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FROM: MICHAEL BARR

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Attached are comments on New Markets Tax Credit by Coalition of CDCs formed to support the credit. We should discuss these recommendations as we draft legislation. I would appreciate e-mail reactions as soon as possible.

Attachment

Community Development Tax Credit Coalition (CDTCC)

Comments on the Administration's New Markets Tax Credit Proposal

The Community Development Tax Credit Coalition (Coalition) was organized by some of the country's leading community development organizations. The Coalition's principal mission is to advocate in favor of a federal tax credit that encourages private investment in community development entities and their work to expand economic opportunities in poor communities. (See attached list of the Coalition's Steering Committee). The Coalition represents many of the community development entities most likely to utilize the New Market Tax Credit (NMTC).

The following comments reflect the Coalition's comments on the New Market Tax Credit as proposed in the President's Fiscal 2000 budget. While the Coalition endorses the NMTC proposal and applauds the Administration's effort to encourage private sector investment in low income communities, the changes that we recommend are based on our experiences working in poor communities and are intended to make the President's proposal more effective.

I. Administration of the NMTC - The process of administering the New Markets Tax Credit (NMTC) must be simple, transparent and consistent to ensure that it can be effectively marketed to investors and utilized by qualified community development entities. We recommend the Treasury Department be the sole authority to certify community development entities, allocate NMTCs, and monitor NMTC activity. At the same time, other Federal agencies will administer programs that are part of the New Market's Investment Initiative and the Treasury Department should work with these agencies to ensure that the NMTC is effectively used in concert with other New Markets initiatives.

Recommendation: Authorize the Treasury Department to administer the NMTC and grant it sole authority to certify eligible community development entities, develop regulations, allocate the tax credits, and maintain oversight. The Treasury Department should be required to work in concert with other Federal Agencies administering New Markets Investment Initiatives.

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II. Term of the NMTC Credit - The NMTC must be structured in a way that enables community development entities to provide the long term financing that is essential to effective community development.

The current proposal would require that an investor maintain an equity investment in the qualified community development entity for at least five years in order to claim the NMTC. While the proposal does not prohibit an investor from maintaining their equity investment for more than five years, an investor in the private market would have no reason do so without any additional tax incentive. The proposed NMTC only provides a 6% credit for each of the first five years that the equity investment is in place.

What low-income communities need most is long term, risk capital. Long term investments are the most difficult to secure and at the same time the most useful in terms of community development efforts. Businesses operating in rural markets or distressed urban areas lack access to affordable, patient capital. This is what the community development entities provide and a short term credit will undermine this effort.

As proposed, however, the NMTC would provide primarily shorter-term, lower-risk capital. A five year holding period would drive participating community development entities to place tax credit investments into shorter term deals. Requiring NMTC investors to maintain their equity interest for ten years, rather than five, would enable community development entities to provide long term financing and investments to the businesses and entrepreneurs they serve.

Recommendation: Extend the term of the tax credit to ten years with a 6% credit for each year.

III. Community Development Entity Definition

Screening community development entities ensures that investment funds are used to meet the community development mission of the NMTC program. In addition to screening applicants to ensure that they meet the basic definition of a community development entity, applicants must be required to demonstrate their skill, capacity and commitment to community development.

While the proposed eligibility formula requires that an entity meet a primary mission test and demonstrate community accountability, there is no requirement that an entity demonstrate its capacity. In order to strengthen accountability and ensure better outcomes, community development entities must be required to submit a comprehensive community development business plan when applying for NMTC status. The business plan would enable the Treasury Department to review an applicant's track record and its understanding of the market. It is critical that the Treasury Department have the ability to effectively screen applicants and assess their capacity and commitment as community developers.

There are a number of organizations that would meet all the eligibility requirements of a community development entity except that they are owned by a parent company that does not meet the requirements. Rather than excluding these organizations from the NMTC, such entities must be required to demonstrate that they have a track record in serving low income communities or populations.

Recommendation: Retain the existing community development entity definition but require that all applicants submit a community development business plan detailing how they intend to utilize the capital brought in through the NMTC. In addition, if an applicant has a parent company that does not meet the "primary mission" test, the applicant would be required to demonstrate their past performance with regard to serving low income communities and/or populations and describe how the NMTC would be utilized. Such a test will ensure that federal resources can and will be used for their intended purposes.

IV. Qualified Low Income Communities - The NMTC proposal requires that a community development entity document its ability to provide investment capital to low income communities, defined as census tracts with poverty rates of 20 percent or median family income which does not exceed 80 percent of the metro area income or 80 percent non-metropolitan statewide income for rural areas. While this formula includes 40% of the communities around the country, it will exclude many pockets of poverty and populations of low income people living within census tracts that do not meet the poverty or median income criteria. For example, this limitation would make it difficult for many community development entities serving low income rural populations in the Midwest or Northeast who live within census tracts that do not reflect high levels of poverty. In addition, the proposal runs counter to the market orientation that tax credits need to succeed.

The statute authorizing the Community Development Financial Institution's (CDFI) Fund addresses this issue by granting CDFIs the option of targeting their development activities to a qualified investment area or a qualified target population. The term 'target population' is defined as individuals or an identifiable group of individuals who are low income or otherwise lack adequate access to loans or equity investments. Applicants must define target populations to the satisfaction of the CDFI Fund. By giving applicants this option, the CDFI Fund ensures that their funds are targeted to individuals and areas in need while granting development organizations the flexibility to effectively serve low income populations that fall outside the screen of census tract data.

Recommendation: Draft the NMTC targeting requirements to conform with those used by the CDFI Fund. Allow community development entities under the NMTC to target their investment activities to qualified low income areas and/or target populations. In order for an entity to qualify for NMTC certification they must demonstrate that they serve a qualified investment area or targeted population as defined by the CDFI statute (see 12 U.S.C 4701, Title I section 103).

V. Qualified Activities - The focus of NMTC compliance should be on the community development entity, its track record and the strength of the comprehensive community development business plan submitted to the Treasury Department. The community development entity should be required to certify its compliance with the targeting requirements of the NMTC - that proposed project activity is in an area which is eligible under the NMTC statute or serves a target population that is eligible under the statute (as proposed in IV).

The 'qualified businesses activity' criteria described in the current NMTC proposal are overly restrictive and would limit community development entities from investing in a wide range of community development activities that would generate wealth and expand economic opportunity for targeted areas and populations.

Eligible community development activities should be defined as those community development investment, lending or grant-making activities that create jobs or economic opportunities that benefit an investment area or targeted population. In addition, when a community development entity makes an investment, loan or grant it should certify that the activity is consistent with the community development business plan they submitted to Treasury.

Recommendation: Strike the language describing 'qualified active businesses' and develop criteria for eligible community development activities. Community development entities should be required to certify that NMTC funds are supporting eligible community development activities. In addition, each community development entity should be required to describe in its community development business plan how it intends to use NMTC funds.

VI. Recapture provisions - The NMTC proposal gives the Treasury Department the authority to recapture credits that have been claimed by an investor if the qualified community development entity fails to maintain its eligibility status . While safeguards should be written into the proposal to ensure that funds are not misused by the certified community development entities, the current recapture language would create such uncertainty about compliance as to dissuade private investors from entering into NMTC deals.

The Treasury Department's initial screening of community development entities must be rigorous enough to ensure that certified entities have the capacity and commitment to stay true to their mission and maintain accountability. In addition, community development entities must certify at the time they make an investment, loan, or grant using NMTC funds, that the capital is being used to support an eligible community development activity. (See point number V).

Recommendation: Strike the recapture provision in the budget proposal. The only cause for recapture against investors would be in a case of investor fraud. Authorize the Treasury Department to issue sanctions against community development entities that are found to be out of compliance with program guidelines.