NEW MARKETS TAX CREDIT COALITION

Comments to the Community Development and Infrastructure Tax Reform Working Group by the New Markets Tax Credit Coalition

April 15, 2015

New Markets Tax Credit Coalition, 1331 G St NW, Suite 1000, Washington, DC 20005

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The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, DC 20510

The Honorable Michael Bennet
United States Senate
261 Russell Senate Office Building
Washington, DC 20510

Dear Senators Heller and Bennet, Co-Chairmen of the Community Development and Infrastructure Working Group:

The New Markets Tax Credit (NMTC) Coalition is a national membership organization that advocates on behalf of the NMTC program. The Coalition, which now includes more than 150 members, is managed by Rapoza Associates, a public interest lobbying, policy analysis and government relations firm located in Washington, DC.

Since the enactment in 2000, the New Markets Tax Credit (NMTC) has become an essential tool for revitalization in urban neighborhoods and rural communities. The NMTC is recognized as an innovative use of federal funds to help communities left out of the economic mainstream, principally because they lack access to patient capital. The credit leverages billions in private sector investment, creating hundreds of thousands of jobs, constructing and improving commercial and community facilities, repurposing vacant buildings, and revitalizing local economies in some of the poorest communities in America.

Based on this record of success, Congress should permanently authorize and expand the NMTC as part of the Internal Revenue Code. In particular, the New Markets Tax Credit Coalition endorses the provisions of the bipartisan extension legislation in the House and Senate, the New Markets Tax Credit Extension Act of 2015 (H.R. 855/S. 591). Both bills provide a permanent authorization for the NMTC, increase the annual credit authority in 2015, with inflation adjustments in future years, and provide an exemption from the Alternative Minimum Tax for NMTC investments.

I. Why Communities Need the New Markets Tax Credit

In December 2000, the Community Renewal Tax Relief Act (P.L. 106-554) was signed into law. This legislation authorized the New Markets Tax Credit (NMTC) program, a modest tax incentive designed to increase the flow of private sector capital to communities long overlooked by conventional lenders. While today's economy differs significantly from the 2000 economy, the challenge of attracting investment capital to underserved areas persists and, in fact, has intensified in the wake of the Great Recession and our slow economic recovery.

Then – as now – the basis for the Credit is that business success depends on access to capital. There are attractive investment opportunities in low income communities, but the cost and availability of capital in these 'New Markets' is an impediment to economic growth. A study in the late 1990s by HUD[1] highlighted two main gaps – capital and information – which hold back the growth of inner city economies. Investors and firms often lack sufficient data to assess property value or consumer demand in low income communities, where informal economies distort data. The capital gap deprives inner city businesses of the investment dollars they need to set up shop and expand. As a result, low income communities are under-retailed as inner city residents leave their neighborhoods to shop. They lack the capital to construct or renovate community facilities that would improve the quality of life. The NMTC bridges the capital gap by easing the flow of capital into these areas, connecting investors with new opportunities in communities in which they had previously not considered investing.

More than a decade later, there is substantial evidence that low and moderate income areas continue to be underserved by private sector capital. A recent study by the Initiative for a Competitive Inner City found that "firms in low income census tracts received 21% fewer loans than would be expected based on the number of firms in the tracts," despite a healthy demand for capital and an untapped consumer base.[2] This lack of capital continues to stifle entrepreneurs and impede growth, allowing urban decay and economic stagnation to persist in downtown areas and small towns, despite opportunities for investment.

After three decades of steep cuts in federal community development spending (see page 9), the NMTC is one of the only federal tools available to help persistently disinvested communities create jobs, improve services, and break out of the cycle of poverty.

Communities use the NMTC to leverage private dollars to improve healthcare access, reclaim vacant and abandoned buildings, and restart the manufacturing sector.

II. Legislative History

The Community Renewal Tax Relief Act was the product of collaboration between President Bill Clinton and Speaker of the House Dennis Hastert (R-IL). The legislation's intention was to reduce poverty by driving private sector investment into low income communities, and the New Markets Tax Credit was the lynchpin of this approach.

In order to stimulate private sector investment in urban and rural low income communities, the NMTC legislation formalized a delivery system of private, for-profit, and nonprofit entities that could provide technical and financial assistance to economically distressed communities and their businesses. The enactment of the Community Renewal Tax Relief Act of 2000 was the culmination of efforts first begun by former HUD Secretary and Congressman Jack Kemp, who had long argued for employing the tax code to incentivize private sector investment in low income communities.

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[1] Retail Buying Power and Sales Gaps in Inner-City New Markets, Department of Housing and Urban Development, 1999.

[2] Capital Availability in Inner Cities: What Role for Federal Policy? 2011.

The Omnibus Reconciliation Act of 1993 (P.L. 103-66) permanently codified the Low Income Housing Tax Credit (LIHTC) and also authorized Empowerment Zones and Enterprise Communities, programs with defined geographies for revitalization. Building on the success of that model, the Clinton-Hastert legislation included $25 billion in new authorities, including: establishment of the New Markets Tax Credit; creation of a companion New Markets Venture Capital program, administered by the Small Business Administration; 40 new Community Renewal Zones; and an increase in the Low Income Housing Tax Credit.

The Bush Administration successfully launched the NMTC program, publishing the interim rule that initially governed the NMTC and allocating the first rounds of Credits from 2003-2007. The Administration proposed and President Bush signed into law extensions of the NMTC in 2008 and 2009. According to an article published in the Hoover Institution's *Policy Review*, the New Markets Tax Credit, along with the Low Income Housing Tax Credit, were "the two main pillars of the President's (Bush) urban renewal program."[3]

The Obama Administration supported expansion of the NMTC in economic stimulus legislation enacted in 2009, and in subsequent federal budget and tax proposals.

To date, Congress has authorized some $43.5 billion in NMTCs. Of this amount:

- $15 billion was made available for 2001-2007 in the Community Renewal and Tax Relief Act;
- An additional $1 billion was authorized for communities hard-hit by Gulf Coast hurricanes in the Gulf Opportunity Zone Act of 2005 (P.L. 109-135);
- In 2006, Congress extended the NMTC for 2008 at $3.5 billion in annual credit authority through the Tax Relief and Health Care Act of 2006 (P.L. 109-432);
- The Emergency Economic Stabilization Act of 2008 (P.L. 110-343) extended the Credit for 2009, again at $3.5 billion in annual credit authority;
- The American Recovery and Reinvestment Act of 2009 (P.L. 111-16), increased credit authority to $5 billion for both 2008 and 2009;
- The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312) provided a two-year extension of the NMTC (2010 and 2011) with annual credit authority of $3.5 billion;
- The American Taxpayer Relief Act of 2012 (P.L. 112–240) provided a two-year extension of the NMTC (2012 and 2013) with annual credit authority of $3.5 billion; and
- The Tax Increase Prevention Act of 2014 (PL113-295) extended the NMTC for 2014 at $3.5 billion in annual credit authority.

Through the end of 2013, $40 billion in credit authority had been allocated. The total cost, in terms of revenue forgone for allocated Credits, is $10.4 billion. The Treasury Department will allocate $3.5 billion, authorized at the end of 2014, in the spring of 2015.

[3] Hendrickson, K. (2004). Hoover Institution. Policy Review, No. 126. Bush and the Cities.

III. How the NMTC works

The NMTC is administered by the Community Development Financial Institutions (CDFI) Fund of the Treasury. The CDFI Fund issues an annual Notice of Allocation Availability (NOAA) that sets out the terms and conditions for the annual allocation application.

Applicants must be certified as Community Development Entities (CDEs). A CDE must be a domestic corporation, have a demonstrated mission of serving or providing capital to low income communities or people, and maintain accountability to residents of low income communities through representation on a governing or advisory board to the CDE.

Applications are scored in four areas: community impact, business strategy, capitalization strategy, and management capacity. Throughout the history of the NMTC, demand for credits has exceeded the authorized amount by 8 to 1. The success rate of applications for Credits is less than 25 percent.

The cornerstone of the NMTC is the ability of the CDE to attract private investors. The NMTC provides a 39 percent, seven-year credit against federal income taxes. A private investor – typically a private financial institution – may make an equity investment in a CDE in return for the Credit. The CDE uses that capital to make loans or investments in businesses in low income communities.

IV. Economic Impact of the NMTC

In December 2014, the New Markets Tax Credit Coalition released an economic impact report on the NMTC. The report aggregated the economic impact of over 3,800 NMTC projects closing between 2003 and 2012[4]. Among its findings:

- The NMTC delivered an unprecedented level of investment to low income communities. Total project investment in NMTC financed businesses came to $63 billion, of which more than $31 billion was NMTC capital, with the balance coming from other sources;
- From 2003 to 2012, NMTC investments directly and indirectly generated nearly $118 billion in economic activity, creating 744,267 jobs in low income rural and urban communities, including 457,487 construction jobs and 286,781 full-time equivalent jobs in nearly every industry sector of the economy;
- NMTC investments generate economic activity, providing a return on investment to the federal government. In 2012 alone, NMTC-financed businesses generated $984 million in federal tax

> **NMTC Evaluation by the Urban Institute**
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> **A recent Urban Institute study examined the extent to which the NMTC helps communities add amenities, improve services, and finance community facilities. The study found that 88 percent of NMTC projects brought direct or indirect quality-of-life improvements to their communities, including parks, playgrounds, shopping centers, health clinics, and other amenities.**

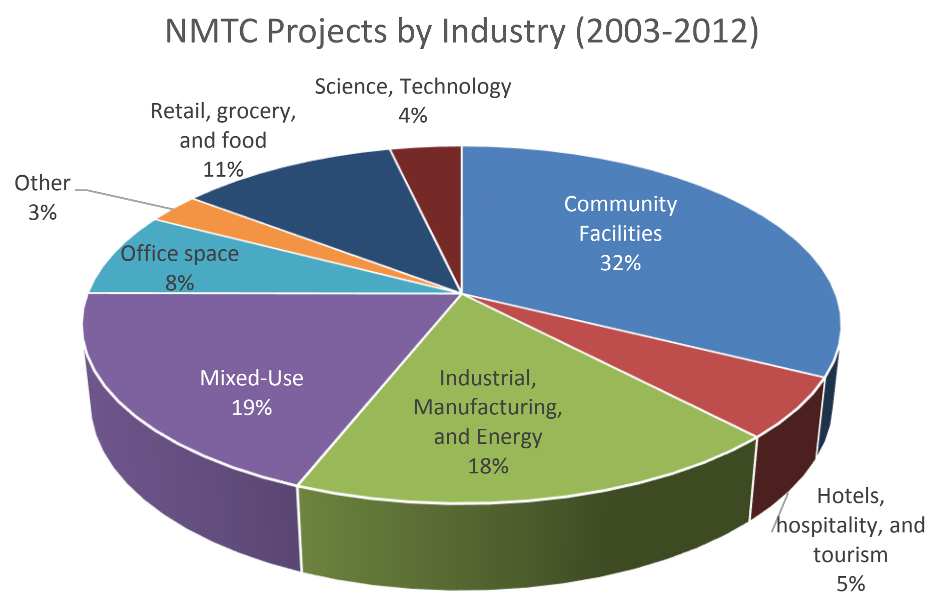
[4] *A Decade of the NMTC: An Economic Impact Report*. NMTC Coalition, December, 2014.

revenue, which more than covered the estimated $800 million cost of the Credit in terms of lost tax revenue in 2012;
- By stabilizing and revitalizing local economies, the NMTC helps boost tax revenue for state and local governments. In 2012, NMTC investments nationwide generated $542 million in state and local tax revenue; and
- Beyond creating jobs and generating economic activity, the NMTC helps enhance community revitalization efforts by financing community facilities and other important quality of life amenities. Between 2003 and 2012, more than 1,200 NMTC projects involved community amenities like healthcare facilities, schools, nonprofit service providers, and daycare centers.

V. Types of Businesses and Projects Financed by NMTC

From business expansions to new healthcare and childcare facilities, the credit was designed as a flexible incentive for economic development that meets evolving community needs. Instead of Washington picking winners and losers, the New Markets Tax Credit empowers local decision-making on important economic development projects. The industry sectors receiving NMTC financing are diverse, reflecting a cross-section of the American economy (see chart below).

Nearly one-third of NMTC projects involve healthcare facilities, daycare space, educational facilities, and other community facilities and amenities that directly improve the quality of life for residents. Another popular use of the NMTC is to finance facilities and equipment for industrial, manufacturing, and energy production firms. Nearly 20 percent of NMTC projects involve industrial activity.



Source: A Decade of the NMTC. NMTC Coalition (2014).

VI. Profile of Communities Served by NMTC Investments

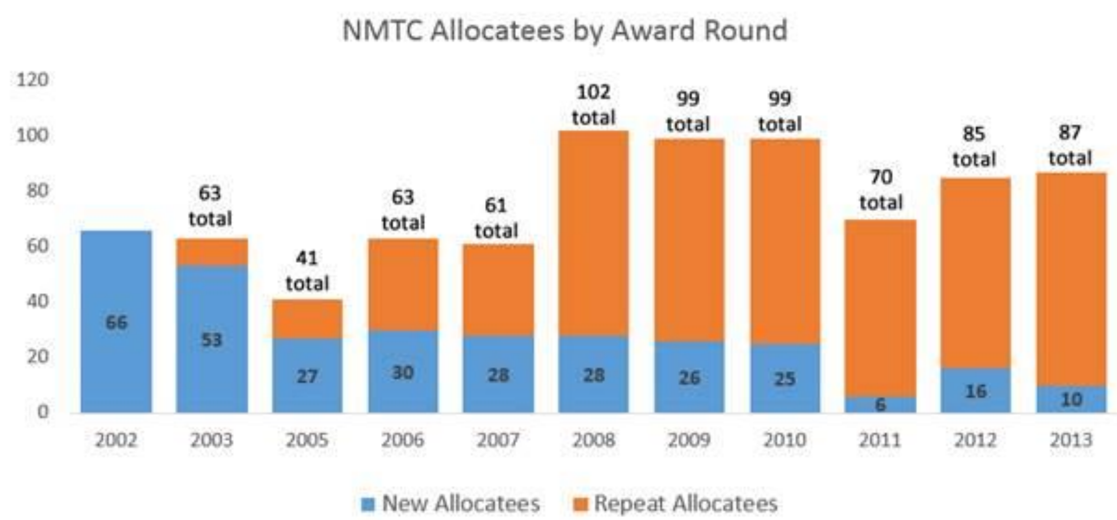
The NMTC targets about 40 percent of nation's census tracts that meet the statutory requirements for economic distress[5]. However, most NMTC financing goes to severely distressed communities that far exceed program requirements for poverty and income. From 2003 to 2012, 76 percent of NMTC projects were located in severely distressed communities[6]. Developing and financing businesses and projects in those high distress communities is challenging in terms of infrastructure, the availability of other sources of private-sector financing, and uncertain markets.

Nearly 20 percent of NMTC investments go to non-metropolitan census tracts, a percentage that reflects the proportion of Americans living in rural towns.

The CDFI Fund has made changes to the NMTC application designed to nudge investment toward states that have not seen their fair share, based on their level of economic distress. The Fund gives a slight preference to the ten "underserved" states that have historically received the lowest share of NMTC investment. These efforts have largely succeeded, as activity has recently increased in states that were underserved during the early years of the program.

Despite keen competition for the NMTC, new entrants continue to gain access to NMTC allocations. Over the past five years, 111 CDEs received their first allocations. This represents approximately 20 percent of the total number of awarded allocations and indicates that successful organizations with solid business plans and a record of performance in community development finance can participate in the program.

The most effective way to ensure the geographic diversity of the program and make certain that NMTC investments reach low income urban and rural communities across the country, is to raise the allocation level.



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[5] Primary criteria: Census tracts with poverty rates at or above 20% or median incomes at or below 80% of the AMI.
[6] Census tracts with poverty rates at or above 30% or unemployment rates at least 150% of the national average.

VII. NMTC and Tax Expenditures

The NMTC represents just a small fraction of federal tax expenditures to support real estate development. According to a 2013 report by Smart Growth America[7], tax expenditures supporting real estate accounted for nearly $680 billion in cost between FY 2007 and FY 2011. The New Markets Tax Credit, which is targeted specifically to low income communities, represented just $3 billion of the $680 billion cost for the same period, or less than 0.5 percent.

According to a recent Joint Committee on Taxation (JCT) report[8], annual tax expenditures for community development totaled $12 billion in 2014. Of this amount, over $8 billion supports the development of rental housing, which benefits low income households, but not necessarily low income communities.

Annual Federal Cost of Tax Incentives for Community Development (2014)

Program	**Annual amount (2014)**
LIHTC	$7,200,000,000
Exclusion of interest on rental housing bonds	$1,000,000,000
Historic Tax Credit (20%) + 10% rehab credit	$1,000,000,000
NMTC	$1,000,000,000
Exclusion of interest for airport, dock, and similar bonds	$800,000,000
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	$400,000,000
Credit for holders of qualified academy bonds	$300,000,000
Recovery zone bonds	$200,000,000
Empowerment zones	$100,000,000
Brownfields redevelopment	$25,000,000
Tribal economic development bonds	$10,000,000
Total	**$12,035,000,000**

The New Markets Tax Credit is unique in its targeting and purpose. The NMTC is the only federal incentive that is primarily intended to drive capital to credit-starved businesses in economically distressed urban and rural communities, accounting for only about 8 percent of annual tax expenditures for community development[9]. Unlike other programs that address a policy concern (like affordable housing) that may overlap with low income communities, the NMTC is the only incentive that provides both (1) the flexibility to finance a variety of businesses and projects in these low income communities, along with (2) an effective, established system to deliver that financing.

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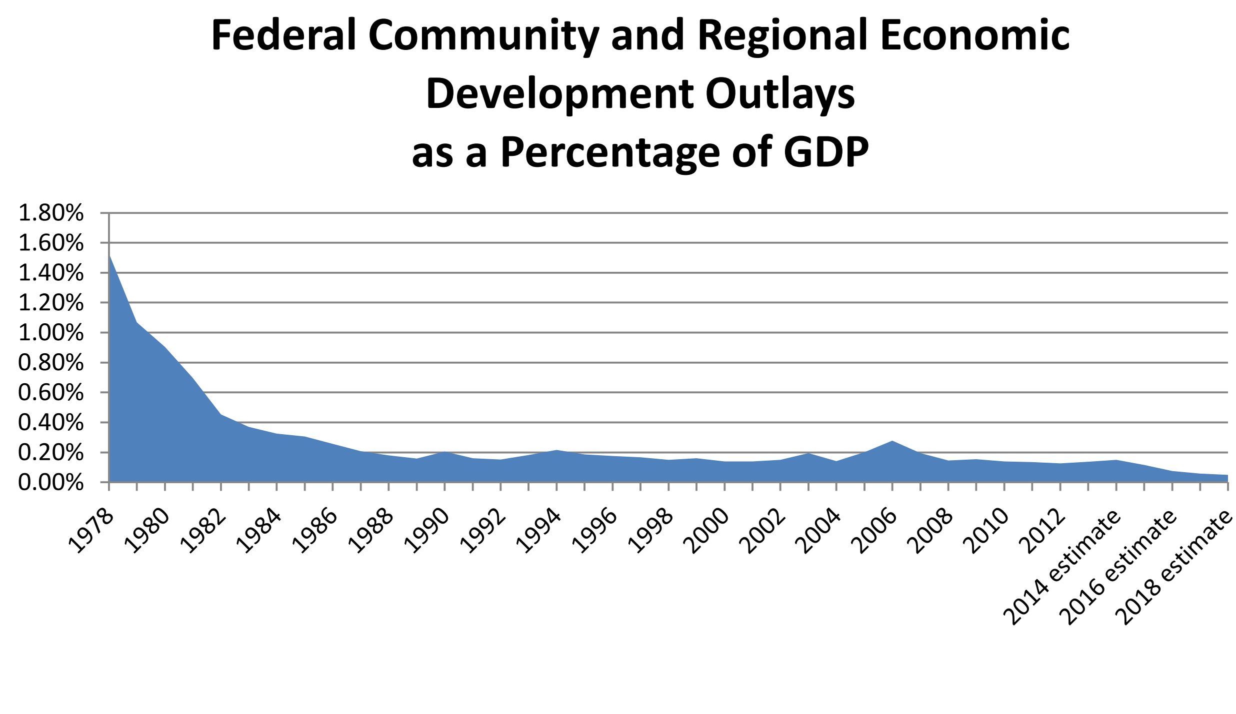
[7] Federal Involvement in Real Estate: A call for examination. Smart Growth America, January, 2013.
[8] ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018. Joint Committee on Taxation, August, 2014.
[9] The NMTC cost the federal government about $1 billion in forgone revenue in 2014. In total, tax expenditures for community development amounted to $12.035 billion.

Because of reductions in federal spending, tax expenditures are an increasingly important element in the federal support for housing, as well as economic and community development. According to data from OMB, as measured as a percentage of GDP, federal spending for community development – HUD, Agriculture, Commerce, and Interior -- has fallen by 75 percent since 1980[10]. (See chart below).

Because the NMTC lacks an annual inflation adjustment, the level of NMTC financing available to distressed communities has also declined. In 2007, $3.5 billion in NMTC allocation authority was available, the same amount available in the 2014 application round. After adjusting for inflation, NMTC allocation authority has declined by 12.3 percent since 2007. The decline of NMTC allocations-when coupled with the decline in federal community development spending – makes the task of revitalizing underserved communities more and more difficult.

In this environment of increasingly scarce resources, sometimes the NMTC is paired with federal incentives for economic development, particularly in highly distressed communities where conventional capital is almost non-existent. However, according to the Government Accountability Office (GAO), only 17 percent of NMTC project costs between 2011 and 2012 came from other federal sources, with most of the balance coming from private investors.

There is little evidence that the blending of the NMTC with public subsidies increases the return to investors. As "last-in" gap filler for projects that cannot proceed without additional funds, the NMTC is used if and only if other public or private sources are not available. Furthermore, with funding for other federal subsidies for community investment continuing to decline (see below), the NMTC has increasingly become one of the few viable options for community revitalization.



[10] OMB Historical Tables.

VIII. An Efficient Approach to Economic Development

As the credit has matured, an intensely competitive application process has increased the efficiency of the NMTC. Throughout the history of the credit, demand for Credits has vastly outpaced the amount authorized. Treasury made the first NMTC allocation in 2003. Between 2003 and 2014, Treasury has received allocation applications totaling for $301 billion, but only $43.5 billion on NMTC allocation has been authorized.

The CDFI Fund requires CDE applicants to demonstrate a record of success in placing investments in communities where the need is greatest and the impact is the largest. The allocation application includes questions related to the prior performance of the applicant, including how past NMTC use has benefited low income businesses and distressed communities. The application requires CDEs to quantify outcomes for previous loans and investments. If CDEs cannot demonstrate they have used NMTC financing to maximize tangible outcomes and impacts in communities, they will be at a disadvantage in the intense competition for Credits.

The NMTC "but-for" test limits the amount of NMTC-generating financing necessary for financial feasibility. The NMTC typically provides "last-in" gap financing, meaning it is the last financing secured to make a project viable. CDEs and investors evaluate the sources and uses of available capital, the business plan of the enterprise in question, and its impact on the low income community in order to determine how much NMTC financing is needed to complete the project and maximize community impact.

If additional subsidies are not needed, the project will not receive NMTC financing. The NMTC is a scarce resource, which CDEs deploy accordingly. CDEs do not have an incentive to provide more NMTC-backed financing than what is absolutely necessary to make a project viable. Only after all the financing from other sources is committed, and the impact is clear, does a CDE commit to providing NMTC financing.

Under the law, CDEs are required to invest at least 85 percent of Qualified Equity Investments (QEIs) into projects. However, according to the GAO's survey for 2011-2012[11], fees and retention only totaled 7.1 percent of total NMTC Qualified Equity Investments (QEIs). The Urban Institute's Evaluation of the NMTC indicated that CDEs invested 97 percent of QEIs into businesses and projects[12]. ***In other words, the two most recent reports on NMTC indicate that investment rates are well above the requirements established in law and regulation.***

In addition to the efficiency gained through steep competition, the structure of the Credit also enhances its efficiency in terms of the cost to the federal government. NMTC is a shallow credit, providing a 39 percent return over seven years. The NMTC is risk-based capital. Market rates for such capital are 6.5 to 13 percent or more annually. However, the NMTC, which is employed in communities that are economically distressed and lack many of the attributes of conventional markets, typically provides an annual rate of return at the low end of that range: 6 to 7 percent.

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[11] GAO-14-500: Published: Jul 10, 2014.

[12] Urban Institute Evaluation of the NMTC: June 2013.

Because the NMTC is a taxable credit, the cost to the government is not 39 percent, but closer to 26 percent. In other words, every dollar invested in an NMTC business costs the federal government 26 cents in terms of revenue forgone. As noted, between 2003 and 2012, NMTC investments total $31 billion and total project costs for NMTC-financed businesses came to $63 billion. The cost to the federal government in terms of revenue loss for the NMTC investments is $8.1 billion. Every dollar of forgone federal revenue generates eight dollars of new investment in the poorest communities in America, creating jobs and business opportunity and improving facilities and services.

Congress can take steps to increase the NMTC's efficiency. The two biggest obstacles to greater efficiency are the absence of a longer time horizon for the program and the lack of an exemption from the Alternative Minimum Tax (AMT) for New Markets investments. A long term or permanent authorization will provide investors and CDEs more time to plan and invest in the infrastructure necessary to support the program.

Exemption from the AMT would diversify the pool of investors who could invest in the NMTC. Unlike other investment tax credits – including the Low Income Housing Tax Credit (LIHTC) and the Historic Tax Credit (HTC) – NMTC investments are subject to the AMT. Providing an AMT exemption for NMTC investments would bring the NMTC in line with those other credits and open up the NMTC investor market to new investors, including community banks and corporate investors that are currently restrained by AMT. When LIHTC was made permanent in 1993, pricing of the credits increased dramatically. When Congress provided an AMT exemption to LIHTC investors through the Housing and Economic Recovery Act of 2008, this also increased pricing. A higher priced credit means more investment flows to projects. Similarly, NMTC permanence – coupled with AMT relief – would broaden the investor base, create better pricing, increase competition and efficiency, and drive even more subsidy to businesses operating in NMTC qualified communities.

IX. Conclusion

The NMTC has met its essential purpose as an incentive for private-sector investment in economically distressed urban and rural communities, most of which far exceed the statutory requirements for investment. The program meets a critical need, delivering capital to underserved communities with high unemployment, and it has done so at a relatively low cost to the government. Investors receive a modest return while businesses and economic development projects receive substantial benefits from NMTC financing. With dwindling government resources, the priority should be given to programs that achieve their purpose efficiently. For that reason, the NMTC merits a permanent extension along the lines of the bipartisan New Markets Tax Credit Extension Act, which is pending before the House and Senate.