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Insurance Companies Use NMTC to Support Community Facilities

By Dan Sheehy and Jean Chang, Impact Community Capital

One of the 66 first-round allocatees, Impact Community Capital has been hard at work since receiving its award of new markets tax credits (NMTC), putting them to work through its subsidiary, Impact Community Capital CDE LLC, a certified community development entity (CDE). Impact received a $40 million first-round NMTC allocation to use for its community facility investment program.

Impact Community Capital creates and manages investments in low-income communities for its insurance company investor/members. To date, most of its investments have been oriented toward pooling and securitizing affordable housing mortgages. This approach enables its investors to make large scale investments that benefit low-income communities and best conform to insurance industry regulatory requirements and guidelines. Impact views the NMTC program as an opportunity to expand its investments beyond affordable housing.

Impact's first NMTC investment is a $10.3 million CDE loan to the Fund for Children and Communities CDE (FCC CDE), an affiliate of the Low Income Investment Fund (LIIF). This investment will be used to finance child-care facilities in low-income communities in California. These facilities typically have difficulty attracting long-term capital because their operations are largely supported by government programs that are subject to annual appropriations and because loans to these facilities typically are smaller and require specialized underwriting and servicing.

With this investment, LIIF and Impact are embarking on a flagship initiative to demonstrate that prudent investments can be made to established child-care operators that are meeting a critical community need. Impact investors are providing the capital, LIIF is providing its origination, underwriting and servicing expertise, and the tax benefits of the NMTC program are allowing Impact investors to make a zero interest CDE loan to the FCC CDE. This combination will make it possible for communities to have stable, modern, appropriate facilities for much needed child-care services.

The investment is made through a leveraged NMTC structure in which Impact investors make both the loan and equity investment in the leveraging entity. The leveraging entity will then make an equity investment in the Impact CDE, an NMTC sub-allocatee, which will then use the funds to make a CDE loan to the FCC CDE. The FCC CDE will make construction loans and mini-permanent loans to child-care facilities operators. While underlying loans to the child-care facilities will use real estate as collateral, most of them will be non-real-estate qualified active low-income community business (QALICB) transactions because they are loans to child-care facilities operators. The graphic on page two shows the structure.

The equity investment made by Impact investors will be repaid largely in the form of tax credits and other tax benefits. In addition, the investment also intends to access a state tax credit program administered by the California Department of Insurance's California Organized Investment Network (COIN). The value of these tax credits permits the Impact CDE to make a zero interest loan to the FCC CDE, which is then able to make loans to child-care facilities at low interest rates.

(continued on page two)

Insurance Companies Use NMTC

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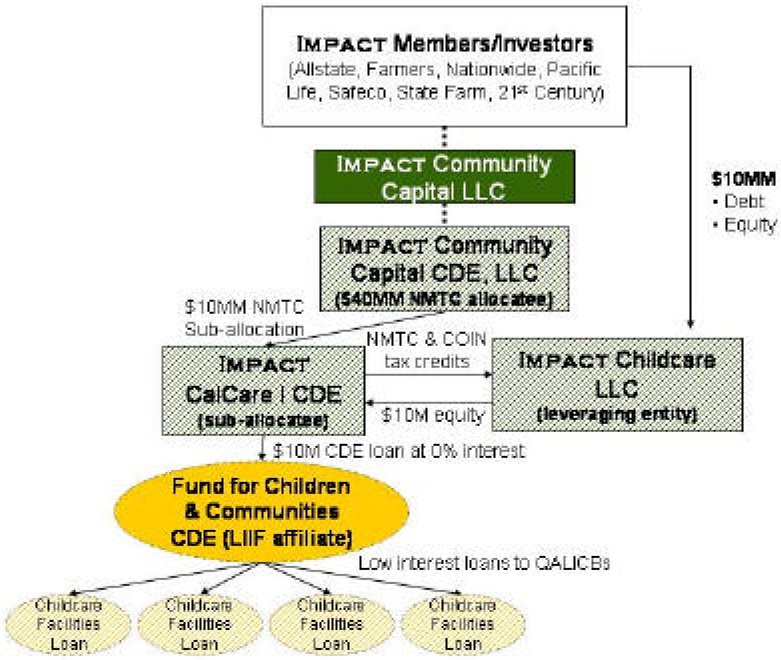

The interest paid by the child-care facilities will support the operating and servicing costs of the FCC CDE. Loans to child-care facilities will be made based on underwriting criteria agreed upon by Impact and LIIF, and using standardized loan documents, which is similar to the structured finance approach Impact utilizes for its affordable housing investments.

In addition to the appropriations risk, Impact investors will bear refinancing risk as the mini-permanent loans made to child-care facilities will be only partially amortizing. In order to mitigate these investment risks, LIIF received a commitment from The David and Lucile Packard Foundation, which will serve as a source of credit enhancement. Impact investors will absorb the first $300,000 of any losses on the pool of child-care facilities loans. Any additional losses will be borne by the Packard Foundation, through LIIF, in an amount equal to 10 percent of the aggregate loan pool. The refinancing risk for Impact investors is also mitigated because the portion of their investment made as equity will be repaid largely through tax credits and tax benefits.

Similar to the experience that has been reported by other NMTC program participants, Impact and LIIF have incurred significant transaction costs to structure and document this investment. Given the goal of providing low-interest loans to the child-care facilities, these costs are borne by Impact's investors rather than the borrowers. Impact investors have been willing to bear these costs because they consider this investment to be a demonstration fund whose success would attract other private investment capital to child-

(continued on page three)

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Insurance Companies Use NMTC

(continued from page two)

care facilities.

The structure and documentation already developed can provide a benefit to replicating and expanding the FCC CDE's activities beyond Impact's $10.3 million CDE loan. In addition, Impact investors expect that their future NMTC investments will replicate this leveraged structure and benefit from this first transaction. Impact is already discussing with another experienced not-for-profit lender a similar structure for health-care facilities.

Both Impact and LIIF expect that monitoring and compliance with the NMTC program may prove challenging and expensive, particularly given the multiple entities required for a leveraged NMTC structure. These costs have been provided for in the economics of the transaction.

The investors in Impact's NMTC child-care fund are Allstate Insurance Company, Farmers Insurance Companies, Nationwide Mutual Insurance Companies, Pacific Life Insurance Company, SAFECO Insurance, State Farm Insurance Companies, and 21st Century Insurance Company. To date, Impact has invested or committed to invest nearly $750 million in low-income communities.

Dan Sheehy is president and CEO of Impact Community Capital LLC (ICC). Jean Chang is a consultant who has worked extensively with ICC on its NMTC investment strategy and implementation. For more information about ICC, go to www.impactcapital.net.

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