

# Non-Profit *Advisor*

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*As the largest full-service real estate advisory firm exclusively representing tenants/users of space, our Non-Profit Practice Group represents non-profits with hundreds of real estate transactions each year. The revenue, tax and governance issues of non-profit organizations are quite different from those of for-profit companies. We have asked Beth Bergman, of the law firm Bergman & Allderice in Los Angeles, an expert lawyer in non-profit law, to provide guidance on the subject of New Markets Tax Credits to our clients and friends.*

## **New Markets Tax Credits For Equity And Low-Interest Loans For Capital Developments**

*by Beth S. Bergman, Bergman & Allderice, Los Angeles*

### **Community Renewal Tax Relief Act Of 2000**

In 2000 Congress passed the Community Renewal Tax Relief Act which created the New Markets Tax Credits program to encourage investments in low income communities. The New Markets Tax Credit Program permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments in projects or businesses which benefit under-served communities. The program, administered by the Community Development Financial Institutions Fund ("CDFI") of the U.S. Treasury Department, got off to a slow start. The first set of tax credits were not allocated until 2003 and were not utilized until later that year.

### **How The Program Works**

Several times each year the CDFI allocates New Markets Tax Credits ("NMTC") to organizations which qualify as a Community Development Entity ("CDE"). To qualify, a CDE must meet the following three-prong test:

1. It must have as its primary mission providing investment capital for "qualified active low income community businesses" (each, a "QALICB") in low income communities;
2. It must have a governing or advisory board accountable to residents of such communities; and
3. It must be certified by the CDFI as a CDE.

In order to be certified as a CDE, an organization must provide information regarding its primary mission and be able to demonstrate that at least 60% of its activities are dedicated to serving low-income communities or persons. Also, the organization must show that it maintains accountability to residents of low income communities through representation on its board or an advisory committee. The organization may be formed as either a Non-Profit corporation or a for-profit entity. However, if the organization is a Non-Profit corporation, it must form at least one subsidiary for-profit entity, which then receives the certification as a CDE.

There are approximately 1600 organizations to date which have been certified as a CDE. Organizations serving the California community that have been certified as CDEs, include Banc of America, CDE, LLC, Citibank NMTC Fund, LLC, CT/KDF Community Development Partners, LLC, The Clearinghouse CDFI, Genesis LA CDE, LLC, Merrill Lynch Community Development Company and National New Markets Fund, LLC. A complete listing may be seen at [www.cdfifund.gov](http://www.cdfifund.gov).

### **What This Means To Your Non-Profit**

An investor that wants to receive NMTCs makes an investment in the CDE. The CDE in turn must use substantially all of the invested dollars to make what is called a "Qualifying Investment." A Qualifying Investment is one of four (4) enumerated investments; the only type of investment discussed in this article is a low-interest loan or equity investment in a Qualified Active

Low-Income Community Business ("QALICB"), which could be your Non-Profit organization. In order to qualify as a QALICB, your organization must be located in a low income community and it must have a substantial connection to that low income community. In general, a low income community is a census tract with a poverty rate of at least 20% or with a median income that does not exceed 80% of the comparable area median income. If the census tract is not in a metropolitan area, it must have a median income of no more than 80% of the statewide median income. CDFI's website, [www.cdfifundhelp.gov](http://www.cdfifundhelp.gov), includes a map of the United States showing all areas which qualify as low income communities. The CDFI uses several measurements to determine whether a business has a substantial connection to a low income community, such as the percentage of employees with households in the community and the percentage of the tangible property owned by the company in the low income community. In addition, the investor must commit to maintaining its investment in qualified investments for at least seven (7) years.

The investment by a private investor purchasing NMTCs is initially made in the CDE; the CDE is then able to use the investment plus the proceeds from the sale of the NMTCs to make an investment in the QALICB. An investment may be in the form of a loan or an equity investment, or some combination thereof.

The amount of NMTCs an investor receives is thirty-nine percent (39%) of the amount of the investment in the QALICB. In each of the first three years, the investor receives a credit equal to five percent (5%) of the total amount loaned or invested in the stock or equity interest. For the final four years, the value of the credit is six percent (6%) of the total investment annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

As an example, if an investor invests \$100 in a QALICB, it may take as credit against taxes owed a total of \$39 over a 7 year period (and its investment must be used for 7 years). The value to the investor of the NMTCs received for its \$100 investment (and therefore the purchase price paid by the investor to the CDE) in today's marketplace is approximately \$28. This amount varies as interest rates fluctuate.

CDFI has issued regulations covering all aspects of the CDE, the QALICB, and the investor, including how to qualify as a CDE, what constitutes a qualifying investment, how much of the capital contributed by the investor must actually be invested by the CDE in a QALICB at any given time, how to determine whether 60% of a QALICB's activities are serving low income communities, the minimum term of the investment and so on.

## The Bottom Line

The NMTC Program is authorized to allocate to CDEs an aggregate amount of \$18.5 billion of NMTCs through 2008. Since late 2003, the Fund has already made 233 awards totaling \$12.1 billion of NMTCs. *Hence, if your Non-Profit organization serves a low income community, assists businesses in low income communities or develops property in a low income community, and is seeking a loan to fund the business or project, it is to your benefit to contact a CDE serving your project area.* Your organization or the activity your organization is supporting may be able to obtain equity capital or a low interest loan to pursue its mission, whether that means purchasing a new facility, renovating a current facility, or operating or assisting a business serving a low income community.



## About the Author

Beth Bergman, J.D., Harvard Law School, is a member of the California, D.C. and New York State Bar Associations, the American Bar Association, Sections on Affordable Housing and Nonprofit Law and the National Association of Bond Lawyers. She sits on several Boards and has served as associate editor for the ABA Affordable Housing and Community Redevelopment Journal. She has also taught Constitutional Law at Loyola Law School, and Environmental Law at Glendale School of Law. Ms. Bergman has worked in both the private and public sectors, as legal consultant to the Los Angeles Housing Department, where she facilitated real estate loans between the City and

Non-Profit corporations after the 1994 Northridge earthquake, utilizing tax credits, bonds and City subsidies. Today, her practice includes the representation of many affordable housing and community developers and lenders in corporate, real estate and tax-exempt financing matters. tax credits, bonds and City subsidies.

Beth Bergman, Esq., Bergman & Allderdice  
1200 Wilshire Blvd., Ste. 600 | Los Angeles, CA 90017  
(213) 736-5101 | Fax (213) 947-4371 | [bbergman@bergmanassoc.com](mailto:bbergman@bergmanassoc.com)