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Making the New Markets Tax Credit Count

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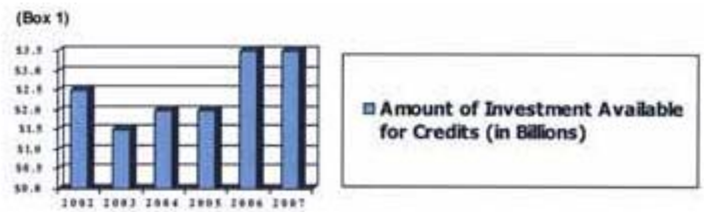
The New Markets Tax Credit (NMTC) program was enacted in December 2000 as part of the bipartisan Community Renewal Tax Relief Act. The purpose of the NMTC is to spur private investment in low-income urban and rural communities. The program is based on the idea that there are viable business opportunities in low-income communities and that a federal tax credit would provide attractive incentive to increase the flow of investment capital to such areas. Between 2002 and 2007, the NMTC will provide for up to $15 billion in investments in low-income communities. The Community Development Financial Institutions (CDFI) Fund of the U.S. Treasury Department administers the NMTC program.

What is a Community Development Entity (CDE) and how are CDEs certified?

The investment vehicle for the NMTC is a Community Development Entity (CDE). An organization must be certified by the CDFI Fund as a CDE to be eligible for NMTCs. Two important considerations for certification are that the organization must have a track record and demonstrate accountability to the community. After receiving certification, a CDE may then apply for credits through an annual competition conducted by the CDFI Fund.[1] CDEs successful in receiving an allocation must have a strong business plan, good management, proven track record of working with investors and proposed projects that will have a substantial impact in low-income communities. In March 2003, the CDFI Fund made its first allocation of $2.5 billion in NMTCs to a total of 66 CDEs. Over 300 Community Development Entities (CDEs) applied in the first round, requesting $26 billion in credits.[2]



How does a CDE market the credit to investors?

Once an allocation has been awarded, a CDE must then seek private investment in exchange for the credit. The CDE has five years to place the credits, after which time the credits can be recaptured and transferred to another CDE. Corporate and individual taxpayers may receive a federal tax credit of 39 percent over seven years in return for their equity investment in a CDE. With the proceeds from these equity investments, CDEs must provide investments of equity, loans, lines of credit and technical assistance to qualified businesses. CDEs have one year to place the funds in qualified investments. In general, if *substantially all* (i.e. 85%) of the proceeds from the credit are not placed in qualified investments, the CDE would be out of compliance. At that point, recapture penalties would be applied to the investor.

An equity investment qualifies for the tax credit if:

1. such credit is acquired by the investor at its original issue solely in exchange for cash;
2. *substantially all* of such cash is used by the CDE to make a *qualified low-income community investment*; and
3. the investment is designated by the CDE as a *qualified equity investment* which may also include the purchase of a qualified equity investment from a prior holder.

What is a Qualified Low-income Community Investment?
Qualified low-income community investments may include loans, lines of credit, debt, direct equity investments, purchase of certain loans made by other CDEs, related services to other businesses, and counseling to other CDEs.

Substantially all of the investment must be used, meaning 85 percent of the cash received from the taxpayer in return for the tax credit must be directly traceable to a qualified low-income community investment, or 85 percent of the aggregate gross assets of the CDE must be deployed in qualified activities.

What areas are eligible for the tax credit?
Areas eligible for the tax credit are low-income communities defined as a census tract with a poverty rate of at least 20 percent or with median income of up to 80 percent of area median or statewide median, whichever is greater; or for non-metro census tracts 80 percent of statewide median. The NMTC may also be used in target areas. A target area is a community within a census tract that does not meet the poverty or median income standard. The target area provision allows certain communities located in ineligible census tracts to participate in the program. Such communities must have pre-existing boundaries such as established neighborhoods, or political or geographic boundaries; meet the poverty rate or median income standard; and have a demonstrated lack of investment capital.

What businesses qualify for investments?
Businesses eligible to receive qualified low-income investments are those corporations or partnerships (including sole proprietorships or unincorporated trades or businesses) that are active and located in low-income communities. The business must derive at least half its gross income from activity (i.e. sales, manufacturing) in the eligible area. In addition, a substantial portion of its tangible property as well as services performed by

employees of the business must be in an eligible community. CDEs may also provide investments to *qualified active low-income businesses* that are owned in whole or in part by the CDE.

Are there any other investment limitations?

Financing of low-income rental housing is not allowed under the NMTC, and the NMTC may not be combined with other federal tax subsidies, including the Low-income Housing Tax Credit. Rental property that derives 80 percent or more of its income from residential tenants is not eligible. However, a mixed-use development, where less than 80 percent of the property's gross income is rental income from dwelling units is allowed under NMTC.

Conclusion

The broad distribution of NMTCs from the first round of allocations allows for any community in America—both urban and rural—to take advantage of this unique opportunity to build a stronger and more diverse economy. Of the 66 CDEs receiving allocations, 16 target a specific city or county, six target more than one city or county, 17 will conduct statewide programs, and 27 will work in more than one state. Of those 27, 15 are nationwide. The following graphs provide a partial look at how the allocations were distributed and which jurisdictions they will serve. Now that the opportunity has been made available to these previously undercapitalized communities, the challenge is to make it work.

CDEs with the Largest Allocations

Table 1 shows the five CDEs with the largest allocations. Combined, they will receive 31 percent of the NMTC funds. Four of the five have a nationwide service area while the Phoenix Community Development and Investment Corporation will serve only Phoenix, AZ.

Table 1

	CDE	HQ STATE	ALLOCATION (x $1 million)	SERVICE AREA
1	Phoenix Community Development and Investment Corporation	AZ	$170.0	Phoenix and surrounding area
2	National New Markets Tax Credit Fund, Inc.	MN	$162.5	National, with focus on CA, CO, MN, NY, OH, PA, TX
3	Community Development New Markets I, LLC	OH	$150.0	National, with focus on CO, IN, ME, NY, OH, OR, WA
4	Wachovia Community Development Enterprises, LLC	NC	$150.0	National, with focus on CT, FL, GA, NC, NJ, VA, PA
5	KHC New Markets CDE, LLC Series A	CA	$134.0	National, with focus on CA, FL, NY, OR, TX, UT, WA
		TOTAL	$766.5	

States with the Greatest Allocations to Their CDEs

Table 2 shows the top five states in terms of combined allocations to their CDEs. Note that a large portion of these allocations is designated for multi-state or nationwide use. The table shows that while the CDEs located in these five states received 55 percent of the allocated funds, just 17 percent of these funds will be dedicated solely to in-state uses.

Table 2

All dollar amounts x $1 million					
STATE	TOTAL ALLOCATION TO CDEs BASED IN STATE	ALLOCATION FOR IN-STATE ONLY	ALLOCATION FOR MULTI-STATE USE	ALLOCATION FOR NATION-WIDE USE	ALLO-CATION TO RURAL AREAS
CA	$428	$236	$58	$134	$87
OH	$313	$88	-	$225	$68
NC	$225	-	-	$225	$41
DC	$213	$86	-	$127	$32
NY	$201	$21	-	$180	$33
TOTAL	**$1,380**	**$431**	**$58**	**$891**	**$260**

CDEs Contributing the Most to Rural Communities (Table 3)

Rural areas stand to gain $509 million in NMTC investments. The CDEs listed in the table below are the five that will allocate the greatest amount of credits to rural communities. REI New Markets Investment, LLC will focus on one state, Oklahoma, while the other four CDEs will conduct multi-state or national programs.

Table 3

	CDE	HQ STATE	ALLOCATION (x $1 million)	SERVICE AREA
1	REI New Markets Investment, LLC	OK	$54.0	Oklahoma
2	Border Communities Capital Company, LLC	CA	$40.0	Oklahoma
3	Coastal Enterprises	ME	$39.0	Northern Forest Belt of ME, NH, VT, NY
4	Community Development New Markets I, LLC	OH	$30.0	National with focus on CO, IN, ME, NY, OH, OR, WA
5	National New Markets Tax Credit Fund, Inc.	MN	$24.4	National with focus on CA, CO, MN, NY, OH, PA, TX
		TOTAL	**$187.4**	

Allocations by State

Table 4 summarizes the allocations to each state and shows totals designated for rural areas.

Table 4

(All dollar amounts x $1 million)						
STATE	TOTAL ALLOCATION TO CDEs BASED IN STATE	ALLO-CATION FOR IN-STATE USE ONLY	ALLO-CATION FOR MULTI-STATE USE	ALLO-CATION FOR NATION-WIDE USE	ALLO-CATION TO RURAL AREAS	PERCENT OF TOTAL ALLOCATION FOR RURAL AREAS
AK	$5	$5	-	-	$4.3	85%
AL	$40	$40	-	-	-	-
AZ	$170	$170	-	-	-	-
CA	$428	$236	$58	$134	$86.6	$0
DC	$213	$86	-	$127	$31.8	15%
DE	$15	$15	-	-	$3.8	25%
GA	$22	-	$22	-	$22.0	100%
IL	$35	$20	-	$15	$3.5	10%
IN	$6	$6	-	-	-	-
KY	$30	$30	-	-	$13.5	45%
LA	$160	$160	-	-	$16.5	10%
MA	$26	$26	-	-	-	-
MD	$161	$10	$36	$115	$15.3	10%
ME	$65	-	$65	-	$39.0	60%
MN	$162.5	-	-	$162.5	$24.4	15%
MS	$15	-	$15	-	$9.8	65%
NC	$225	-	-	$225	$41.3	18%
NJ	$15	$15	-	-	$0.8	5%
NY	$201	$21	-	$180	$32.5	16%
OH	$313	$88	-	$225	$68.0	22%
OK	$134	$134	-	-	$72.5	54%
PA	$8.5	$0.5	-	$8	$4.0	47%
TN	$10	$8	$2	-	$8.8	88%
VA	$15	$15	-	-	-	-
WI	$21	$21	-	-	$8.4	40%
WV	$4	$4	-	-	$2.6	65%
TOTAL	**$2,500**	**$1,111**	**$198**	**$1,192**	**$509**	**20%**

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[1] September 30, 2003 is the application deadline for the next round of tax credit allocations. For more information, go to www.cdfifund.gov.

[2] The law provides $1 billion in NMTC investments in 2001 and $1.5 billion in

2002. No credit allocations were made in 2001, thus $2.5 billion are available in 2002. Also, 2003 and 2004 are being combined for $3.5 billion in allocations to be available in 2004.

Biography

Robert A. Rapoza is president and principal of Rapoza Associates, a public interest lobbying and government relations firm located in Washington, D.C. and established in 1984. Mr. Rapoza has more than two decades' experience as a professional lobbyist and is an expert on the federal budget and appropriations process, with special expertise in federal housing and community development policy. He has been responsible for numerous legislative accomplishments that include saving federal rural housing and community development programs from budget cuts, establishing the Intermediary Re-lending Program at the Agriculture Department, sustaining and increasing funding for community development programs at the Department of Health and Human Services, promoting the creation of a YouthBuild program at the Department of Housing and Urban Development and, most recently, successfully steering the New Markets Tax Credit program to enactment. He first became involved with community development issues while serving with the Massachusetts Department of Community Affairs. A graduate of Boston College and the University of Massachusetts at Amherst, Mr. Rapoza has served on the boards of several housing and community development organizations and has been profiled in the Washington Post and in the authoritative Beachman's Guide to Key Lobbyists.