

# New Markets Tax Credit Important Facts & Status Report November 2004

The New Markets Tax Credit (NMTC) was created to address the lack of capital available to business and economic development ventures in low income communities. The NMTC provides the incentive of a federal tax credit to individuals or corporations that invest in Community Development Entities (CDEs) working in targeted low income communities.

## Community Development Entities

CDEs are the investment vehicle for the NMTC. An organization must be certified as a CDE by the CDFI Fund within the Treasury Departments before it can apply for an allocation of Credits. To date, close to 1,400 organizations have been certified as CDEs. In order to qualify as a CDE, an organization must:

- Have a primary mission of serving or providing investment capital for low income communities, and
- Be accountable to residents of that community through a governing or advisory board.

## Applying for an Allocation of NMTCs

Once certified, a CDE can apply to the CDFI Fund for an allocation of NMTCs.

Competition for Credits is steep and applications are scored in four areas:

- Community Impact – the extent to which a CDE targets economically distressed communities, has the active participation of community representatives and can demonstrate programmatic impacts;
- Business Strategy – A CDEs must describe the economic distress and needs of the target area and demonstrate how the CDE plans to provide financial products and services that address the needs of the community;
- Capitalization Strategy – A CDE must demonstrate that they have investors committed to or interested in investing in the CDE or a strategy for securing investments; and
- Management Capacity – A CDE must demonstrate that they have the experience and the staff and partners to execute and effective NMTC strategy

## Securing Private Investors

If awarded an allocation of NMTCs, a CDE will then need to secure investors to make equity investments in the CDE in exchange for the Credit. Once an equity investment is made in the CDE, the investor can claim the NMTC worth 5% of the investor's equity in the first 3 years and 6% in the last 4 – (39% tax credit over 7 years). The CDE in turn will be required to use substantially all of the investor's equity to make qualified low

## NMTC Quick Facts

- Enabling legislation (PL 106-554) signed in to law as part of the Community Renewal Tax Relief Act of 2000
- NMTC is the largest federal economic development initiative to be launched in 20 years with \$15 billion in NMTC investments being generated by 2007
- NMTC is administered by the CDFI Fund within the Department of the Treasury
- The IRS issued a temporary rule for the NMTC Program in December, 2001, with a revised rule issued in March 2004 and a final rule expected in December 2004
- The CDFI Fund accepts CDE Certification Applications on a rolling basis and issues NMTC Allocation Applications annually, usually during the summer

## Uses of NMTC Investments

A CDE can use its investments to make loans or investments in qualified businesses, invest in or loan to other CDEs, purchase qualified loans from other CDEs, or provide financial counseling to qualified businesses or community resident. While substantially all of a CDE's investments must be targeted to the low income service area identified by the CDE, there is significant flexibility in the types of businesses and development activities that can NMTC investments can support – including community facilities like child care or health care facilities and charter schools, for-profit or non-profit businesses, and homeownership projects.

## Oversight

The CDFI Fund administers CDE certification, the allocation of NMTCs, and monitors CDE compliance once Credits are awarded. The Internal Revenue Service (IRS) is responsible for issuing guidance on the NMTC and monitors tax payer compliance. The Program has been operating under a temporary rule issued by the IRS in December of 2001 and a final rule on the program will be issued by the end of 2004.

### Status Report on NMTC Allocations

The CDFI Fund awarded the 1<sup>st</sup> round of NMTC Allocations worth \$2.5 billion in March of 2003 and the Fund announced the 2<sup>nd</sup> round of NMTC Allocations worth \$3.5 billion in May of 2004.

The CDFI Fund received applications for both NMTC allocations rounds worth ten times what was available and all indications are that demand for the program is continuing to grow.

#### *Overview of Round I NMTC Awards.*

- 66 CDEs were awarded NMTC Allocations in 2003
- 1st Round Allocatees represent 25 states and the District of Columbia
- The average NMTC award was \$38 million
- The largest award: was \$170 million
- The smallest award: was \$500,000
- 50% of the NMTC awards were for \$21 million or less
- 80% of the NMTCs went to CDEs serving urban and suburban areas
- 20% of the NMTCs went to CDEs serving rural areas
- *To date, close to \$700 million in Qualified Equity Investments have been made in CDEs.*

#### *Overview of Round II NMTC Allocation Awards*

- Overall demand for NMTCs increased 17 percent from the 1<sup>st</sup> Round
- 62 CDEs were awarded NMTC Allocations in 2003
- The average NMTC award was \$56 million
- The largest award: was \$150 million
- The smallest award: was \$2 million
- 50% of the NMTC awards were for \$50 million or less
- 85% of the NMTCs went to CDEs serving urban and suburban areas
- 15% of the NMTCs went to CDEs serving rural areas

Applications for the 3<sup>rd</sup> Round of NMTC Allocations worth \$2 billion were submitted on October 6<sup>th</sup>. The Fund received 208 applications requesting \$23 billion in Credits and Allocation awards will be made in the spring of 2005