NEW MARKETS TAX CREDIT COALITION

Testimony of Ronald L. Phillips
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New Markets Tax Credit Coalition
Washington, D.C.

Regarding the Report of the Governmental Accounting Office (GAO) on Minority Community Development Entity (CDE) Participation in the New Markets Tax Credit (NMTC) to the

House Ways and Means Committee
Subcommittee on Select Revenue Measures

House Financial Services Committee
Subcommittee on Domestic Monetary Policy and Technology

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on GAO Report on Minority Participation in the NMTC

Subcommittee on Select Revenue Measures
of the House Ways and Means Committee

Introduction

Chairman Neal and Ranking Member Tiberi, and members of the Subcommittee on Select Revenue Measures, House Ways and Means Committee, my name is Ron Phillips, and I am the current chair of the New Markets Tax Credit Coalition, a Washington, D.C.-based group that advocated for the passage of the New Markets Tax Credit Program and which currently advocates on behalf of the Program and the success it is having in attracting capital to low income communities. I am pleased to submit this testimony on behalf of the 150-member Coalition. Earlier this week our 35-member board of directors discussed the report, and many of my comments reflect our concerns and interest in ensuring that minority-owned and controlled Community Development Entities (CDEs) seeking an allocation are successful.

I am also the President and Chief Operating Officer of Coastal Enterprises, Inc. (CEI) which was founded in 1977. CEI is a 501c3 private non-profit community development corporation (CDC) and community development financial institution (CDFI) based in Wiscasset, a small village in the midcoast region of Maine.

CEI is also a major allocatee of the New Markets Tax Credit program, directing some $481 million of private capital to underserved low income rural regions with a range of projects from community facilities such as health care clinics to natural resource ventures supporting the forestry, farm and fishing communities, to small businesses that create jobs and new economic opportunities for rural residents. Our projects - and many of those financed with NMTC - are increasingly deploying capital in ways that meet environmental responsible standards, produce renewable energy, and ameliorate not only global warming, but also create "green economy" jobs. So it is a very popular, diverse and flexible program targeting benefits to people, places and projects out of the economic mainstream.

CEI's mission is to help create economically and environmentally healthy communities in which all people, especially those with low incomes, can reach their full potential. CEI pursues this mission by providing financing and technical assistance in the development of small, medium and micro enterprises, natural resource ventures, community facilities such as child care, and affordable housing. Since inception CEI is mobilized over $1.8 billion of capital to create jobs and services for people and places out of the economic mainstsream. With roots in the civil rights movement CEI is one of the nation's premiere rural CDCs/CDFIs. CEI serves all of Maine, its primary market, and areas of northern New England, Western Massachusetts and upstate New York.

About the New Markets Tax Credit Coalition

The New Markets Tax Credit (NMTC) Coalition was founded in 1998 by a group of local, regional and national community development organizations that came together to advocate for a federal tax

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credit that would encourage private investment in economically distressed communities. There are currently 150 members of the NMTC Coalition, and its 35 member board of directors represents diverse CDEs from all across the U.S. Thus we have been with this program since inception, know it very well, and are enthusiastic not only about its current success and impact, but what the future holds for many communities in the U.S. as the program reaches more and more places in need.

As you may know, the goal of the NMTC was to create a federal tax credit that could do for community and economic development what the Low Income Housing Tax Credit had done to house low income families – in effect, driving capital to underserved regions or projects that met certain societal goals, in this case, economic development.

The Coalition worked with the Clinton Administration and a bipartisan coalition within the 107th Congress to see the New Markets Tax Credit authorized as part of the Community Renewal Act of 2000. Since the NMTC became law, the Coalition has worked closely with the Administration and Treasury Department officials to launch the program and to develop implementing regulations and procedures.

Targeting Low Income Communities

The program has been successful beyond anyone's expectations in attracting investment capital to distressed communities. While the statutory definition of "low income community" encompasses roughly a third of the census tracts in the country, in each year of the program, the competitive process has required those winning allocations to agree to target their investments to areas of higher distress than minimally required by the program statute. According to the CDFI Fund, the percent of investments CDEs anticipate will be deployed to areas of "higher distress" has risen steadily, from an average of 77 percent in round two, to an average of 97 percent in round five.

It is noteworthy that approximately 95 percent of the projects financed with NMTCs are located in designated areas of higher economic distress than the statute requires. Over 75 percent of projects were located in census tracts with:

1) a poverty rate of at least 30 percent;

2) a median family income at or below 60 percent of the applicable area median family income; or

3) an unemployment rate at least 1.5 times the national average.

The CDFI Fund estimates that on average, 47% of the population is non-white in the census tracts that have received NMTC investments.

Highlights: NMTC Coalition Annual Survey

The Coalition has just completed its fifth annual survey of New Markets Tax Credit Allocatees. The Coalition's 2009 ***Progress Report*** indicates that the New Markets Tax Credit (NMTC) continues to be an important revitalization tool for America's economically distressed communities. Over the course of the program, dating back to the first allocations in 2003, and particularly since 2006,

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Community Development Entities (CDEs) have raised investor equity and deployed that equity in low income communities at a pace faster than required by law or regulation. The initial $13.4 billion invested in low income communities through the New Markets Tax Credits has bolstered local economies, increased economic opportunity and improved the lives of many Americans. The competitive application process places a premium on applicants that commit to invest funds more quickly than required by statute.

The New Markets Tax Credit has a track record of success in providing the incentives necessary to raise capital for loans and investments in economically distressed urban and rural communities. The capital available through NMTC has provided a sufficient subsidy to spur financing for a wide range of business and community development projects that have helped jump start local economies, create jobs, bring quality services to low income communities and provide business opportunities.

There is substantial evidence that the NMTC is an effective incentive to encourage private sector investment in low income areas. A recent GAO report indicated that 88% of investors surveyed would not have made the investment in the low income community without the Credit. A total of 69% of the investors indicated that they had not made an investment in a low income community project prior to working with NMTC.

Across America, NMTC investments support a wide variety of projects, ranging from the investment by a faith-based CDE in a new childcare facility on the west side of Chicago, to financing for an Iowa-based manufacturer of truck bodies, to qualified investments in first new supermarket in the most distressed ward in Washington, DC in 30 years, to new financing for businesses in southeastern Massachusetts, to capital for the creation of a new aerospace facility in rural Oklahoma and to financing to reinvigorate a timber company in Northern Maine. All of these projects demonstrate the capacity of the Credit to leverage private investment, create job and business opportunities, improve services and strengthen local economies.

Profiles of CDE Projects

The exciting part of the NMTC Program is the chance to describe the many different kinds of projects and the highly beneficial impact they are having in low income communities, and on behalf of low income populations.

I am presenting you with our NMTC Coalition report *50 States 50 Stories*. There's a story in virtually every state in the country in this report, and they are only a sampling of the 2000 businesses which have benefited from the financing by the NMTC Program. The diversity of communities and the variety of businesses has been tremendous. It may be a charter school in Los Angeles; a credit union in New Orleans; a health clinic in Harlem; or a paper mill in rural Maine. The point is that the NMTC is a very flexible credit driving private investment capital into hitherto undercapitalized regions of rural and urban America. It's a unique program.

The CDE with which I am affiliated is an example, and given where we are in the country, our focus has been to revive economic development in rural areas. CEI to date has invested half of its total allocation of $481 million to 27 projects. These funds have leveraged an additional $780 million in new private capital investment in low-income areas resulting in a leverage of over $3 for every tax credit dollar. Importantly, these funds have directly preserved or created over 7,700 jobs in the marine research and fishing, organic farm, paper and wood products, recreational tourism,

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manufacturing, arts, health, and service industries. CEI's particular strategy is to invest dollars in rural communities. Examples are:

- Our first investment of over $30 million was in Katahdin Forest management in Millinocket. The NMTC financed 300,000 acres of sustainably managed timberland to reopen an idle and historic mill of the Great Northern Paper Co. Some 600 of many thousands of jobs that have disappeared in the industry were retained. The mill is still challenged by global competition and energy to produce paper on one of its machines, and there are now plans for a renewable-energy biomass facility to ensure the future viability of this operation.

- Another investment of $7.4 million was in the River Valley Market, North Hampton, MA. This is a cooperatively-owned natural foods store to create 70 new jobs. Built to certain LEEDs standards, the project will also support sustainable agricultural development in the Connecticut valley region of rural New England. 50 farm enterprises in the area will supply some of the nutritious, locally-grown produce and processed foods important to the economy of the region, and an alternative to a food system in the U.S. that is heavily dependent on energy and transportation. Already there are dues-paying members of some 2,000.

- The Plymouth Community Health Center in Plymouth, New Hampshire is a $3.4 million new facility affiliated with the Speare Memorial Hospital. Creating 17 high-paying jobs, in addition to its location in a low-income census track, the area is defined as medically underserved by the U.S. Department of Agriculture and a health professional shortage area as defined by the New Hampshire Health Resources and Services Administration.

I hope by these examples you get an idea of the scale, impact and targeting of capital to benefit low income communities. Great examples abound each time one visits a project. Recently, for example, we closed on another project in Northern Maine's Grand Lakes Stream community with a land trust and timber investor involving some 22,000 acres of working and protected forestlands, with 182 acres set aside for affordable housing and small business development. In a recent project with a Maine community bank, Bangor Savings, we're pioneering a $9.5 million SME pool of capital to get funds to small businesses.

GAO Report

Let me turn now to the GAO report. We read with great interest the GAO Report - <u>Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities</u>. The report acknowledges the importance of the Credit in providing assistance to low income communities.

One cannot underestimate the success of the New Markets Credit in getting capital to some of the poorest communities in the country, including minority populations. CDFI Fund data shows that census tracts that have received NMTC investments have, on average, non-white populations of 47%. The Credit has made a significant contribution to improving many communities across that country and that success should not be confused with the attributes of the CDEs that compete for and are awarded Credits.

That said, however, it is equally important that all CDEs have an equal shot at gaining access to Credits and those CDEs with ties to the communities which they serve should be active in the

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program. It is essential to the future success of the program that minority CDEs have access to the Credit. The NMTC Coalition Board of Directors discussed the report in detail just this week during its annual policy council. Many of our board members represent minority groups, so we benefit from their input and voice, as well as the mission-driven concerns of other board members and membership.

Some of the ways the Coalition intends to work toward greater participation by minority-owned and controlled CDEs is through partnering with trade associations or other organizations that already are working to achieve greater minority participation. The Coalition can bring experts and expertise to these organizations which will expand interest in the NMTC Program among their constituents and either deliver or help them to develop technical assistance services to their members. In addition, Coalition board members discussed other ways that minority-owned entities can be helped to access the credit, admittedly, a complex program for any type of institution, with its many requirements for underwriting projects and complying with the CDFI Fund and IRS regulations. Approaches the Board discussed include:

1. Encouraging partnerships between minority CDEs and experienced Allocatees to finance projects in their service areas, both involving the minority CDE in the entire NMTC process and enabling them to become a financial partner in the transaction which will give them a share of the revenues, and build capacity for future applications. Many current Allocatees are more than willing to undertake such partnerships – and some like CEI already have such agreements in place with minority-owned and controlled CDEs. In CEI's case, we have a formal "Working Partner" agreement with the Four Directions Development Corporation, a Maine-based Native American CDFI, and with Oweesta Development Corporation based in South Dakota, which represents several Native American CDFIs.

2. Encouraging minority-owned and controlled CDEs to become involved in the periodic training and technical support offered by the Coalition as well as professional accounting, legal and other networks active on NMTC issues which typically address the Program's challenges, the best application strategies, and the like. An organization that invests time in learning about the program and consistently applies is likely to have a high degree of success in subsequent rounds according to the GAO Report. .

Commentary on GAO Conclusions

With respect to specific findings, we have taken a careful look at the GAO report and its conclusion indicating a very low level of participation by minority-controlled or owned CDEs. We offer the following comments:

For purposes of the NMTC Program, the CDFI Fund defines a **Minority-Owned or Controlled** business as one that is more than 50 percent owned or controlled by one or more persons who are members of a minority ethnic group. If the business is a for-profit concern, more than 50 percent of its owners must be minorities; if the business is a non-profit concern, more than 50 percent of its board of directors must be minorities (or its Chief Executive Officer, Executive Director, General Partner or Managing Member must be a minority).

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Table 6 of the GAO Report indicates that between 2005-2008 minority CDEs received only 8 awards totaling $354 million. Our knowledge of the allocatees suggests there is greater participation. The Coalition identified 18 CDEs that fit the definition of a minority CDE and those CDEs received 22 awards totaling over $1 billion during the 2005-2008 period and 35 allocations for over $1.5 billion overall. Most of the successful minority CDEs we identified are larger, well-established organizations with track records in community development and finance. We have attached a table with a list of those Minority CDEs to this statement.

We think the reason for the discrepancy between our numbers and those of GAO is because this information is not required by the application, but rather is one of several characteristics on which applicants may or may not choose to self-identify. On Page 2, question 6 of the NMTC allocation application asks the CDE to check a number of boxes describing the parent company and whether it is a non-profit entity, a for-profit entity and other such characteristics, including whether it fits the definition of a minority CDE. We think that many CDEs simply do not check all the boxes and others, particularly CDEs controlled by non-profits, would not necessarily identify themselves as a minority owned or controlled business unless they looked at the CDFI definition in the application's glossary.

Regardless, it is important to improve the competitiveness of minority CDEs and smaller organizations. We agree with the analysis on page 19 of the GAO report, for example, which states that smaller minority and non-minority CDEs seem to share a number of obstacles in obtaining an award of Credits including:

1. Demonstrating the ability to use the amount of NMTC capital for which they apply;
2. Demonstrating a track record for both making investments in low-income communities and investing in large projects that would appear to generate significant impacts;
3. Demonstrating that they have the capacity to complete proposed projects that will have community impacts that compare favorably to the impacts described by larger CDEs;
4. Having the ability to absorb the transaction costs involved in complex NMTC transactions; and
5. Having the ability to absorb the costs – external and internal –involved in putting together an application for the Credits.

NMTC is unique in that it is a large federal program for community development, but unlike programs of similar purpose at HUD, Agriculture or the CDFI Fund for that matter, there is not a technical assistance or capacity building component of the program for minority CDEs.

Technical assistance could include training on raising and managing capital from private sector sources, building a track record of lending and investing in communities eligible under NMTC and planning, implementing and managing a lending and investment program financed through the Credit. This authority could be carried out through specifically developed training curricula, as well as through one-on-one technical assistance whereby minority CDEs could obtain an assessment of their particular organization and create an individualized business plan that would prepare them to participate in the program. The technical assistance would include working with previously unsuccessful minority CDE applicants. The GAO report notes that success is more likely the more often an organization applies, increasing to 90% if an applicant applies four times.

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Under current law, communities located in census tracts with poverty rates of at least 20% and median incomes not exceeding 80% are eligible for Credits. We strongly support the targeting of NMTC to low-income communities. As we noted, the keen competition for Credits has driven the Credit to the poorest communities in the country. The typical community with a qualified NMTC investment has higher rates of poverty and lower median incomes than required in law and often has a very high rate of unemployment.

The central recommendation of the NMTC Coalition is that Congress establish a technical assistance and capacity building program aimed at helping minority CDEs better prepare themselves to participate in the New Markets Tax Credit Program. As noted above, we also are discussing ways the Coalition can reach out to minorities to help with access to the Credit. We believe that the best way to build a more diverse set of NMTC allocatees is to provide assistance to organizations to build the capacity of those that have not been successful in applying for the Credits rather than through setasides or priorities for any particular class of CDE or business sector.

Other Issues

The economy in which the New Markets Tax Credit program was launched is not the economy of today. The late 1990s were a period of sustained economic growth, prosperity, budget surpluses at the federal level and an expanding financial services industry. The New Markets program was enacted and spurred on by President Clinton who said, "If we cannot attack poverty in this economy, when can we?" In the economy of 10 years ago, it was reasonable to assume that a shallow credit such as NMTC would be an adequate incentive to persuade the private sector to invest in low income urban neighborhoods and small towns and farming communities.

Today, we have a different economic situation. Median household income today is 1% lower than in 2000. There has been a swing in the federal budget from a $238 billion surplus to a $1 trillion and climbing deficit; unemployment is heading toward double digits and there has been an enormous expenditure of federal funds to rescue banks. In 2008 the nation experienced the largest bank failure in U.S. history when WAMU collapsed, and already in 2009 over 30 banks have failed. The tightening of credit across all sectors of the economy is well documented.

In many ways, economically distressed communities need the Credit more than ever. Sources of capital for lending and investing are drying up and there a continuing need for economic stimulus in many of our communities. We strongly supported the provision of the America Reinvestment and Recovery Act (ARRA) that gave an additional $3 billion in credit authority for NMTC equally divided between 2008 and 2009. The loans and investments from those Credits will help jump start urban and rural economies across America.

Chairman Neal was a leader in this effort and we appreciate your support and thank you very much.

NMTC has generated over $13.4 billion investments in low income communities. However, as the taxable income of many banks and corporate entities decline there is growing concern that investors will have less appetite for the Credits as they have less taxable income to offset and other, more attractive options in the credit marketplace.

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For these reasons, CDEs are now seeking alternatives to their traditional investor base and are exploring relationships with smaller, regional and community banks that are profitable and good candidates for a federal tax credit. We are also looking in to a revenue ruling that could open up the Credit to high net worth individuals. With respect to the smaller institutions, there are obstacles, however, as many of these institutions do not have a community development staff or a CRA obligation, and therefore may not have the internal capacity or the regulatory incentive to undertake NMTC transactions.

HR 2628 – New Markets Tax Credit Extension Act

HR 2628, the New Markets Tax Credit Extension Act, is critically important to the continued success of the New Markets program. Not only does it extend the Credit for 5 years at $5 billion annually, the legislation also provides NMTC investors with AMT relief. There is a pressing need the extension the New Markets Tax Credit. It is a proven tool for economic revitalization in urban and rural communities across the country.

We applaud the efforts of Reps. Richard Neal and Pat Tiberi in sponsoring this important legislation.

Alternative Minimum Tax exemption

There is also a pressing need to provide an exemption to the Alternative Minimum Tax (AMT) for investors in New Markets Tax Credits (NMTC). NMTC must be kept current with other federal tax credits by providing investors an exemption from the Alternative Minimum Tax. The New Markets Tax Credit will be at a competitive disadvantage in the investor marketplace without AMT relief.

The Housing and Economic Recovery Act of 2008 provided that the Low Income Housing Tax Credit (LIHTC) (IRC Section 42) and the Historic Rehabilitation Tax Credit (HRTC) (IRC Section 47) can be used to offset AMT liability. A provision to provide NMTC with AMT exemption was contained in the Senate version of economic recovery legislation, but dropped in conference.

A January, 2007 GAO reported indicated that about 70% of the investors in the NMTC were banks and individuals and of that number, banks and corporations made up the largest share. The GAO also reported that roughly half of the NMTC investors surveyed were also LIHTC investors. So marketing to the same investors, NMTC is at a competitive disadvantage.

For example, Aegon USA (parent to Transamerica) had been one of the largest NMTC investors for Massachusetts Housing Investment Corporation (MHIC), an NMTC allocatee. Aegon invested in an MHIC Fund that financed Project Hope where the Secretary Geithner made the announcement of the allocation of 2008 Credits included in ARRA. Aegon has recently withdrawn from investing in NMTC because of AMT limitations. If NMTC investors had an exemption from AMT rules on a par with other federal credits, Aegon and others would continue to participate. The result would be an increase in the number of investors thereby ensuring the highest possible price for NMTC -- and the best deal for the government

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Additional NMTC Incentives

With changed circumstances in the economy the NMTC Coalition may recommend further changes to the NMTC structure. Evolving circumstances of the financial services industry and the declining economies of many low income communities, combined with anecdotal data from those CDEs working with the program, indicate that additional incentives may be necessary to ensure the continued success of the Credit. We hope to work with Congress on this important matter.

Thank you for the opportunity to testify today on behalf of the NMTC Coalition and responses to the GAO report. I will be happy to answer any questions you may have.

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