I, Jason Chamlee, hereby submit this original work as part of the requirements for the degree of Master of Community Planning in Community Planning.

It is entitled:
Financing Community Development: Attracting Investment Capital through the New Markets Tax Credit program

Student's name: Jason Chamlee

This work and its defense approved by:

Committee chair: Michael Romanos, PhD
Committee member: Jeanne Schroer, MBA
Financing Community Development:
Attracting Investment Capital through
The New Markets Tax Credit Program

A Thesis submitted to the
Graduate School
of the University of Cincinnati
in partial fulfillment of the
requirements for the degree of

Master of Community Planning

in the School of Planning
of the College of Design, Architecture, Art, and Planning

2011

By
Jason Chamlee
B.A. History, Miami University, 2004

Committee:
Chair: Michael Romanos, Ph.D.
Faculty Member: Jeanne Schroer, MBA
Abstract

A major obstacle to community and urban redevelopment is the lack of investment capital due to market failures, high risks, and unattractive investment returns. The New Markets Tax Credit (NMTC) program was established by the Federal Government in 2000 in order to attract private capital to low-income communities by offering tax credits as an enhancement to investor returns. The program provides resources for low-income communities through the tax code, rather than direct subsidy, in order to engage the private sector in community development activity. This research project examines four NMTC investment funds in Cincinnati, Ohio as case studies that illustrate the different ways in which the program can be used to attract investment capital. It answers questions concerning how the investments funds are structured, the benefits of each structure type, and the effectiveness of the NMTC program for achieving community development objectives.

The research finds that the NMTC program has been an extremely effective method of attracting private investment for community development financing in Cincinnati, generating $324 million of investment with $51.5 million of tax credits. Leveraged and “bottom-up” investment structures offer more flexibility in the financing stage, but are restrictive in project type. Conversely, non-leveraged and “top-down” investment structures are restrictive in financing sources, but provide greater flexibility for project types. Financing through the NMTC program is largely led by private for-profit and non-profit organizations, employing investment measures and underwriting techniques to ensure that projects are financially feasible and sustainable. The program also facilitates public-private partnership, obtaining private investment for public redevelopment projects such as parks and squares. The research also reinforces the existence of program biases toward real estate projects and large, sophisticated CDEs.
Acknowledgements

This project could not have been possible without the guidance, focus, and advice provided by Dr. Michael Romanos. He shares my passion for urban redevelopment and understands the significance of project financing to urban planning and community revitalization. Additionally, the professional experience and expertise of Jeanne Schroer was invaluable in providing knowledge and insight into the field of real estate development financing. The staff members at the Cincinnati Development Fund, especially Joe Huber and Jeanne Golliher, were patient and encouraging as they taught me about the New Markets Tax Credit program and the specifics of how CDF has used it. Adam Gelter, of the Cincinnati Center City Development Corporation, was also very helpful in explaining 3CDC’s use of the program and providing necessary data for the project. Finally, I would like to thank my wife, Susana, whose faithful love and support consistently compels and inspires me.
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Table of Figures</strong></td>
<td>iii</td>
</tr>
<tr>
<td><strong>Table of Tables</strong></td>
<td>iv</td>
</tr>
<tr>
<td><strong>List of Abbreviations</strong></td>
<td>v</td>
</tr>
<tr>
<td><strong>Chapter 1. Introduction to Research Project</strong></td>
<td>1</td>
</tr>
<tr>
<td>1.1 – Overview</td>
<td>2</td>
</tr>
<tr>
<td>1.2 – Research Project Methodology</td>
<td>5</td>
</tr>
<tr>
<td><strong>Chapter 2. Review of the Literature</strong></td>
<td>10</td>
</tr>
<tr>
<td>2.1 – Community Development Financing</td>
<td>11</td>
</tr>
<tr>
<td>2.2 – New Markets Tax Credit Program</td>
<td>16</td>
</tr>
<tr>
<td><strong>Chapter 3. Citywide Cincinnati Development Fund I</strong></td>
<td>26</td>
</tr>
<tr>
<td>3.1 – Upper Tier Investment Vehicle</td>
<td>27</td>
</tr>
<tr>
<td>3.2 – Leveraged Structure</td>
<td>28</td>
</tr>
<tr>
<td>3.3 – Benefits of the Financing Structure</td>
<td>31</td>
</tr>
<tr>
<td>3.4 – Why it was Structured in this Manner</td>
<td>32</td>
</tr>
<tr>
<td><strong>Chapter 4. Citywide Cincinnati Development Fund II</strong></td>
<td>34</td>
</tr>
<tr>
<td>4.1 – Upper Tier Investment Vehicle</td>
<td>35</td>
</tr>
<tr>
<td>4.2 – Leveraged Structure</td>
<td>38</td>
</tr>
<tr>
<td>4.3 – Benefits of the Financing Structure</td>
<td>40</td>
</tr>
<tr>
<td>4.4 – Why it was Structured in this Manner</td>
<td>42</td>
</tr>
<tr>
<td>Chapter 5. Uptown Cincinnati Development Fund</td>
<td>...........................................44</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>5.1 – Upper Tier Investment Vehicle</td>
<td>...........................................45</td>
</tr>
<tr>
<td>5.2 – Leveraged Structure</td>
<td>...........................................47</td>
</tr>
<tr>
<td>5.3 – Benefits of the Financing Structure</td>
<td>...........................................49</td>
</tr>
<tr>
<td>5.4 – Why it was Structured in this Manner</td>
<td>...........................................52</td>
</tr>
<tr>
<td>Chapter 6. Cincinnati New Markets Fund</td>
<td>...........................................54</td>
</tr>
<tr>
<td>6.1 – Non-Leveraged Structure</td>
<td>...........................................55</td>
</tr>
<tr>
<td>6.2 – Investment Terms and Achievements</td>
<td>...........................................57</td>
</tr>
<tr>
<td>6.3 – Benefits of the Financing Structure</td>
<td>...........................................60</td>
</tr>
<tr>
<td>6.4 – Why it was Structured in this Manner</td>
<td>...........................................61</td>
</tr>
<tr>
<td>Chapter 7. Research Findings</td>
<td>...........................................63</td>
</tr>
<tr>
<td>7.1 – Different Types of Investment Structures</td>
<td>...........................................63</td>
</tr>
<tr>
<td>7.2 – Effectiveness of the NMTC Program for</td>
<td>...........................................66</td>
</tr>
<tr>
<td>Community Development Financing</td>
<td>...........................................66</td>
</tr>
<tr>
<td>7.3 - Conclusion</td>
<td>...........................................70</td>
</tr>
<tr>
<td>Reference List</td>
<td>...........................................71</td>
</tr>
<tr>
<td>Appendix A – Glossary of Terms</td>
<td>...........................................76</td>
</tr>
<tr>
<td>NMTC Terms</td>
<td>...........................................76</td>
</tr>
<tr>
<td>Development Financing Terms</td>
<td>...........................................77</td>
</tr>
</tbody>
</table>


## Table of Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Figure 1</strong></td>
<td>Example of an NMTC Return on Equity Calculation</td>
<td>20</td>
</tr>
<tr>
<td><strong>Figure 2</strong></td>
<td>CCDF I Financing Structure</td>
<td>29</td>
</tr>
<tr>
<td><strong>Figure 3</strong></td>
<td>CCDF II Financing Structure</td>
<td>37</td>
</tr>
<tr>
<td><strong>Figure 4</strong></td>
<td>UCDF Financing Structure</td>
<td>47</td>
</tr>
<tr>
<td><strong>Figure 5</strong></td>
<td>CNMF Timeline and Flow of Funds</td>
<td>57</td>
</tr>
</tbody>
</table>
## Table of Tables

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1 – CCDF I Project Profile</td>
<td>32</td>
</tr>
<tr>
<td>Table 2 – CCDF II Project Profile</td>
<td>41</td>
</tr>
<tr>
<td>Table 3 – UCDF Project Data</td>
<td>51</td>
</tr>
<tr>
<td>Table 4 – CNMF Project Data</td>
<td>59</td>
</tr>
</tbody>
</table>
List of Abbreviations¹:

AMI – *Area Median Income*. The median household income of the metropolitan statistical area, used as a benchmark to compare specific areas within the metropolitan area.

3CDC – *Cincinnati Center City Development Corporation*. A community development organization that finances and conducts development activity in urban areas of Cincinnati, Ohio.

CDE – *Community Development Entity*. Organizations, certified by the CDFI Fund, that are eligible to apply for and receive New Markets Tax Credits

CDF – *Cincinnati Development Fund*. A community development organization that finances and conducts development activity in urban areas of Cincinnati, Ohio.

CDFI – *Community Development Finance Institutions*. Organizations which are associated with and supported by the Community Development Finance Institutions Fund.

DCR – *Debt Coverage Ratio*. Represents the relationship between debt service and Net Operating Income

LIC – *Low Income Community*. Census tracts that are eligible to receive investments from New Markets Tax Credit investments.

LTV – *Loan to Value*. Represents the relationship between loan amount and property value.

NMTC – *New Markets Tax Credit*. A Federal program that offers tax credits in exchange for equity investment.

NOI – *Net Operating Income*. Project income after gross revenues and operating expenses are considered.

QALICB – *Qualified Active Low Income Community Business*. A business that is deemed eligible to receive New Markets Tax Credit investments.

QEI – *Qualified Equity Investments*. Loans and equity contributions made by investors in exchange for Federal tax credits.

¹ These are abbreviations frequently used in the research paper. For a more detailed description of each of these terms, please refer to Appendix A.
QLICI – *Qualified Low Income Community Investment*. Loans made to qualified businesses through the New Markets Tax Credit program.

ROR – *Rate of Return*. The financial gain received from an investment.

TIF – *Tax Increment Financing*. A municipal financing tool to finance development in blighted areas.
Chapter 1

Introduction to the Research Project

A significant problem for community development and revitalization of low-income and neighborhoods is the lack of investment capital and access to development financing. There have been many governmental policies and programs at the federal, state, and local levels that have attempted to reverse the disinvestment that has taken place by trying to provide resources to these target areas. The results of these different efforts have been mixed, as some programs have proven far more effective than others. More recent approaches to this problem have focused on the importance of attracting private investment by providing incentives such as tax credits. One such program, administered at the federal level, is the New Markets Tax Credit program, which offers investors tax credits in exchange for investment capital for low-income communities.

The New Markets Tax Credit program was first authorized in 2000, and since then has been expanded and extended on numerous occasions. As the program enters its eleventh year, there is now enough data and results available to begin to extensively study and evaluate the program to determine its effectiveness and to better understand the ways in which it has been used in community development practice. One particular area that can be studied further is the ways in which NMTC investment funds have been structured to most effectively and efficiently raise development capital. This research project was conducted in order to examine existing NMTC investment vehicles and provide insight into the NMTC mechanisms that can attract and leverage private investment for urban redevelopment financing.
This research project consists of a case study of the NMTC investment funds that have been used in Cincinnati. The case study method has been chosen in order to illuminate the decisions that were made concerning the structuring of NMTC investment funds - why decisions were made, how they were implemented, and what the results were. Cincinnati has been chosen as a case study because of the role NMTC investment has played in recent redevelopment activity, the variety of approaches taken for NMTC financing, and the access to data that has been made available for the sake of this research project.

1.1 Overview

The New Markets Tax Credit program is a federal program aimed at attracting private investment into low-income communities for the purpose of revitalization and economic development. The program is administered by the Community Development Financial Institution (CDFI) Fund, whose purpose is to fund community based financial institutions and to provide incentives for community development financing, and was first funded in 2002 with $15 billion of tax credit authority (Seidman 2005, Stainback 2008). The CDFI Fund makes annual NMTC allocations to certified Community Development Entities based on a new round of applications each year. The awards are not project specific, but rather rely on the effectiveness and expertise of CDEs to properly allocate and leverage the NMTCs.

1.1.1 Problem Statement

Low-income, mostly urban, communities have experienced decades of disinvestment, and now have difficulty accessing the investment capital and financing necessary for revitalization. In order to attract private capital, investors must be able to receive an economic
return on their investment. When projects are not able to provide a financial return on their own merit, they require supplemental forms of capital from public subsidies in order to fill the gap between its cost and its value to the investor. This research project is chiefly concerned with the NMTC program’s ability to attract investment capital for development financing into communities and projects that would not otherwise be able to obtain such financing.

Although there is a wealth of literature available concerning the rules, regulations, and intended purposes of the New Markets Tax Credit program, there is very little that deals with the NMTC program in practice. Critical questions remain concerning the NMTC program and its implementation, such as how NMTC deals are structured, what the specific financial benefits to NMTC investors are, and what the specific financial benefits to NMTC funded projects are. This project has sought to answer these questions by conducting a case study of the NMTC financing structures used in Cincinnati, which will help to fill gaps between the theory and practice of the NMTC program.

1.1.2 Research Questions

The research questions that have been addressed by this project include the following: 1) how NMTC investments are structured; 2) what are the benefits of the different financing structures are; and 3) how effective is the NMTC program for community development financing. Answering these questions required a first-hand examination of existing NMTC investment structures in order to gather insight into the specific mechanisms most important when making use of this program in practice. Studying the use of NMTCs in Cincinnati has proven to be instructive because the program has been involved in the funding of a variety of
high-profile, large-scale development projects with different financing approaches, which provides a strong sample of different types of structures and applications of the program.

1.1.3 Cincinnati Case Study

The City of Cincinnati has experienced steep social and economic decline over the past fifty years. Once a thriving port city, Cincinnati was among the top ten largest cities in the country in 1900, and among the top twenty largest in 1950 (Gibson 1998, 13, 18). But by 2010, Cincinnati’s population no longer ranked among the top fifty cities in the country as much of the inner city population had emptied out into the surrounding suburban areas. In addition to residents, jobs and investment also fled the urban areas of Cincinnati, leaving the City with high unemployment and poverty rates. The lack of investment resulted in deep urban decay, as many urban neighborhoods and structures fell into disrepair. This trend continued until interest and investment in the urban core of Cincinnati was reinvigorated in the early-2000s, led largely by Cincinnati corporations who realized the value of a strong urban core to attract and retain talented employees (City of Cincinnati 2003).

Cincinnati is currently experiencing an ongoing experiment in urban redevelopment and revitalization. There has been significant investment and redevelopment activity taking place in the urban areas of Downtown, Over-the-Rhine, and Uptown, led by non-profit development agencies in cooperation with the City of Cincinnati. These development agencies serve as a conduit for corporate and institutional investment through creative and innovative project financing. Within this structure, New Markets Tax Credits have been used extensively in order to attract and leverage capital for redevelopment activity.
Cincinnati has been chosen as the focus of this case study for three specific reasons. Primarily, NMTCs have driven private investment in areas of Cincinnati that have gone without significant investment for over fifty years, thus proving to be instrumental in the redevelopment of Cincinnati’s urban core. In addition, the development agencies who have administered NMTCs in Cincinnati have done so in a variety of ways. There are four different investment funds that have used NMTCs to leverage private investment, each of which illustrates a different approach to using NMTCs and therefore can provide a broad understanding of this program. Finally, Cincinnati has been chosen as the focus of this case study because of the accessibility of the agencies that have used NMTCs. Relationships have been developed with the two primary agencies that have used NMTCs and permission has been granted to access the data necessary for this research project.

1.2 Research Project Methodology

A case study is the preferred methodology to use when a comprehensive, thorough examination is necessary to better understand the topic being researched (Feagin et al 1991). Therefore, this project used the case study research method in order to explain the NMTC program within the context in which it is employed. The case study that was conducted focuses on the use of New Markets Tax Credits by two different community development organizations and their ability to use the program to raise investment capital for urban redevelopment financing. The two organizations studied, the Cincinnati Development Fund and the Cincinnati Center City Development Corporation are both certified as Community Development Entities by
the CDFI Fund, and exist to support the economic development of low-income communities of Cincinnati.

These two CDEs have received New Markets Tax Credit allocations which were used to raise capital for investment vehicles that provide financing for redevelopment projects. Specifically, four investment vehicles have been created by these two CDEs between 2004 and 2008, utilizing $132 million of tax credit allocation. These four investment vehicles include the Cincinnati New Markets Fund (CNMF), the Citywide Development Fund I (CCDFI), the Citywide Development Fund II (CCDF II) and the Uptown Cincinnati Development Fund (UCDF). These investment vehicles were the individual cases that were studied in this project.

A holistic, multiple-case design was applied, with the four investment funds each as an individual case that was studied and analyzed. The multiple-case design was used in order to generate robust research and to achieve more substantial analysis (Yin 2009, 61). Each case was studied separately in order to triangulate the results to ensure accuracy in data interpretation (Stake 1995, 108). Connections were then made between the investment structure that was used and the underlying project(s) that received financing. Based on the results of the four separate case studies, conclusions were made as to different ways in which NMTC investments can be structured, the benefits and challenges of each structure type, and the effectiveness of the NMTC program for community development financing.

This is an exploratory study because existing literature is limited and therefore a good theoretical framework is difficult to establish (Yin 2009, 37.) Therefore, the research project used mostly primary, quantitative data from the creation, structuring, and administration of
each investment vehicle. The tasks that were involved in the research project included data
collection, data aggregation, data analysis, and drawing conclusions. Further details describing
the tasks that were completed in this research project are provided below.

1.2.1 Data Collection

The first task required in this research project was to collect the necessary data to
answer the research questions. In order to do this, the data types and location was identified by
meeting with each CDE’s staff members to better understand the components of the funds
themselves. In addition, working with staff members revealed what data exists and how it can
be acquired. Once the components were understood, they were broken out into data types to
be collected.

In general, the data that was collected was the specific terms and arrangements made
between NMTC investors and CDEs for each investment fund. This data included the amount of
tax credits involved, the amount of equity and/or debt contributed to the investment fund, the
timeframe of the investment, and the expected return on investment. In addition, it was
determined how each investment fund went about funding projects and what the particular
project focus of each fund was. The data collection process generated raw data that became
the foundation of the research project.

1.2.2 Data Aggregation

Once all the raw data was collected, it was aggregated and grouped in order to create a
framework for each investment structure. There were instances in which the data was only
available at the project level, in which case it was aggregated to the investment fund level, per
the parameters of the research project. After this, descriptive statistical calculations were
performed in order to generate ratios, averages, and other metrics of each investment fund.

The structure of each investment fund became clear once all of the data was aggregated
and organized. This provided data such as total investment for each fund, total project
investments made from each fund, the ratio of project investments to NMTCs, the average
length of investments, the investment returns, and the types of projects financed by each fund.
The aggregated information of each investment vehicle was then analyzed and summarized in
order to determine the benefits of each investment structure, as well as the benefits of the
NMTC program in general.

1.2.3 Data Analysis

Once all the data was aggregated and grouped for each investment fund, an analysis was
carried out. This led to a deeper understanding of what that different types of structures were,
how each structure utilized the NMTCs, and why that particular structure was implemented.
Finally, connections will be made between the various types of structures and the project types,
in order to know when each structure might be most appropriate.

The final piece of data analysis was to identify the unique characteristics of each of the
investment funds in order to determine trends and differences between each structure. In
addition, each structure’s financial benefits – benefits for the investors as well as benefits for
the projects - was examined to identify links between each specific structure and the financial
benefits it produces. These various forms of analyses provided a detailed answer to each of the
research questions concerning how NMTC investments are structured and what the distinct benefits of these structures are.

1.2.4 Conclusions

The data analysis allowed for the original research questions to be answered, which then led to conclusions being drawn concerning the various types of NMTC structures and the benefits that each generates. This also facilitated an assessment of the NMTC program in general, and its effectiveness for financing urban redevelopment. These conclusions will serve as a guide to planning and development practitioners when determining how to best use the NMTC program for development financing.
Chapter 2

Review of the Literature

The New Markets Tax Credit program is significant because of its ability to attract private investment for community development financing. In order to understand the context and framework of this program, the academic and professional literature that addresses community development financing, attracting private investment and public-private partnerships will be extensively reviewed. Following this, an in-depth review of the literature that deals specifically with the New Markets Tax Credit program will be conducted in order to explain the background and intent of the program, the mechanisms that it uses to achieve its objective, its accomplishments to date, and to perform a critical analysis of the strengths and weaknesses of the program.

The New Markets Tax Credit program has been in existence for less than ten years, and therefore the body of academic literature that deals specifically with this program is not extensive. The primary sources of such literature are publications by federal agencies and policy advocacy or research organizations, who have evaluated the program in order to measure its achievements. Professional publications and documents written by legal, accounting, and development firms also provide insight into the specific details of the program and how it is used in practice. The current academic literature that serves to supplement these sources comes from the legal, real estate, and urban planning journals and publications.
2.1 Development Financing in Low-Income Communities

Access to investment capital and financing services is a basic component of a healthy, thriving community, yet traditional sources of such credit and equity investment is often severely lacking in economically distressed or low-income communities (Rubin 2007, GAO 2007). Without patient, affordable capital to build and rehabilitate housing, community properties, and community facilities, as well as capital to finance business creation and expansion, it is very difficult to improve the economic and social conditions of a community (Rubin 2007, Urban Institute 2010). Many urban communities have faced disinvestment for a variety of reasons, and this lack of investment has created a market failure where there are not sufficient economic incentives for property maintenance, which depresses property values and furthers the cycle of disinvestment (Brueckner & Helsley 2011, Urban Institute 2010).

According to Karl Seidman, the definition of Economic Development is the “process of creating and utilizing physical, human, financial, and social assets to generate improved and broadly shared economic well being and quality of life for a community or region” (2005, 36). Finance is a vital component of this process in order to create commercial activity and neighborhood amenities to support the well-being of the community (Seidman 2005, 133-134). Furthermore, real estate development capital is necessary in order to remove or rehabilitate abandoned or underutilized properties that lead to blight, crime, and disinvestment (Seidman 2005, 133-134).
2.1.1 Sources of Investment Capital for Low-Income Communities

The two primary sources of community development financing are through private sources such as equity, debt, foundation grants and corporate sponsorship or through public sources such as governmental loans, grants, and tax credit programs (Giles & Blakely 2001, 79-85). Private funds come through traditional investment vehicles that are largely based on measurements of expected risk and return, whereas public funds use a variety of mechanisms to either directly provide needed resources or enact public policy to encourage and facilitate the flow of capital from other sources (Giles & Blakely 2001, 2-5).

The evolution of the field of community development has led to the emergence of specialized development finance organizations who serve low-income communities by raising capital from a variety of sources to promote economic development activity in their target community (Seidman 2005, 268-269). These organizations are private financial institutions, but are not regulated like traditional financial institutions so that they can act as an intermediary between sources of capital and other organizations such as developers, businesses, and non-profit organizations who work in low-income communities (Seidman 2005, 268-269). These organizations are able to raise capital from socially-driven investors, banks who are fulfilling Community Reinvestment Act requirements, and government economic development programs to provide below-market financing to support community development objectives (Seidman 2005, 268-269).
2.1.2 Private Investment in Low-Income Communities

A major community development policy objective for all levels of government is to attract private investment into low-income communities, as the most effective use of public resources is to facilitate access to investment from the private sector (Adair et al 1999, Adair et al 2000). Therefore, public policy plays an important role in community development, as low-income communities do not offer substantial risk and return characteristics for private investors without some form of subsidy to help make such investments profitable (Rubin 2007, Adair et al 2000). Evidence suggests that community development funding can achieve meaningful results when invested strategically and that after a certain point of public investment, private investment increases substantially, often leading to self-financing redevelopment efforts (Galster et al 2006).

A critical objective of any type of development financing is to achieve a leveraging effect, which can happen when one source of financing serves to attract additional sources of financing or when multiple sources of financing are combined together for a particular project or objective (Urban Institute 2010). Leveraging is significant because it allows for the use of different types of financing, such as mixing equity with debt capital, but more importantly it allows for the use of limited public resources to attract additional private investors, thus achieving a greater impact at less cost to the public entity (Urban Institute 2010). Among all the types of economic development incentives, tax credits are especially effective at engaging the private sector, which can lead to private investment many times greater than the amount of public funds committed (Steinbach 1998).
2.1.3 Techniques to Attract Investment Capital in Low-Income Communities

Over the last three decades, there have been numerous products, programs, policies, and specialized organizations aimed at directing financial resources towards low-income communities (Rubin 2007). State governments were among the first to provide economic development financing, as they tried to restructure their sagging economies by using federal grants and their taxing or bonding authorities to stimulate new development or urban revitalization activity (Seidman 2005, 133-134). The growth of the development financing field led to programs such as public revolving loan funds, nonprofit loan funds, community development credit unions, and partnerships between local governments or community development organizations and financial institutions such as banks and insurance companies (Seidman 2005, 133-134).

Financial intermediaries, such as banks or investment firms, are the bridge between personal savings and investment capital (Lyons & Hamlin 2001, 71-72). In order to attract private investment, practitioners must be able to navigate the financial intermediary system to induce investors to put their capital to work in ways that also achieve community development objectives (Lyons & Hamlin 2001, 71-72). One way to achieve this is through public policy that benefits the investor by either reducing the risk or increasing the return on investment while benefiting the borrower by making capital affordable and available (Lyons & Hamlin 2001, 71-72). Some possible public programs that can achieve this objective and direct private investment into low-income communities are loan guarantees, micro-loans, revolving loan
funds, second position loans, equity injections, and direct subsidy (Lyons & Hamlin 2001, 72-82).

2.1.4 Public-Private Partnerships for Community Development Financing

In light of the need for capital in low-income communities and the importance of private investment, many local governments have turned to public-private partnerships, empowering private organizations to perform functions previously done by the public sector (Erie et al 2010). Public-private partnerships are collaborations between a public entity and a private firm in order to carry out the financing, design, construction, and operation of physical development and are appropriate when the interests of the public converge with the interests of the private sector, such as reduced crime rates and increased property values (Stainback 2000, Alexandre 2008). Public-private partnerships are necessary for redevelopment because of challenges relating to market demand, public requirements, problems with development sites, and other political or intangible problems (Stainback 2008).

An effective community development effort requires coordination among the local government, private sector, nonprofit organizations, and the community (Adair et al 1999). It is necessary to find a way to align the private sector’s profit motive with redevelopment objectives while ensuring that private partners have both the ability and the incentive to achieve public objectives (Chapin 2002, Erie et al 2010). Public-private partnerships are most successful when the partners recognize their shared interests and therefore work together, yet have well defined contract terms detailing the amount of investment and risk for each partner (Sagalyn 2007). Tax incentive programs are especially significant because they allow for the
leveraging of private resources while acting as a catalyst for public-private partnerships (Rittner 2006).

2.2 The New Markets Tax Credit Program

The New Markets Tax Credit program was established by Congress as part of the Community Renewal Tax Relief Act of 2000 in order to facilitate investment in low-income communities (CDFI Fund 2008). The NMTC program was created to better address the problem of revitalizing impoverished communities by bridging financing gaps that existed in development projects in order to help make them financially feasible (GAO 2007, McGrath 2008). Originally authorized to distribute up to $15 billion in allocations through 2007, the program has been extended and expanded on four separate occasions, and currently has $33 billion of allocation authority through 2011 (New Markets Tax Credit Coalition 2010). Throughout its legislative history, the NMTC program has received strong bi-partisan support, as it was created under President Clinton’s democratic administration, but implemented under President’s Bush’s republican administration and became one of the primary focal points of his urban renewal policy (New Markets Tax Credit Coalition 2010).

2.2.1 NMTC Background and Purpose

The intent of the NMTC program was to encourage private capital investment into low-income communities, and was based on the belief that tax credits were a necessary incentive to achieve this objective (Urban Institute 2010). The ideology of this program was rooted the Federal Government’s movement towards decentralization, privatization, market-based incentives, and the empowerment of local organizations to foster economic development and
private investment in low-income communities (McGrath 2008). An important precursor to this program was the creation of the CDFI Fund in 1994 to support the growing number of private community development agencies, who eventually were able to effectively promote economic activity by linking tax credits with private investment and community development opportunities (McGrath 2008, Steinbach 1998).

The NMTC program uses the tax code to direct capital to low-income communities rather than using public sector grants thus engaging the private sector in community development and utilizing its investment expertise and disciplines (Steinbach, 1998). The program allows for a variety of nonprofit, for-profit, and public sector organizations to compete for tax credit allocations, thus opening up the process to market competition in order to create more innovative and creative solutions (Pappas 2001). Other key benefits of using the tax code rather than direct subsidy to allocate resources includes increased impact per tax dollar and a higher quality of projects – only ones that meet rigorous investment standards - which increases the likelihood that the projects will be financially sustainable (Pappas 2001).

Although the program is administered and funded by the Federal Government, all project selection and underwriting is done by local community development organizations, which ensures that community priorities are taken into consideration (Steinbach 1998, Urban Institute 2010). In addition to giving a great deal of discretion to local organizations, the program also allows for a wide range of project types, so that resources can be directed toward projects that best meet community needs (Urban Institute 2010, Wong & Wolff 2010). The program also employs a shallow subsidy, which ensures that additional capital must be raised,
thus decreasing the cost to the government (Wong & Wolff 2010). This type of subsidy requires that a project must generate some economic benefits beyond the tax credits in order to be profitable to an investor, which leads to the selection of stronger, more sustainable projects (Wong & Wolff 2010, Armistead 2005).

2.2.2 NMTC Program Details

The key actors in the New Markets Tax Credit program are Community Development Entities (CDEs), i.e., community development organizations which, if certified with the CDFI Fund, are eligible to apply for and receive tax credit allocations (NMTC Program Overview and Glossary 2005). Once a tax credit allocation is received, the CDE has five years to obtain a Qualified Equity Investment (QEI) from an investor in exchange for tax credits totaling 39 percent of the total investment spread over seven years - five percent each of the first three years, and six percent each of the final four years (Caputo 2007, Lance and Farzana 2003). In order to be certified as a Community Development Entity an organization must prove that its primary mission is to serve the interests of low-income communities (Seidman 2005, Lance and Farzana 2003). CDE investments made in low-income communities must go towards loans and investments for business operations, development of real estate, mixed-use projects, or development of for-sale housing (New Markets Tax Credit Coalition 2010).

Once a QEI is made, the CDE then has twelve months to make a Qualified Low Income Community Investment (QLICI) in a Low-Income Community (LIC), which is defined as a census tract with a poverty rate of at least 20% or a median income less than 80% of AMI (NMTC Overview and Glossary 2005). Furthermore, the QLICI must be directed to a Qualified Active
Low Income Community Businesses (QALICB), which is a qualified business that receives its income from, provide services to, or is located within an LIC, and the QALICB then has twelve months to invest at least 95% of the investment proceeds in its business operation (NMTC Program Overview and Glossary 2005, Lance and Farzana 2003).

Tax credit benefits are spread over seven years, during which time investors and CDEs are required to remain in compliance with the NMTC regulations (McGrath 2008). During this timeframe, or compliance window, failure to adhere to the program regulations can result in the loss of the tax credits, also known as tax credit recapture, which would lead to a significant financial loss to the investor and loss of CDFI certification for the CDE (McGrath 2008). There are several recapture provisions in the NMTC legislation, including the restriction that investment principal cannot be repaid by the borrower during the compliance window, and if principal is repaid, the CDE has twelve months to reinvest the capital, or face tax credit recapture (Armistead 2005). The compliance window and recapture provisions comprise the majority of investment risk for NMTC investors, and leads to complexities in structuring to mitigate these risks and ensure program compliance (McGrath 2008, Armistead 2005).

2.2.3 New Markets Tax Credit Financing Structures

The two primary financial structures used when making NMTC investments are leveraged and non-leveraged structures (Caputo 2007). Leveraged structures are used when banks or other lending institutions are comfortable using debt for community development, as funding for the CDE is split between debt and equity financing (Caputo 2007). The leveraged model uses an “upper-tier” investment vehicle that borrows funds from the investors and
passes it through the CDE to the QALICB in the form of a development loan (New Markets Tax Credit Coalition 2009). As of December 2006, nearly 81 percent of all NMTC investments were made using the leveraged structure because it offers a more attractive combination of risk and return by offering equity investors tax benefits while debt investors receive economic benefits in the form of loan repayment (GAO 2007, New Markets Tax Credit Coalition 2009). This structure is attractive to lenders because they receive better LTV ratios, DCRs, and a primary mortgage position, while investors are attracted to it because their return is not tied to the success of the underlying investment (GAO 2007).

Alternatively, New Markets Tax Credit financing can also be structured using a non-leveraged model, which is attractive to investors who are more risk adverse and prefer to use equity financing in the form of capital contributions (Caputo 2007). Despite its popularity and opportunity for enhanced investment returns, the use of leveraged financing is declining as

![Figure 1 – Example of an NMTC Return on Equity Calculation](source: Caputo 2007, 14)
credit remains tight and banks are acting far more conservatively, which has led to an increased need for non-leveraged financing (New Markets Tax Credit Coalition 2009). Figure 1 illustrates a calculation for return on equity of a New Markets Tax Credits deal using a non-leveraged model. Without the NMTCs, the return on this project would only be 1.5 percent, but the tax credits received by the investor increase the annual return on investment to 7.1 percent.

2.2.4 New Markets Tax Credit Program Accomplishments

New Markets Tax Credits are attractive to investors because they yield average net returns of 7-12 percent, in addition to their tax credits (Kennard 2009, Caputo 2007). Investors who have participated in this program have reported rates of return that range between 5-20 percent annually, depending on the financing structure being used (Caputo 2007). As with any other investment, there are risks involved in this type of project. The key risks that are unique to an NMTC project are CDE performance and management risk, tax compliance and recapture risk, and collateral risk (Caputo 2007).

The benefits to low-income community projects are also significant, as 83 percent of transactions have received below-market loan rates, 59 percent have received origination fees below the average rates, and 54 percent were given longer than standard periods of interest-only payments (CDFI Fund 2008). This type of financing typically provides interest rates at 1-2 percent below market rates, frequently allows for debt forgiveness at the end of the seven year term, and exhibits leniency towards foreclosure from default, at least for the seven year term of the credits (Kennard 2009).
A Government Accountability Office survey of NMTC investors revealed that the investments being made to low-income communities had increased since the inception of the program, which indicates that investors were redirecting resources toward these areas as opposed to just substituting NMTC investments for other types of low-income community investments (2007). This study also found that 88 percent of those surveyed would not have made the investment without the tax credit, and 69 percent of those surveyed had not made an investment in a low-income community prior to the NMTC investment (GAO 2007).

In addition, the New Markets Tax Credit Coalition gathered comprehensive program data from the CDFI Fund for transactions between 2003-2009 and found that $15.5 billion of allocations, which generated $6 billion of actual tax credits, was used to finance over 3,000 businesses and generated nearly $50 billion of total investment, a ratio of $8 of private investment for every $1 of tax dollar (2010). Furthermore, the study found that most NMTC activity took place in extremely disadvantaged communities, NMTC investments financed a wide range of projects, demand for tax credit allocations has been nearly seven times greater than what is available, and NMTCs financed projects that created or retained an estimated 500,000 jobs (New Markets Tax Credit Coalition 2010).

Although the New Markets Tax Credit program is smaller than other federal programs, it has been a vital source of new capital for community development projects (Rubin and Stankiewicz 2005). The CDFI Fund, which administers the program, has been very flexible in learning from experience and making changes to the program when necessary, and has therefore been successful in continually attracting new investors and improving the economic
standing of low-income communities (Rubin and Stankiewicz 2005). Also, the program can be combined with other tax credit programs, such as Historical Rehabilitation Credits, in order to enhance investor returns and facilitate development projects that would otherwise not be profitable (Caputo 2007).

2.2.5 New Markets Tax Credit Program Analysis

Although there is a limited sample size due to the newness of the program, early research indicates that the tax credits are being used to make marginal projects financially feasible and contributing to their ability to obtain financing (Armistead 2005). Furthermore, exposing this type of local economic development to competitive pressures has created more robust strategies and innovative approaches to attracting private investment for project financing (Pappas 2001, Armistead 2005). Although the program does not specifically require obtaining additional financing beyond the NMTC allocation amount, this practice is encouraged through the application process, as applicants are selected partially based on how efficiently they plan to use the tax credits, which includes incorporating other sources of public funds such as Historic Tax Credits (Urban Institute 2010).

Despite its success, one frequently voiced concern of the program is its bias towards real estate projects, as 66 percent of all investments made through 2006 were real estate based as opposed to financing business creation or expansion (Lambie-Hanson 2008). This bias in the program is disappointing to those who feel that the intent of the program is to provide capital for existing business operations and that real estate projects do not empower underrepresented business owners, do not create as many quality jobs, and are not the
greatest need (Lambie-Hanson 2008, Armistead 2005). It can be argued that the focus on physical development rather than addressing the immediate economic needs of the residents in LICs makes NMTC an ineffective tool for producing sustainable social change (Forbes 2006).

The real estate bias of the NMTC program is largely due to investors’ belief that such projects are more profitable and less likely to fall out of compliance with program regulations because there is no risk that they’ll no longer be located in a low-income community and long construction periods prevent early repayment of principal (Lambie-Hanson 2008). It would require a change to program regulations to facilitate a more balanced investment approach by adjusting recapture provisions, using the application process to favor CDEs that invest in local businesses, and to change the value of the tax credit when used for business investments, increasing the amount of subsidy provided for such investments (Lambie-Hanson 2008). Despite the concerns, real estate projects do achieve program objectives by attracting additional private investment, providing community facilities and an environment of increased economic activity (Lambie-Hanson 2008).

Another limitation of the NMTC program is that the expense and expertise required by the program’s complexity favors the largest and most sophisticated CDEs (Rubin 2008). A Government Accountability Office report (2010) found that due to the complexity of the program’s structure, it is difficult to carry out small transactions, which prevents small business owners and LIC community organizations from accessing the capital raised by New Markets Tax Credits. Although it is possible for CDEs to distribute their NMTC financing among a variety of smaller projects, thus offsetting this limitation, the program is rarely used in this capacity
One solution to this is for smaller organizations to try to partner with larger organizations so that they can be involved in the project stage, if not the allocation stage (Armistead 2005).

The New Markets Tax Credit program has proven to bring private investment into urban and community development projects, making it one of the most valuable federal redevelopment tools available (Miara 2004). It is not capable of making a bad project into a financially viable one, but it fills the investment gap for projects that otherwise have strong economic fundamentals (Miara 2004). In spite of the worst economy in sixty years, and the tight credit and difficult investment environment of the early 2010’s, NMTC investments have not decreased (New Markets Tax Credit Coalition 2010). In general, the program has created a framework that allows investors to have flexibility and creativity in providing resources to low-income communities, relying on the ability of CDEs to link investment capital with feasible projects and to manage these projects to completion (McGrath 2008).
Chapter 3
Citywide Cincinnati Development Fund I

The Citywide Cincinnati Development Fund I, LLC (“The Fund”) is a special purpose entity and wholly owned subsidiary of Cincinnati Development Fund (CDF), a Community Development Entity. CDF received a $30 million New Markets Tax Credit allocation from the CDFI Fund in 2009 and created The Fund, designating $13,476,919 of its allocation to it. Unlike other NMTC investment funds, The Fund was created using a “bottom-up” approach. That is, CDF had already identified a specific project and created The Fund for the sole purpose of financing that project.

The project that The Fund was created to finance was the rehabilitation of a historic hotel, the Vernon Manor, to repurpose it into Class A and B office space. In addition to the office space, a 440-space public parking garage will be built on the property to service the office building and surrounding community. The total project cost was $36,696,438 of which The Fund was only able to provide 36.7%, and therefore a partnership was formed with National City NMTC No. 23, who provided an additional $22 million of NMTC allocation. The final financing came from developer equity, tenant equity, and interest on cash reserves. This financing deal closed on April 22, 2010 and construction was expected to last 12 months.

2 All material in this section comes from the following sources:

- Cincinnati Development Fund NMTC Application 2009.
- Vernon Manor Loan Recommendation 2010.
- American Fact Finder 2010.
In order to carry out this project, Vernon Manor Offices, LLC (“The Developer”) was created to serve as the Qualified Active Low Income Community Business (QALICB), or recipient of the NMTC investment. The Developer was the borrower of the NMTC financing and was required to maintain characteristics consistent with QALICB requirements per the NMTC legislation. The Developer then contracted with Cincinnati Children’s Hospital (“The Tenant”) to establish terms of the lease, which will be the revenue stream to operate the facility and repay the NMTC debt.

3.1 Upper Tier Investment Vehicle

The two CDEs used the combined $35,476,919 of NMTC allocation to create the Vernon Manor Investment Fund, LLC (“The Investment Vehicle”). This vehicle is a shell LLC created to pool investment resources and invest capital to the CDEs in the form of Qualified Equity Investments (QEI). In exchange for the QEIs, The Investment Vehicle received tax credits that it distributed to investors and received equity in return (see Figure 2). It was necessary to attract an amount of capital equal to the total allocation ($35,476,919) to generate the maximum amount of NMTC equity. In order to fully finance this project, a leveraged structure was necessary to enhance The Investment Vehicle’s ability to raise the amount of investment capital required for the project.

The NMTC allocation generated $13,835,998 of tax credits, which were sold at a discount to PNC NMTC Investment, LLC (“The Equity Investor”) based on the market rate for such tax credits. The tax credits were sold for $0.72 per dollar of tax credit, which returned $9,961,919 of equity for the project. Once all tax credits have been redeemed, the investment
will yield $3,874,079 of profit, or an annual rate of return of 8.82\%, to The Equity Investor. As a result of receiving a desirable return solely from the purchase of tax credits, an additional return will not be required, and therefore the equity will remain in the project without repayment.

Based on NMTC legislation, The Equity Investor owns 100\% of The Investment Vehicle. Although The Equity Investor will receive a financial return apart from the project itself, they will remain involved in the project to ensure there is no default or violation of program regulations, which would lead to a recapture of tax credits and a significant financial loss. Once the seven year compliance period is over, The Equity Investor will no longer have a need to maintain ownership of The Investment Vehicle, and will therefore exercise the put option that was previously agreed upon in the investment contract. When the NMTC compliance period ends, The Equity Investor will exercise the put, selling their interest in The Investment Vehicle to The Developer for 5\% of the total investment, or $498,096. At this point in time, The Developer will assume The Investment Vehicle’s outstanding debt, but will no longer have any obligations to The Equity Investor because they will have sold their stake in the investment.

3.2 Leveraged Structure

In addition to the equity investment of $9,961,919, The Investment Vehicle needed to raise $25,515,000 of debt capital to reach the full NMTC allocation amount. However, the project was not able to support this much debt and therefore used a duel loan structure, with

---

3 The Equity Investor, which was a national bank, will apply a portion of the total credits against its Federal Income Tax liability, thus reducing its tax burden, each year for 7 years. The difference between the credits received by the investor and the price paid for them represents the return on investment.
both senior and junior debt sources (see Figure 2). The senior lender (“The Bank”) made a seven year loan for $18,525,000, at a 5.65% interest rate for the first year and a 5.98% interest rate the remaining 6 years, receiving a mortgage lien as collateral. This loan also was structured to have interest only payments during the seven year NMTC compliance period, therefore not

Figure 2: CCDF I Financial Structure
paying down any principal over the life of the loan. The loan will be refinanced after seven years to retire the senior loan and assume a traditional debt structure. The Bank’s annual rate of return over the life of the loan will be 6.01%. The junior lender was the Ohio Department of Development, who provided a subordinated loan in the amount of $7,100,000 for 30 years. This loan had interest only payments for seven years at 1%, and a rate of 5.38% for the remaining 23 years, for a combined interest rate of 3.5% over the life of the loan. This loan was amortized over 40 years and so will require an outstanding principal payment when the loan matures.

The low-interest, subordinated junior loan was provided by the Ohio Department of Development as part of the state’s economic development program to spur investment and development. This was required for the junior debt since no traditional lender would have made this type of loan. Furthermore, since it was determined that this project could only support the $18,525,000 senior loan, the City of Cincinnati pledged TIF revenue to repay this debt. The project will be able to support the 1% interest payments during the seven year compliance period and after that, debt service and the final balloon payment will be repaid by funds that accumulate in the Cincinnati TIF district. Based on the investment structure used, the project received $35,476,919 from The Investment Vehicle but only had to support $18,525,000 of debt. The NMTC structure allowed for this project to receive 47.94% of its funding from gap financing sources.

---

4 This was an Urban Revitalization Loan, which is one of the Economic Development tools offered by the State of Ohio.
3.3 Benefits of the Financing Structure

As previously noted, The Equity Investor received an annual rate of return of 8.82% from this investment paying $0.72 cents per dollar of tax credit. This return comes with minimal risk and no direct real estate risk. The investor’s primary risk deals with a failure of the project to comply with the NMTC regulations, which has been mitigated by the structuring of the investment, timing of project funding, and the track record of the CDEs involved. Any risk from the failure of the project would fall on the CDEs, as it would be their responsibility to recover the funds and reinvest them into another project. The Bank received an annual rate of return of 6.01% along with a first mortgage lien on the project and personal guarantees from The Developer. As a result of this investment structure, The Developer will be able to achieve a stabilized DCR\(^5\) of 1.74, meaning that The Bank has very little risk of not receiving interest payments. Furthermore, The Bank had a term of only seven years, limiting the liquidity and interest rate risk being taken by this loan.

The project received more than $35 million dollars in loans while only having to support $18,525,000 of debt, thus enabling it to be financially feasible. In addition, The Developer paid below-market interest rates on its loans, had a seven year period of interest only payments, and had partial debt forgiveness contingencies as part of the loan. This enabled The Tenant to receive reasonable lease terms so that they would commit to a 19 year lease, providing the project with a continuous and reliable source of revenue to support the operations and debt.

\(^5\)DCR is a relationship between a project’s income and its debt service. This ratio indicates the financial strength of a project and its ability to successfully support its debt. A standard DCR that is acceptable to traditional lenders is 1.2.
it were not for the unique financing offered by the NMTC investment structure, this project would not have been able to take place, as no traditional lender or investors would have undertaken this loan based on the cost and financial projections of the project (see Table 1).

Table 1: CCDF I Project Profile

<table>
<thead>
<tr>
<th>Project Information</th>
<th>Vernon Manor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Name:</td>
<td>400 Oak Street</td>
</tr>
<tr>
<td>Project Address:</td>
<td>Corryville</td>
</tr>
<tr>
<td>Project Neighborhood:</td>
<td>Cincinnati Development Fund, National City NMTC No. 23</td>
</tr>
<tr>
<td>Project Description:</td>
<td>Redevelopment of an historic hotel into a medical office building</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Financial Data</th>
<th>$36,696,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Project Cost:</td>
<td>$34,946,000</td>
</tr>
<tr>
<td>NMTC Loan Amount:</td>
<td>$1,750,000</td>
</tr>
<tr>
<td>Additional Investment:</td>
<td>95.2%</td>
</tr>
<tr>
<td>Tax Credits to Project Cost Ratio:</td>
<td>95.2%</td>
</tr>
<tr>
<td>Max Loan - DCR:</td>
<td>$26,170,000</td>
</tr>
<tr>
<td>Max Loan - LTV:</td>
<td>$21,020,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Achievements</th>
<th>600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permanent Jobs Created:</td>
<td>Office</td>
</tr>
<tr>
<td>Square Feet of Commercial Space:</td>
<td>185,350</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Location Data</th>
<th>34</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Census Tract:</td>
<td>53.0%</td>
</tr>
<tr>
<td>Poverty Rate:</td>
<td>18.9%</td>
</tr>
<tr>
<td>Housing Vacancy Rate:</td>
<td>$21,580</td>
</tr>
<tr>
<td>Median Household Income (in 2009 $):</td>
<td>40.9%</td>
</tr>
<tr>
<td>Median Household Income as a % of Hamilton County:</td>
<td></td>
</tr>
</tbody>
</table>

1 Based on a DCR of 1.2
2 Based on a LTV of 80%
3 Data based on 2000 Census

Source: Vernon Manor Financial Forecast 2010
Hamilton County Auditor 2011

3.4 Why it was Structured in this Manner

The Fund was created for the sole purpose of financing the underlying development project. It was a very costly project, as it involved historic rehabilitation in a low-income community, but did not offer a corresponding rate of return to justify the project. Therefore,
the NMTC leveraged model was chosen in order to incorporate tax credit equity and other sources of gap financing into the structure, supplementing the traditional senior loan. The junior loan partner was chosen because it was a public program that offered flexibility and a willingness to offer subordinated debt supported by TIF revenues rather than the project itself. It would be very unlikely that a traditional lender would agree to such terms, and therefore a public loan program was necessary. The amount of NMTC allocation that was dedicated to the project through The Fund was decided upon after the financial projections and tax credit equity amount had been determined, so as to ensure that the necessary amount of equity would be acquired.

The terms of the investment were largely based on market rate terms, which take into account the NMTC structure and associated risks. The senior loan interest rate was based on the fact that a mortgage lien, as well as developer guarantees, was obtained. More important though, was the fact that the project was receiving additional funding that did not require debt service, allowing the senior lender to be confident in its repayment, pricing the loan accordingly. In a similar fashion, the price paid by the equity investor for the tax credits was based on market rates and potential NMTC compliance risk. The junior lender’s intent, being a public loan program, was to provide additional loan capital to encourage economic development and therefore set its interest rate based merely on the need to cover administrative costs.
Chapter 4

Citywide Cincinnati Development Fund II

The Citywide Cincinnati Development Fund II, LLC (“The Fund”) is a special purpose entity and wholly owned subsidiary of Cincinnati Development Fund (CDF), a Community Development Entity. CDF received a $30 million New Markets Tax Credit allocation from the CDFI Fund in 2009, and created The Fund and designated $16,523,081 of its allocation to it. This investment fund was created using a “bottom-up” approach in which a specific project had been identified for NMTC financing. CDF, in partnership with Cincinnati Center City Redevelopment Corporation (3CDC) and Local Initiatives Support Corporation (LISC) created The Fund and apportioned the necessary allocation to it for the sole purpose of attracting capital to finance the proposed project.

The Fund was created to help facilitate the redevelopment of Washington Park, an 8 acre public park and the largest public space within the urban core of Cincinnati. Over 150 years old, the park had become overrun by homelessness, drug dealing, and other criminal activity. As a catalyst for community redevelopment, 3CDC and the Cincinnati Park Board decided that it was necessary to renovate the park, which included the construction of an underground 450-space parking garage to service the park and surrounding neighborhood. In addition, the park was expanded from 6 to 8 acres, with a great lawn, upgraded playground, interactive water

All material in this section comes from the following sources:

Cincinnati Development Fund NMTC Application 2009.
American Fact Finder 2010.
features, a performance stage, event plaza, and dog park, among other new amenities. 3CDC, as project lead, committed some of their own NMTC allocation, but also sought out LISC, a national CDE, and CDF to provide additional tax credits to achieve the necessary investment level.

The total project cost was $49,949,783, of which The Fund provided 33.1%, 3CDC’s investment fund, Cincinnati New Markets Fund Redevelopment, provided 34.1%, and LISC’s investment fund, New Markets Investment 52, provided 27.9%. The final financing, 4.9%, came from developer equity in the form of assignment of leasehold interest. This financing deal closed on November 10, 2010 and construction was expected to last up to 18 months.

In order to carry out this project, Washington Park Restoration, LLC (The Developer) was created to serve as the Qualified Active Low Income Community Business (QALICB), or recipient of the NMTC benefit. The Developer was the borrower of the NMTC financing and was required to maintain characteristics consistent with QALICB requirements per the NMTC legislation. The Developer then contracted with the City of Cincinnati and the Cincinnati Park Board to establish terms of leases for both the operation of the park and the parking garage, which will be the revenue stream to operate the park and repay the NMTC debt.

4.1 Upper Tier Investment Vehicle

The combined NMTC allocation of $47,499,783 was pooled by the 3 CDEs in order to create the Washington Park Investment Fund, LLC (“The Investment Vehicle”). This fund was then used to attract investment capital which could be invested in the CDEs in the form of Qualified Equity Investments (QEI) and eventually invested lent to The Developer in the form of
a Qualified Low Income Community Investment (QLICI) loan. In order to assemble enough investment capital to fully fund this project, a leveraged structure was developed (see Figure 3). This structure included the tax credit investor and a lending entity, named Washington Park Restoration Leveraged Lender, LLC (“The Leveraged Lender”). This lending entity was created to pool resources from a variety of sources to create a single loan pool which could be leant to The Investment Vehicle as a single source (see Figure 3). This was done because the nature of the project, a public park with limited revenue sources, would not qualify for traditional loans, even within the NMTC structure. The creation of The Leveraged Lender facilitated the use of non-traditional financing sources such as grant funds and municipal bonds to be incorporated into The Investment Fund.

The NMTC allocation generated $18,524,915 of tax credits, which were sold at a discount to PNC New Markets Investment Partners, LLC (“The Equity Investor”), based on the market rate for such tax credits. The tax credits were sold for $0.72 per dollar of tax credit, which returned $13,337,939 of equity for the project. This investment yielded $5,186,976 of profit, or an annual rate of return of 10.37\%\(^7\). As a result of receiving a desirable return solely from the purchase of tax credits, The Equity Investor will not require and additional return, and therefore will not require repayment of investment capital upon the completion of the project.

Based on NMTC legislation, The Equity Investor owned 100% of The Investment Vehicle, and therefore was responsible for monitoring program compliance, as any violations would

---

\(^7\) The Equity Investor, which was a national bank, will apply a portion of the total credits against its Federal Income Tax liability, thus reducing its tax burden, each year for 7 years. The difference between the credits received by the investor and the price paid for them represents the return on investment.
result in a recapture of their tax credits, leading to a significant financial loss. However, once the program’s compliance period is over, the equity investor will no longer have a need to maintain ownership of The Investment Vehicle since a financial return has already been achieved, and will therefore sell their ownership interest. In order to accomplish this, a put option was inserted into the investment contract, allowing The Equity Investor to sell its

Figure 3: CCDF II Financial Structure

Source: Washington Park Financial Forecast 2010
Interest in The Investment Vehicle to The Developer for $1,000. At this point in time, The Developer will assume all outstanding debt of The Investment Vehicle, but will not have any repayment obligations to The Equity Investor.

4.2 Leveraged Structure

The Washington Park redevelopment project required over $47.5 million in capital, yet the tax credits could only generate $13.3 million of equity. Therefore, a $34.2 million gap existed in this project. Using a basic, non-leveraged structure, the tax credit equity investor would have to provide the full NMTC allocation amount ($47.5 million) and would receive the $18.5 million as a return. However, the investor would still require repayment of the full investment amount, which was beyond the capacity of this project. In order to resolve this problem, a leveraged structure was employed, under which the tax credits were sold to The Equity Investor for $13.3 million in equity, and only $34.2 million (rather than $47 million) of additional financing was necessary to fill the financing gap (see Figure 3).

The nature of this project is significant because as a public park and parking garage, it offered limited income for debt repayment. Based on financial projections, the project would have a stabilized\(^8\) NOI of $788,105, which would be able to support annual debt of $9,134,272.\(^9\) This, coupled with the fact that no mortgage would be available for the publicly owned park, made it very difficult to secure traditional debt in the leveraged structure. In response to this,

---

\(^8\) Stabilized NOI refers to the income level of a project once its complete and operating at full capacity

\(^9\) Based on a DCR of 1.2 and an interest rate of 6%, both of which are standard for this type of deal.
The Leveraged Lender was created as a conduit for other sources of financing, which would then serve as the debt instrument for the leveraged structure.

The financing sources used in The Leveraged Lender included city bonds, city grants, state grants, foundation grants, and state economic development loans. The City of Cincinnati issued $11.5 million in bonds, to be repaid by TIF\textsuperscript{10} revenues, and also provided a $2.5 million capital grant. The State of Ohio provided a $2.8 million capital grant and two local foundations provided a total of $1.35 million in grants. In addition, the Ohio Department of Development provided an Urban Redevelopment Loan for $5 million and the Cincinnati Equity Fund provided a permanent loan for $4.28 million and a bridge loan for $3.36 million. Bridge loans and day loans were also incorporated into The Leveraged Lender to provide funds at closing that would be repaid by grants and developer equity to be contributed at a later date. In all, The Leveraged Lender pooled $34,233,643 of capital and lent it to The Investment Vehicle for project financing (see Figure 3).

Although The Leveraged Lender provided a loan of $34.6 million to The Investment Vehicle, only about $12.6 million of that will be repaid by the project. The grants will not require repayment and the City of Cincinnati loans will be repaid by TIF revenues. Both the CEF permanent loan of $4,281,930 and the CEF bridge loan of $3,362,381 have terms of 15 years and an interest rate of 4%. Interest only payments will be made for the first seven years and the loans are amortized over 25 years, so there will be balloon payments when the loan matures.

\textsuperscript{10} The City of Cincinnati issued Bonds to raise capital for the project, which will be repaid over time through resources that have accumulated in the TIF district. The City expects that this project will catalyze additional development in the area, thus increasing property tax payments and covering the City’s debt obligations.
Similarly, the Urban Redevelopment Loan of $5,000,000 has a term of 15 years, with interest only payments for the first seven years. The interest rate is zero for the first five years and then accrues at 3% for the next ten years. The financing structure plans for a refinancing to take place after the project's seven year compliance period. The Developer will use the proceeds of this refinance to retire the principal of the three loans. The NMTC leveraged structure allowed for the combination of grants, TIF-backed bonds, and low interest economic development loans to generate $47 million of financing with only $12.6 million of actual debt.

4.3 Benefits of the Financing Structure

The Equity Investor received an annual rate of return of 10.37% from this investment paying $0.72 cents per dollar of tax credit. There is no direct real estate risk to the investor, as the return is not predicated on the financials of the project or its ability to repay debt. The only risk associated with this investment is failure of the project to comply with program regulations, which has been mitigated by the structure of the investment, timing of the project funding, and the expertise of the CDEs involved. One particular risk of this project is redeployment risk. NMTC regulation requires that any repayment of principal must be redeployed within 12 months by the CDE, who absorbed this risk by taking responsibility for reinvesting any proceeds of liquidation if the project were to fail. Furthermore, The Equity Investor owns 100% of The Investment Fund and therefore would play a role in the redeployment of funds, ensuring the tax credits are not forfeited due to program noncompliance.

The Investment Fund received a loan in the amount of $34.6 million at a rate of 1.02%. The interest rate on $34.6 million helps the financials of the project while also collecting
enough interest to service the $12.6 million of debt, as well as pay for additional administrative fees and expenses. The Leveraged Lender did not have any capital sources that had the

Table 2: CCNF II Project Profile

<table>
<thead>
<tr>
<th>Project Information</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Name:</td>
<td>Washington Park</td>
</tr>
<tr>
<td>Project Address:</td>
<td>1230 Elm Street</td>
</tr>
<tr>
<td>Project Neighborhood:</td>
<td>Over-the-Rhine</td>
</tr>
<tr>
<td>CDE(s):</td>
<td>Cincinnati Development Fund, LISC, 3CDC</td>
</tr>
<tr>
<td>Project Description:</td>
<td>Redevelopment of a Public Park and construction of a Public Parking Garage</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Financial Data</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Project Cost:</td>
<td>$48,208,000</td>
</tr>
<tr>
<td>NMTC Loan Amount:</td>
<td>$45,758,000</td>
</tr>
<tr>
<td>Additional Investment:</td>
<td>$2,450,000</td>
</tr>
<tr>
<td>Tax Credits to Project Cost Ratio:</td>
<td>94.9%</td>
</tr>
<tr>
<td>Max Loan - DCR(^1):</td>
<td>$16,950,000</td>
</tr>
<tr>
<td>Max Loan - LTV(^2):</td>
<td>$7,400,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Achievements</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Temporary Jobs Created:</td>
<td>920</td>
</tr>
<tr>
<td>Type of Commercial Space:</td>
<td>Public Park and Parking Garage</td>
</tr>
<tr>
<td>Other Development Metrics:</td>
<td>8 Acre Park; 450 Parking spaces</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Location Data(^3)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Census Tract:</td>
<td>9</td>
</tr>
<tr>
<td>Poverty Rate:</td>
<td>61.6%</td>
</tr>
<tr>
<td>Housing Vacancy Rate:</td>
<td>34.1%</td>
</tr>
<tr>
<td>Median Household Income (in 2009 $):</td>
<td>$8,978</td>
</tr>
<tr>
<td>Median Household Income as a % of Hamilton County:</td>
<td>17.0%</td>
</tr>
</tbody>
</table>

\(^1\) Based on a DCR of 1.2  
\(^2\) Based on a LTV of 80%  
\(^3\) Data based on 2000 Census

Source: Washington Park Financial Forecast 2010  
Hamilton County Auditor 2011

intention of profit maximization. The majority of the sources did not require repayment and the other loan sources were low interest loans that were made available to spur economic and community development. The bridge loans, the only commercial loans being used, will be repaid quickly using grant funds that will come within a year or two of project closing. The aggregate rate of return for the three sources of debt was 2.85%.
Due to the limited sources of revenue, a large amount of gap financing was necessary to ensure that the project was financially feasible. The total loan of $47 million represents 93.32% of total project costs (see Table 2), yet only 26.8% of this debt will be supported by the project itself. On top of the high amount of non-debt financing committed to this project, the debt was also structured to have below-market interest rates and seven years of interest only payments. This structure will lead to a debt coverage ratio\(^{11}\) of 2.0, ensuring that the project will have more than enough financial flexibility to succeed. This will allow the project plenty of time to generate revenue and reserves that will allow it to refinance the original debt and support a traditional debt structure after the NMTC compliance period. Furthermore, lease contracts have been negotiated between the City of Cincinnati and 3CDC, establishing the rates and terms of park and garage operation, guaranteeing the project’s revenue stream over the next 30 years.

4.4 Why it Was Structured in this Manner

Although this is a public project, it has significant implications for private and community development. Therefore, the City of Cincinnati, the State of Ohio, and local foundations partnered with private investors and developers to finance this project. A public park is not a typical income-producing property and so the leveraged NMTC structure enabled equity, debt, and non-traditional financing sources to be pooled to fill the gap between what

\(^{11}\) DCR is a relationship between a project’s income and its debt service. This ratio indicates the financial strength of a project and its ability to successfully support its debt. A standard DCR that is acceptable to traditional lenders is 1.2.
the project cost and what it could financially support. On the one hand, this project only had $12.6 million of actual debt, so that nearly 75% of project costs will not be repaid. On the other hand, $13.5 million of city funds were able to generate $47 million of investment capital, the rest of which came from private sources.

The Fund was created with the specific and sole purpose of facilitating the financing of this project. The size and scope of the project dictated that three CDEs participate, each contributing large portions of their NMTC allocation in order to generate enough investment capital for the project. The amount of allocation that was committed to The Fund was determined after the financial projections and tax credit equity price had been determined, so as to ensure that the necessary amount of equity could be acquired. Had the debt and/or grant financing been contributed outside of the NMTC structure, it would have limited the amount of tax credit equity the project could acquire, thus preventing the project from taking place.
The Uptown Cincinnati Development Fund, LLC ("The Fund") is a special purpose entity and wholly owned subsidiary of Cincinnati Development Fund (CDF), a Community Development Entity. CDF received a $52 million New Markets Tax Credit allocation from the CDFI Fund in 2005 and created The Fund to receive the full amount of NMTCs. The Fund was created using a “top-down” approach, in which the financing sources were established before specific projects were identified. In addition, this fund was meant to provide financing for numerous projects, rather than just one particular project, thus achieving a broader impact in the community. The Fund received its first investment capital in 2006, and the final funding took place in late 2010, financing a total of nine projects ranging from $300,000 to $13 million.

The Fund was created to infuse investment and development capital into the uptown area of Cincinnati. Uptown is comprised of several neighborhoods, most of which are low income communities, but it also is home to large local institutions such as the University of Cincinnati, Cincinnati Children’s University, and the Cincinnati Zoo. The creation of The Fund came out of a partnership between CDF and the Uptown Consortium, a community development organization established by five of the major institutions in the uptown area. This

---

12 All material in this section is from the following sources:

Cincinnati Development Fund NMTC Application 2005.
Romanos 2006.
Uptown Partners Operating Agreement 2006.
Hamilton County Auditor 2011.
partnership led to the development of a plan for revitalization through private and public investment capital. The Fund was created to combine the resources committed by the Uptown Consortium member institutions with the NMTC allocation received by CDF to create an investment pool that could be used to infuse capital and catalyze redevelopment of this area (Uptown Consortium 2004, 8.2).

5.1 Upper Tier Investment Vehicle

Whereas The Fund was created to receive the NMTC allocation and distribute it to investors, the Uptown Partners Investment Fund ("The Investment Vehicle") was created to pool equity and debt capital that would then be invested in The Fund in the form of Qualified Equity Investments (QEI). The Investment Vehicle pooled a total of $54.6 million, with $2.6 million being used to fund the operations and administration of the Uptown Consortium and the remaining $52 million being used as QEI (see Figure 4). In exchange for this administrative fee, the Uptown Consortium was responsible for the management of The Investment Vehicle, attracting equity investors and determining investment terms.

In order to maximize the resources committed by the Uptown Consortium, a partnership was created with a group of five national banks ("The Equity Investors") with significant local presence. The Equity Investors agreed to collectively invest in the tax credits, dividing the investment evenly among the five partners to reduce individual risk. The $52 million of NMTCs generated $20,280,000 in tax credits, which were purchased at a rate $0.87 per dollar of tax credit, which yielded $17,617,919 in equity investment for The Investment Vehicle (see Figure 4). In addition to the tax credits, The Equity Investors will also receive a total
of $880,896 in equity distributions once all capital is repaid to The Fund, which was agreed upon in the investment operating agreement. The Equity Investor’s total return over the investment period will be $3,542,977, or 20.1% of their original investment. Despite paying a higher price for the tax credits, the equity distribution will supplement the returns, achieving an annual after tax internal rate of return of 8.19%.\(^\text{13}\)

Although the investment terms were agreed upon up front, equity contributions and the corresponding tax credits were only made as projects were identified by The Fund and approved by The Investment Vehicle\(^\text{14}\) to ensure that only projects with strong financials received financing. Additionally, to make a QEI before a project is identified and ready to begin would put the investors at risk of recapture, since NMTC regulation allows for only 12 months between the QEI and the QLICI. In this instance, one of the members of The Equity Investors decided that the risks were too high for continued participation and their 20% stake in The Investment Vehicle was sold to two of the other four remaining members (10% each), which resulted in two members with a 30% share and the other two members maintaining their 20% share. Additionally, three years into the investment, one of the members had a corporate merger with another member, thus resulting in a 50% share of The Fund.

---

\(^{13}\) The Equity Investors will apply a portion of the total credits against their Federal Income Tax liability, thus reducing their tax burden each year for 7 years. The difference between the credits received by the investors and the price they paid for them represents the return on investment.

\(^{14}\) Per NMTC regulation, The Investment Vehicle owned 99.9% of The Fund because of the leveraged structure. Therefore, despite collaboration between these two entities, the Uptown Partners Investment Fund ultimately had control over which projects would receive financing.
5.2 Leveraged Structure

A leveraged structure was used for The Fund in order to take advantage of the resources that had been committed by the Uptown Consortium member institutions. The five institutions that make up the Uptown Consortium had agreed to provide loan capital at below-market rates and favorable terms in order to stimulate development activity in the uptown area. Once The
Fund was created and the terms were agreed upon with The Equity Investors, an additional $34,382,081 of loan capital was required to generate $52 million of QEIs and $2.6 million was necessary to fund the administration of the Uptown Consortium CDE for a total loan amount of $36,982,081.

In order to facilitate the lending of resources by the Uptown Consortium partners, the Uptown Loan Pool I (“The Leveraged Lender”) was established. The lending institutions would lend their share of capital into The Leveraged Lender, which would then loan the pooled capital to The Investment Vehicle to make QEIs (see Figure 4). Similar to the equity investors, the lending institutions would not provide their capital until projects were identified and approved by The Investment Vehicle. The debt portion of The Investment Vehicle was 66% and the equity portion was 34%, so for each project The Leveraged Lender would be required to provide 66% of the capital, while The Equity Investors would be required to provide 34%. The five Uptown Consortium members each loaned a different, pre-determined proportion of the total loan commitment, which allowed each one to undertake a comfortable level of risk and investment for each project.

The result of this structure was two layers of leverage\textsuperscript{15} for the institutions that comprised the Uptown Consortium. The first layer of leverage was achieved through the NMTC structure, as the member institutions provided $36 million of capital in order to establish a $52 million loan fund. By providing the debt capital, these institutions were able to attract additional investment through the tax credit program. Furthermore, the structure of the

\textsuperscript{15} This is leverage in the general sense, using one source of funding to attract additional source of funding, not using leverage in the specific NMTC structure sense.
Uptown Loan Pool I provided a second layer of leverage, as each institution only had to contribute a certain percentage of the $36 million of capital (average of $7 million each) in order to create the $52 million investment fund. For each Uptown Consortium institution, this represents an impact over 7 times greater than their individual investment while also allowing them to reduce their risk through diversification.

The Leveraged Lender loaned its capital to The Investment Vehicle at an initial interest rate of 2%, which corresponded with low interest rates and interest only payments for each project that received capital. However, The Leveraged Lender also had a deferred interest rate, which was essentially the principal repayments of the equity investment, which represented 34% of the full loan amount. Whereas other structures are setup to have equity investors exercise a put option and sell their equity stake to the project, this fund was setup to have The Leveraged Lender receive the repayment of equity as deferred interest on the loan. This enabled the low initial interest rate, thus keeping the cost of capital low for each project. The combination of the initial interest rate and the deferred principal and interest payments gave The Leveraged Lender a 4% return on investment, despite lending at a 2% interest rate. The total rate of return for The Investment Vehicle was 5.86%, with the remaining capital repayments being used to fund the administration and loan servicing costs of the Uptown Consortium.

5.3 Benefits of the Financing Structure

Using the NMTC structure to finance nine different development projects in the uptown area of Cincinnati provided benefits to all parties involved. For The Equity Investors, the tax
credit investment yielded an annual rate of return of 8.19% over the life of the investment. This return came at minimal investment risk and no direct real estate risk. The investors were able to mitigate the NMTC compliance risk by withholding funding until projects were identified and ready to begin. Furthermore, the partnership that was created among the original five (and eventual three) investors allowed them to reduce their own relative risk and commitment level while still pooling enough equity capital to fully capitalize The Investment Vehicle. Finally, the NMTC structure facilitated a fair return on investment while allowing the banks’ to fulfill their obligation to see their local communities redeveloped.

The NMTC structure also benefitted The Leveraged Lender, by creating significant additional capital, thus magnifying the impact of each member institution’s resources. The Uptown Consortium (the members of which comprised The Leveraged Lender) was able to achieve its organizational mission of providing development capital to the communities of uptown Cincinnati by providing $36 million and attracting an additional $17.6 million of private investment. The Leveraged Lender was willing to provide investment capital at low cost, but was still able to receive a 4% rate of return. The NMTC structure allowed for low interest rates, and the ability to buy down\textsuperscript{16} the risk of default by using equity repayment as an additional source of debt service. Furthermore, this structure allowed The Fund to provide capital for community redevelopment at below market costs and very favorable terms. The primary risk was compliance with NMTC regulation, specifically in relation to the timing of project funding.

\textsuperscript{16} An investor requires a rate of return based on the level of risk that must be taken. This return was achieved by using equity repayments as deferred interest, thus compensating the lender for taking on the risk of the investment.
<table>
<thead>
<tr>
<th>Project Description</th>
<th>Total Project Cost</th>
<th>NMTC Loan Amount</th>
<th>NMTC Loan Term</th>
<th>Loan Start Date</th>
<th>Loan Due Date</th>
<th>Collateral</th>
<th>Loan Payments</th>
<th>Project Achievements</th>
<th>Property Value before Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feasibility Study</td>
<td>$1,400,000</td>
<td>$1,400,000</td>
<td>7 Years</td>
<td>5/1/2006</td>
<td>5/31/2013</td>
<td>Guarantee from the borrower</td>
<td>Interest only payments, principal repaid at maturity</td>
<td>Feasibility Studies for potential development projects</td>
<td>N/A</td>
</tr>
<tr>
<td>Burnet Ave Acquisition and Predevelopment</td>
<td>$41,175,000</td>
<td>$10,725,000</td>
<td>7 Years</td>
<td>11/1/2006</td>
<td>9/30/2013</td>
<td>Assignment of membership interest of the single asset borrowing entity</td>
<td>Interest only payments, principal repaid at maturity</td>
<td>Land Acquisition and Site Development</td>
<td>N/A</td>
</tr>
<tr>
<td>Herald Building</td>
<td>$6,975,000</td>
<td>$1,675,000</td>
<td>7 Years</td>
<td>2/1/2007</td>
<td>1/31/2014</td>
<td>Third mortgage on subject property</td>
<td>Interest only payments, principal repaid at maturity</td>
<td>Construction of a new Office Building</td>
<td>46,260 SF of Office Space $2,178,000</td>
</tr>
<tr>
<td>Stetson Square</td>
<td>$2,850,000</td>
<td>$300,000</td>
<td>2 Years</td>
<td>3/1/2008</td>
<td>2/28/2010</td>
<td>First mortgage and assignment of rents and leases on all property acquired</td>
<td>Interest only payments, principal repaid at maturity</td>
<td>Construction of new townhomes and condominiums</td>
<td>12 Market Rate Condos</td>
</tr>
<tr>
<td>Short Vine Land Banking</td>
<td>$7,620,000</td>
<td>$6,075,000</td>
<td>10 Years</td>
<td>7/1/2008</td>
<td>6/30/2018</td>
<td>First mortgage and assignment of rents and leases on all property acquired</td>
<td>Interest only for first seven years, then principal and interest payments based on 20 year amortization; remaining principal balance due at maturity</td>
<td>Site acquisition and land banking for future development projects</td>
<td>N/A</td>
</tr>
<tr>
<td>Hampton Inn</td>
<td>$18,265,000</td>
<td>$14,115,000</td>
<td>10 Years</td>
<td>4/1/2009</td>
<td>3/31/2019</td>
<td>First mortgage and assignment of rents and leases on Hotel</td>
<td>Interest only payments, principal repayment will occur from the proceeds of sales</td>
<td>Construction of a hotel</td>
<td>132 Hotel Rooms $1,128,000</td>
</tr>
<tr>
<td>Vine Street Parking Garage</td>
<td>$6,200,000</td>
<td>$6,200,000</td>
<td>15 Years</td>
<td>4/1/2009</td>
<td>3/31/2019</td>
<td>Installment sale agreement obligating TIF and Garage revenues for debt service</td>
<td>Interest only for 3 years, principal and interest payments for the remaining 12 years</td>
<td>Construction of a bi-level public parking garage</td>
<td>219 Parking Spaces $153,300</td>
</tr>
<tr>
<td>Tri-Health</td>
<td>$28,753,000</td>
<td>$8,911,000</td>
<td>7 Years</td>
<td>12/1/2010</td>
<td>12/31/2017</td>
<td>Guarantee from the borrower</td>
<td>Interest only payments, principal repaid at maturity</td>
<td>Construction of a medical office building</td>
<td>65,000 SF of Office Space</td>
</tr>
<tr>
<td>Total</td>
<td>$113,238,000</td>
<td>$49,401,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Uptown Cincinnati Development Fund Financial Forecast 2010
Hamilton County Auditor 2011

51
The capital raised through The Fund was used to finance nine different projects, ranging from $300,000 to $13,000,000, all of which took place in the low income communities located in uptown Cincinnati (see Table 3). These projects would not have been financially feasible with traditional lending terms and rates, and therefore required the NMTC financing. The project interest rates ranged from 3.6%-5.01% and the total cost of capital for all projects was 2.75%. The average LTV ratio of all the projects was 93.3% and project DCRs ranged from 1.8-2.2 due to a seven year period of interest only payments. In addition, this particular financing structure allowed for more flexible borrower credit standards, nontraditional forms of collateral, and longer than standard amortization periods. All of these benefits contributed to improving the financial performance of the projects so that debt could be adequately serviced without additional financial strain.

5.4 Why it was Structured in this Manner

The principal reason for the specific structure of The Fund was the presence of the Uptown Consortium members who were willing to provide loan capital at reduced interest rates. As a result, the leveraged NMTC structure was employed to attract additional private investment in order to magnify the impact of this investment in the uptown Cincinnati area. Furthermore, this “top-down” approach allowed one investment vehicle to be used to finance nine different projects, thus greatly reducing the administrative costs for each project. There is a significant amount of legal and accounting expertise that is required to ensure compliance with NMTC regulation, especially when using a leveraged model. Therefore, by using one vehicle for multiple projects, these costs were greatly reduced on a per project basis, allowing
more capital to go into the projects, thus fulfilling the intended purposes of the NMTC program.
Chapter 6

Cincinnati New Markets Fund

The Cincinnati New Markets Fund, LLC (“The Fund”) is a private organization and a Community Development Entity that is managed by the Cincinnati Center City Development Corporation (3CDC). The Fund was established in 2004 with a $50 million NMTC allocation award which was utilized to attract investment capital from 13 local corporations (“The Equity Investors”) in order to create financing programs aimed at redeveloping the urban core of Cincinnati. The Fund’s target area was the three Cincinnati census tracts that make up the neighborhoods of Downtown and Over-the-Rhine. These areas were unable to attract private investment or traditional financing due to high levels of economic distress. The Fund partnered with City Officials, community organizations, and community residents to achieve its objectives of providing capital for land banking, predevelopment, and development loans.

The Fund employed a “top-down” approach, meaning that the investment capital was raised before the specific projects were identified. Projects were then given development loans based on the underwriting analysis that was conducted by 3CDC and approval by The Fund’s

---

17 All material in this section is from the following sources:
Cincinnati Center City Development Corporation 2011.
Cincinnati New Markets Fund NMTC Application 2010.
Cincinnati New Markets Fund Loan Portfolio 2011.
Hamilton County Auditor 2011.

18 These were census tracts 7, 9, and 10 in Hamilton County, Ohio. They have a poverty rate of 29.7%, 61.6%, and 47.7%, respectively, and the median household income of these three census tracts is 43.3%, 17.0%, and 35.5%, respectively, as a percentage of AMI. Under federal regulations, each of these constitutes an economically distressed census tract.
board of directors. The objective of The Fund was to catalyze a broad redevelopment effort and therefore the focus of this investment vehicle was on multiple, smaller projects, rather than a few larger projects. The financing products offered through this structure were a mixed-use senior loan product for projects that could not obtain a traditional loan and a subordinated mezzanine loan product to enhance a project’s capital. The Fund provided loans and equity investments for commercial, residential and community real estate redevelopment projects located in its target area in order to have a strategic impact on revitalization and the strengthening of the urban core of the City of Cincinnati.

6.1 Non-Leveraged Structure

The Fund applied a non-leveraged structure when raising capital for the investment vehicle. This means that The Equity Investors provided the full QEI of $50 million for the investment fund and in return received 39%, or $19.5 million of tax credits, spread over seven years. Therefore, unlike other NMTC structures, there was no leveraged lender or separate investment vehicle apart from The Fund. The Equity Investors included two banks, two media companies, three consumer products companies, two energy companies, and one insurance company. These corporations had significant operations located within the urban areas of Cincinnati and therefore were in a position to benefit from redevelopment activity, thus their motivation to provide investment capital.\(^\text{19}\) That capital was then pooled to create a loan fund used to provide capital for redevelopment projects.

\(^\text{19}\) These local corporations were primarily concerned with redeveloping the urban core of the city to enhance their ability to attract talented employees to the area. Therefore, they were willing to provide flexible capital and accept lower than market-rate investment returns.
NMTC legislation requires that no principal can be repaid to investors or lenders during the seven year compliance period of the program and any principal that is repaid must be reinvested by the CDE within twelve months. Whereas other NMTC deals are structured to prevent the repayment of principal because they do not want to deal with reinvesting the capital, The Fund was structured as a revolving loan fund to take advantage of this regulation. Although the loans were structured to have interest only payments with principal due at maturity, the projects were permitted to repay principal throughout the life of the loan when appropriate. As principal was repaid by the projects, the capital was repackaged into new loans to finance additional development, enabling The Fund to maximize the impact made by the original NMTC investment (see Figure 5).

Although the revolving loan feature of The Fund enhanced its ability to finance development projects, it created significant administrative challenges in order to comply with the program regulations. Complex and thorough accounting and record keeping was required to ensure that all principal payments were reinvested within the twelve month timeframe. These repayments came from multiple outstanding loans, and could not be reinvested until a new project was ready for financing. Therefore, continual focus had to be maintained to ensure that principal repayments were accounted for and able to be reinvested in a timely manner.

---

20 Most of the projects that received loans from The Fund were condominium projects. When construction on these units was completed, they were sold to homeowners and principal repayments were made from the sale proceeds.
### 6.2 Investment Terms and Achievements

The Equity Investors were satisfied with the tax credits as return for their investment which allowed The Fund to offer its loan products at extremely low interest rates. Almost every
one of the 18 projects received an interest rate of 2% (See Table 4), which was the minimum rate necessary to cover the administrative costs of managing the fund. Furthermore, The Fund received an agreement from the City of Cincinnati to provide TIF funds as collateral for the loans. This was necessary because the targeted projects were very costly and had limited income potential. Even with the NMTC financing, the risk of loan default was still very high. At the end of the NMTC compliance period, TIF funds will be used to account for the difference between the investment principal ($50 million) and the total principal repaid by all projects so that the investors will receive their full investment principal back, plus the returns they received from the tax credits, which will amount to an annual Internal Rate of Return of 5.52%.

As of January 31, The Fund has made a total of 27 loans to 18 different projects with no loan being greater than $13.2 million, and the average loan amount per project being $3.5 million (See Table 4). Since this investment structure is a revolving loan fund, the principal repayments that are made from the borrowers are loaned back out for additional development projects. Therefore, despite a starting investment of $50 million, the fund has made loans in the amount of $66.9 million thus far (see Table 4). The biggest impact of The Fund for financing community development is its ability to catalyze private investment in the target areas. Whereas The Fund provided $66.9 million of loans, these loans financed $126 million of projects (see Table 4). Not only was the original $50 million used to generate additional loan capital, but these loans were strategically made to finance only a portion of the projects, so that additional capital would have to be raised. The resulting impact is that, to date, every one dollar of tax credit has led to $6.50 of community investment. This ratio will continue to go up
### Table 4: CNMF Project Data

<table>
<thead>
<tr>
<th>Project</th>
<th>Total Project Cost</th>
<th>NFFC Loan Amount</th>
<th>Principal Repaid</th>
<th>Loan Term</th>
<th>Interest Rate</th>
<th>Loan Start Date</th>
<th>Loan Due Date</th>
<th>Collateral</th>
<th>Loan Payments</th>
<th>Property Value before Investment</th>
<th>Project Description</th>
<th>Project Achievements</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fountain Square</td>
<td>$42,650,000</td>
<td>$13,138,000</td>
<td>$205,000</td>
<td>10 years</td>
<td>0.50%</td>
<td>10/27/2016</td>
<td>12/31/2016</td>
<td>Shared first priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>Redevelopment of a Public Square with an Underground Parking Garage</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Gateway</td>
<td>$3,950,000</td>
<td>$670,000</td>
<td>$0</td>
<td>7 years</td>
<td>2.00%</td>
<td>6/9/2008</td>
<td>6/9/2013</td>
<td>Shared first priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>Creation of new commercial space</td>
<td>4,832 SF of Commercial Space</td>
<td>$600,000</td>
<td></td>
</tr>
<tr>
<td>Duvaneck Flats</td>
<td>$3,008,000</td>
<td>$4,026,000</td>
<td>$1,693,553</td>
<td>2 years</td>
<td>2.00%</td>
<td>6/28/2006</td>
<td>6/28/2013</td>
<td>Shared first priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>Creation of new commercial space</td>
<td>7,035 SF of Commercial Space</td>
<td>$796,000</td>
<td></td>
</tr>
<tr>
<td>Bremen Lofts</td>
<td>$15,773,000</td>
<td>$4,867,000</td>
<td>$3,075,530</td>
<td>7 years</td>
<td>2.00%</td>
<td>8/30/2008</td>
<td>8/30/2013</td>
<td>Shared first priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>Creation of Market Rate Condos and Affordable Housing Units</td>
<td>21 New Condos</td>
<td>$429,000</td>
<td></td>
</tr>
<tr>
<td>Duncanson Lofts</td>
<td>$7,414,000</td>
<td>$5,103,000</td>
<td>$2,590,865</td>
<td>7 years</td>
<td>2.00%</td>
<td>9/26/2008</td>
<td>9/26/2013</td>
<td>Shared first priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>Creation of new commercial space</td>
<td>9,048 SF of Commercial Space</td>
<td>$1,294,000</td>
<td></td>
</tr>
<tr>
<td>12th &amp; Vine</td>
<td>$800,000</td>
<td>$800,000</td>
<td>$0</td>
<td>7 years</td>
<td>2.00%</td>
<td>5/21/2007</td>
<td>5/21/2014</td>
<td>First priority mortgage, assignment of rents/leases</td>
<td>Interest only payments, principal due on maturity</td>
<td>Surface Parking Lot</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Lackman Bar</td>
<td>$2,835,000</td>
<td>$2,365,000</td>
<td>$1,329,499</td>
<td>7 years</td>
<td>2.00%</td>
<td>7/24/2008</td>
<td>7/24/2015</td>
<td>First priority mortgage, assignment of rents/leases</td>
<td>Interest only payments, principal due on maturity</td>
<td>Creation of new housing</td>
<td>8 New Condos</td>
<td>$247,000</td>
<td></td>
</tr>
<tr>
<td>Righteous Room</td>
<td>$2,133,000</td>
<td>$1,963,000</td>
<td>$45,154</td>
<td>7 years</td>
<td>2.00%</td>
<td>1/20/2009</td>
<td>1/20/2016</td>
<td>$100,000 cash collateral, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>New housing and commercial</td>
<td>3 New Condos</td>
<td>$599,000</td>
<td></td>
</tr>
<tr>
<td>Vine Street - Streetscape</td>
<td>$2,175,000</td>
<td>$2,175,000</td>
<td>$1,159,990</td>
<td>4 years</td>
<td>2.00%</td>
<td>7/2/2009</td>
<td>6/30/2013</td>
<td>Unconditional guaranty from borrower</td>
<td>Annual principal payments of $54,750 due 4/15, 2011, 2012, and 2013</td>
<td>Streetscape Improvements along Vine Street</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Westfallen Lofts</td>
<td>$3,382,000</td>
<td>$3,022,000</td>
<td>$1,201,326</td>
<td>7 years</td>
<td>2.00%</td>
<td>5/17/2010</td>
<td>11/4/2016</td>
<td>First priority mortgage, assignment of rents/leases, guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>New housing</td>
<td>8 New Condos</td>
<td>$77,000</td>
<td></td>
</tr>
<tr>
<td>Lackman Bar</td>
<td>$588,000</td>
<td>$425,000</td>
<td>$27,243</td>
<td>7 years</td>
<td>2.00%</td>
<td>6/10/2010</td>
<td>6/10/2017</td>
<td>First priority mortgage, assignment of rents/leases, guaranty from borrower</td>
<td>Annual principal payments of $22,000 beginning 12/15/2012 plus 6% of gross sales over $200,000</td>
<td>New commercial</td>
<td>Commercial Space</td>
<td>$26,000</td>
<td></td>
</tr>
<tr>
<td>Color Building - Redevelopment</td>
<td>$1,500,000</td>
<td>$1,500,000</td>
<td>$0</td>
<td>2 years</td>
<td>2.00%</td>
<td>7/29/2010</td>
<td>7/29/2012</td>
<td>First priority mortgage, assignment of rents/leases</td>
<td>Interest only payments, principal due on maturity</td>
<td>Acquisition and Development</td>
<td>N/A</td>
<td>$121,000</td>
<td></td>
</tr>
<tr>
<td>Nassau - Redevelopment</td>
<td>$385,000</td>
<td>$385,000</td>
<td>$0</td>
<td>2 years</td>
<td>2.00%</td>
<td>7/29/2010</td>
<td>7/29/2012</td>
<td>First priority mortgage, assignment of rents/leases</td>
<td>Interest only payments, principal due on maturity</td>
<td>Acquisition and Development</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Parvis Lofts</td>
<td>$10,558,000</td>
<td>$3,510,000</td>
<td>$91,275</td>
<td>2 years</td>
<td>2.00%</td>
<td>8/20/2010</td>
<td>8/1/2012</td>
<td>First priority mortgage, assignment of rents and leases, unconditional guaranty from borrower</td>
<td>Interest only payments, principal due on maturity</td>
<td>New housing and commercial</td>
<td>32 Market Rate Condos</td>
<td>$282,000</td>
<td></td>
</tr>
<tr>
<td>1421 Race - Redevelopment</td>
<td>$315,000</td>
<td>$315,000</td>
<td>$0</td>
<td>2 years</td>
<td>2.00%</td>
<td>10/15/2010</td>
<td>10/14/2012</td>
<td>First priority mortgage, assignment of rents/leases</td>
<td>Interest only payments, principal due on maturity</td>
<td>Acquisition and Development</td>
<td>N/A</td>
<td>$141,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$126,085,000</td>
<td>$66,896,000</td>
<td>$20,860,863</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Sources:** Cincinnati New Markets Fund Loan Portfolio 2011, Hamilton County Auditor
as more principal repayments are made and The Fund makes additional development project loans.

6.3 Benefits of the Financing Structure

The biggest advantage of this structure was that there was no debt instrument necessary to raise investment capital, thus enabling The Fund to collect only patient capital. The equity investors will receive a reasonable return, but they provided capital because of the benefits they would receive from the redevelopment of Cincinnati’s urban core rather than to maximize their investment return. Thus, the investors were willing to give The Fund a long timeframe (approximately 10 years) before requiring principal repayment, which facilitated the revolving loan feature. This structure also allowed The Fund to minimize overhead costs when structuring the investment by using a straightforward interpretation of the NMTC regulations which did not require complex legal handlings and elaborate accounting procedures to ensure program compliance.

The largest beneficiaries of this structure type were the projects that received development loans from The Fund. All of the projects received loan terms that could not be achieved by any traditional lending source, yet were necessary because the projects were not capable of financially supporting traditional loan obligations. The projects that were financed received a 2% interest rate, interest only payments for the life of the loan, 100% LTV, DCR of less than 1:1, and non-recourse provisions. In addition to these terms, the projects had TIF revenues to serve as collateral for any shortcomings in principal repayments. These favorable
loan terms enabled impactful redevelopment of Cincinnati’s urban core through projects that, but for the NMTC structure, would not have been financially viable.

The structure used by The Fund enabled it to achieve a broad impact on its target investment area. The strategy of smaller, short term loans facilitated The Fund to make loans to many projects, widely distributing the capital while keeping the administrative, legal, and accounting costs for each project at a minimum. Furthermore, the revolving loan feature of the fund allowed it to make additional loans, increasing the number of projects that could be financed. The Fund achieved a 1.9:1 ratio of total project investment to loan amount; a 3.4:1 ratio of loan amount to tax credits, and a 6.5:1 ratio of total project investment to tax credits. The result of this financing structure was the renovation of 41 vacant buildings into 218 housing units and over 82,000 square feet of commercial space as well as the creation of five parking facilities and the redevelopment of a public square. The new housing and commercial space alone has increased in property value by over 330%, from $7.8 million to $25.9 million since the inception of The Fund.

6.4 Why it was Structured in this Manner

The Fund was created using a non-leveraged structure primarily because of the existence of private investors who were willing to provide the full $50 million in equity\(^\text{21}\). Therefore, a leveraged structure was not required because The Fund did not need to supplement equity with debt financing. Using a non-leveraged structure allowed The Fund to

\(^{21}\) The group of private investors was actually willing to commit up to $90 million to create The Fund, but only $50 million of NMTC allocation was awarded. The additional commitment helped The Fund receive additional NMTC allocation awards in 2008 and 2010.
limit the complexity of the financing structure, which minimized its legal and accounting overhead costs while reducing the risk of recapture caused by non-compliance with NMTC regulations. Furthermore, the use of a non-leveraged structure, coupled with investors who were satisfied with the tax credits as their sole investment return, enabled The Fund to offer very inexpensive capital to development projects that did not have strong financials and would not have been feasible if not for the use of this structure.

In addition to its non-leveraged structure, The Fund was structured as a revolving loan fund in order to spread the investment capital across many projects while maintaining compliance requirements of the NMTC program. The nature of the projects that were financed allowed The Fund to use the same original capital to finance multiple projects over the course of the NMTC compliance period. The use of this feature was put in place to enhance the impact of the original investment and achieve the level of community redevelopment that was being targeted.
Chapter 7

Research Findings

The four NMTC investment funds that have been used in Cincinnati are very instructive for understanding how the program has been used and what different approaches can be taken for raising investment capital for community development. Each of the four case studies illustrates unique characteristics about the program, revealing its flexibility and the various ways in which it can be applied. Although the Cincinnati case studies do not provide a comprehensive view of all the ways in which an NMTC investment fund can be structured, they do provide an understanding about how the program works in practice, details about the different components involved in the investment process, and insights into the effectiveness of the program as a whole.

7.1 Different Types of Investment Structures

The two types of investment structures, based on the NMTC regulations, are a leveraged and non-leveraged structure. Within the context of the NMTC financing structure this refers specifically to whether or not the structure incorporates a single investment source that provides capital in exchange for tax credits (non-leveraged) or multiple investment sources that each provide capital, some of which to receive tax benefits and some to receive economic benefits (leveraged). The leveraged structure is most common because it allows for the use of a variety of financing sources, each source with different characteristics, allowing the investment fund to maximize the amount of subsidy that is generated for project financing. However, the
non-leveraged structure has distinct advantages as well, as it has significantly less complexity, and thus reduced administrative costs. Furthermore, since there is only one source of capital, it produces much more flexibility in financing terms and rates as well as project number and type.

The NTMC program is a shallow subsidy, meaning that tax credits at most can comprise only 39%, not 100% of total project costs, and therefore a degree of creating leverage is inherent in the program. However, in the general sense of the term, each of the structure types have proven to be able to leverage the tax credits to attract additional investment capital outside of the NMTC structure. This is evidenced by the fact that the four investment funds used a total NMTC allocation of $132 million (or $51.5 million of tax credits) to invest in projects with total cost of $324 million. These investment funds have been able to leverage NMTCs beyond what is mandated by the legislation, so that tax credits comprised only 15.8% of all project costs or $6.50 of investment for every $1 of tax credit.

The four different investment funds have each been created using one of two approaches; either a “top-down” approach or a “bottom-up” approach. The “top-down” approach - used by the UCDF and CNMF - involves the arrangement of financing based on a strategic development plan rather than specific projects. Investors must be willing to commit capital to fund an overall development strategy as opposed to any one specific project. Investors will have input into which projects receive financing, but they are limited by the timeframe regulations of the NMTC program to find projects that are worthy of financing, or risk losing the tax credits. This creates a significant burden on the management and administration of the CDEs, as well as the relationship between CDE and investor, to ensure
that compliance requirements are met. The benefits of this approach are the ability to spread
the NMTC allocation to multiple projects that all adhere to a single strategy, thus achieving
more focused and targeted results. Furthermore, the legal and administrative costs are able to
be spread across multiple projects, reducing the cost to each project, allowing smaller projects
to be financed.

The “bottom-up” approach used by CCDF I and CCDF II involves the creation of an
investment fund and the arranging of financial partners for the purpose of financing a specific
project. This allows CDEs to effectively split their NMTC allocations up to be used for various,
unrelated projects, which makes program compliance significantly easier. However, since there
is only one project being funded, there are high legal and administrative costs that all must be
absorbed into the project cost. Therefore, the “bottom-up” approach only works for projects
that are large enough and have enough scale so that these NMTC related costs are worthwhile
and there is still have enough tax credit equity remaining to benefit the project’s financials. This
approach is best used for single, large projects that bring significant economic benefits in order
to justify the time, cost, and portion of a CDEs total NMTC allocation.

A “bottom-up” investment fund is directly connected to a specific project, and therefore
the structure type is a singular investment fund. However, when using this approach, the
investment fund can be very creative as to what type of capital it incorporates into the NMTC
structure. For every dollar of financing that is incorporated into the structure, it generates an
additional $0.39 of tax credit, thus increasing the subsidy for the project. Therefore, as long as
the NMTC allocation is available from CDEs, it directly benefits the project to incorporate as
much capital into the NMTC structure as possible. Therefore, in addition to traditional debt being used to generate tax credits, grants, public funds, other tax credits (such as Historic Tax Credits), and additional equity can also be used to increase the amount of tax credits generated for a project.

The “top-down” approach is much more restrictive in what types of financing it can incorporate into the NMTC structure because it must all be identified and committed up front, yet this approach allows for greater flexibility in how it is implemented. As previously mentioned, this approach has reduced administrative costs, so it can finance a wider variety of project types and sizes. In addition, this approach is able to provide products such as mezzanine financing, gap financing, or catalytic\(^2\) financing, each of which facilitates additional investment. Of the four case studies, the two “top-down” funds accounted for only 48.5% of total project costs, whereas the two “bottom-up” funds financed 95% of total project costs. Finally, this type of fund is able to incorporate creative features to enhance its effectiveness, such as CNMF’s partnership with the City of Cincinnati and their TIF resources, UCDF’s partnership with the Uptown Consortium, and CNMF’s revolving loan feature.

### 7.2 Effectiveness of the NMTC program for Community Development Financing

The case study of NMTC use for community development financing in Cincinnati reveals that the program is an incredible tool for generating investment and financing for low-income communities. As previously mentioned, a total investment of $324 million has been made in

---

\(^{22}\) Catalytic financing is providing the first, and often times riskiest investment, to projects or areas that will see increased investment activity after the initial investment is made.
among the four case studies as a result of the NMTC program. The reason it is able to attract so much investment capital is because of the considerable subsidy that is being offered in the way of tax credits. Of the total investment that was made in projects associated with NMTC financing, 15.8% of all project costs were subsidized through the tax credit program, significantly more so for some of the larger projects. This tax credit subsidy allows for projects that have high costs or limited return potential to become financially feasible. The majority of the 28 projects that were funded through these four investment funds would not have been able to take place if not for the $51.5 million of tax credit subsidy that was deployed.

The critical entities involved in the four investment funds were the CDEs, tax credit investors, and lenders. It is noteworthy that all of these entities were private organizations, motivated be either profit-maximization or a mission of community development. This illustrates the point that the NMTC program can be entirely facilitated by the private sector, with the public sector’s primary role as administrator of the program. This allows community development activity to utilize the mechanisms of the private sector to select projects of the highest economic quality that are likely to be financially sustainable. Each of the 28 projects satisfied strict underwriting standards and financing criteria, ensuring that only projects with strong financials and the ability to provide economic returns receive funding, which increases the impact of the public resources and decreases the likelihood that the project will require additional subsidy in the future. Furthermore, two different projects involved the redevelopment of public space, revealing the program’s ability to engage the private sector in not only traditional, income-generating projects, but also public works type of projects.
In addition to engaging the strengths of the private sector for development financing, the NMTC program also is able to incorporate local public involvement, facilitating public-private partnership. The most significant example of this in the Cincinnati case studies was the use of TIF to further subsidize projects that aligned with public objectives. Each of the four investment funds used TIF financing in its investments, whether it was incorporated into the NMTC financing structure or into an agreement to provide enhanced collateral for NMTC loans. In addition to TIF, the two projects involving redevelopment of public space include the City of Cincinnati in development and lease contract agreements, proving that the public can provide more than just financial resources to a development partnership. This type of partnership, facilitated by the NMTC program, is able to take advantage of the strengths of both the public and private sector, achieving a much greater impact on community development objectives.

The context of the NMTC investments is also illustrative as to the impacts of the program for community development. The majority of the investments that were studied were made between 2008-2010, which coincides with the collapse of the real estate market and the worst economic recession in seventy years. The general response to these economic conditions was a conservative investment approach and very tight credit and high lending standards from financial institutions. Despite this environment, the NMTC program facilitated continual investment in the urban communities of Cincinnati. At a time when all other investment decreased, community development investment actually increased, due to the investment opportunities presented through the NMTC program.
The real estate bias that is common in the NMTC program was evident in the four investment funds that were studied. All but one of the 28 projects that received financing were direct real estate projects, and none of the NMTC loans that were made went to finance the creation or expansion of a non-real estate business. This is largely due to the aversion of non-real estate businesses because of the increased compliance risks that would be involved. The bias toward large, sophisticated CDEs was also clear, as both of the Cincinnati CDEs have large capacity and a long track record of significant community development financing. In addition, two of the investment funds included national CDEs that are larger and more sophisticated than the local CDEs.

These biases are most likely rooted in the program regulations and administration, which has steered investment in this direction. Despite these biases, and perhaps because of them, the NMTC financing was able to be used in large, difficult, and complex projects that may have been unmanageable for smaller, less experienced CDEs. The projects that received funding created jobs, both temporary and permanent, for the low-income communities, and provided facilities such as office and commercial space for business expansion. It is clear that four cases have achieved the intended purposes of the NMTC program, and thus cannot be accused of any type of program abuse or misuse.

In addition, the program seems to have barriers to smaller development agencies, smaller projects, and lower-profile communities. The investment capital generated by NMTCs was not evenly distributed across low-income communities, thus enabling it to have significant impact in certain areas, and negligible impact in other areas. Costs and complexities precluded
financing to be available for smaller projects and smaller agencies. Changes to the NMTC legislation would be required to remove these barriers and increase the access of smaller communities, projects, and development organizations to investment capital through NMTC financing. Until changes take place, smaller communities, agencies, and projects can gain access to NMTC financing through strategic partnerships and coordinated development plans.

7.3 Conclusion

The New Markets Tax Credit program has proven to be an exceptionally successful tool for community development financing. It effectively uses tax credits to make community development financing profitable for private investors, while attracting desperately needed investment capital to low-income communities. A great deal of discretion is given to local development organizations that have the knowledge and expertise to strategically deploy the tax credits, maximizing the outcomes. The program also permits the CDEs to have flexibility in determining how to structure the investment vehicles and what projects to finance, broadening the impacts of the tax credits and allowing for a much greater leveraging effect. The four investment funds that have been used in Cincinnati clearly demonstrate the program’s significance and value to the field of urban planning and community development financing.
Reference List


Internal Revenue Service (IRS). 2010. *New Markets Tax Credit (May)*.


Appendix A

Glossary of Terms

New Markets Tax Credit Terms

Community Development Entity (CDE) – Any domestic corporation or partnership where: 1) the primary mission of the entity is serving or providing investment capital for low-income communities or low-income persons, 2) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity, and 3) the entity is certified by the CDFI Fund as a CDE.

Compliance Period – The tax credit period is 7 years, beginning on the date an investment is initially made. Compliance with all program regulations must take place throughout this seven year period or the investor may face a loss of tax credit benefits.

Low Income Community – Any population census tract where: 1) the poverty rate is at least 20%, or 2) the median family income does not exceed 80% of the greater of the statewide median family income or the metropolitan area median family income.

Qualified Active Low Income Community Business - Any corporation or partnership where: 1) at least 50% of the total gross income is derived from the active conduct of a qualified business within any low-income community, 2) a substantial portion of the use of the tangible property is within any low-income community, and 3) a substantial portion of the services performed by its employees are performed in any low-income community.

Qualified Equity Investment - Any equity investment into a CDE where substantially all of the investment is made into a Qualified Low-Income Community Investment.

Qualified Low Income Community Investment (QLICI) - 1) Any capital or equity investment in, or loans to, any QALICB, 2) the purchase from a CDE of any loan made by such entity that is a QLICI, 3) financial counseling and other services to businesses located in, and the residents of, low-income communities, or 4) any equity investment in, or loan to, any CDE.

Recapture – If, at any time during the 7 year compliance period, there is an event that does not comply with program regulations, then the tax credits benefits will be removed, or recaptured, from the investor.

23All NMTC definitions come from the following sources:
NMTC Program Overview and Glossary 2005.
IRS 2010
Development Financing Terms

Amortization – The paying off of debt through regular periodic installments. The length of the amortization period determines the size of each installment payment.

Balloon Payment – When a loan has a maturity that is shorter than the amortization period, not all of the principal will be repaid from the installment payments, and so a lump sum of principal must be repaid to retire the debt at maturity.

Bridge Loan – An Interim loan used to help finance a project until more permanent financing is arranged.

Collateral (or Security) – An asset that can be repossessed and sold by the debt holder in order to apply the sale proceeds to unpaid interest, principal, or collection costs.

Debt – A contract whereby funds are provided by a lender (debt holder) to another party (borrower) who must repay the funds based on specified terms.

Debt Coverage Ratio (DCR) – A measure of a borrower’s capacity to repay debt based on the relationship between debt payments and projected cash flow, or income.

Equity – An owner’s investment in a business or project.

Gap Financing – Providing specific types of capital to a particular group of borrowers or projects that otherwise cannot receive such capital due to market failure.

Interest – The price charged to a borrower for the use of loaned funds.

Junior Loan – See Subordinated Loan.

Leasehold Agreement – The right to hold or use property for a fixed period of time at a given price, without transfer of ownership.

Lien – A claim against a property used to secure a debt, a charge, or the performance of some act.

Loan-to-value Ratio (LTV) – The ratio of the loan principal to the market value of the loan collateral.

All financial definitions come from the following sources:
Armistead 2005
Peca 2009
Seidman 2005
Market-Rate – The risk or return that an investor would most likely receive in the open marketplace.

Mezzanine Debt – A financing vehicle that is between equity and debt, in terms of risk and return, as a piece of a project’s financing structure.

Mortgage Loan – A loan secured by real estate.

Net Operating Income – A before-tax computation of gross revenue less operating expenses and anticipated vacancies. This measure is a key indicator of a project’s financial strength.

Non-Recourse Loan – A loan in which the debt holder does not have any rights to the personal assets of the borrower to satisfy repayment.

Principal – The total amount of money being borrower or lent.

Put – A financial contract granting the holder an option to sell the underlying asset at a predetermined price.

Rate of Return – The increased value of an investment, divided by the original value of the investment. This indicates the percentage increase of the investment.

Recourse Loan – A loan in which the debt holder rights to the personal assets of the borrower to satisfy repayment, if necessary.

Return – The change in the value of an investment over an evaluation period, including any distributions made from the investment during that period.

Revolving Loan – A pool of capital that provides loans for development activity, with loan repayments being recycled to make additional loans over time.

Risk – Degree of uncertainty of the return on an asset.


Senior Loan – A loan with a first security position that is repaid before subordinate loans.

Shallow Subsidy – A governmental subsidy that does not account for the total cost of the project, so that the project must also generate an economic benefit in order to warrant investment.

Subordinated Loan (or Junior Loan) – A loan with a second or lower security position that is repaid after senior loans.
**Tax Incentives** – A reduction of taxes through abatements, credits, and exemptions intended to use the tax code to encourage specific activity that is deemed to benefit the public.

**Tax Increment Financing** – A form of financing in which the increased tax revenues generated in a designated area are set aside to fund specific projects or activities.

**Underwriting** – The process by which a financial institutions applies criteria or standards to evaluate whether a borrower or a project is an acceptable investment risk.