Keeping Your Eye on the NMTC Ball - Jennifer Gilbert

Congratulations, your nonprofit is doing a project utilizing New Markets Tax Credits (NMTCs)! NMTC equity often makes the difference between project life and death. We trust you’ve hired experienced staff, consultants and lawyers to protect your interests in the fine points of the transaction. But even with the A-team as support, a nonprofit’s board and staff may soon throw up their hands in utter desperation at the complications of this financing tool.

Our suggestions? For starters, take a deep breath and appoint a group we will call the “Mavens” — perhaps your CFO or members of your finance committee — who will become thoroughly versed in the NMTC structure. For the mere mortals, leave the 50+ page projections to the experts and laser-focus on our top questions below to ask, understand and memorialize. Your NMTC Mavens and A-team should document the final details on each in a project hand-off manual after your transaction closes.

1. What are the ongoing financial obligations: how much, to whom, and when?

NMTC transactions carry extremely complex structures with underlying debt, leverage loans and equity. Your Mavens should understand all the ins and outs. For everyone else, it’s more a question of “At the end of the day, how big is the check, are we budgeting for it and to whom is it made out?” Typical obligations are:

   **Debt service.** In the more familiar bank loan transaction, your organization would have a monthly or quarterly payment to your lender, typically amortizing both principal and interest. For NMTCs, the ongoing loan payments frequently do not travel directly from your organization to your lender. For the mere mortals, the issue is making sure you have the resources to pay the real debt service. Any regular update on the proforma during predevelopment should include a line estimating your ongoing debt payments given your team’s best understanding of loan terms and likely interest rate. The Mavens need to understand all the payments you need to make, to whom, by way of whom, and when as well as where a journal entry needs to be made, an invoice created and a payment submitted. Again, your project manual should translate this into exquisite detail.

   **Upfront and Annual fees.** Parties to the NMTC transaction charge fees for the transaction. Some will occur at the outset, reducing the equity available to the deal. Others — sometimes characterized as asset management fees and sometimes as interest payments — are due annually. If your organization does not or cannot reserve the annual payments upfront, you will need to budget for payment.

   **Other third party costs:** You should budget annually for other ongoing third party costs such as annual audits or other similar fees your investor and CDEs may incur.

1 We assume here knowledge of some NMTC basics. NMTC 101 guides free online include www.novoco.com/new_markets/resources/lexicon.php.
2. What are ongoing organizational obligations? Who makes sure we fulfill them?

**Guarantees, Etc.** NMTC transactions carry obligations very much like traditional borrowing: construction completion guarantees, environmental indemnifications, etc. Obligations frequently extend to the sponsor nonprofit.

**Reporting.** NMTC funding sources need regular reporting not only on the financial performance of your project but also your economic impact and your compliance with all those NMTC “no-no’s.” (See #4 below.) Required reporting varies depending on the CDE and the investor. Your task is to know what will be required, build the systems and procedures so you can fulfill the obligation efficiently and budget staff time for the work. Particularly in the first year, staff may spend significant time completing forms, surveying employees, etc. A tickler list of reporting obligations by date and content is helpful.

3. What are any project sources and uses outside the NMTC structure?

Immense confusion may be avoided by distinguishing the NMTC structure budget and your overall project budget. One budget is the “deal”--as in the financial transaction-- and one budget is the “project”-- as in the wonderful new building you will soon be enjoying. There will be overlap in sources and uses, hopefully significant overlap. However, NMTCs don’t work with every source. Some may come into the project outside that structure. Further, for tax reasons far, far beyond the scope of this essay, some costs integral to the project (e.g. reimbursement for sponsor staff time) may not be appropriately allocated toward the “deal”/NMTC budget. Additional confusion may be caused by bridge loans covering, for example, donations pledged but not yet paid to your organization’s capital campaign. **And that’s okay.** But only as long as you keep your eye on the ball of the totality of those project costs which need to funded by the totality of project sources. End result: You may need to carry two budgets and/or carefully track sources and uses outside the structure.

4. What are the ongoing shalts and shalt-nots?

To keep NMTC funders and the IRS happy during the compliance period, you will need to constantly comply with multiple covenants contained in your NMTC documents. Many of these are similar to those required by lenders (e.g. restrictions around more indebtedness, minimum insurance requirements) while others are specific to the list of activities which are “no-no’s” under the NMTC program (e.g. no farming for the QALICB!). Some may have real implications for the way you might do business. For example, there may be a prohibition on the QALICB itself having employees. Again, a list (in plain English in your project manual) will keep you on the straight and narrow.

5. When it’s over, how do we say good bye?

Considerable time will be spent negotiating the “unwind,” the process by which your investor/funders exit from the transaction seven years after the closing when the compliance period ends. Specifics vary; your attention should be focused on the process that will need to occur, what costs may be involved and what are the ramifications if the unwind doesn’t occur, or doesn’t occur in a timely fashion.