MOODY'S
INVESTORS SERVICE

RATING
METHODOLOGY

Moody's Methodology for Rating Debt Issuance Under Certified Capital Company, New Markets Tax Credit and Similar Programs

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This rating methodology replaces *Moody's Methodology for Rating Debt Issuance Under Certified Capital Company and New Markets Tax Credit Programs* published in September 2016. We have clarified our rating approach, and we made limited editorial updates. The updates do not change the substantive approach of the methodology.

Introduction

A number of jurisdictions have regularly used the Certified Capital Company (CAPCO), New Markets Tax Credit (NMTC) and other tax credit programs to encourage investment in small businesses, low-income communities or other areas such as renewable energy. Our ratings of the debt issued by tax-credit-earning issuers takes into account not only the credit risk of the notes, as determined by the issuers' ability to make required payments from the cash generated by underlying assets, but also their ability to operate in accordance with the statute in a manner that allows them to produce any payments through the tax credits awarded to them under the relevant statutory program.

Typical CAPCO and NMTC Program Structures

CAPCOs are entities certified under state statutes to encourage investment in smaller businesses operating in a state by awarding credits for state premium tax liability to investors in the CAPCO. Insurance companies are the most typical example of businesses subject to taxation under state law for receipt of premium revenue and which can therefore benefit from premium tax credits by investing in debt issued by a CAPCO. Because CAPCO programs are implemented under state law, the statutes applicable to CAPCOs vary by state, but share certain common principles.

Congress enacted the NMTC program as part of the Community Renewal Tax Relief Act of 2000, to encourage investment in low-income communities. Participants in the NMTC program can receive credits to use against their federal income tax liabilities. Individual states have since enacted their own programs, closely following the outlines of the federal NMTC program, to allow participants to obtain tax credits for their state income tax or other state tax liabilities. Our description of NMTC program operations refers to the federal regime unless we specify otherwise.

Earning Tax Credits Through Qualified Investments

CAPCO Programs

Under a typical state CAPCO statute, investors in the debt or equity of a CAPCO are allocated state premium tax credits that they can use to reduce their state insurance premium tax liability in an amount equal to 100% of such investment. Thus, an investment of $100 will entitle investors to take $100 of credits against their premium tax liability over a period of time specified by the statute. The CAPCO earns the tax credits by making "qualified investments" in specified types of businesses (qualified businesses) in the state, in accordance with the investment milestone deadlines in the CAPCO statute. In general, however, the statutes presume that the CAPCO will make the necessary qualified investments by the investment milestone deadlines. For instance, some statutes state that the tax credits are fully "vested" upon making the investment in the CAPCO.[1]

NMTC Program

Under the federal NMTC program, investors receive credits against federal income taxes for making qualified equity investments (QEIs) in designated community development entities (CDEs). To be certified as a CDE, an organization must be a domestic US corporation or partnership with the primary mission of serving or providing investment capital for low-income communities or persons and must be accountable to the residents of the low-income community through their representatives on the CDE's governing or advisory board. Investors making QEIs in a CDE receive the benefit of income tax credits allocated to the CDE so long as the CDE makes qualified low income community investments (QLICIs) in the statutorily required amount, which the investors can use to lower their federal income tax liability in an amount equal to 39% of such investments. Thus, an investment of $100 will entitle investors to take $39 of tax credits against their federal income tax liability, spread out over seven years: $5 in each of the first three years, and $6 in each of the next four. State NMTC programs have generally followed the federal NMTC framework, though often incorporating certain differences that vary from state to state. For instance, some state programs have added an explicit reference to "debt" to the definition of a "qualified equity investment." To obtain the benefit of a state NMTC program, the CDE must make investments as QLICIs within that state.

Investment Milestone Requirements

CAPCO Programs

For an investor in a CAPCO to become entitled to the benefit of state tax credits, a CAPCO must invest specified amounts of "certified capital" (capital raised from investors) in qualified investments within the investment milestone deadlines the statute specifies. State statutory requirements vary, but under a typical statutory framework, a CAPCO must invest an amount equal to at least 30% of its certified capital in qualified investments within three years of the date on which the state allocated the portion of available tax credits to the specific CAPCO and 50% of its certified capital within five years of the tax credit allocation date.

The CAPCO must meet these investment benchmarks to remain certified under the state CAPCO law and for the tax credits to remain available to investors. If it does not, the tax credits allocated to the CAPCO are subject to forfeiture and recapture. Thus, depending on what payments the tax credits provide in the transaction structure, investors would lose payments of principal or interest on the notes to the extent of the forfeiture or recapture of the tax credits. (After passing an investment benchmark, the tax credits the investor has used up to that point generally cannot be recaptured.) For example, in a structure in which all

[1] Texas Certified Capital Company Act, codified at Articles 4.51 through 4.73 of the Texas Insurance Code (Texas CAPCO Act), Article 4.65(a).

repayment of principal is made via the availability of tax credits and the CAPCO fails to meet an initial investment benchmark, the investors could lose the entire principal they had invested.

The requirement to make qualified investments is only a matter of identifying and deploying the certified capital to investment in qualified businesses. The investment return received on such qualified investments is not relevant to the availability of the tax credits to the CAPCO debt investors.

Typically, once a CAPCO has satisfied the five-year/50% investment milestone, the tax credits allocated to and used by the investors within the five years of the tax credit allocation date are no longer subject to recapture; the tax credits attain at that point a "safe harbor" status, which provides statutory assurance that the tax credits will be available. Tax credits to be used following the five-year mark could be forfeited, however, if the CAPCO does not remain certified. In some statutes, such forfeiture risk continues only until the fifth year anniversary of the tax credit allocation by the state, so long as the CAPCO is certified through that anniversary date.[2]

Under the typical CAPCO statute, only when the CAPCO has reached the point of investing 100% of its certified capital in qualified businesses can it make distributions to equity holders. At that point, the CAPCO is typically dissolved and the equity holders receive the residual value.

NMTC Programs

For investors to benefit from NMTC tax credits, the CDE must invest "substantially all" of the QEI it receives (85%, according to the statute) as QLICIs within a year of receiving the QEI. Redemption cannot take place for seven years following the investment, or the tax credits will be subject to recapture. In the event of a QLICI's early redemption, a cure period allows reinvestment of the redemption proceeds without loss of the tax credits.

In NMTC programs, as with CAPCOs, if the CDE does not meet the deadline for deploying the QEI as QLICI, the tax credits allocated to the CDE (the entity making the qualified investments for the NMTC debt issuer) are subject to forfeiture and recapture. In that event, depending on what payments the tax credits provide in the transaction structure, investors would lose payments of principal or interest on the notes to the extent of the forfeiture or recapture of the tax credits. If all repayments of principal are based on the availability of tax credits allocated to one CDE and that CDE fails to meet the deadline to invest at least 85% of the QEI it has received within one year, investors could lose all of the principal they have invested.

The NMTC requirement to make a QEI in a CDE, which in turn makes QLICIs, is only a matter of identifying and deploying the funds as QLICIs, in a manner similar to CAPCOs. The investment return on such QLICIs is not relevant to the availability of the tax credits.

Unlike CAPCOs, however, statutory provisions in NMTC programs have not included any explicit protection or "safe harbor" from forfeiture or recapture of a portion of tax credits upon meeting the investment deadline for making qualified investments. Thus, although we are not aware of instances in which the federal or any state authorities have determined that the allocated tax credits be forfeited or recaptured, the possibility of such a government challenge to the availability of the tax credits to any investor is never eliminated.

[2] E.g., Texas CAPCO Act, Article 4.63(a)(3).

Requirements for CAPCO and NMTC Transaction Arrangers

Under typical CAPCO statutes, arrangers must capitalize the CAPCO with a minimum amount of equity in unencumbered cash or cash equivalents. In addition, a certain number of principals operating the CAPCO must have a designated minimum number of years of venture capital experience. For example, the statute may require that a CAPCO have at least two principals or employees having each at least four years of experience in the venture capital industry. Biographical and historical information for principals must typically be submitted to the state, which may be required to include information concerning prior venture capital firms where the principal was employed and to provide details about the valuation of the firm's portfolio investments and historical investment performance.

In contrast, NMTC requirements are fewer, but the allocation of tax credits is determined by the Community Development Financial Institutions Fund (the CDFI Fund), an agency of the U.S. Treasury Department. The CDIF Fund selects CDEs for the award of tax credit allocations among CDE applicants. Any organization wishing to receive awards under the NMTC program must be certified as a CDE. To become certified as a CDE, an organization must be a US entity with a primary mission to serve low-income persons or communities.

Primary Risks in CAPCO and NMTC Issuer Debt

Source of Payments in Typical Transaction Structures

Although many CAPCO and NMTC debt issuance structures have a cash-payment element for a portion of the interest payments or principal repayment of the issuer's debt, supported by cash or liquid investments made at the time the notes are issued, most of the payments will come from the availability of tax credits, which investors can take in some proportion to their tax liability.[3] Thus, few CAPCO and NMTC issuer structures rely on the cash generated by the issuer's underlying assets to make payments on a large portion of an issuer's debt obligations.

As a result, the credit risk of the underlying investments is not generally the primary risk in CAPCO and NMTC issuer transactions. Although we generally analyze the cash-payment element in a CAPCO or NMTC structure on a "pass through" basis, taking into account the characteristics of the underlying investments (not including investments in qualified businesses pursuant to the CAPCO or NMTC statute) supporting the cash payment,[4] the primary risk in most CAPCO and NMTC structures is the ability of the CAPCO or NMTC issuer to produce the premium tax credits themselves. Thus, we evaluate the ability of the CAPCO or NMTC issuer to meet cash-payment obligations to investors separately from the ability of the issuer to meet the statutory requirements for preserving the availability of the tax credits for investors. We do not run a model as part of this approach.

[3] Many NMTC transaction arrangers use leverage from a third-party lender to increase the capital investment to the point where the transaction structure can provide tax credit investors a dollar-for-dollar ratio of capital investment to tax credit.

[4] Our pass-through analysis takes into account the credit quality of the underlying investment (not including investments in qualified businesses pursuant to the appropriate tax credit program statute), usually as determined by ratings, to support the credit quality of the issuer's obligations. In doing so, we consider the likelihood that the underlying investment will make payments to the issuer such that the issuer can make payments on its own liabilities. In addition to credit quality, we also examine whether the particular investment will (a) provide the issuer with a sufficient quantity of cash to cover the issuer's cash pay obligations and (b) provide such payment before the issuer's own cash pay obligations are due. If the underlying investments are short-term, we also take into account our guidelines for eligible investments in structured finance transactions. For more information on our approach to the temporary use of cash in structured transactions, a link to a list of our sector and cross-sector methodologies can be found in the "Moody's Related Publications" section.

Operational Risks

Because many CAPCO and NMTC structures rely primarily on the availability of tax credits (instead of cash) to make interest or principal payments to debt investors, the most significant risk to the issuer's ability to make principal and interest payments arises from the manner in which the issuer operates and whether it carries out the requirements of the CAPCO or NMTC statute.

Certain CAPCO and NMTC operational risks could be classified as administrative, such as the ability of the issuer to comply with statutory or regulatory reporting requirements, often with audited financial statements, or to pay annual program fees.

The more significant risks in operating any CAPCO or NMTC issuer, however, are the ability of the issuer's managers to identify investments in qualified businesses in accordance with the definition of the applicable statute, and the investment of enough capital in qualified businesses in time to meet the statute's investment deadlines.

Many CAPCO statutes incorporate a pre-investment approval process for gaining assurance from the applicable state's offices that the proposed investment will indeed constitute a qualified investment, another "safe harbor" against potential government challenges to the investment's qualification. The federal NMTC program and many state NMTC programs do not, however, leaving open the possibility of a government challenge to whether any particular investment of a CDE as QLICI does indeed meet the statutory requirements.

There is also the risk that an investment in what was a qualified entity at the time of the investment ceases to be a qualified investment during the life of the CAPCO or NMTC issuer. In a typical CAPCO statute, post-investment changes to the qualified-investment status of a business will not prevent the CAPCO's investment from counting toward meeting investment benchmarks. The main exception to this rule applies when a formerly qualified business moves out of the state that allocated the CAPCO tax credits. In those instances, the amounts invested in the business would need to be reinvested in another qualified business to count toward meeting statutory investment benchmarks.

In the federal NMTC program, whether a CDE has invested in a QLICI depends on a number of requirements. For example, at least half the QLICI's total gross income must come from the active conduct of a qualified business in a low-income community. If that particular business ceases to meet the criterion, the CDE's investment in the business will still qualify so long as the CDE "reasonably believed" at the time of the investment that the business would remain a qualified business. When making the investments, the transaction parties often obtain third-party opinions from accountants or legal counsel that there is a reasonable belief that the investment will remain a QLICI.

Legal Risk

There is also a theoretical legal risk that the CAPCO or NMTC statute of the jurisdiction allocating the tax credits will later be amended or repealed. In the absence of any proposal to change an applicable statute, we view this risk as sufficiently small as to not affect our ratings of CAPCO and NMTC debt issuance. However, if a CAPCO or NMTC statute were to be amended or repealed or the likelihood of such change becomes significant, we would review our ratings to take into account the changes (or proposed changes) to the statute with regard to the ongoing ability of the issuer to meet its obligations to noteholders.

Rating Debt Issued Under CAPCO and NMTC Programs

Rating Level

We have concluded that when:

1. the ability of the CAPCO or NMTC transaction sponsor to successfully manage a CAPCO or NMTC issuer has been satisfactorily established,
2. appropriate contractual safeguards are in place, and
3. there is legal assurance that a CAPCO or NMTC issuer's compliance with its contractual requirements will be sufficient for the issuer to keep the tax credits available to the issuer's debt investors,

an A3 rating at the outset of such a transaction reflects the credit and operational risk of most CAPCO issuance.

As we have noted, our rating analysis does *not* address the following:

» The eligibility of an investor to effectively use the tax credits the CAPCO or NMTC issuer generates against the investor's tax liability.

» The likelihood that the jurisdiction will make any amendments to, or repeal, the operative CAPCO or NMTC statute.

We consider a number of factors when assigning a rating to CAPCO or NMTC transactions issued without a financial guarantee or some other form of credit enhancement. These factors include the complexity and clarity of the governing statute and any accompanying regulations, the adequacy of contractual safeguards and the limited nature of the promise to investors.

Both state and federal governmental entities continue to show their strong commitment to CAPCO and NMTC programs. The willingness of such entities to continue allocating tax credits under such programs is testament to the success of these programs to encourage productive and targeted qualifying investments in those jurisdictions. However, there has been a shift toward greater use of NMTC program options at both the federal and state levels, and away from traditional CAPCO programs.

The relative success of CAPCO programs is likely due, at least in part, to the self-contained and relatively clear-cut nature of CAPCO statutes. The chief responsibility of a CAPCO manager is to make qualified investments in sufficient cumulative amounts to reach the investment benchmarks and to follow statutory reporting requirements. The remaining statutory requirements are for the most part straightforward and administrative.

Likewise, in NMTC transactions, the responsibility of the transaction manager is also to make qualified investments in sufficient cumulative amounts to reach specified levels within a specific period. In addition, a transaction manager will need to (1) reinvest in the event of a qualified investment's early redemption, (2) maintain community participation on a board of the CDE and (3) comply with statutory reporting and administrative requirements.

A key protection for investors is the absence of any link between the performance of the qualified investments and the availability of the tax credits to the holders of the CAPCO's or NMTC issuer's debt. In addition, trustees acting for the benefit of noteholders have thus far retained control over certified capital, releasing funds for investment in qualified businesses or to pay expenses only after meeting the conditions the documentation requires. Such provisions are credit positive for investors.

Program Protections Consistent With A3 Rating

Satisfaction of the conditions we list below are generally necessary for a CAPCO or NMTC transaction debt to achieve a A3 rating. However, these conditions, which are largely consistent with the provisions of existing CAPCO programs, are not necessarily sufficient in and of themselves for a A3 rating. Rather, additional requirements addressing other credit and operational risks we perceive in particular structures could be necessary. We review the structure and documentation of every CAPCO and NMTC transaction for the following minimum conditions:

» Evidence that the manager is capable, in our opinion, of operating the CAPCO or NMTC issuer and meeting statutory requirements, as well as managing and complying with the requirements of the legal documentation under which the transaction's debt is issued: In forming our assessment, we may meet with the manager's principals and other personnel or conduct onsite operations reviews of the manager's facilities; we may also consider the performance of the manager's previous issuance.

» Evidence that the CAPCO or NMTC has been certified as required in accordance with the jurisdiction's statutes or regulations and that the issuer's manager has also been approved, if necessary, such that the issuer or other relevant entity will be allocated tax credits under the relevant statute.

» Legal documentation providing that the issuer retains any initial equity capitalization the statute requires until all of the tax credits to be available to investors are no longer subject to forfeiture or recapture.

» Legal documentation providing that, prior to investment in any proposed business, the issuer will seek confirmation from the applicable government authority, where available under the program, that such investment is a qualified investment within the meaning of the relevant statute: For CAPCOs, doing so typically entails using the pre-investment approval procedure provided by the statute.

» Legal documentation providing that the trustee or agent acting for the bondholders maintains and controls the issuer's accounts and disbursements of funds so that it can disburse the necessary funds directly to the qualified businesses (after obtaining confirmation from the jurisdiction that the proposed investment is in a qualified business, where available).

» Legal documentation providing that at some meaningful time in advance of the statutory investment deadlines for maintaining the availability of the tax credits (e.g., six months in advance), the issuer will report to the investors and to us whether it has met the applicable investment requirement: If it has not met any benchmark at that point ahead of the statutory deadline, a majority of the noteholders will have the option to temporarily take over management of the issuer or to engage a replacement manager.

» Legal documentation providing that eligible investments for funds not yet invested in qualified investments are at least as conservative as any statutory requirements (i.e., cash and cash equivalents).

» Our periodic receipt of independently verified information that any issuer funds not invested in qualified investments have been invested in eligible investments in accordance with the statutory requirements and legal documentation.

» In addition to the usual legal opinions (e.g., those concerning the enforceability of the documents, the creation and perfection of security interests and that the issuer will not be subject to tax), a legal opinion from counsel practicing in the jurisdiction that enacted the operative statute that if the issuer complies with the documentary requirements as drafted, the issuer will be in compliance with the statute or regulations, such that the noteholders will be entitled to the benefit of the tax credits allocated under the statute.

In addition, we review the issuer's contractual documentation. We expect to see basic representations and covenants related to the status of the issuer, such as a representation that the issuer is certified in accordance with the statute, and a covenant that the issuer will comply in all respects with the applicable tax credit program statute, as well as a security interest created and perfected for the benefit of the noteholders in all of the issuer's assets.

» For the purpose of monitoring the CAPCO or NMTC transaction's rating, the legal documentation should also provide that we will regularly receive information verified by an independent third party that the transaction is meeting the requirements of the statutory tax credit program. In addition, we expect to receive copies of any reports the statute requires the issuer or other relevant party to submit to a government agency or authority about the status of the issuer, as well as any other reports and notices prepared for noteholders.

» We expect the issuer or its manager to notify us if the statute is amended or repealed while the issuer's notes are outstanding and to provide with a copy of the changes.

» For NMTC transactions, we should receive independent third-party-generated reports or certifications both (1) at the time of an investment, that a qualified investment has been made and (2) annually, that the qualified investments remain outstanding. In addition, we should receive third-party confirmation at the one-year deadline that the requisite 85% of QEI has been invested in qualified investments.

Investors' Ability to Use Tax Credits

Our ratings of CAPCO and NMTC issuer debt take into account only the ability of the CAPCO or NMTC debt issuer to make the tax credits available to investors; the ratings do not take into account the eligibility of any investor to effectively use these tax credits because this is a matter of the investor's analysis of its specific legal and tax circumstances.

Other Tax Credit Programs

In addition to the programs already described, several jurisdictions have enacted other tax credit programs that follow principles similar to CAPCO and NMTC programs. These other programs are also the result of statutes enacted to encourage certain kinds of investments in targeted sectors. Participants in such programs typically must also meet ongoing requirements in order to retain the availability of the tax credits. One example is state renewable energy tax credit programs, which seek investors for solar or other alternative energy projects within the state by making tax credits available to those investors so long as the project is completed by, or maintained until, a certain date.

These programs often have risks similar to CAPCO and NMTC programs, such as the possibility of recapture or forfeiture of the tax credits if program requirements are not met by specified deadlines. As with CAPCO and NMTC programs, the availability of tax credits to the investors through the purchase of the issuer's debt is typically managed by the transaction arranger. The arranger/manager oversees the investment of the note proceeds into the program's required investments and takes the actions necessary to ensure the issuer complies with the administrative requirements of the program. As a result, the arranger/manager's knowledge of the statutory requirements and ability to cause the issuer to comply are critical to the issuer's operations and the availability of tax credits for debt payment. Therefore, to the extent that other tax credit programs pose similar risks, we analyze transactions generating the availability of such program's tax credits with the same approach we use for rating the debt issued by CAPCO and NMTC transactions. We analyze and consider all the factors noted in this report to rate debt issued under such programs, to the extent relevant, including contractual safeguards in the legal documentation and independent verification that program requirements are being met.

As with CAPCO and NMTC transaction ratings, our ratings of the debt issued to make tax credits available to note investors under other programs do not take into account the eligibility of any investor to effectively use those tax credits.

Monitoring

Rating Upgrades

When CAPCO transactions meet their benchmark requirements, tax credits are usually no longer subject to recapture or forfeiture to various degrees. If the transaction achieves these benchmarks and we receive sufficient evidence that the CAPCO has done so,[5] upgrades from the original CAPCO debt ratings could be warranted.

Under the typical CAPCO statute, upon reaching an initial investment benchmark (such as 30%-within-three-year benchmark), tax credits that have been eligible for use by investors by that time are no longer subject to recapture. However, tax credits that investors can use only in the future are still subject to forfeiture in the event that the CAPCO does not meet the next investment benchmark or is otherwise decertified by the governmental authority.

Upon reaching the next or final investment benchmark (often the 50%-within-five-year benchmark) tax credits that have been eligible for use by investors by that time are also no longer subject to recapture. However, tax credits that can only be taken in the future are still subject to forfeiture in the event of later de-certification of the CAPCO. In at least one CAPCO statute, however, after meeting the fifth year benchmark, tax credits are no longer subject to recapture or forfeiture if the CAPCO was certified through the fifth-year anniversary date of the tax credit allocation.[6] In this case, after the five-year mark has passed, there appears to be no further risk of recapture of tax credits already used by investors or forfeiture of tax credits which investors may use in the future.

Finally, CAPCO statutes typically provide that once a CAPCO has invested 100% of its certified capital in qualified investments, the tax credits it provides investors will no longer be subject to any forfeiture or recapture. Generally, the statute does not require the CAPCO to reach this level of investment in certified capital within any specific period, although the CAPCO must invest 100% of its certified capital before it can return any equity it holds to the equity holders.

When a CAPCO has reached a point when the tax credits it has to make available to investors are no longer subject to recapture or forfeiture, and especially when the possibility of de-certification will have no impact on the tax credits, we may upgrade the rating on CAPCO notes significantly from the original A3 level, even to Aaa if little to no risk remains to investors for the repayment of the CAPCO debt.

NMTC statutes differ from typical CAPCO statutes in key respects. To date, NMTC statutes have not provided the explicit statutory "safe harbors" that are common in CAPCO statutes, namely, a government pre-approval mechanism for selecting a qualified investment, or explicit assurance that, by having met an investment deadline by a certain time, the allocated tax credits will be beyond forfeiture or recapture. Without the assurance that a government challenge to the availability of the tax credits is cut off at a particular point, we do not expect that the rating on the debt of NMTC transactions will be able to reach the Aaa level.

5 In determining whether the evidence that a CAPCO has met investment benchmarks is sufficient, we consider statements and information from the CAPCO manager, but need evidence from independent third parties for factual matters critical to our rating, such as the reports of independent auditors or written statements by officials of the state that allocated the CAPCO tax credits.

6 E.g., Texas CAPCO Act, Article 4.63(a)(3).

We may also upgrade the rating of notes issued under other tax credit programs, examining considerations similar to those for CAPCO and NMTC program notes, including the issuer's progress in meeting statutory investment requirements and any benchmark deadlines to avoid recapture or forfeiture of the tax credits.

Our monitoring of CAPCO, NMTC or similar debt ratings also incorporates an analysis of an issuer's ability to meet any of its remaining cash-payment obligations (beyond the availability of tax credits) on its outstanding obligations.

In addition to our regular monitoring we examine the ratings of a CAPCO, NMTC or similar debt transaction when it has passed an investment deadline date. In the case of CAPCO issuers, although a transaction may have reached its requirement for investing a percentage of certified capital in qualified investments before the investment benchmark deadline, the typical statute offers no additional protection from the recapture of tax credits investors have used before the deadline until the actual benchmark deadline date has passed.

Once a CAPCO, NMTC or similar transaction issuer has met its initial investment requirements, the deadline date has passed, and there have been no issues with the management of the issuer or administration under the applicable statute, we would generally consider upgrading our rating on the CAPCO, NMTC or similar transaction debt, often to a A1 level.

To upgrade, we will need to receive sufficient evidence, including appropriate reports or statements from, or verified by, independent third parties, that the program has met its investment benchmarks. In determining whether the evidence that a CAPCO has met investment benchmarks is sufficient, we consider statements and information from the CAPCO manager, but need evidence from independent third parties for factual matters critical to our rating, such as the reports of independent auditors or written statements by officials of the state that allocated the CAPCO tax credits.

Rating Downgrades

We would downgrade the ratings on the debt of a CAPCO, NMTC or similar issuer if it does not meet its investment deadline requirements or does not otherwise comply with the obligations in the issuance documentation. Causes for downgrade actions from an original rating include the following:

- Any basis for de-certification of the CAPCO, determination that an NMTC issuer's relevant CDE is no longer eligible, or the failure to maintain any other program eligibility requirements under the applicable statute or relevant regulations: A downgrade would be appropriate when such decertification or ineligibility would affect the availability of the promised tax credits to pay an issuer's noteholders.
- A breach of contractual obligations or a default, even if it does not result in de-certification or other ineligibility, could be evidence that the noteholders are subject to increased operational risk. Such a "softer," non-de-certification breach could be the basis for an incremental downgrade (i.e., one or two rating levels) from an original A3 rating. Such a rating action would depend on specific circumstances, such as whether breaches had occurred before, whether ongoing or unremedied softer breaches could ultimately lead to de-certification or ineligibility (e.g., failing to meet an investment benchmark at a time required in the transaction documentation, even when such failure is in advance of the statutory deadline and is not cured), and the viability of the mechanisms to cure any breach. In such cases, even though an issuer could remain investment-grade after a breach as long as the issuer is not in danger of losing its eligibility for providing tax credits, we would likely await full documentary compliance before restoring the issuer's previous A3 or higher rating.
- When an issuer fails to meet an initial investment deadline, we would be likely to downgrade the issuers' debt rating to the B1-B3 range to account for default under the transaction documents, the risk of recapture of used tax credits and any risk of de-certification or ineligibility, depending on the issuer's plan for rehabilitating investments in time to avoid de-certification or ineligibility and to rectify its

investment approach. When an issuer such as a traditional CAPCO issuer fails to meet a final investment benchmark, a rating downgrade to Ca or C might be warranted in light of default under the transaction documents, the potential recapture of tax credits used after meeting the initial investment benchmark and the limited remaining opportunities for rehabilitating the issuer before the possible forfeiture of scheduled tax credits not yet used by investors.

The notes issued by similar tax credit programs may also be downgraded if the issuer fails to invest in accordance with the statute or does not comply with the issuance documents and ongoing program requirements.

Moody's Related Publications

Credit ratings are primarily determined through the application of sector credit rating methodologies. Certain broad methodological considerations (described in one or more cross-sector rating methodologies) may also be relevant to the determination of credit ratings of issuers and instruments. A list of sector and cross-sector credit rating methodologies can be found here.

For data summarizing the historical robustness and predictive power of credit ratings, please click here.

For further information, please refer to *Rating Symbols and Definitions*, which is available here.

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