saying, this is a non-important urgent and that is not where I should be spending my time.

I should be focused on the important urgent and non-urgent, and it is a challenge. And I do like that quadrant approach. I also think though that as you advance in your career, it's more important to say no because you have more incoming. And at some points early in your career, it's more important to say yes, because you don't know what opportunities are presenting themselves.

And then as you get along in your career, lots of opportunities are presenting themselves. Then you have to be more focused on the times to say no. So I would say that you may be, aren't learning it late. You might be learning it at the appropriate pace.

[00:51:02] **Matt Meeker, CPA:** Well, I appreciate that.

[00:51:04] **Michael Novogradac, CPA:** That’s so true. But a no for one is a yes for somebody else and vice versa. So let's go to a second question. I only keep you on for two questions. I have been rededicating myself to reading books and this is actually something that started during COVID. I found myself with more time away from work that wasn't being occupied by activities outside the home.

So I started rededicating myself to reading. What's a book that you'd recommend to our listeners and why?

[00:51:46] **Matt Meeker, CPA:** Other than the New Markets Tax Credit Handbook, I assume that, you know, that's an obvious read.

[00:51:51] **Michael Novogradac, CPA:** That's an obvious one. When I about your favorite podcast, favorite YouTube video channel. But the New Markets Tax Credit Handbook, another Novogradac handbook.

[00:52:04] **Matt Meeker, CPA:** A recent book I read is Get Your Life Back by John Eldridge. The premise of the book is really was kind of a similar theme of learnings about that. It really talks about the hectic lives a lot of us live and there’s so much thrown at us between social media, work commitments, there's all of a thrown at book really focuses on seeing that, understanding that, and kind of listening to yourself, your mind, your body, your soul, and being able to take breaks.

And sometimes it's just even stepping back for, you know, 30 seconds taking a pause, just to take a breath. And just to kind of be more socially you know just more personally aware of the demands that you have on yourself. And to be able to take that break. It is really about kind of restoring yourself.

It's not about getting relief from the busyness of life, but restoring yourself from our hectic lives and just the mental health aspects to it. And the kind of that reassuring that replenishing yourself can go a long way with all the demands in today's world. So it's, it was something written oddly enough, I think it was right before the pandemic. I think it was 2020 when the book was written but it very much so seems applicable today in the last few years than ever.

[00:53:22] **Michael Novogradac, CPA:** Thank you for that. I will have to add that to my reading list, Get Your Life Back. And who was the author again?

[00:53:31] **Matt Meeker, CPA:** Eldridge.

[00:53:33] **Michael Novogradac, CPA:** So I'll look forward to that. It does sort of tap in a bit to your suggestion regarding productivity. I suspect the book talks about the importance of "no," as part of getting your life back

[00:53:46] **Matt Meeker, CPA:** It does.

[00:53:47] **Michael Novogradac, CPA:** Yeah. I also constantly try to focus on being as intentional as possible with respect to my life. And there's so many ways in which you can feel like you're losing control of your life based upon external demands. And I suspect this book will give a lot of tips and observations and ways in which one can do a better job of getting their life back.

[00:54:19] **Matt Meeker, CPA:** Absolutely. Yep. A lot of it just kind of self-awareness and really thinking through that. Definitely it's a thinker. It makes really. Reevaluate your life and think through things that maybe you have taken for granted or didn't realize were impacting you as much.

[00:54:34] **Michael Novogradac, CPA:** And as you've heard me say before Matt in partner meetings and the like, I'm sure there's much of the book that is just common sense, but since common sense isn't common practice.

[00:54:47] **Matt Meeker, CPA:** Absolutely. Absolutely. Mike.

[00:54:49] **Michael Novogradac, CPA:** it's very much worth reading books like that to focus yourself on things that are common sense, but you get distracted from. So Matt, I appreciate joining us on the podcast and to our listeners, thanks for listening.

Additional Resources

Email

Matt Meeker