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Overview of New Markets Tax Credits

Marquita Russel, CEO

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What Are New Markets Tax Credits?

- Created by the Clinton Administration and first implemented by the Bush Administration, the NMTC program is a "shallow" tax credit focused on economic development in low-income communities nationwide
- The NMTC program is administered through the Community Development Financial Institution Fund, an arm of Treasury, and credits awarded through an annual competitive process. Entities that compete must first become certified Community Development Entities (CDEs)
- Award-winning CDEs can invest the NMTC credit into qualifying projects, from business creation/expansion to community facilities to commercial real estate
- An allocation of credit to a project provides an investment tax credit equal to 39 cents on the dollar. Investors earn this credit over 7 years, 5% in each of the first 3 years and 6% in the remaining years
- Credits cannot be funded into projects that are considered "sin" businesses or projects that have greater than 80% of the annual income streaming from residential rental
- In general allocation is typically placed in areas considered to be "highly distressed"

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Community Benefit

- Create additional economic development for the local community:
  - Direct creation of permanent jobs
  - Construction jobs
  - Indirect job creation
  - Increased tax base
  - Blight removal
- Attract and/or retain skilled workforce
- Bring new goods or services to rural and underserved communities
- New Capital investment to rural and underserved communities

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NMTC Leveraged Structure

Also known as alphabet soup...

The CDFI Fund	Community Development Financial Institutions Fund (US Dept. of Treasury)
Awards NMTC allocation to	New Markets Tax Credits
CDEs	Community Development Entities
Investors make QEIs into	Qualified Equity Investments
CDES	
CDEs make QLICIs	Qualified Low Income Community Investments
In QALICBs	Qualified Active Low Income Community Businesses

Allocation of Tax Credits ≠ Cash

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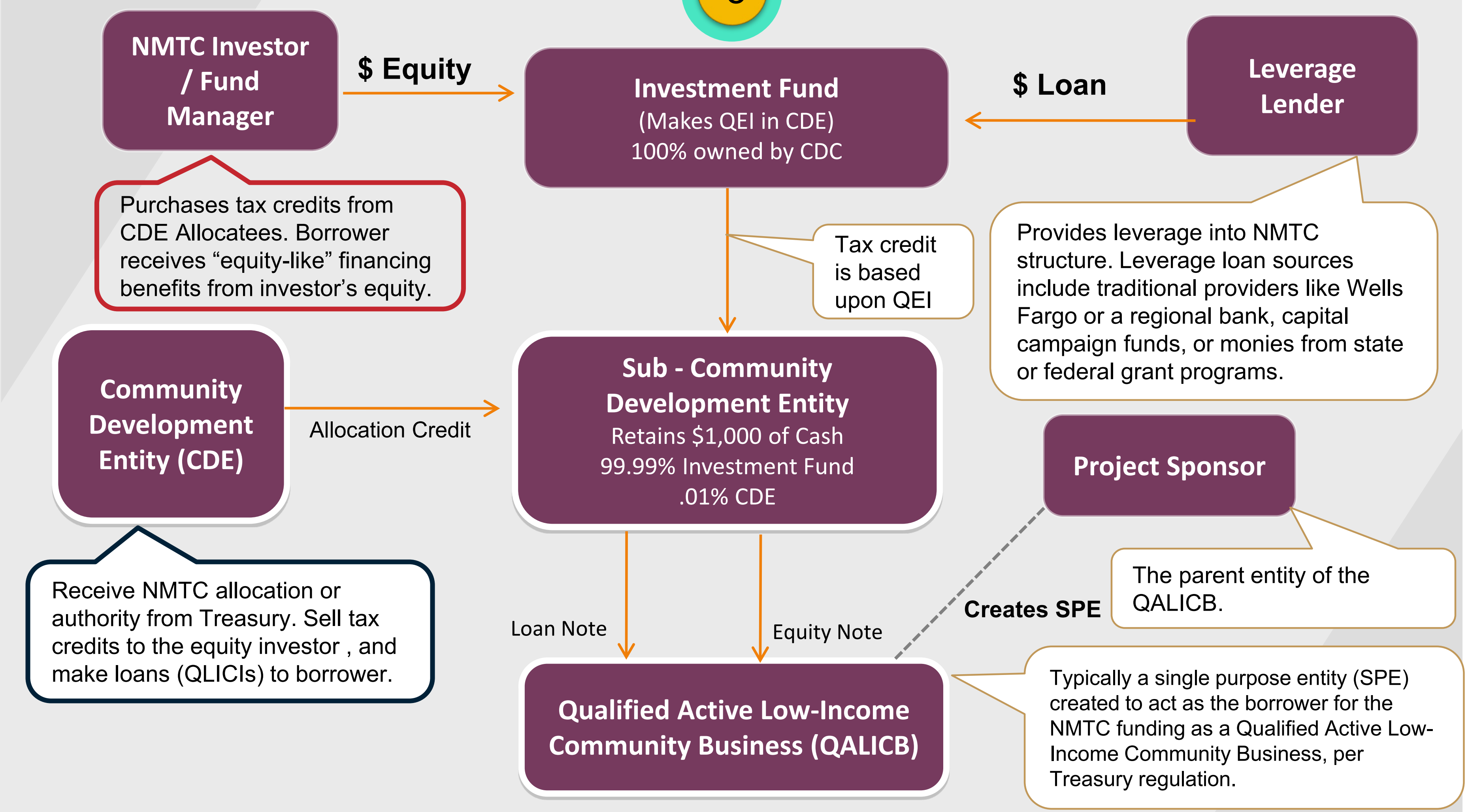
Players in a Leveraged Model Structure



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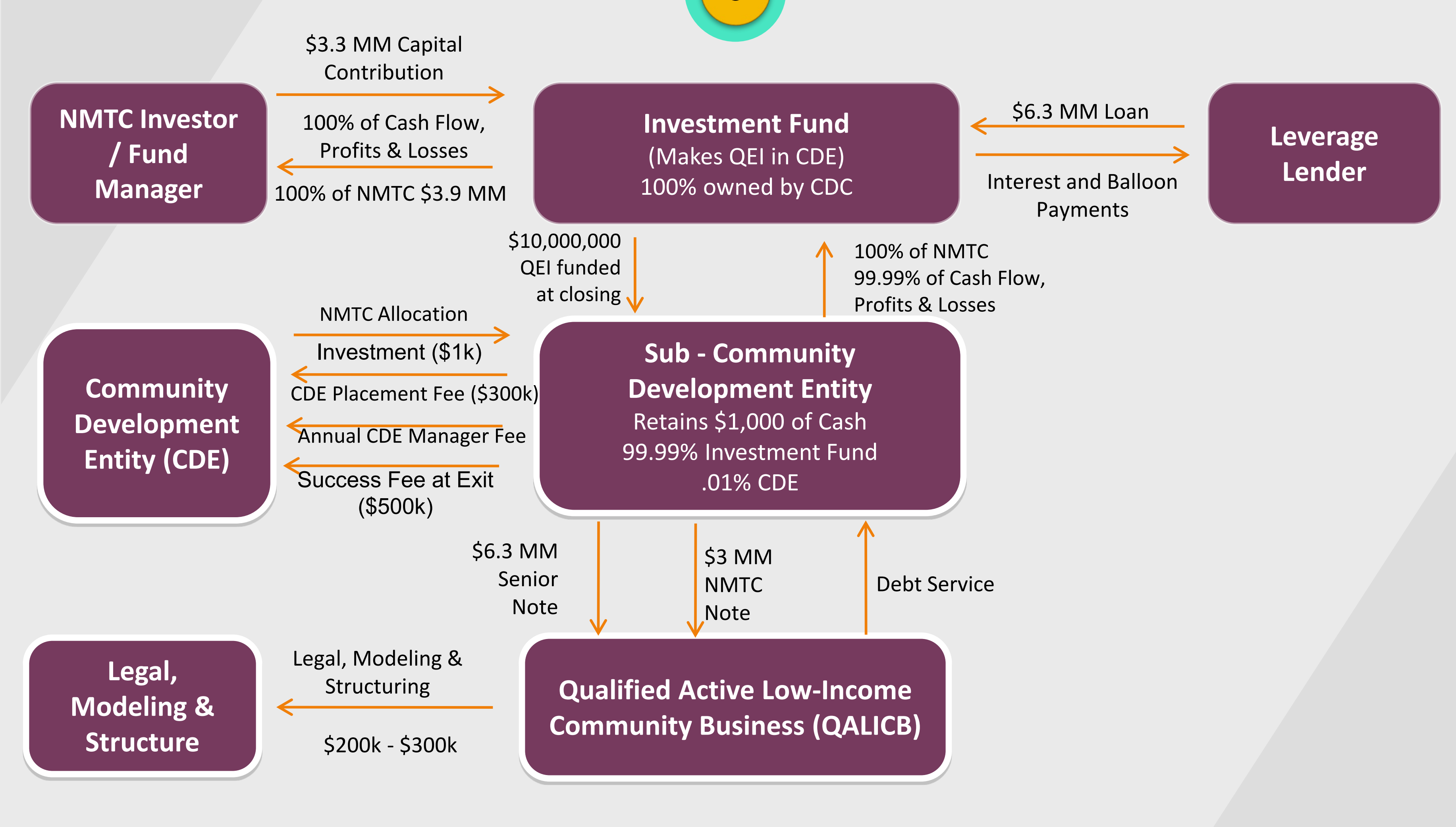
Sample NMTC Leveraged Transaction Diagram



$10 million example

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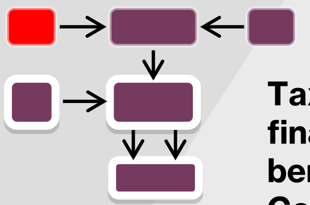
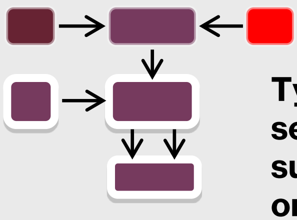
NMTC Participants



Tax credit buyer, typically a financial institution, receives the benefit of the NMTCs and often Community Reinvestment Act (CRA) credit

- Credits purchased from a CDE and realized over a 7-year period
- No economic interest in the Qualified Active Low-Income Community Business (QALICB)
- Investor currently pays about $0.76-$0.88 in the current market for NMTCs
- Is the primary driver in the transaction as their funding is truly the “gap” money.
- Frequently acts as leverage lender
- Utilizes the leveraged funds to increase the amount of credit that will flow through the transaction and stimulate the overall amount of NMTC equity paid in.
- Main concern is to avoid recapture



Typically, new or existing senior lender, subordinated note-holder or equity investor (can be a combination of multiple sources)

- Needs to execute forbearance agreement indicating they will not foreclose for the length of the NMTC investment
- Agrees to lend funds to another QALICB if existing QALICB ceases to exist during the compliance period
- No amortization of loan for duration of the NMTC investment
- Collateral consists of an assignment of LLC member interests versus direct assignment of borrower collateral

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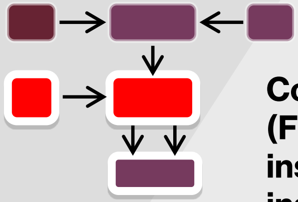
NMTC Participants

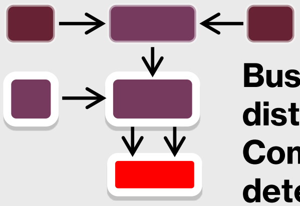


Community Development Entity (Finance New Mexico, LLC, for instance), typically a financial institution, delivers the benefit of the NMTCs to high-impact community projects

- Community Development Entities (CDE’s) have a primary mission of serving or providing investment capital to support low-income communities and are accountable to the residents of that community through a governing or advisory board

- Delegated authority by CDFI to sell NMTCs to fund QEIs

- Responsibility for ongoing monitoring and maintenance of Sub-CDE and underlying QLICIs



Business located in a highly distressed Low-Income Community (federal determination, made by census tract)

- Basic Compliance Requirements
  - 50% of gross income is derived in a Low-Income Community
  - 40% of the tangible property is located in a Low-Income Community
  - 40% of the services are performed by the employees in a Low-Income Community

- Ineligible activities
  - Residential rental property (80% or more of income from residential dwelling units)
  - Racetracks
  - Golf courses
  - Gambling facilities
  - Liquor Stores
  - Certain farming businesses
  - Massage businesses

NMTC Program Benefits

What is the Economic benefit to borrower/QALICB?

- Capital to fund projects, business expansion or debt refinancing
- Tax credits are monetized to bring additional capital to the capital structure
- Low cost of capital
- Flexible loan terms including longer amortization and higher LTV ratios
- **Debt Conversion**
  - At the end of the 7-year compliance period a component of the NMTC benefit may be converted to equity or carried as debt by an affiliate of the borrower or the borrower itself, depending on the circumstances of the transaction.

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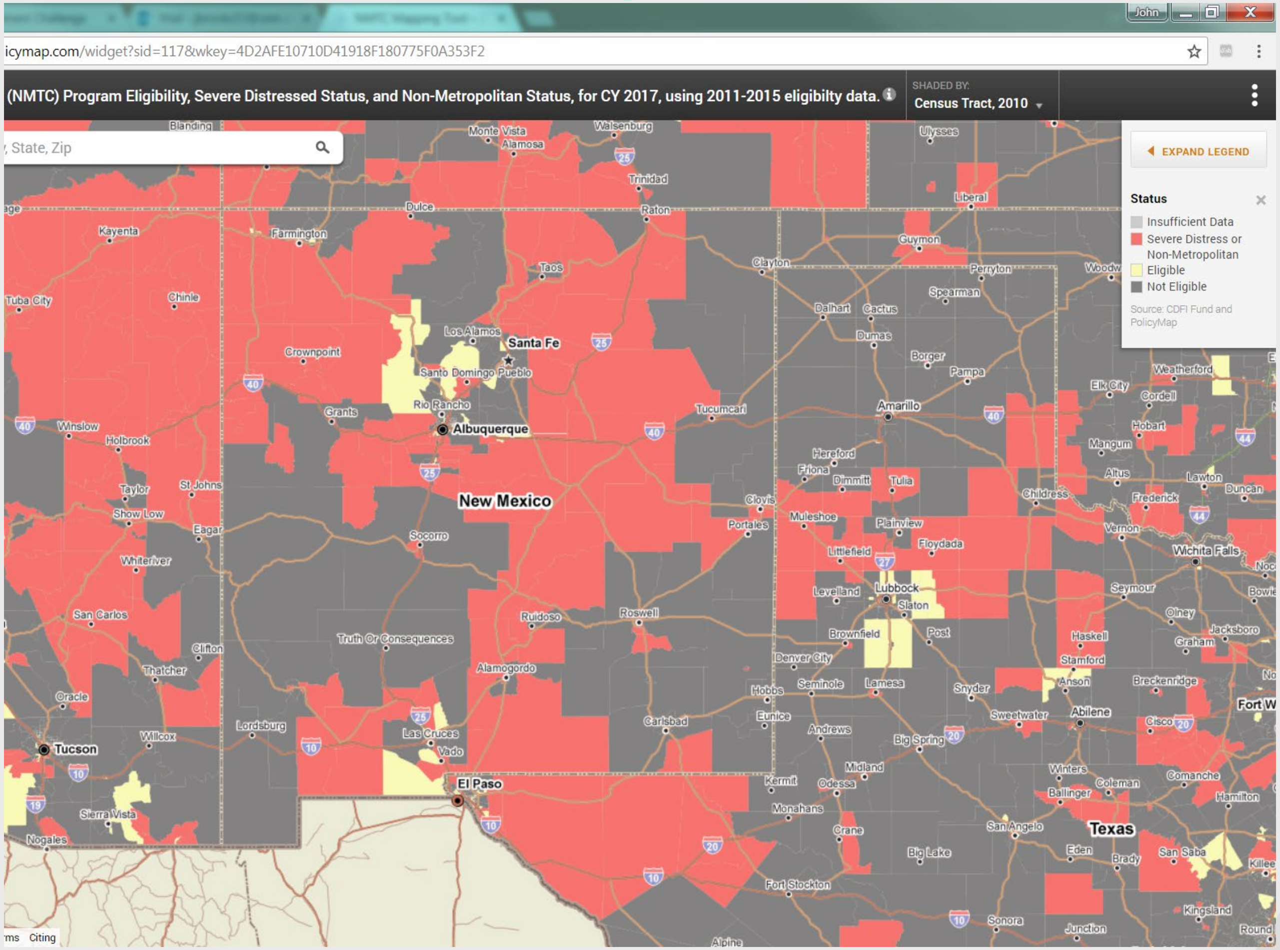
Community Eligibility



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What makes a good QALICB candidate?

- Located in a “highly distressed” census tract – any one of the following:
  - Poverty > 30%
  - Median Income < 60% of statewide
  - Unemployment > 1.5 times national average
  - Non-metropolitan county
  - Two of any secondary criteria
- Community impact
  - Tangible community benefit – measured by quality job creation, providing unmet goods & services to low income communities (grocery stores), environmentally sustainable construction, etc.
  - Part of an existing plan for economic revitalization
  - “But for” test – NMTC fills a real funding gap that would otherwise not happen
- Ready to go
  - Other sources of funding are committed
  - Approvals all in place

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Economic Impact Policies

- Finance New Mexico has targeted the following goals:
  - Filling Infrastructure Gaps in Rural and underserve areas of New Mexico
  - Wealth Creation and Capital Investment
  - Increased Wages through Job Creation
  - Community Good & Service
  - Geographic Diversity

- Economic Impact Policies is to design and implement a systematic, transparent approach to prioritizing projects that meet the over-arching goals of economic development statewide for financial evaluation and structuring

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Ranking of Projects

Applicant Need and Readiness	20
Financial Soundness of Proposal The proposed project must demonstrate the potential for success based on financial feasibility and leveraging of private funds.	5
"But For Test"-A project must demonstrate that "but for" the subsidy provided by the New Markets Tax Credit resource it would be unable to proceed or attract additional capital necessary to complete its financing structure.	5
Project Readiness Proposed project must demonstrate readiness to move forward and be financially feasible with an ability to close on a New Markets Tax Credit transaction within 3-6 months of application in order to be considered. Readiness includes evidence of site control for the proposed project. Term sheet from proposed leverage lender must be submitted in order to be determined as Moderate or High Readiness. *High Readiness Determination 5 points *Moderate Readiness Determination 3.5 points *Low Readiness Determination 2 points	5
Qualified Management Team The proposed project should demonstrate a strong and qualified management team.	5

- Each project is reviewed on 100-point scoring system
- Categories of the ranking system
  1. Community Impact Support – 20 points
  2. Job Creation and Employment – 35 points
  3. Applicant Need and Readiness – 20 points
     a) **"But For Test" – 5 points**
  4. Business Location – 10 points
  5. Economic/Export Based Companies – 10 points
  6. New Capital Investment – 5 points

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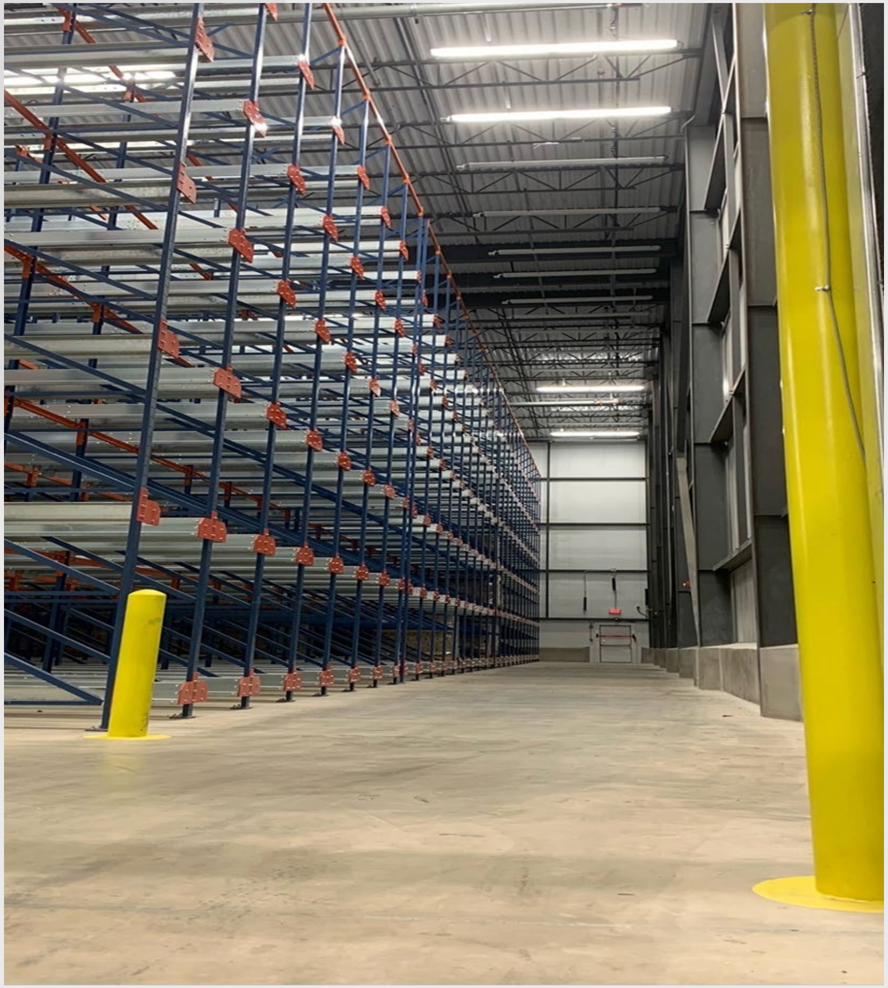
Power of "But For"

- But "For" Test:
  - The proposed project for El Encanto Inc. dba Bueno Foods would not be feasible without the assistance of various programs such as the NMTC, LEDA, IRBs, Company investment and affordable loans. By taking advantage of various tax incentives, they can move forward with a project that will create an additional 49 good paying jobs with benefits over six years in an economically depressed area of the City, export New Mexican agricultural products out of state and bring money back into the economy. Only with tax savings, tax credits, Company investment, IRBs and affordable borrowing is this project possible. Public/private collaboration makes this project feasible

- Proposed Community Impact Criteria
  - The Exit Fee shall be reduced by an amount equal to 30% if throughout the NMTC Compliance Period, Bueno Foods creates 49 new jobs at the Bueno Foods facility, during the 7 years. (30% reduction)

Projects – Bueno Foods Plant Expansion



- $16 million plant expansion that has 2 Phases
- Phase 1 is 25,000 sq ft freezer facility addition
- Reduce storage costs and eliminate storing in distant locations
- Wells Fargo LTV 65% requirement for its Senior Debt Revenue Bonds
- Without NMTC combined with other Tax Incentives this project is not completed
- NMTC fills $2.8 million TPC gap
- 2nd lien allows higher LTV 78%

Projects – CDEC Broadband Project

- Broadband internet in the rural communities of Grants, Milan, Bluewater and San Rafael
- Communities had adoption rate of 5%
- 50 Mbps up/down
- More affordable than current services which is not reliable

- All financing options had been exhausted
- Need higher adoption rate without NMTC to make the rates cost effective
- NMTC fills $2.5 million TPC gap
- Lower cost of funds allows for this project to cashflow

NMTC Small Loan Pool

NMFA created the NMTC loan pool program to respond to market needs for smaller eligible projects between $500,000 and $4 million. Eligible projects include equipment, working capital, building and infrastructure.

Loan Structure:

- Loans must be in NMTC qualifying census tracts
- Each borrower is required to be a Qualified Active Low-Income Community Business (QALICB)
- Loans expected to be interest-only through the 7-year NMTC compliance period
- Low interest rates (50% below market rate) fixed for 7 years
- No origination fees
- Have higher LTV than standard loans
- Community Benefit Agreement on an annual basis
- 5% equity requirement for all loan pool transactions
- Below market requirements for Debt Coverage Ratio at 1.10x

Higher Collateral Value Determination:

Structuring maximizes the leverage of the assets available for security by offering its NMTC Proceeds Loans with higher than standard loan-to-value ratios.

- Senior Lien Positions LTV 90% for real estate and durable equipment
- Subordinate Lien Positions LTV 95% on the same project types as listed above