NEW MARKETS TAX CREDIT COALITION

A Comment on *Back in Black* and Recommendations for the New Markets Tax Credits

On July 18, Senator Tom Coburn (R-OK) released a deficit reduction proposal entitled Back in Black, which calls for elimination of the New Markets Tax Credit (NMTC). The document relies on a widely discredited report in Bloomberg Markets magazine and does not take into account objective data compiled by federal agencies and others on the success of the New Markets Tax Credit. Finally, Back in Black appears to misunderstand or misinterpret requirements of the program related to private sector investment, targeting of the Credit to low income communities and the actual cost of the NMTC to the federal government.

Back in Black contends that the New Markets Tax Credit (NMTC):

- Provides tax breaks to big banks;
- Subsidizes expensive projects like the Blackstone Hotel; and
- Provides financing to projects that do not benefit low income communities.

Here are the facts:

The New Markets Tax Credit (NMTC) was initially authorized in the Community Renewal Tax Relief Act of 2000, and is designed to stimulate investment and economic growth in low-income communities that are often overlooked by conventional capital markets. The purpose of the New Markets Tax Credit is to provide a modest federal incentive that will encourage private sector investment in low-income communities.

The NMTC provides a 39 percent Credit against federal income taxes for investments in Community Development Entities (CDEs), which are investment vehicles for the Credit. These CDEs use the capital derived from the Credit to lend or invest in businesses in low income communities.

So, an NMTC investment, often made by a regulated private financial institution, and always in an economically distressed community, provides a return far below market rates of return for similar investments. Thus, NMTC investments, which are viewed as risk-based capital, provide on average a 5.5 percent annual return to investors, far below market rate returns for similar financing that average returns of 6.5 to 13 percent.

There is substantial evidence that the NMTC is an effective incentive to encourage private sector investment in low-income areas. According to a U.S. Government Accountability Office (GAO) report[i], 88 percent of NMTC investors – including banks -- surveyed would not have made the investment in the low income community without the Credit. And according to the Treasury Department every $1 of foregone tax revenues under the NMTC leverages about $12 of private investment in distressed communities on a cost basis[ii].

Through December 31, 2009 $15 billion in private sector capital was raised through New Markets. This leveraged more than twice that amount at the business level, bringing the total investment in NMTC eligible census tracts to $50 billion and resulting in financing for some 3,000 business that range from the first supermarket in a generation in Southeast Washington, DC, to a charter school in Florida, to a manufacturing plant in Oklahoma, to a health center in rural Louisiana, a solar company in New Mexico, and revitalization projects in Iowa, Michigan and Virginia. The majority of Credits are used to invest in manufacturing, retail, and community-facility spaces where businesses can grow and expand.

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Every project or business financed by NMTC is located in a low- income community and/or benefits low-income persons. The vast majority – over 90 percent -- of investment dollars generated though NMTC has gone to communities with levels of economic distress that far exceed minimum requirements of the law, and 60 percent has gone to communities with very high unemployment rates that are at least 1.5 times the national average[iii].

Through NMTCs, credit starved small and medium-sized businesses – from bakeries and manufacturing facilities to community health centers and technology companies – receive financing on terms and conditions that are below market rate.

Results from surveyed Community Development Entities[iv] reaffirm that:

- 100 percent offer loans at below-market interest rates to their borrowers,
- 80 percent offer subordinated debt, and
- 86 percent provide lower than standard origination fees.

The NMTC program attracts private capital in a particularly difficult economy, and investments create thousands of full-time jobs and construction jobs. While a limited number of NMTC investments have been made in hotels and museums, economic-development experts cite these as 'on-ramps' to jobs for lower-skill workers. Jobs are vital to rebuilding low-income neighborhoods.

While the Blackstone Hotel has been extensively and inaccurately criticized in the media, it met the requirements of the law, had substantial financing from the City of Chicago and created several hundred jobs that mostly went to residents of low income neighborhoods. Nonetheless, it is not a typical NMTC project in either the profile of community served or the asset class. As noted, 90 percent of the NMTC activity is in communities with poverty rates higher than the 26 percent poverty rate for the community in which the Blackstone is located, and only 5 percent of the businesses financed by NMTC are in the hospitality industry.

It is important to note the efficiency of NMTC. The federal tax credit is 39 percent over seven years. However because the Credit is taxable and returns derived from the NMTC investment are taxed, the actual cost to the government is 26 percent and not the full 39 percent. Through 2009, NMTC cost the federal government, in terms of lost revenue, less than $4 billion that leveraged some $50 billion in investments in low-income communities and created or retained an estimated 500,000 jobs.

At this moment in time, with unemployment at high levels, a 29-year low in job creation, and a reduction in business lending activity, New Markets Tax Credits are providing patient flexible capital to some of the most economically distressed urban and rural communities in America and creating jobs and opportunities for economic growth.

July 27, 2011

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[i] U.S. Government Accountability Office. 2007. Report to Congressional Committees, GAO-07-296. Tax Policy.

[ii] February 2010 Treasury Department Fact Sheet. Retrieved at http://www.treasury.gov/press-center/press-releases/Documents/nmtc%20fact%20sheet.pdf

[iii] The New Markets Tax Credit 10th Anniversary Report. December 2010. New Markets Tax Credit Coalition. Retrieved at http://nmtccoalition.org/wp-content/uploads/NMTC-2011-Progress-Report-FINAL-6-1-11.pdf

[iv] The New Markets Tax Credit Progress Report 2011. June 2011. New Markets Tax Credit Coalition. Retrieved at http://nmtccoalition.org/new-markets-tax-credit/10th-anniversary-report/

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