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Credit Where Credit's Due

Legal angles abound in New Markets tax credit deals

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They're long, complicated transactions stemming from a young, still-evolving federal program—and that's exactly what makes New Markets tax credit deals ripe for legal representation.

Only a relative handful of attorneys specialize in these types of transactions, which are designed to stimulate development in low income areas, but those who do routinely shuffle between representing lenders, investors and developers in varying stages depending on the deal.

"My representation really runs the gamut," said Arthur J. Momjian, chair of Duane Morris' affordable housing,

community development and syndication practice group, who recently represented Sovereign Bank as the leverage lender in a transaction that eventually led to the construction of a combination retail and residential structure called the Hub on Chestnut Street in the University City section of Philadelphia.

"I represent some for-profit developers, some nonprofits and certain entities that have allocation of New Markets tax credit authority," he said. "Also, I have clients that are investors in credits as well as some that provide leverage."

WHAT ARE NEW TAX CREDITS?

Established by Congress as part of the Community Renewal Tax Relief Act of 2000, the New Markets Tax Credit Program allows individuals and corporations to receive a credit against federal income taxes over a seven-year span for making equity investments in

what are known as community development entities, or CDEs, according to the Web site for the U.S. Treasury's Community Development Financial Institutions Fund.

Each CDE, which is granted the authority to allocate tax credits to its investors by the CDFIF, must then put the majority or all of the total investment toward developing designated low-income communities.

In return, each investor receives a credit for each of the first three years at a rate of 5 percent of the total amount paid for the stock or capital interest at the time of purchase.

The credit rises to 6 percent annually for the last four years.

After seven years, the credit amounts to 39 percent of the cost of the investment.

Credit

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The idea of the New Markets tax credit, according to Charles M. Naselsky, a partner in Deeb Petrakis Blum & Murphy's business transaction group in Philadelphia, is to create a "line item of incentive money ... that could close the loop on the underwriting" in a deal.

Similarly, Dionne T. Savage, a founding partner of Lowe & Savage in Philadelphia who specializes in New Markets tax credit transactions, said these tax credit incentives "don't make a bad deal go, but they do make transactions that lack a little equity better."

Momjian said the program was one of the last to be enacted by the Clinton Administration and took a few years to get off the ground.

"When it first came out, it really wasn't understood that well," he said. "People quickly learned that, as long as [the project you're investing in is] located in a designated low income area, you can use the program for virtually anything other than residential rental property."

The program has since been embraced by the Obama administration, which, under the American Recovery and Reinvestment Act — the stimulus bill — increased the amount of New Markets tax credits available annually from \$3.5 billion to \$5 billion in both 2008 and 2009.

The president's proposed FY2011 budget provides for an additional \$5 billion per year in 2010 and 2011.

The New Markets Tax Credit Extension Act of 2009 stretched the life of the

program to 2014.

"What's really interesting about the program in 2010 is that it's completely compatible and really part of the current administration's goal to incentivize and revitalize," said Naselsky.

But even now, Momjian said, the program remains "relatively esoteric."

"Even though it was enacted in 2000, it's still a relatively new program," he said, adding that, "This is still a program that's being defined."

The complexity of these New Markets tax credit deals means a relatively small number of attorneys nationwide specialize in them, but it also means each transaction offers plenty of opportunity for lawyers to get involved.

ANGLING FOR LEGAL ANGLES

Naselsky said the tax credits themselves are but a "small piece" of a multi-faceted transaction.

In its simplest form, a New Markets tax credit deal usually begins with an investor borrowing money from a lender and then investing the money, in exchange for tax credits, through a CDE, which then has 12 months to reinvest the capital into a designated low-income community.

And each one of these entities needs a lawyer.

For example, Naselsky and colleague Jon G. Hillsberg, who is also a partner in Deeb Petrakis' business transaction group, recently represented both the lender, Bankcorp Bank, and the Reinvestment Fund, which acted as both the CDE and an additional lender, in a transaction that brought two Fresh Grocer supermarkets to distressed neighborhoods in the Philadelphia area: one in Germantown, near LaSalle University, and in North Philadelphia,

near Temple University.

"What we've been trying to do is to not only help the lenders through the process, but we've represented CDEs at times," Naselsky said. "They're the facilitators."

Savage said that while she often represents lenders and investors on the transactional side of these deals, she dedicates a large portion of her practice to helping CDEs apply for tax credit allocations from the CDIF, tasks that require a very different type of lawyering.

"The interesting thing [about the application process] is that what you're doing is you're getting this particular organization to tell its story about its community work, about what it intends to do with an allocation and, most importantly, about how it can deploy the cash," said Savage, who recently represented the Reinvestment Fund in its role as CDE in a project that brought a new ShopRite supermarket to the Parkside neighborhood in West Philadelphia.

The more complex the transaction, the more opportunities there are available to attorneys.

For example, Savage said, some deals involve multiple CLEs and multiple tiers of lenders.

According to Savage, one attorney can represent several players in a single transaction without conflict as long as all the players are on the same level and have the same interests.

For example, she said, attorneys often represent more than one CLE in a transaction, but counseling lenders on different tiers in a single transaction "can get a little dicey sometimes."

"On one transaction I'm represent-

ing a subordinate leverage lender and if I were also representing a senior leverage lender [in the same deal], that would be a little bit of a conflict," she said.

NEW MARKETS CREDIT CRUNCH

Like most business transactions that largely rely on loans, New Markets tax credit deals have slowed during the recession, but the attorneys *The Legal* spoke to remain optimistic.

"We don't have the traditional lending environment [right now]," Naselsky said, but added that these transactions "will flourish as lenders start to ease back into lending the money."

Momjian said that when the credit crunch hit, "allocations started to pile up because people couldn't use them," a phenomenon that has led to more self-leveraging.

"I'm probably working on 10 deals right now and I'd say eight or nine of them involve no real debt," he said, but added that while it has become tougher to close deals in a more conservative lending environment, the recession did have the positive effect of encouraging the federal government to extend the program and increase allocation dollars.

Savage agreed that loans are harder to come by in the current economic climate but said a "bright spot" has emerged in the form of funding from nonprofits and federal agencies, such as the U.S. Department of Housing and Urban Development.

Savage added that there are still banks that are willing to lend money for these types of projects as well.

"We definitely see things picking up," she said. •