



### New Market Tax Credits

#### What are New Markets Tax Credits?

The New Markets Tax Credit (NMTC) Program provides a tax incentive for private sector investment into economic development projects and businesses located in low-income communities. The program is overseen by the United States Department of the Treasury and is directly administered by the Community Development Financial Institutions (CDFI) Fund.

NMTCs are allocated by the CDFI Fund to community development entities (CDEs) under a competitive application process.

To qualify as a CDE, an entity must be a domestic corporation or partnership that:

- has a mission of serving, or providing investment capital for, low-income communities or low-income persons;
- maintains accountability to residents of low-income communities through their representation on a governing board of, or advisory board to, the CDE; and
- has been certified as a CDE by the CDFI Fund.

CDEs offer the NMTCs to investors in exchange for qualified equity investments (QEIs). The CDEs then invest those funds into qualified active low-income businesses (QALICBs).

NMTCs provide a subsidy to businesses and economic development projects in low-income

communities that is equal to approximately 20% of the project financing. These projects, in turn, provide jobs, economic activity, and needed products and services in low-income communities.

#### What are the benefits to banks?

- The NMTC provides a subsidy that helps banks participate in projects in low-income communities that might not otherwise be eligible for financing.
- Bank investors receive a credit against federal income taxes for making qualified equity investments in CDEs. The credit totals 39 percent of the cost of the investment and is claimed over a seven-year period.
- NMTC participants can also earn interest income on their investments, depending upon how they are structured.
- Banks may receive positive CRA consideration for NMTC investments, provided the investments benefit a bank's assessment area.

#### How can banks participate in the NMTC Program?

Banks can participate as tax credit investors in two ways:

- *Bank-operated CDE Model*

A bank can form a subsidiary CDE and apply to the CDFI Fund for an allocation of NMTCs.

- The CDE can apply for certification with the CDFI Fund.
- CDFI Fund-certified CDEs are eligible to apply for NMTC during the CDFI Fund's annual funding round. Please see the CDFI Fund's website for further information on the application process.

- *Third-party Model*

A bank can also invest in an existing NMTC allocatee. This can be an attractive option for banks that do not want to undertake responsibility for the program's compliance and reporting requirements.

- A list of CDEs that have received NMTC allocations is available on the CDFI Fund's website.

Banks can also participate as lenders through the leverage loan structure. As a leverage lender, banks can receive competitive returns while the borrower has below-market interest payments.

### **What are the key risks and regulatory considerations with NMTC investments?**

- NMTCs are subject to recapture for seven years after an equity investment is made in a CDE if:
  - A CDE ceases to be a certified CDE, or
  - "Substantially all" of the equity investment proceeds are no longer used for qualified Low-Income Community Businesses, or
  - The CDE redeems the equity investment.
- An investor bank should consider the CDE's management, experience, and compliance capabilities. A bank should also consider the credit and liquidity risks of any investment in NMTCs.

- The National Bank Act, 12 USC 24 (Eleventh), and the OCC's Part 24 rules implementing that section of the Act enable national banks to make equity investments in certain CDEs as well as in NMTC investment funds.
- The leverage structure often requires non-traditional collateral, forbearance agreements, and non-amortizing debt for the seven year compliance period.

### **For more information**

- OCC's February 2007 Community Developments *Insights* report entitled ["New Markets Tax Credits: Unlocking Investment Potential"](#)
- OCC's Summer 2004 *Community Developments Investments* entitled ["New Markets Tax Credits – Bridging Financing Gaps"](#)
- [OCC's Web-site](#) for information about the Part 24 community development investment authority.
- [OCC's District Community Affairs Officers](#)
- [CDFI Fund's New Markets Tax Credit Program](#)
- [The New Markets Tax Credit Coalition](#)