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NMTC-HTC Twinning Back After HBH Slowdown

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The new markets tax credit (NMTC) and historic tax credit (HTC) are twins who spent a few years apart and are now together again.

Following their widespread separation stemming from the 2012 court ruling in the Historic Boardwalk Hall (HBH) case and subsequent wait for Internal Revenue Service (IRS) guidance on the partnership structure for HTC transactions, the twinning of the credits is back at or above the previous rate, according to industry insiders.

"Obviously, we look at things over time and I would say there's been an uptick in twinning transactions over the past two years as people get comfortable with the ramifications of Rev. Proc. 2014-12 [which provided guidance]," said Ryan Brunton, a partner at Husch Blackwell in Kansas City, Mo. Brunton's legal representation work includes structuring and closing NMTC and HTC transactions on behalf of participants serving in each of the major transactional roles.

The Third Circuit Court ruled in 2012 that investors must have a meaningful stake in the success of the investment in a HTC transaction–and the Supreme Court declined to address the case several months later. That slowed the HTC industry as investors waited for safe harbor guidance from the IRS, as well as the proper tax treatment of Section 50(d) income.

Adjusting to a New World

The post-HBH confusion wasn't unique, according to Ben Swartzendruber, a tax attorney at Applegate & Thorne-Thomsen in Chicago.

"My sense is this industry gets buffeted by a regulatory bump every few years," Swartzendruber said. "A lot of uncertainty got restored with the Rev. Proc. and the 50(d) ruling. … My sense is that most investors have decided to stay in the market. Now that we know how the 50(d) income is treated and have a safe harbor, most investors and their counsel have gotten over the uncertainty. It's a process that has taken a number of years, though."

Both tax credit programs are mature–the HTC has been around since 1978, the NMTC since 2001–and there is a history of combining them to make some deals pencil out. However, the HBH ruling and subsequent wait for guidance slammed the brakes on many transactions.

"A lot of deals marched forward and shed the historic tax credit component," Brunton said. "The chilling of the market came as people passed on the HTC."

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Joseph Summers, principal and chief financial officer who heads up all NMTC and HTC consulting at Cross Street Partners, a real estate company that focuses on rebuilding communities, estimated that it took nine months to a year for the industry to adjust to the new regulations with Rev. Proc. 2014-12 and the 50(d) ruling.

Always More Complexity

While opinions vary on the frequency and what's trending in the twinning of tax credits, insiders are universal in their admonition to be informed before making the choice.

"No. 1, you need to understand [that twinning the credits] adds complexities," Brunton said. "You add transaction costs. It's inevitable that there's more complexity and more costs. The argument [for twinning] is that if you're doing them side-by-side, there's some economy of scale. But, it's still entirely a different set of complexities."

Brunton said it's important for all participants in a transaction to understand the complexities. "You need to talk to the investor, CDE or lender and you need someone on your team who can ask the baseline questions [regarding] the requirements of the specific investor," Brunton said. "Some [transaction participants] require certain levels of comfort. You don't want to get into a situation where you think progress looks good and then you get snagged by a fatal flaw."

David Lutz, head of the tax credit finance group at Stinson Leonard Street's office in Omaha, Neb., said there are specific issues that are crucial to understand.

"I think you need to understand that [twinning] makes the transactions more complex and expensive," Lutz said. "You need to understand that you might have different investors, developers, CDEs that they have different interests and views on the transaction structure. That can have an impact on the economic impact for the developer. You need to look at how the investor structures the entire deal."

Brad Elphick, a partner in Novogradac & Company LLP's Atlanta office, said complexity is a given.

"Anytime you add another program or subsidies to a NMTC transaction, there will always be more complexities," he said. "Especially if you have different investors. You need to get everybody comfortable with the structure."

Getting advice ahead of time is paramount, according to Summers.

"When we've got [a developer] who isn't used to it, the first thing we suggest is finding legal counsel that's done it before," Summers said.

Swartzendruber said he'll err on the side of frankness when talking twinning. "As a developer counsel, we recognize that a proposed twinned structure may not be universally accepted," Swartzendruber said. "You want to preview the overall structure with the investor and counsel as soon as possible. You can meet yourself coming and going [with a twinning transaction]. Some historic tax credit program requirements are difficult to reconcile with the NMTC program."

Where Pairing Works Best

While there are specific transactions where the pairing of the tax credits is attractive, there aren't many broad conclusions.

"It's all over the map [for best practices with twinning]. There are a lot of mixed-use developments," Lutz said. "You can't have pure residential rental, so there is a lot of mixed-use development or small business incubators."

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Brunton pointed out another option. "I can't say any particular transactions work best," Brunton said. "But we've seen an uptick in hotels being at least a component. You get a revenue stream and you can be more confident [in performance] on both the NMTC and HTC side."

Elphick said it's all about the structure. "I don't think it's a specific type of project that drives whether it's a good fit," he said. "It's how you structure it to ensure all the pieces of financing work together to provide the amount of subsidy needed."

Same Investor, Two Credits?

With two tax credit programs–and sometimes more, if there is a state tax credit involved–there are multiple options for handling the investors. Do you pursue a deal with one investor for all credits or do you work with different investors? Opinions vary, but the simplest solution is one investor.

"Deals I touch are more likely to have an appetite for the investor to have both the NMTC and the federal HTC," Brunton said. "We've certainly worked on a number where credits are bifurcated, which brings another level of complexity."

Summers said his firm prefers the same investor, but doesn't insist on it. "Having two [investors] adds one more player and one more set of lawyers," he said. "But it depends on who the investor is, so sometimes it's split."

Lutz sees more splitting of the credits. "One thing I have seen more recently is the bifurcation of the credits between the NMTC and HTC investor," Lutz said. "In the past, it was more typical to have one investor for both credits, but now it's not unusual to have a different investor for the HTC portion of the transaction. One reason is probably that some of the NMTC deals are generating small HTC investments and there's been more activity with small-deal funds in the HTC space, which allows other investors to be competitive for the HTC even though they are not investing in the NMTC." ❖

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