

Statement of the New Markets Tax Credit Coalition

Subcommittee on Tax Policy

Member Proposals for Tax Legislation

May 23, 2016

My name is Robert Davenport and I am the President of the National Development Council (NDC). Focusing on Homes, Jobs and Community, NDC was founded as a national nonprofit in 1969 to create economic opportunity in America's low income communities. NDC invests capital to support the development and preservation of affordable housing, the creation of jobs through training and small business lending and the advancement of livable communities through investment in social infrastructure. Through its subsidiary, the NDC Housing and Economic Development Corporation (HEDC), NDC has made more than 90 loans and investments using the New Markets Tax Credit. This financing has revitalized economically distressed urban neighborhood and rural communities, creating jobs and business opportunities and improving industrial, commercial and community facilities.

I also serve as the President of The New Markets Tax Credit Coalition, a national membership organization with more than 150 community development organizations, financial institutions and public officials that advocates and supports the New Market Tax Credit. The Coalition is pleased to submit this statement in support of the New Markets Tax Credit and to indicate strong support for H.R. 855, *The New Markets Tax Credit Extension Act of 2015*, sponsored by Reps. Tiberi, Neal, Reed and 62 other Members of the House from both parties.

H.R. 855 does three things:

- Provides an indefinite extension of the New Markets Tax Credit (NMTC);
- Provides an increase in the annual NMTC allocation and indexes the allocation to inflation in future years; and
- Provides Alternative Minimum Tax (AMT) relief for NMTC investments thereby ensuring NMTC investors the same consideration under the AMT as is currently provided to investors in many other federal tax credits.

The NMTC was originally authorized in the *Community Renewal Tax Relief Act of 2000* (P.L. 106-554) as part of a bipartisan effort to stimulate investment and economic growth in low income urban neighborhoods and rural communities that lack access to the patient capital needed to support and grow businesses, create jobs, and sustain healthy local economies. That legislation authorized NMTC for 2001-2007 and made \$15 billion in annual credit authority available. Since that time, Congress has extended the NMTC several times:

- An additional \$1 billion was authorized for communities hard-hit by Gulf Coast hurricanes, *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* (P.L. 113-295) extended the NMTC for 2014 at \$3.5 billion in annual credit authority.

Most recently, the *PATH Act* (P.L. 114-113) extended the NMTC for five years, from 2015 to 2019, at \$3.5 billion in annual credit authority. The *PATH Act* was the longest authorization for the NMTC since the *Community Renewal Tax Relief Act* and, at \$17.5 billion, the largest in the history of the Credit.

The NMTC program works by attracting capital to eligible communities by providing private investors with a modest federal tax credit for investments made in businesses or economic development projects located in some of the most distressed communities in the nation – census tracts where the individual poverty rate is at least 20 percent or where median family income does not exceed 80 percent of the area’s median income. NMTC investors receive a tax credit equal to 39 percent of the total Qualified Equity Investment made in a Community Development Entity with the Credit, realized over a seven-year period. This amounts to 5 percent annually for the first three years, and 6 percent in years four through seven. Returns on NMTC investments are taxable, so the cost of each dollar of NMTC allocation to the federal government is not 39 cents, but rather, 26 cents.

The basis for the NMTC is that businesses’ 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. 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 businesses of the investment dollars they need to set up shop and expand. It impedes the construction or renovation of community facilities and revitalized industrial

and commercial facilities that would create jobs, economic opportunity and improve the quality of life.

Fifteen years after the NMTC's inception, the need for patient, flexible capital is as great as ever in low and moderate income rural, urban, and native areas underserved by commercial lenders.

A 2011 study by the Initiative for a Competitive Inner City found that "firms in low income census tracts received 21 percent fewer loans than would be expected, based on the number of firms in the tracts," even with a healthy demand for capital and an untapped consumer base. As a result, inner city neighborhoods are under-retailed, forcing residents to leave their neighborhoods to shop.

Small towns and farming communities also continue to be underserved by conventional lenders. A 2013 analysis by the Federal Financial Institutions Examination Council found that while rural low income census tracts include about 6 percent of the population and about 6 percent of the businesses, they only received around 5 percent of the loans and about 6 percent of the total dollar amount of small business loans in 2012. The decade's long trend of community bank closure and consolidation has hit rural areas particularly hard. The number of community banks in the United States has declined by an average of 300 per year over the past 30 years, according to data from the Federal Deposit Insurance Corporation.

The Office of the Controller of Currency found that residents of Indian Country¹ face challenges securing commercial credit, including "limited access to brick-and-mortar offices of regulated financial institutions; the perception by tribal business enterprises, even those with adequate collateral and good credit histories, that commercial bank financing is difficult to secure; a lack of diversity in funding sources; a lack of equity resources, collateral, and credit history, resulting in commercial credit denials for Indian small business owners."

The NMTC has a strong and proven track record in meeting the capital needs of these communities. Between 2003 and 2014, \$38 billion² in direct NMTC investments were made in businesses. In turn, these NMTC investments leveraged nearly \$75 billion³ in total capital investment to businesses and revitalization projects in communities with high rates of poverty and unemployment. By law, all NMTC investments must be made in economically distressed communities. However, more than 72 percent of all NMTC investments have been in communities exhibiting severe economic distress, including unemployment rates

¹ Commercial Lending in Indian Country: Potential Opportunities in a Growing Market", the Office of the Controller of Currency, February 2016

² CDFI Fund's FY 2015 Agency Financial Report

³ NMTC Coalition Estimate

more than 1.5 times the national average, a poverty rate of 30 percent or more, or a median income at or below 60 percent of the area median.

Between 2003 and 2012, the NMTC generated about 750,000 jobs⁴, at a cost to the federal government of less than \$20,000 per job. The New Markets Tax Credit generates economic activity, providing a return on investment to the federal government. In 2012, NMTC-financed businesses generated \$984 million in federal tax revenue which more than covered the estimated \$800 million cost of the Credit in terms of lost tax revenue in 2012. In addition in 2012, NMTC investments nationwide generated \$542 million in state and local tax revenue.

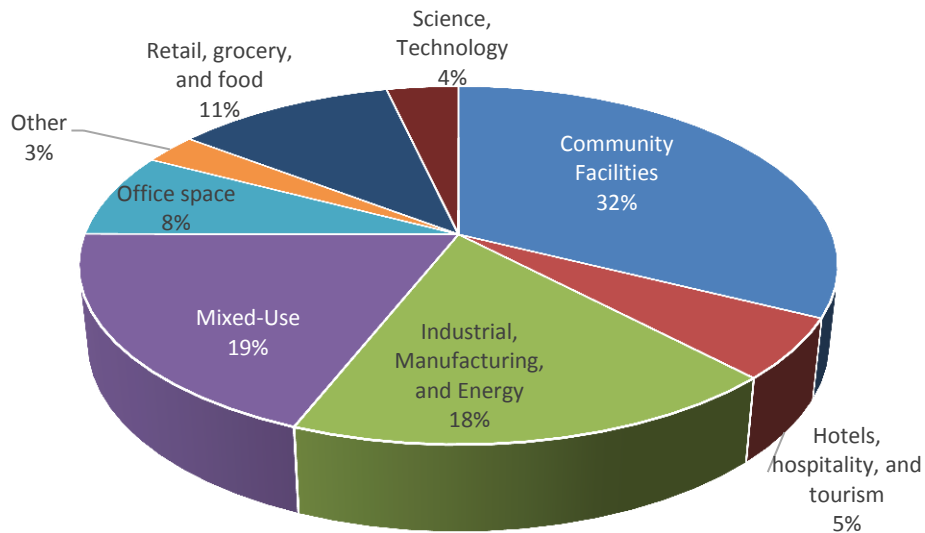
Beyond creating jobs and generating economic activity, the NMTC helps enhance community revitalization efforts by financing community facilities and other important quality of life amenities. Between 2003 and 2013, more than 1,300 NMTC projects involved community amenities like healthcare facilities, schools, nonprofit service providers, and childcare centers. 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.

From business expansions to new healthcare and childcare facilities, the program 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 nonprofit and industry sectors receiving NMTC financing are diverse, reflecting a cross-section of the American economy.

Nearly one-third of NMTC projects involve healthcare facilities, affordable space for innovative nonprofits and social enterprises, educational facilities, and other amenities that directly improve the quality of life for local residents. Another popular use of the NMTC is to finance facilities and/or equipment for industrial, manufacturing, and energy production firms. Approximately 20 percent of NMTC projects involve industrial activity. (See Chart below).

⁴ A Decade of the NMTC (2003-2012), NMTC Coalition (December 2014).

NMTC Projects by Industry (2003-2013)



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 about 8 percent of annual tax expenditures for community development⁵. Unlike other programs that address a policy concern (such as affordable housing) that may overlap with low income communities, the NMTC 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.

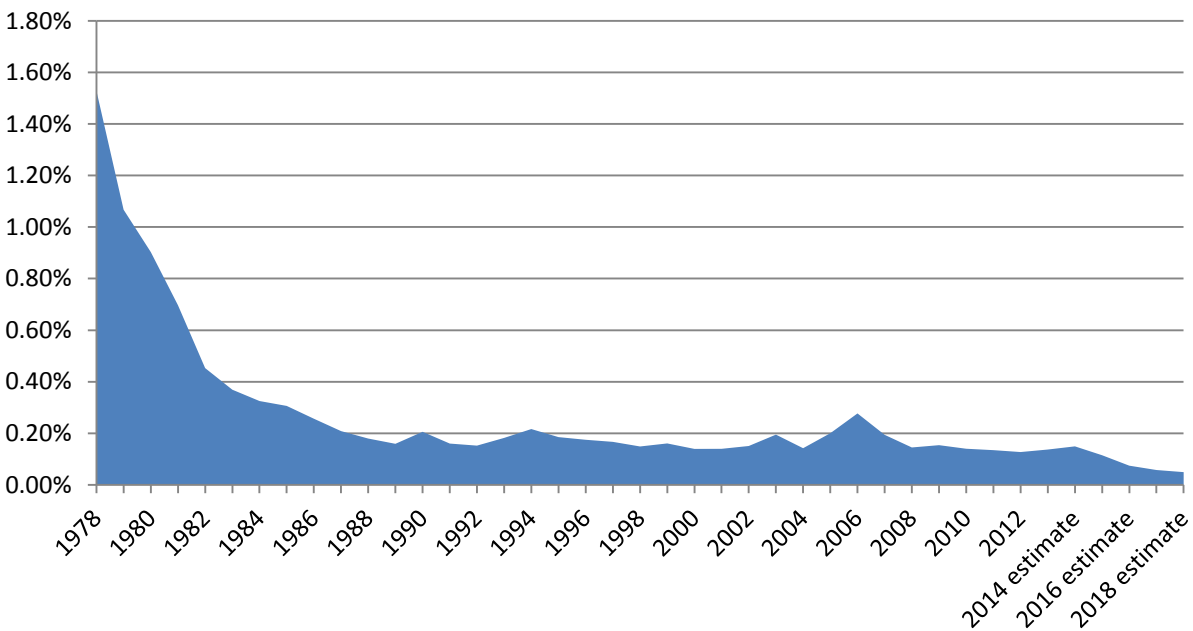
NMTC projects vary widely in size and scope – from a microloan fund in Portland Oregon that makes \$5,000 loans to minority entrepreneurs in low income neighborhoods, to the financing of a hospital in the GO Zone in Louisiana and a healthcare center in a very poor city in Massachusetts, to a tire factory in rural South Carolina, which created 1,600 permanent jobs in a county with an unemployment rate of 12.1 percent. Yet, all produce the same impact: better lives, communities and opportunity for urban neighborhood and rural communities that are left of the economic mainstream.

Because of reductions in federal spending, tax expenditures for community development 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 percentage of GDP, federal spending for community development – HUD, Agriculture, Commerce, and Interior -- has fallen by 75 percent since 1980⁶. (See Chart below).

⁵ 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.

⁶ OMB Historical Tables.

Federal Community and Regional Economic Development Outlays as a Percentage of GDP



Intense competition for Credits and a demonstrated record of success in placing Credit where the need and impact is greatest has increased the efficiency of NMTC. Over the history of the program demand for Credits has vastly outstripped the amount authorized. Treasury made the first NMTC allocation in 2003. Between 2003 and 2015, Treasury has received allocation applications for \$314.7 billion and has had just \$50.6 billion in NMTC allocation available.

The allocation application includes questions related to prior performance of the applicant, including how past NMTC use benefited low income businesses and distressed communities. The application requires applicants to quantify outcomes for previous loans and investments. If CDEs cannot demonstrate they 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 have no 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 provide NMTC financing.

Under the law, CDEs are required to invest at least 85 percent of Qualified Equity Investments (QEIs) into projects. According to the GAO's survey for 2011-2012⁷, fees and retentions 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 projects⁸. In other words, the two most recent reports on NMTC indicate that investment rates are well above the requirements established in law and regulation.

Broadening the NMTC investor base would increase competition and efficiency, leading to better pricing, and driving even more subsidy to businesses operating in NMTC-qualified communities. By enacting H.R. 855 Congress can take steps to increase the NMTC's efficiency. The real obstacles to greater efficiency are the lack of a longer time horizon for the program and 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 who are currently restrained by AMT.

It is time to expand and make the New Markets Tax Credit permanent. The NMTC meets an important and critical need for private-sector investment in economically distressed urban and rural communities. It blends the market incentive of Jack Kemp's Enterprise Zones with the flexible community-driven approach of Lyndon Johnson's Economic Opportunity Act. Furthermore, data on the impact of the NMTC shows that it has not only achieved its purpose, but it has done so at a relatively low cost to the federal government, particularly when compared to traditional economic development grant programs. Perhaps most importantly, these investments drive and attract additional and new investments to the community, creating a ripple effect of economic development in some of the poorest and hardest hit areas in America. With dwindling government resources, the priority should be given to programs that achieve their purpose efficiently, and the NMTC hits the mark.

⁷ GAO-14-500: Published: Jul 10, 2014.

⁸ Urban Institute Evaluation of the NMTC: June 2013.