How Qualified Active Low-Income Community Businesses Can Attract NMTC Financing

The new markets tax credit (NMTC) incentive provides $5 billion a year in allocation authority to community development entities (CDEs) to support businesses in low-income communities or those that support low-income people. As a qualified active low-income community business (QALICB), there are standards to meet and competition with which to contend to receive the financing. In this week's podcast, the 750th of Tax Credit Tuesday and the first of a three-part NMTC series, Michael Novogradac, CPA, and Novogradac partner Nicolo Pinoli, CPA, discuss the standards and provide tips for businesses to be more competitive to receive such financing. They examine the big picture of the incentive and go over the qualifications to be a QALICB before looking at the amount of financing available and the competition to receive NMTC financing. After they, they examine what businesses should consider at the start of transaction in which they'd like to receive NMTC financing, share key points in the timeline and discuss at what CDEs are looking for when they decide which businesses in which to invest.

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Transcript

[00:00:11] **Michael J. Novogradac, CPA:** I'm Michael Novogradac and this is Tax Credit Tuesday. This is the Sept. 6, 2022, podcast.

I do hope that you had a pleasant Labor Day Weekend. Today, the Tax Credit Tuesday podcast reaches a milestone. Today's podcast marks the 750th episode of Tax Credit Tuesday. Wow: 750 episodes. Now, you may be a dedicated listener who started with us back in October of 2007 and listened to our very first episode. Or you may be a listener who started listening somewhere along the way or perhaps today is your very first episode. For each of you, let me say personally, thank you for listening. And as I often say during the course of a podcast, if there are ways we can better serve your needs, please email CPAs@novoco.com. We are constantly striving to improve our podcast every week and listener feedback is critical in that regard.

Introduction

Now let's turn to today's podcast. Today's episode will focus on the new markets tax credit and this is the first of three episodes aimed at helping our listeners better prepare for the coming new market tax credit awards announcement and, sometime after the awards announcement, for the opening of the calendar year 2022 application round. Today's podcast is going to center on the businesses that receive new market tax credit financing. Next week, the second installment of our new markets tax credit trilogy will review the roles of the key players in a new market tax credit financing, as well as various sources of new market tax credit. Leverage financing is a term of art that we'll explain in greater depth today and obviously in considerable depth next week. In the third installment of the trilogy, the week after next, we'll go into detail about the closing of a new market tax credit transaction and we'll have a particular focus on some of the many challenges presented today, given our current economic climate.

Now I referenced this as a new market tax credit trilogy, but it will eventually become a tetralogy as there will be a fourth episode. That's because when the calendar year 2021 new market tax credit awards are announced, we will have a bonus episode that summarizes the awards and the key next steps in deploying the credit authority awarded. Some believe that the awards announcement will be sometime this month, which may interrupt the schedule of the coming episodes that I previously outlined. However, the awards announcement could slip into October, meaning that the fourth NMTC episode may come after other Tax Credit Tuesday non-new market tax credit-related podcasts. In any event, whenever the awards are announced, we'll interrupt our regularly scheduled programming and hold a podcast episode addressing the awards and next steps.

Now let me begin this week with some level-setting. The new market tax credit is a tax incentive that helps subsidize businesses that serve low-income communities and persons. New market tax credits allow finance companies known as community development entities, or CDEs, to provide subsidized gap financing to businesses that satisfy certain criteria. The new market tax credit was created back in the year 2000 and is currently authorized at $5 billion a year in equity issuance authority through 2025. Thanks to the long-term extension, new market tax credit participants can plan now for upcoming allocation rounds.

Now I mentioned that we're awaiting the awards for this year's round, the awards announcement for this year's round. Regarding that, there were 199 applications requesting $14.7 billion in allocation issuance authority and there's just $5 billion available to be awarded. I'll also note that we expect about 100 awards, which means roughly half of the applicants will be successful, but the amount of the award on average at an awardee receives will be about 70% of the amount requested. The financing that the awardees will ultimately provide to businesses will generally be debt financing, but I'll note can be equity financing.

We at Novogradac do get many calls from businesses seeking new market tax credit financing from CDEs and we do encourage those calls, so if you're listening, please reach out. These businesses, to be eligible to receive new market tax credit financing, must be what is known as a qualified active low-income community business or QALICB. And if you're new to new market tax credits, then you may not know, but the new market tax credit world has a lot of acronyms. Now, the individual words that make up the acronym, QALICB, namely qualified, active, low-income and community, have specific statutory definitions that provide the framework for determining what is an eligible business. We will delve into some of these definitions during the course of the podcast today, as we review what is required for business to qualify as a QALICB.

A key purpose of today's podcast is to help a business learn if they are or can become a qualified active low-income community business, or QALICB, and thus be eligible for new market tax credit financing. That said, we're not able to go into it in sufficient detail where you'd be able to determine for certain. That's why it's very important to have experienced new market tax credit advisers. Now, if you're not a business seeking new market tax credit financing, today's episode is still valuable as all participants in new market tax credit financing need to know what makes the business eligible to receive such financing and how to attract such financing from a CDE.

We're very fortunate today to have joining us, my partner, Nicolo Pinoli. He's from Novogradac's Portland, Oregon, office. Nicolo is a frequent guest on Tax Credit Tuesday, discussing a variety of tax incentives. He's an expert in many community development tax credits and serves as technical editor of Novogradac's low-income housing tax credit publications. Today he's here, obviously, to talk about the new market tax credit, an area in which he has considerable expertise, which he draws upon when he chairs our January new market tax credit conference. I should note that we do have three new markets tax credit conferences a year, and our next new market tax credit conference is October 27-28 in New Orleans. Nicolo works with a variety of new market tax credit stakeholders, from community development entities to investors to developers to QALICBs, so he sees the incentive through multiple angles or from multiple perspectives.

In today's podcast, we're going to start with the basics, including what makes the business eligible for the incentive and how competitive the tax credit financing is. Then we'll discuss some of the logistics, including timelines and when a business in search of NMTC financing should start talking with other new market tax credit stakeholders. After that, we'll address a part of the podcast that might be most interesting to listeners who are already active in a space, and that is looking at what makes a business attractive to a CDE, which is the entity that provides the subsidized financing. I expect listeners will learn a lot today, so if you're ready, let's get started.

[00:08:16] **Michael J. Novogradac, CPA:** Nicolo, welcome back to Tax Credit Tuesday. I can't think of someone I'd rather have on the 750th episode.

[00:08:23] **Nicolo Pinoli, CPA:** Well, thanks for having me, Mike, it's great to be back and excited to be here for the 750th episode.

[00:08:30] **Michael J. Novogradac, CPA:** Now, as I said during the opening, we'll start with the basics. We undoubtedly we have some listeners for whom this topic is new, so if you could explain at a high level how the new markets tax credit incentive works, that would be a great way to kick off the podcast.

High-Level Overview

[00:08:46] **Nicolo Pinoli, CPA:** All right, there's a lot to unpack there, but maybe just high level we can cover a handful of details to help listeners better understand the players and the process. And as Mike mentioned earlier, there is a $5 billion pool of annual allocation authority that's available. And the program is administered by the Community Development Financial Institutions Fund, or CDFI Fund, which is an arm of the Treasury.

And CDEs apply annually to the CDFI Fund to receive a piece of that nationwide pool and then CDEs, if they are successful and actually receive an allocation of allocation authority, then they in turn allocate that to individual projects and those projects, as a result, end up receiving subsidized financing. Often, we even refer to it as subsidy, whereby they're able to use that subsidy to close financing gaps. Certainly there are a whole host of other players that come into the scene, everyone from tax credit investors to leverage lending sources, accountants, lawyers, consultants, and the list goes on and on. But hopefully, at least in terms of very high level, you now understand the basic process around allocation awards, seeking allocation from CDEs and certainly as we get into the details today, we'll be talking a lot about what makes a QALICB attractive and what the basic requirements are to be a QALICB.

[00:10:21] **Michael J. Novogradac, CPA:** So, I mentioned in the intro when I was talking about the $5 billion, made reference to equity issuance authority and I didn't say tax credits. Maybe you could explain to our listeners the difference between the two.

[00:10:34] **Nicolo Pinoli, CPA:** Sure. And certainly the $5 billion in allocation issuance authority really translates to what we call qualified equity investments. So, for every dollar in allocation authority, a CDE has the ability to designate an equity investment that it receives as a qualified equity investment. For every dollar in qualified equity investment, there is a 39% credit or 39-cent credit that's generated for every dollar. So, when you look at $5 billion in allocation authority and you do the math, at 39%, you end up with $1.95 billion in credits that are actually available.

[00:11:20] **Michael J. Novogradac, CPA:** Great, thank you for that. And for our listeners, those that are newer to new market tax credit financing, at the CDE level, you end up with that $1.95 billion of credits being used to raise equity. And then there's also oftentimes some degree of debt that is used to blend with the equity to make the investment and that's where our leverage lenders come in. As I mentioned in the intro, we'll go into leverage lending sources in more detail next week, but I just wanted to fill in some of those blanks. Thank you, for that Nicolo.

So today though, we're specifically talking about businesses that are seeking an NMTC financing and those businesses must serve low-income communities or low-income populations to be eligible to receive the financing and there are other requirements. I would note that we refer to businesses or projects somewhat interchangeably, technically all borrowers or investees, if they get equity investment are businesses, just many of them are real estate-oriented businesses, so we oftentimes refer to projects and businesses or interchangeably. I wanted to share that with our listeners, but if you Nicolo could give an overview of some of the key requirements that a business has to meet.

Understanding QALICBs

[00:12:36] **Nicolo Pinoli, CPA:** Sure and maybe right off the bat, we'll get into a little bit of controversy here because you say QALICB and I say, QALICB. But I like to walk my way through the QALICB acronym and because each of those elements within the acronym, each letter, in some cases groups of letters, really helps us to focus as you consider the qualification requirements here.

So we start off with Q. And I remember when I first got into the new markets program, there was this dawning realization that you could almost do anything with new markets, except for there are a handful of restricted or prohibited activities. And for me, that was a bit of a revelation. So in a lot of ways, when we think about qualifications, we're really talking more about what you *can't* do as opposed to what you can do. Here's a short list of what you can't do. They have, there are prohibitions on things that we call sin businesses and I suppose the sinning and degree of sinning is in the eye of the beholder, but things like liquor stores, suntan facilities are great examples of sin businesses. But then in addition to that, there are also prohibitions on things like farming, as well as residential rental property. And then there are also limits imposed on certain types of assets that can be owned by a QALICB, limits where only 5% of your assets can be held in the form of financial property and collectibles. Each of those has a 5% limit. So, when we talk about collectables, since we're accountants, a lot of people think we're talking about accounts receivable, but no collectables in this case actually means things like wines and rugs and coin collections and works of art, so think of those. And obviously it's rare to get into a situation where a QALICB has, especially when it comes to collectibles, there's–that prohibition is not one that we often run into. And maybe just to unpeel a little bit more, when it comes to the residential rental prohibition, because that's an issue that people have a lot of questions about when comes to mixed-use housing, mixed-use real estate, specifically. It's permissible to have mixed-use buildings as long as at least 20% of your rental revenue comes from nonresidential spaces. And usually people want a buffer there. So as a result, certainly mixed-use buildings tend to be a common and exciting use of new market tax credits for ownership by a QALICB. So, moving along. So that was a Q.

[00:15:18] **Michael J. Novogradac, CPA:** That was the Q. Now are we on active?

[00:15:20] **Nicolo Pinoli, CPA:** We're onto A stands for active. And in this case, active is not that difficult to meet. In order to be active, you just have to, as a for-profit business, you have to generate revenues within three years of closing the new markets. Or if you're a nonprofit, you have to engage in activities that further your nonprofit mission within three years. So generally speaking, the only time you're going to run into a problem there is if you're doing a construction project that's going to run for more than three years, which is uncommon, but certainly a possibility. So that's the active definition.

Next, we have the low-income community piece. This is you get three letters all at once: LIC. And really the requirement here is that the business has to be located in a low-income community. And certainly for real estate, the good news is real estate doesn't move around a lot and so it's generally pretty easy to tell whether or not you're located in a low-income community. Either you are or not and there's no in-between. When it comes to other businesses that aren't real estate businesses, where you have moving parts, things that move around, there are really three key criteria, which are: Where is your gross income located? Where is your tangible property located? And where are your employees located? The good news is you don't have to meet these at crazy high levels. They don't have to be at 90%, 95%, generally speaking you're at 40%, 50% of these different benchmarks being located in a low-income community. And so in general, even for an operating business, as long as the majority of your activity is happening in a low-income community, based on these three metrics, you will be deemed to be located in a low-income community.

The last part, the B part of our QALICB, relates to stands for business and really relates to the organization of your business. In general, the default is that the business needs to be either a partnership or a corporation. However, there is also a special rule that allows for a portion of a business to qualify, in which case, even single member LLC disregarded entities in theory can qualify. And in some cases, even divisions or operating lines of a business can also be made to qualify, even though they're part of a larger business.

So there you go, that's it, high level, what is a QALICB and what can QALICBs do or more specifically what they can't do in order to meet the baseline statutory requirements for QALICB status.

[00:17:57] **Michael J. Novogradac, CPA:** Thank you for that, Nicolo. That was a very good sort of high-level overview and I would note for listeners, if you think you didn't satisfy one of the requirements that Nicolo mentioned, don't self-select yourself out. A lot of these rules aren't absolute percentage tests, like you mentioned with residential rental and rather than assume that you don't qualify. You should reach out to someone more expert in new markets like Nicolo to see if you actually do.

One of the areas that comes up quite a bit is the geography, that it is a low-income community as a general rule. It's geography-based, but there is a targeted-populations approach where your business itself isn't located, under the various tests that Nicolo mentioned, isn't located in a low-income community from a geography perspective, but is serving a targeted population, which is generally going to be serving low-income persons or there's a broader definition there. We won't go into here. I would direct you though, we did do a podcast with my partner Brian Hung a few weeks ago, many weeks ago now, on targeted populations, so that I'd encourage you to listen to that as well. But to me, the key takeaway from Nicolo's comments is don't self-select yourself out. He gave you an overview that you can use to form a foundation for considering and moving forward. Anything else to say Nicolo before we move on?

[00:19:28] **Nicolo Pinoli, CPA:** No, I think maybe just one last point to make, which is maybe just to give folks a flavor for the types of businesses that we often see. It can be anything from, say, a manufacturer, a childcare facility, a health care facility, a renewable energy project. Those are just examples and flavors. Certainly, it can be lots and lots of exciting and different things, those are just a handful of examples and as long as you're not violating the prohibitions that we talked about, it can be most anything as long as it's located in a low-income community or serving targeted populations and deemed to be located in a low-income community.

NMTC Financing Expectations

[00:20:07] **Michael J. Novogradac, CPA:** Correct. So, let's discuss the dollar amount of NMTC financing that an individual business could expect to receive. There's obviously a broad range of financing needs of various businesses, but I thought it'd be useful if you explain to our listeners maybe the size range that projects generally receive in terms of new market tax credit financing.

[00:20:31] **Nicolo Pinoli, CPA:** Sure. And certainly, this is an important element because you do find that in terms of sizing, at least when we're talking about sort of one-off transactions, which are, I would say, are the most common transactions within our world. They do tend to fall within a fairly tight range. And some of you who heard us talking earlier about $5 billion in annual nationwide allocation authority, you might have decided, “great, that means I can do a $5 billion deal myself, and I’ll just take the entire nationwide allocation.” My guess is that's not going to happen, but what you do find is when you look at that $5 billion, there are usually at least in the last few rounds, there were 100 winners and, I’m happy to report as accountants we can do that math. Maybe Mike can confirm it for me, $5 billion divided by 100 winners means $50 million in average size. And obviously that is an average. You look at around that average, there is a range. The smallest awards tend to be in the $20 to $25 million range. The largest awards In the last round, I believe were topped out at $65 million, $60, $65 million tend to be the biggest award. So obviously i"s not that wide of a range in terms of winnings, in terms of allocation authority. Obviously, once a CDE receives authority, it in turn uses that authority, allocates that authority, uses that authority to go out and finance projects and a CDE will choose. For any given CDE, i"ll probably pick five to 10 to maybe 15 deals to go out and finance depending on whether it gets a smaller allocation or a larger allocation.

That's, obviously, we're talking in broad generalities here and in averages. So as a result, you'll find, and in fact, many CDEs, they will even cap the amount that they're willing to bring to any one project. Many CDEs set a cap in some cases of $7 to $10 million that they're willing to bring to any one project. Some of them will go a little above that they might go to $12 or $15 million, or when we later, when we talk about golden unicorns, projects that are very attractive, they might even be willing to make exceptions, but as a result, certainly you find that many projects tend to be in the sort of $5 to $15 million in allocation range. Sometimes they're a little above that if they can find multiple allocatees, you might pop up into the 20s and every once in a while you might dip below five.

Certainly, I think just to give listeners a better understanding, when you talk about that low end, in terms of a $5 million-sized project, part of the reason why that ends up being a conceptual floor is just because there's a lot of work that goes into closing a deal. There are also a lot of transaction costs for paying all the accountants and attorneys to help you close a deal. And typically, when I think about the subsidy that's derived from an allocation and from closing a deal, usually it's roughly 20%, maybe even sort of in the high teens, percentage-wise, relative to your allocation. So, if you're closing a deal at $5 million, you're probably looking at maybe a million dollars, maybe just under a million dollars in net subsidy. And certainly, once you start to drift below that, it starts to make a lot less economic and financial sense to say, “I want to go out and do a new market deal if all I'm netting, in terms of net subsidy to my project, in terms of gap-filler, ends up being something that maybe is too small to make sense.”

So maybe a few other observations and points there. If I had to guess, an average size when you sort of boil all that down, looking at the deals that I work on, I would guess an average size is probably going to be $7, $8, $9 million somewhere in that range. Because you have, you do have a number of deals that are on the 5, 6, 7 range. You have a number of deals that pop into the low teens and then you've sort of got outliers around that. But in general, I would guess maybe somewhere in that $7 million range for one-off transactions.

Obviously, we've been talking about one-off transactions. There's also some CDEs who have what they call sort of small deal loan funds, where they're willing to go out and look at much smaller deals, transactions that are maybe even in the $1 million range, $2 million range and in some cases, they even do micro transactions that are getting down into the $50,000 or $100,000 range. But certainly, I would say that the number of CDEs that go out doing small loan funds and certainly dipping down into the micro transaction sizing tends to be pretty limited. There might only be half a dozen, give or take, CDEs that are very active in that space.

How Difficult is it to Receive NMTC Financing?

[00:25:27] **Michael J. Novogradac, CPA:** Great. Thank you for, that Nicolo. That's a good overview in terms of the dollar size to give listeners an opportunity to try to gauge what range they might be eligible for.

But if I am a business that meets the criteria you mentioned earlier and I'm interested in new market tax credit financing, there's one thing we haven't discussed yet. We've hinted at it. And that's the competition for the financing. Please share with our listeners how competitive the incentive is. Basically, is it a long shot? Is it something that's a sure thing? Where is it or somewhere in between?

[00:26:00] **Nicolo Pinoli, CPA:** Well, the good news is I'm happy to report that your odds are better than successfully navigating an asteroid field, which I have it on good authority is 3,720-to-1. The bad news is it's not a slam dunk for most businesses because this is a very valuable incentive. There is a lot of demand for this incentive. And you can think about it two ways.

One, we talked about on the application front for CDE applying. There's a lot of demand there, but once the CDE receives an award, their phone starts ringing off the hook and they get a lot of emails and basically every would-be QALICB in the country, whether they're a real estate developer, whether they're a business looking to locate in a low-income community, they're all looking to take advantage of this subsidy because it is a very valuable subsidy at a 20% subsidy give or take. That's an important give or take, and if you're looking at $5, $10, $15, $20 million even, and sometimes above, you're talking about millions of dollars in subsidy, in gap-filling subsidy that is incredibly valuable and incredibly precious and as a result, you'll find that for every project that a CDE actually can finance, I wouldn't be surprised if they received 25 requests and maybe even more, might even be 50 or 100 requests in terms of the projects relative to the projects that actually end up financing. I think if you think about that $5 billion every year, if we were to estimate, if it's $7 million is the average project size, that gets you about 700 projects a year, which is a good number. Certainly, it's possible that we might drift down a little bit if the project average project size is slightly larger, more like $10 million, that gets you about 500 projects a year. Which you might think that's a lot and I suppose in raw terms, it's not bad. At the same time, that's, you think about nationwide? If you're talking about 10 per state or maybe 12 or 15 per state on average, some in more states and, some in, some *more* in some states and less in other states, maybe that's not a lot all of a sudden, in terms of the amount of allocation to go around. I think fundamentally, if I had to handicap your odds and I do think when I think about projects and your odds, I think about projects that are less desirable. And maybe just to give you an example of a less-desirable project, a project in suburban Portland, since I'm here in Portland, that is maybe just a strip mall that it really isn't doing anything very exciting, isn't generating a whole lot of community outcomes other than sort of the economic outcomes. I would say that's a relatively unexciting project and your odds of success with that project probably aren't real good. I might handicap your odds at 10% on a good day.

On the other end, if you sort of look at what will define later as a golden unicorn that checks a lot of boxes is very attractive from a CDE perspective, your odds of getting allocation rise pretty dramatically and certainly I would peg your odds for a golden unicorn, they might almost round to a 100%. You never say 100, but certainly, 80s and 90s percentage wise, in terms of your probability of finding allocation for a golden unicorn.

[00:29:22] **Michael J. Novogradac, CPA:** So thank you for that, Nicolo. Before we move on to some of the logistics of seeking new market tax credit-subsidized financing from a CDE, are there any other basics that you think we should touch upon?

Definitions of Severe Distress

[00:29:34] **Nicolo Pinoli, CPA:** I think there's one other key element, which is the notion of severe distress. We talked at the outset about your location being located in a low-income community. And certainly, that's a basic requirement from a statutory requirement. However, in the allocation application, CDEs commit to do at least 85% of their dollar volume in severely distressed locations. So as a result, for most CDEs, they actually target 100%. And maybe if the perfect deal runs along that isn't severely distressed, but is merely in a low-income community, if it's the right size, they might do it. But my experience is almost every deal that gets done these days is in a severely distressed location.

And part of the fun is that the criteria for severe distress changes from round to round because the application actually outlines the indicia of severe distress. It's on question 25 in the 2021 application. I invite you to go to our website. There's actually 14 different criteria. There's three major criteria and if you meet one of them, then you are severely distressed. And if you don't meet the major criteria, there are 11 minor criteria and you have to meet two or more of those criteria to be severely distressed. And I'll just add one other tidbit. So that's a critical element. If you're not severely distressed, your odds of getting allocation, they probably are a lot lower than whatever you thought to begin with. One poorly understood concept within the new markets space is that if you were to look at a Venn diagram of the overlap between severely distressed and low-income communities, a lot of people assume that every severely distressed deal is by definition in a low-income community and assume that severe distress would be a subset of low-income communities, but unfortunately it's not. There is some areas where they don't overlap simply because for example, nonmetro counties are an indicia of severe distress all on their own and not every nonmetro county and not every nonmetro census tract in the entire country is a low-income community. So, it's important to make sure you meet both and don't just merely assume that if I'm severely distressed, therefore I must be in a low-income community.

[00:31:56] **Michael J. Novogradac, CPA:** Now, thank you for that Nicolo I would just add that if you are severely distressed, but not in a low-income community, that's where targeted populations come in.

[00:32:03] **Nicolo Pinoli, CPA:** Bingo.

What to Consider When Starting

[00:32:07] **Michael J. Novogradac, CPA:** Go. Which I mentioned was an earlier podcast, but my partner, Brian Hung, *our* partner, Brian Hung. So let's move on to the next step. Assuming a business is eligible to receive new market tax credit financing, what advice do you give clients as to when they should begin to seriously pursue such financing?

[00:32:24] **Nicolo Pinoli, CPA:** Sure. And I do think there are some considerations here with the calendar and when I talk about the calendar, I mean the awards calendar and the application calendar. I think there are also some considerations when it comes to whether or not you are just starting the process or whether you're really ready to get going.

Let's talk first about sort of more of the early-stage aspect of today. Today, if let's say you had a project and you were looking to get on some radar screens, there's an upcoming award announcement, as Mike mentioned, coming in the next few weeks to months, following that there will be another application round. And as part of that application, CDEs will be looking to include projects in their pipeline that is included in the application. Now is a great time to approach a CDE with somewhat of an early-phase project and say, I've got the project that you want to include in your application. Getting it in the application doesn't mean you're going to get an allocation, it doesn't mean they're definitely going to give you a suballocation if they win, but it definitely helps to get on their radar screen. Start the process early. It's definitely not necessary. If you didn't get on somebody's application, that doesn't mean you have no chance of winning an award, but certainly more is more.

I think, conversely, if you had a project that was ready to go now and you had a CDE who had some allocation, part of the fun today is many CDEs are either out of allocation or they're about to be out of allocation because the awards were announced roughly 12 months ago and so they've used a lot of that allocation. But maybe a better example is in a few weeks, two months when the award announcements come out, every CDE that wins will have lots of allocation available. And your project, if you approach them about doing your deal, what you'll want to have in hand in terms of readiness, I think there are two key elements I think about that seem to be near and dear to CDE's hearts.

One is what is the readiness of the project to proceed? Is it really shovel ready or not? The other really is a look at the other financing that you have lined up because the new markets tax credit is really only going provide subsidy of roughly 20% of your capital stack. Therefore, you have that other 80%. It's important to remember that a tax credit deal starts with a business deal. And if the business deal isn't ready, well, we're nowhere ready to actually start with the tax credit piece that gets layered on top of that business deal. So, when I talk about project readiness, I think I'm really talking about where are you at with your drawings, your specs, your architectural engineering? Do you have permits? Are you ready to go pull your permits? The further you are along in that process, the closer you're going to be to a CDE saying, let's do it, let's move forward. Obviously, if you don't have drawing specs, architectural engineering, your permits are months or years away, a CDE is going to say, "thanks for telling me about your project, tell me more. Let's come back and talk more once you're a bit closer and you've got either all those in hand or you're really close to having them in hand."

When you think about the financing, you think about, it's really–we talk about leverage being that other 80% piece of your capital stack and the two hardest things to find in new markets land are allocation and leverage. And the reason why the leverage is difficult to find is due to some of the limitations and restrictions placed on those loans that make them a little bit of funky loans to make for a bank. As a result, they tend to be often some nontraditional sources, things like grants and/or retained earnings or capital campaigns for nonprofits. And then you also see often coming into play, what we almost might look at as a balance-sheet loan from a lender that's used to and has a relationship with your organization, where they're willing to make a loan to sort of your parent company, which you then bring to our new market structure as leverage. Often, we call that loan a source loan. But having all that leverage lined up because it's one of the most difficult things to find, having it lined up is an important aspect to a CDE deciding yes, your project really is ready, your business deal really is ready and therefore, we can really start the closing process. Obviously without the project readiness, without the leverage readiness, the rest of your financing readiness and really they're looking for a pretty firm commitment on that leverage readiness. Without those pieces, you'll find most CDEs will say, thanks for telling me about your project. Let's talk more once you've got those other pieces ready to go.

Key Points in NMTC Timeline

[00:37:25] **Michael J. Novogradac, CPA:** So maybe building this out a little bit more, or stepping farther back as listeners are thinking about a timeline for new market tax credit-financed business, what are some of the key benchmarks that you think of or key points in a timeline for a transaction?

[00:37:43] **Nicolo Pinoli, CPA:** Yeah. I think part of the fun here is that this is really a marathon and not a sprint. This isn't like walking down to the local branch of your local bank and getting a mortgage on your house where you're done and start to finish in like 30 days. I often like to think of the process almost like the dating process, where if you decide tomorrow you're going to go on the hunt to find a spouse, that process in some ways is not that dissimilar from the new markets process. And I would break it down almost into four different phases. There's a flirting phase. There's a dating phase. There's an engaged phase. And then you get married, when you close.

And the flirting phase really is you're going out, talking to CDE, trying to find allocation, you're talking to as many people as you can, trying to get anybody to talk to you. Anybody who might be interested. Once you start to have some CDEs who say, hey, let's talk some more, let's talk about your deal. Because a lot of CDEs, they might just say, thanks, but no thanks and I'm moving on. But some CDEs in a perfect world will say, let's talk some more, tell me more about your deal. Here's an intake form and let's start the process of at least trying to decide whether this makes sense to proceed and that's really the dating phase, right? Where you learn more about the CDE and the CDE learns more about you. And that phase can go on for usually weeks, maybe a few months. Whereas the flirting phase, it could go one day where you get lucky, right? You walk out the door and you find the CDE or the perfect person and you're ready to go, but it might also take months. It might take years, it might take the rest of your life and it might never happen. So that often when you start talking about timelines, you really do have to break them down into these different phases, like I said, flirting phase can vary dramatically dating phase. You're probably looking at weeks, maybe a few months at most, unless the only exception to that rule is if a CDE says, I really love your deal, it's in my pool, let's wait and see what else happens, let's see if I get allocation. You're sort of in limbo a little bit where you're not fully dating and yet you're not fully not. And that can go until they get allocation or other deals fall off their radar to where then they're ready to proceed with yours.

Once you get a term sheet and a CDE says, let's do it. Let's proceed to closing that, now you're engaged. You've got, they give you a term sheet, you sign the term sheet, you get term sheets from multiple parties, usually from your leveraged lender, your CDE, your tax credit equity investor and you're ready to go. You get your counsel engaged. Everybody else gets their counsel engaged. You get an accountant engaged, let's roll through the closing process. Now you're engaged. And this is now the march to the finish, which is more of a sprint, at least a little bit more, and in this phase you're really talking about, I would say on average, you're looking at three months. Sometimes a little faster if the stars align and you can move really quickly and people are really motivated, you might get it down to say two months, two-and-a-half months. I think the fastest deal I've ever closed is probably closer to six weeks as like the absolute record blazer. And sometimes if things drag, then you could be looking at four, five, six months if problems happen. It's not uncommon many deals during the engaged phase, they have near-death experiences and those near-death experiences mean we've got to work out issues. And that can add to the timeline. The environmental comes in and it turns out there's something you didn't know about and you've got to clean it up, you've got to address it. That adds another month or two to your timeline.

And ultimately you get to the end, you close and now you're married. Congratulations. I understand some countries actually are offering marriages now that have a guaranteed expiration date. In some ways it's like that because seven years out, although it's not guaranteed after the seven-year compliance period, then if the project exits, then you get a divorce and that's your timeline for getting from cradle to grave and my experience in closing deals.

How to Approach at CDE

[00:41:49] **Michael J. Novogradac, CPA:** So, thank you for that timeline. That was very helpful in terms of setting the stage for businesses that are trying to understand approaching a CDE for financing their business. So now maybe we could go to that critical point. How do you recommend a business go about approaching a CDE or to find a CDE that has allocation and is interested in financing their business?

[00:42:20] **Nicolo Pinoli, CPA:** Absolutely. Well, this is certainly a place where you want to cast a wide net and you want to talk to as many CDEs as possible. My experience is if you look at that list and the good news is the award winners are published. The CDFI Fund has a database that goes and shows all prior award winners. And not only does it show the award winners, but it also gives you details about the types of projects they're looking to finance, where they're looking to do deals, geographically speaking. It also gives you contact information for who you can contact at those CDEs. So that database, I would look at the most recent round and may maybe even look at two or three rounds back just to get a full population of who's out there, who's got awards or who has had awards and who's likely to get some in the upcoming round as a starting place. And then I think in a lot of ways you start looking to contact with those CDEs. Certainly, our conferences are a great place. Most of those CDEs are going to be at our conference and if you can get a meeting or if you can hijack them in the hall, do whatever you need to in order to get in front of them, share with them all about your project.

There's also a process where you want to be able to pitch your project to all these CDEs. So, you want to get ready for it. You don't just call up and say, if I got a deal for you and then attempt to pitch them on your deal over the phone. You want to be prepared, knowing what they're looking for, knowing some of the things we're talking about today and really looking to target your project by selling your project. What matters to most of those CDEs? One of the great ways to do that is to have a pitch sheet. Many would-be projects and QALICBs actually have a one-, maybe a two-page front-and-back pitch to share with a reader everything about their project and that way, really quick and easy, everyone who looks at your project, they can figure out where you're at, what you're looking to do, where you're at in terms of readiness to proceed and all the sorts of great things that your project is going deliver for the community and pretty quickly they can tell, yes, this is something that's worth talking about, or no, you're not the right project for me. And you can move on, speed date the next CDE, because that one, maybe wasn't a great fit.

But those are some ideas, some tips and tricks, some approaches to take, to identify the population.

I mean, if you look at it for any given QALICB, you look at that list of 100 winners in the last round and once you start filtering down for geography and project type, you might almost be in a spot where, depending on where you're at of course, you're going have different answers if you are in Los Angeles or New York City or something versus Sheboygan. You might find that some locations you might have as many as 20 or 25 CDEs who work for you. And in other cases you might only have as few as maybe five or 10. And again, project type also matters, right? So, some project types you're going to find more CDEs are interested in others less so, and that's going to influence that list of how many CDEs are going be excited about your deal.

[00:45:33] **Michael J. Novogradac, CPA:** So, I'm glad that you mentioned what you called the pitch deck. Because we definitely have lots of clients and businesses seeking financing that'll work with us to help develop some parts, some features of the pitch deck and it kind of goes without saying that a pitch deck is designed to include features of your business or project that you think will be attractive to a CDE. So maybe you can talk about what CDEs look for in borrowers or looking at it from the flip side, what a potential borrower investee, what a business can do to attract a CDE.

What CDEs are Seeking

[00:46:14] **Nicolo Pinoli, CPA:** OK. So, we go back to our dating analogy and what do I need to do to make myself someone that my counterparty is going to be interested and excited about. And I do have any number of clients who come to me and say, here are all the amazing things about my project that make it the absolute best project in the world and why CDEs have got to love me and got to give me allocation. And usually, my answer to them is those are great things. Those are amazing things. I love your project. Sadly, not all those things are necessarily the things that CDEs are looking for. So, what are CDEs looking for? And I think this list really in a lot of ways touches on the elements in the application.

When CDEs submit their application to the CDFI Fund, part of that application includes set asides and also includes innovative transactions. And there are set asides and innovative transactions for a reason: they're not easy to do. And if everybody could do them, then they wouldn't be innovative. And as a result, when you look through the list of what is really attractive, it tends to boil down to a handful of key issues and I will state them in sort of roughly descending order, starting with the most important, working our way down to slightly less important issues as we work our way through the stack. And certainly, the more boxes you can check the better. And when we talk about a golden unicorn checks all these boxes or nearly all of these boxes in terms of their ability to really be a lot of really exciting things for a CDE.

First one right out the gate is nonmetro. If you are a nonmetro transaction, that's one of the most exciting features you can have. To be nonmetro that means you are located in a nonmetro county. It doesn't mean that you're in a rural area that's way far away from a city, because sometimes I've been shocked at some areas that are in fact, metro areas, even though you drive out there and you look around and you think this there's no way, this is nonmetro, but it is based on the county and if you're on the edge of a county that is a metro county, sadly, you're out of luck. So that's the first thing. Am I nonmetro? And that's just a matter of where the lines are drawn and based on your geography.

Second, do I have non-real estate uses? And really, I need a lot of non-real estate uses. So usually you're looking at $5 million, $10 million or more in non-real estate uses, so things like equipment, things like working capital. These obviously are really focused on operating businesses rather than real estate businesses. And obviously tends to trend more toward manufacturing businesses that need lots and lots of equipment, need lots and lots of working capital. And it's very expensive equipment and it's equipment that tends to last for a long time. Obviously, those aren't the only ways to get there, but certainly non-real estate uses is a key feature, a key element to be very attractive to a CDE.

Next on my list, we have identified states. And if you're not sure which states are the identified states, it changes from round to round. So, you have to go and look at every single round, depending on which allocation a CDE is bringing to your particular deal. That can mean that the identified states change. But if you're wondering, the most recent application that just went in, what are the identified states? They are as follows: Arizona, California, Colorado, Florida, Nevada, North Carolina, Tennessee, Texas, Virginia, West Virginia. And also include the territories of Puerto Rico and all of our island territories. So, if you are in one of those areas, congratulations, you won the new markets lottery. You are in an identified state or identified area, I guess if we pick up the territories. So therefore, your odds of attracting allocation are dramatically higher. In fact, I have some friends who work extensively in the industry who very actively seek out projects in these locations because they're the easiest to get financed.

Next, I'll mention one of the other set asides and/or more difficult things to find are projects that are located in Indian reservations, off-reservation trust lands, Hawaiian homelands and Alaska native village statistical areas. That is an innovative transaction within the new markets framework and so being in one of those locations makes your project that much more attractive.

And I'll add maybe two additional things to the list that aren't necessarily part of the application, at least not directly named as innovative features, but I do find tend to be sort of subcategories on this list. One, is there a state tax credit in the state where I'm located? If so, that's usually helpful. It's usually attractive and makes my deal that much more exciting to would-be allocatees and investors.

And finally, which is not to suggest that it's the least important effect, I would say this one in some ways is difficult to place in terms of order, and the feature is do I have diversity equity and inclusion features? And I would say probably over the last two, two-and-a-half years, this is really grown to be a much more important element in project selection for CDEs. Many CDE nowadays are looking to be investing in projects that deliver on diversity, equity and inclusion goals and objectives and features. And in some cases, some CDEs are looking to invest 100% of their allocation in projects that serve those communities and those populations. And it could be everything from your employees pull from demographics. It could be your customers, including, think about health care or childcare or charter schools or even like renewable energy and who your renewable energy is going to. The whole host of other criteria, all of those elements. It could be, if I didn't mention it, could be your employees that come into play, who you're hiring and actually are the beneficiaries of this new business, this new transaction. Certainly, there are a large number of ways to have DEI criteria and to be serving these communities, but it's difficult to really place it in an order other than to say, it's got to be on the list. And it's certainly one of the most important areas, I think, especially, an ascending area in importance where many CDEs are very focused on it in addition to investors being very focused on it as well. So, there you go. I would say that's my list. if you're looking to make your project the most exciting and trying to maximize your odds of getting allocation, you're going to want to check as many of those boxes as possible.

[00:53:25] **Michael J. Novogradac, CPA:** And I guess I would just amend your comment as this is your partial list.

[00:53:29] **Nicolo Pinoli, CPA:** Sure.

[00:53:31] **Michael J. Novogradac, CPA:** Because there's a lot more that I know if we had time, additional features that you'd want to be sure to mention, which is kind of brings us back to the pitch deck, how important the pitch deck is to make it easier for a CDE to identify how close you are to being a golden unicorn. And that's also why a lot of the CDEs have intake forms, which are an extension of and are more specific to what it is that their key goals are and what levels of deeper distress and criteria that they're using to identify what makes a particular business or project attractive.

[00:54:06] **Nicolo Pinoli, CPA:** And maybe Mike, just to spend one more minute on it. I think I didn't mention it, but it's sort of like a baseline assumption, right? Obviously, you've got to be located in a low-income community. Obviously, you really want to be severely distressed and then you want a project that's doing great stuff in the community and is delivering great community outcomes for that community, serving the community and that's your ticket to the dance. You meet those three baseline criteria and now we're talking about the additional pieces that set you above the rest of the crowd by making you, more or less, a golden unicorn.

Tips for Business Newcomers to NMTCs

[00:54:38] **Michael J. Novogradac, CPA:** I'm glad you added that additional discussion. So, one of the other interesting parts about new markets tax credit financing is most of the businesses that are getting the financing haven't used new market tax credit financing before, so they're new and many of them won't use it again because they have their business and they want to get it financed and then once it's financed, they'll go and do great work in the community. So, what do you tell clients who are interested in pursuing new market tax credits for the first time?

[00:55:10] **Nicolo Pinoli, CPA:** Well, certainly one big piece of advice is to work with experienced professionals that know what they're doing and certainly we should be on that list of professionals that people are working with. Not just us, of course, but also includes a large number of attorneys that are out there in the industry as well, potentially consultants that are out there as well, that are looking to help QALICBs to work through the process. I think my advice in general is to get educated and realize this is a very complex program. There's a lot of moving pieces and the more, the better armed you will be to get allocation, the better armed you will be to work through the process of actually closing your deal and less painful it will be.

Along those lines, there's a wealth of resources out there and available, certainly from our organization, we've got our website, we've got handbooks, we've got webinars, we've got conferences, we've got the Journal of Tax Credits, we've got the Tax Credit Tuesday podcast. And those are just a handful of all the great resources we have available as you're learning to ramp up your knowledge and understanding of new markets tax credits and become maybe not an expert, but certainly well enough versed so that you are well prepared to begin the process and work your way through the process.

[00:56:25] **Michael J. Novogradac, CPA:** So, thank you for that, Nicolo, and now we're continuing to discuss new market tax credits in the coming weeks. As I mentioned, next week we'll talk about some of the key roles or the key players, as well as go more in depth on leverage financing. And the week after that, we'll talk in detail about closing a transaction. And obviously, as I mentioned earlier, unless we have the new market tax credit awards, and will be interrupted with a podcast on that. But what else would you like to add that listeners should know when it comes to being a business that receives new market tax credit financing.

[00:57:02] **Nicolo Pinoli, CPA:** Yeah, maybe I'll just, mention a few things, some of which are repetitive of things we've already discussed. First, I'd say it's a marathon, not a sprint. So be ready to be invested and involved for a while. This is not like falling out of bed. It's so competitive and it takes a while to get the job done, so be prepared for that. Sort of along with that is the notion that you're going to be sharing a lot of information about your organization to a lot of people. And you need to get comfortable with that because everybody's going to want to know a lot about who you are and what you're doing, and that's going to be part of the process and if you're not comfortable sharing that information, you're going to have a difficult time. It's going to be painful. So, get ready for it. Know it's coming and be comfortable with it.

And I guess my last two things I would share are, have fun with it. While certainly most things in life are exciting and challenging and difficult, you have a choice whether you want to be miserable or whether you want to have fun with it. And my advice is as long as you're doing it, you might as well enjoy it and I suppose that plays into the last piece, which is we're here to help. We're definitely here to help. We're here to make your life easier. We're here to serve and we have a wealth of resources and knowledge and whether you're calling me or any of my partners or any of the professionals here at Novogradac and Co., we're here to serve and make your life easier so that we can take some of the burden off you and help you get to the finish line.

[00:58:26] **Michael J. Novogradac, CPA:** Great. Thank you for that, Nicolo, and I appreciate you joining us today. Please do stick around for our Off-Mike section at the end of the podcast, where I'll get to ask you some fun off-topic questions to get some words of wisdom from you.

To our listeners, please do be sure to tune into next week's podcast, where we have the second of our three-part series on new markets tax credits. My partner Amanda Read from our Cleveland, Ohio, office will join me to talk about key roles in a new market tax credit structure, and how qualified businesses leverage different sources of financing from their capital stack to better close financing gaps.

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Off-Mike Section

[00:59:39] **Michael J. Novogradac, CPA:** Now I'm pleased to reach our Off-Mike section, where listeners get some off-topic advice and words of wisdom from our podcast guests. So, Nicolo, let me ask you a question I love asking our guests. It helps me learn, helps our listeners learn. What's the best leadership lesson you've ever heard or learned or discovered?

[01:00:02] **Nicolo Pinoli, CPA:** Sure. And, not only is this the 750th podcast, but this month marks my 20-year anniversary with the firm and looking back, it seems like it was only yesterday. In fact, I remember my first day vividly, getting on the BART train, having it break down halfway into the city and running from the station all the way to the office, thinking that it started at 8 a.m. and then running up five floors of stairs to 246 First Street and realizing that we didn't start until 9. I think I tell that story and make that reference because really, I think my best leadership lesson or advice, I think boils down to the fact that for all of us, we started at the beginning. We started at the bottom and worked our way up. Certainly in life, when, you enter this world, you enter with not a whole lot of resources, not a lot of skills and knowledge and understanding and over time you get to build on those. And some of us we’ve been able to build a pretty nice, solid level of understanding and ability and skills. And when it comes to being a leader, obviously, you tend to be leading others. Many of whom might not be further so far along, at least in terms of their abilities and skills and process here in this life. So, for me, I think the best lesson that I've ever learned is the Golden Rule and I realize that's awfully simple and awfully basic.

I think as a leader, if you're not meeting the Golden Rule, if you're failing that, then everything else you do is probably going fall short. And I think in a lot of ways, that's the baseline for a good leader is you really have to be willing to treat others the way that you would have others treat you. And then obviously there's plenty to go beyond that, but it seems like that's where it really has to begin, is your willingness to live the Golden Rule and treat others the way you wanted to be treated back when you were at the very beginning of your career as well.

[01:02:06] **Michael J. Novogradac, CPA:** No, I like that, the Golden Rule, it might be commonly understood, but it's certainly a great guiding principle. I also like to layer in the rule, don't do unto others which you don't like done to you.

[01:02:24] **Nicolo Pinoli, CPA:** The inverse, certainly.

[01:02:26] **Michael J. Novogradac, CPA:** That's something that is, useful to keep in mind as well. So, let's turn to productivity. Everyone's always trying to be a little bit more productive. However, one wants to define productivity. What's your best or–it's always hard. I always struggle when I say the best because nothing can ever be the best. We could spend time talking about what it means to be the best. So what is one of the best productivity tools that you're using right now?

[01:02:53] **Nicolo Pinoli, CPA:** Well, this might be a little bit unusual, at least when you think about productivity tools, but quite honestly, it's probably the most important element for me personally. And in some ways, this sort of crosses over into the leadership side as well, but quite honestly, my best productivity tool is delegation. It starts with hiring good people, training my people, teaching them everything they need to know, delegating to my people, which really means that I'm willing to not just do it myself, but I'm willing to bring others into the process and then trust my people that they can get it done. Obviously, the trust has to be earned, where over time, over working together, I learn what they can get done and what they need help with and it's part of the fun, part of the journey, part of the adventure is we work on things together.

But certainly that virtuous cycle of hiring people, training them, delegating and trusting them. That is my key to productivity in a lot of ways, that's kind of a cop out because I'm not doing it myself. Hopefully, I have a role to play in that process as we hire and train and delegate and trust, and we work together every day. But in a lot of ways, you think about it, if this weren't Novogradac and Co., this was Mike Novogradac's one-man shop, I'm guessing would get a whole lot less done than we do today. And an important part of the process of every organization is your willingness to share the love and really grow from within and delegation is a key aspect of my process that helps me to be incredibly productive.

[01:04:31] **Michael J. Novogradac, CPA:** I like your spin on the question because even when I was introducing the question, I was even hinting at productivity. We're always searching for ways to be personally kind of more productive, but life isn't about what an individual person can do, as much as they can out of the day, or out of the week, or out of the year, productivity kind of goes beyond that and you have a good example of ways in which productivity goes well beyond that. So thank you for that.

[01:05:01] **Nicolo Pinoli, CPA:** Thanks Mike.

[01:05:02] **Michael J. Novogradac, CPA:** So thank you, Nicolo. I appreciate you joining us for the podcast and this bonus session, this Off-Mike section. To our listeners, I'm Mike Novogradac. Thanks for listening.

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