

**NEW MARKET TAX CREDITS – HURRICANE KATRINA RELATED INVESTMENT INCENTIVES  
ANOTHER DISASTER FOR THE STATE OF MISSISSIPPI**

A review of data and information related to the allocation of New Market Tax Credits and specifically the proposed allocation guidelines adopted by the CDFI Fund and the Department of the Treasury for Hurricane Katrina related New Market Tax Credits indicate that Mississippi does not receive a relatively proportional share of New Market Tax Credits, nor will the State of Mississippi, the local communities and residents of qualified low-income communities be able to exercise reasonable control over how these funds are utilized by CDE recipients. Analysis of New Market Tax Credit allocations raises a serious question regarding the current NMTC allocations process and its alignment with the intent of Congress expressed in the Community Renewal and New Market Act of 2000 and the subsequent Community Renewal Tax Relief Act of 2000.

**Background.** During the final years of the Clinton Administration, President Clinton and Dennis Hastert introduced the Community Renewal and New Market Act of 2000 resulting in the passage of the Community Renewal Tax Relief Act of 2000; this legislation amended the internal revenue code to create a tax credit in the amount of 39 percent for the purpose of promoting economic revitalization and community development in low-income communities that are underserved by traditional financial institutions. To be eligible to apply for a New Market Tax Credit, an organization must be certified as a Community Development Entity (CDE) by the CDFI fund. Under Section 45D, Paragraph (c) establishes only three eligibility requirements for receipt of a New Market Tax Credit allocation: (1) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons, (2) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory boards to the entity, and (3) the entity is certified by the Secretary for purposes of this section as being a qualified community development entity. The regulatory language stipulating “the primary mission of the entity” is serving low income communities or low-income persons coupled with the requirement that “the entity maintains accountability to residents” indicates the intent of Congress that CDEs receiving New Market Tax Credit allocations should be knowledgeable of and responsive to the needs of the low-income communities and residents on whose behalf and for whose benefit the entity is receiving the New Market Tax Credit. Regulatory language indicates that newly formed for-profit or non-profit entities and small local entities are to be eligible recipients of New Market Tax Credits. Although Section 45D provides clarity that the intended beneficiary of the New Market Tax Credit is the low-income community and its residents, additional language contained in House Report 106-706 – Part 1 – New Markets Initiative Act of 1999, cited below, provides additional language pertinent to the Congressional intent for the creation of New Market Tax Credit Legislation, qualifications of applicants for New Market Tax Credit allocations, and equitable geographic distribution of New Market Tax Credits. The text cited below is an exact copy of the language contained in House Report 106-706 - Part 1 - NEW MARKETS INITIATIVE ACT OF 1999:

**“BACKGROUND AND NEED FOR LEGISLATION**

*In an era of unprecedented economic growth and prosperity, there remain many economically distressed communities, both rural and urban, where many people have not benefited to any great degree from the most recent economic expansion enjoyed by our Nation. In these communities, levels of unemployment, poverty, and other indicia of social distress, remain stubbornly high--yet untapped market opportunities exist to establish and expand businesses and to develop jobs and community assets.*

*There is bipartisan consensus in Congress that the federal government can and should play a role in encouraging investments in these communities. For several years both Republicans and Democrats have proposed and supported granting tax and regulatory relief, including capital gains tax relief to businesses operating within distressed areas. Many of these proposals were part of H.R. 815, the ‘American Community Renewal Act,’ introduced by Representatives Jim Talent and J.C. Watts, which would have designated a number of these areas as ‘renewal communities’ eligible for such benefits. The House has already passed the tax provisions of H.R. 815, and this Committee has passed provisions relating to HUD property disposition within these communities as part of H.R. 1776, the ‘American Homeownership and Economic Opportunity Act of 2000.’*

*The Administration has also proposed a series of programs, collectively known as the ‘New Markets Initiative,’ also intended to foster economic development in low-income communities. These proposals include tax credits for businesses in these*

areas ('New Markets Tax Credits'), a small business component (establishing a 'New Markets Venture Capital Program'), and the formation of a number of companies intended to make relatively large scale equity and credit investments in distressed areas--APICs. The FY 2000 VA/HUD Appropriations Act provided that \$20 million in credit subsidy would be available for use by APICs for Fiscal Year 2000 if the program was authorized by June 30, 2000. If the program is not authorized by that date, the funding reverts to the Community Development Financial Institutions program administered by the Department of the Treasury.

The APIC portion of the New Markets Initiative falls under the jurisdiction of this Committee. The proposal is closely related in concept to the Small Business Investment Companies ('SBIC') program currently administered by the Small Business Administration (SBA), except that the SBIC program is limited in the size of projects it can serve and that SBICs invest in ventures only, not real estate. Community development organizations maintain that the infusion of additional amounts of equity capital is especially vital for enabling large-scale investments to occur in distressed areas. Importantly, these investments would be economically viable as freestanding business entities, providing a profitable return to investors. However, because the costs of establishing these businesses in some of these distressed areas are higher relative to other areas due to a variety of factors (remediation of environmental contamination, for example), the return on investors equity is not as high as demanded by these investors. APICs are intended to lessen the cost of capital so that these large-scale investments would be made.

APICs are not intended to fund or subsidize the operations of businesses, that are not economically viable. On the contrary, the goal of these entities is to encourage the establishment of fundamentally sound businesses in certain locations. Possible uses for APICs' funds include the establishment of a new facility, such as a call center, data processing 'back office,' or factory, by a large company (or a small company joint venturing with a large one). In addition, a mid-size manufacturing company seeking to increase production could use APIC investments for expansion of an existing facility, the upgrading of equipment or the hiring of new employees. Other uses could include expansion of the service area of a mid-size service company, such as a trucking company, building contractor, or home health care firm; development of a multi-tenant shopping center; or opening or expanding a large retail company in a new geographic area. Buyout of a company to be revitalized in its existing facility, acquisition of the property of a departing large company, and development of an incubator or industrial park, or investment in another fund that invests in businesses locating or expanding in targeted low-to-moderate income areas are all methods whereby an APIC could fulfill its public purpose investment role.

By passing this APIC legislation, the hope and expectation of this Committee is that a bipartisan, comprehensive package of measures to help revitalize America's distressed urban and rural communities, which would include the best elements of the American Community Renewal Act and the New Markets Initiative, be enacted this year."

Importantly, there were two versions of Bill Number H.R.2848 for the 106th Congress; both contained the same language regarding Congressional intent and a description of the eligibility requirement for New Market Venture Capital Companies. The most important language specifically states that newly formed entities with a management team with experience in community development financing are eligible – Section 353 (a) and distribution of NMTC allocation that assure nationwide distribution – Section 353 (3), cited below:

#### SEC. 353. SELECTION OF NEW MARKETS VENTURE CAPITAL COMPANIES.

(a) ELIGIBILITY- A company shall be eligible for participation in the New Markets Venture Capital Program if--

- `(1) it is a newly formed for-profit entity or a newly formed for-profit subsidiary of an existing entity; and
- `(2) it has a management team with experience in community development financing or venture capital financing.

(b) APPLICATION- To participate in the New Markets Venture Capital Program, an eligible company shall submit an application to the Administration that includes--

- `(1) a business plan describing how the company intends to make successful venture capital investments in low- or moderate-income geographic areas;
- `(2) information regarding the qualifications of the company's management;
- `(3) a description of how the company intends to work with community organizations;
- `(4) a description of how the company will use the grant funds provided under this part to provide marketing, management, and technical assistance to smaller enterprises;



`(5) a description of the criteria the company will use to evaluate whether and to what extent it meets the objectives of the program established under this part;

`(6) information regarding the management and financial strength of any parent firm, affiliated firm, or any other firm essential to the success of the company's business plan; and

`(7) such other information as the Administration may require.

`(c) **CONDITIONAL APPROVAL-**

`(1) **IN GENERAL-** From among companies submitting applications under subsection (b), the Administration shall in accordance with this subsection conditionally approve companies to participate in the New Markets Venture Capital Program.

`(2) **SELECTION CRITERIA-** In selecting companies under paragraph (1), the Administration shall consider the following:

`(A) The likelihood that the applicant will meet the goals of its business plan.

`(B) The experience and background of the company's management team.

`(C) The need for equity investments in the areas in which the company intends to invest.

`(D) The extent to which the company will concentrate its activities on serving the areas in which it intends to invest.

`(E) The likelihood that the company will be able to satisfy the conditions under subsection (d).

`(F) The extent to which the activities proposed by the company will expand economic opportunities in the areas in which the company intends to invest.

`(G) Any other factors deemed appropriate by the Administration.

`(3) **NATIONWIDE DISTRIBUTION-** In selecting companies under paragraph (1), the Administration shall ensure that companies are chosen in such a way that investments under the New Markets Venture Capital Program will be made nationwide.”

According to the 2004 GAO analysis of CDFI fund data, there is a significant skewing of NMTC awards away from non-profits (non-profits received only 22% of allocations);<sup>1</sup> away from local entities (only 23% of allocations were awarded to local entities); and increasingly to larger institutional financial firms (parent firms with subsidiaries received 75% of allocations)<sup>2</sup> with significant investment track records. In many circumstances these large traditional institutional financial firms are specifically the entities that have long underserved low-income communities and the low-income residents of these communities and have a demonstrated record of **not** having “the primary mission of serving, or providing investment capital for, low-income communities or low-income persons.”

As demonstrated in Figure 1 on page 4 and Map 1 and 2 on page 5 and 6, entities domiciled in 10 states have received 69 percent of all NMTC allocations over the life of the New Market Tax Credit program. Although these entities may state their intent to serve a wide geographic area in their NMTC allocation applications, there is evidence that geographic distance acts as a significant barrier to developing actual strong ties to communities and their low-income residents, and responsiveness to or knowledge of the needs of those communities and their residents. As demonstrated in Map 1 and Map 2, investments of NMTC tend to cluster within the state of domicile of NMTC recipient CDEs.

### **Why is it Important for State Domiciled Community Development Entities to Receive New Market Tax Credits?**

In 2005, the Federal Reserve Banks of Boston, New York and Philadelphia held a conference in New York in cooperation with the Corporation for Economic Development that focused on asset-building policy and programs. Across the United States there is increasing awareness and emphasis by organizations and people on the need to help low-income and rural communities to build wealth through financial education, savings and investment, home ownership, and micro-enterprise. These asset building policies are predicated on the fact that a deficit in assets keeps low-income persons, poor communities and poor states trapped in poverty. Visionary philanthropic organizations, such as the Ford Foundation and the Kellogg Foundation, increasingly support the creation of asset building partnerships between the non-profit and for-profit sector that leverage resources and bring new investment, financial services, and asset development to communities to provide venture capital, promote affordable housing and home ownership, generate business development, and to finance community facilities that provide needed health and human services such as education, childcare, and healthcare without stripping the wealth from these communities.

<sup>1</sup> GAO Analysis of CDFI Fund data, GAO-04-326

<sup>2</sup> GAO Analysis of CDFI Fund data, GAO-04-326  
[phillips@sig.msstate.edu](mailto:phillips@sig.msstate.edu)

**Allocation of New Market Tax Credits 2002 to 2006**

Source: CDFI NMTC Database

**States that have never received NMTC:**

Idaho	North Dakota
Nevada	New Hampshire
Wyoming	Connecticut
Kansas	Rhode Island

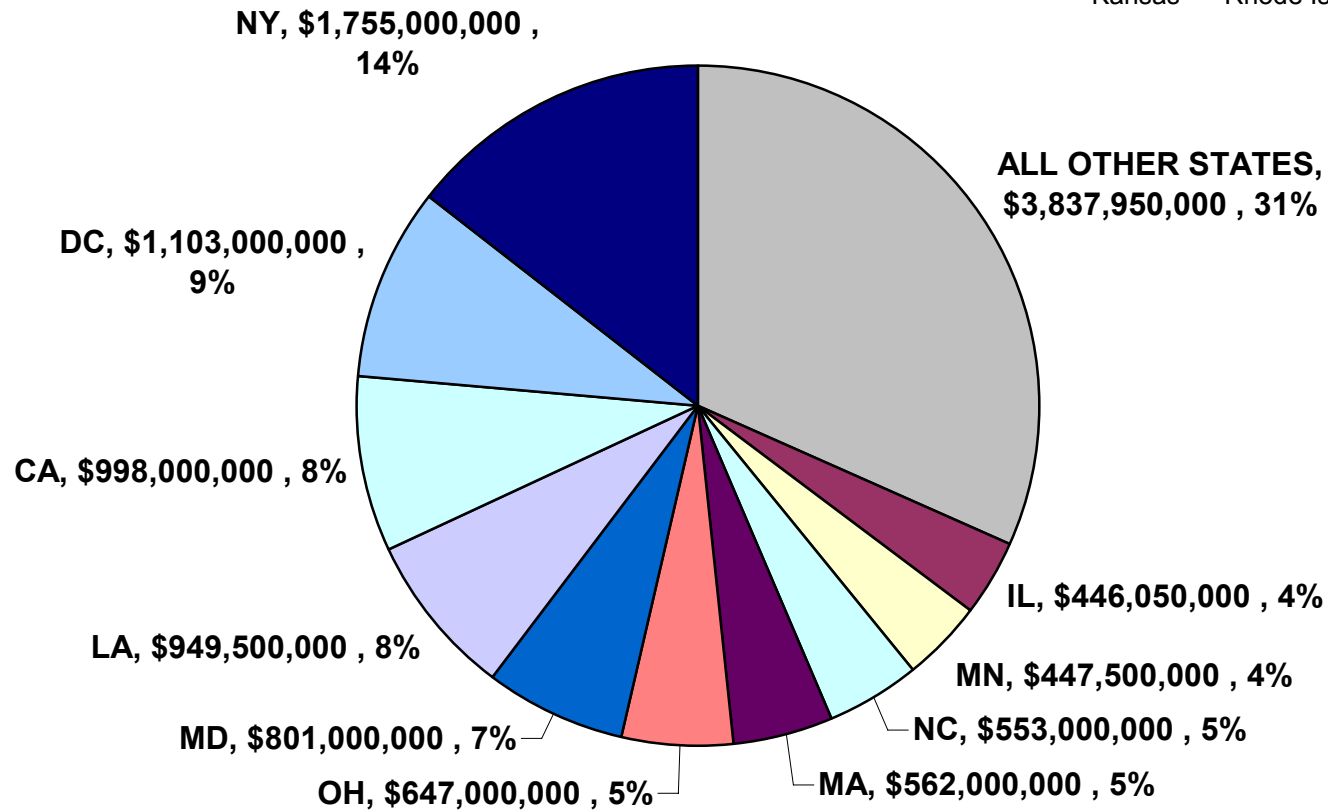
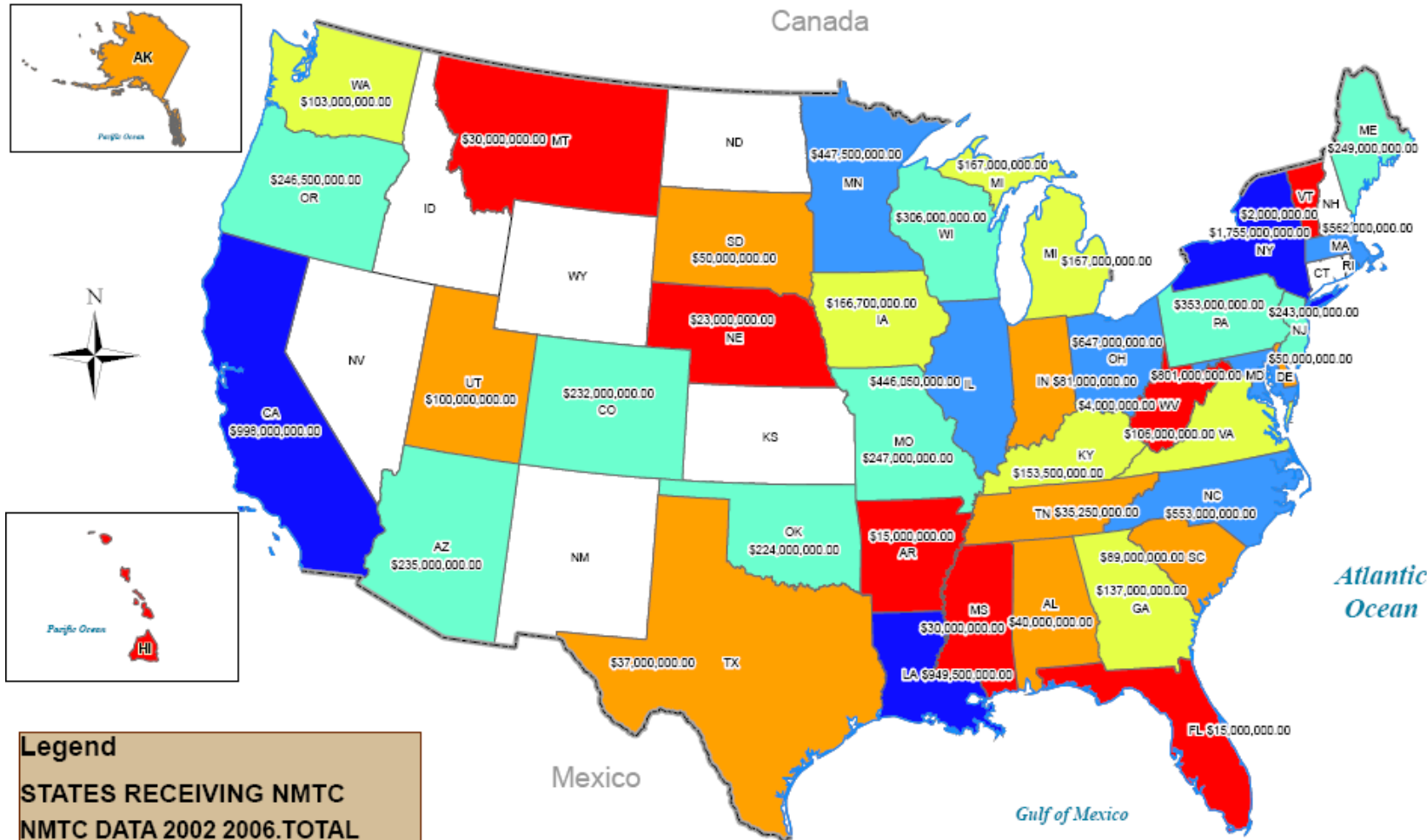


Figure 1: Geographic Allocation of NMTC 2002 - 2006



**Legend**

**STATES RECEIVING NMTC**

**NMTC DATA 2002 2006.TOTAL**

Red	\$2,000,000.00 - \$30,000,000.00
Orange	\$30,000,000.01 - \$100,000,000.00
Yellow	\$100,000,000.01 - \$167,000,000.00
Light Green	\$167,000,000.01 - \$353,000,000.00
Blue	\$353,000,000.01 - \$801,000,000.00
Dark Blue	\$801,000,000.01 - \$1,755,000,000.00
White	NEVER RECEIVED NMTC

**New Market Tax Credit Allocations 2002 to 2006  
by Recipient Organization's State of Domicile**

660 330 0 660 Kilometers

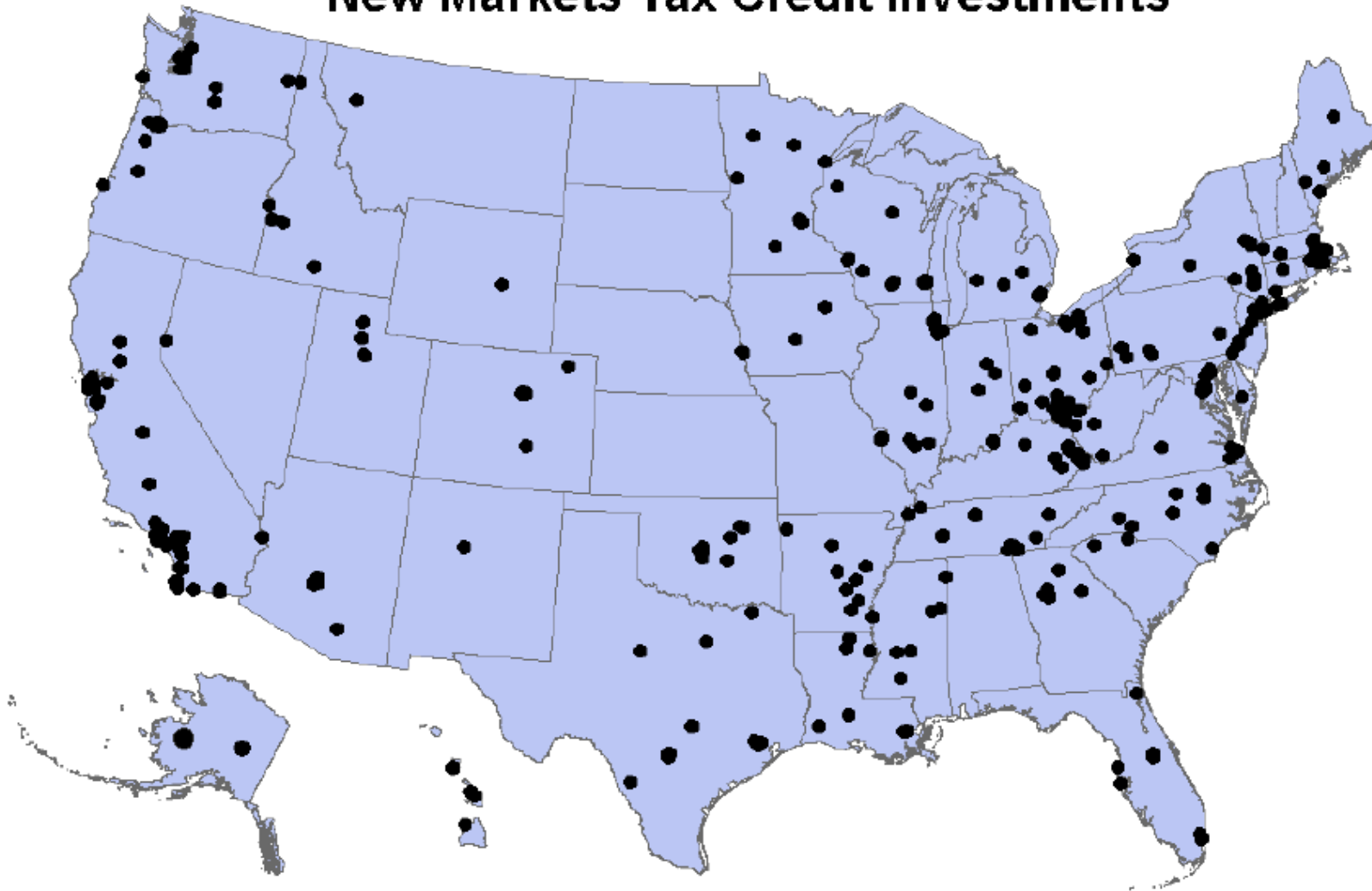
For more information: [phillips@sig.msstate.edu](mailto:phillips@sig.msstate.edu)  
[ben@sig.msstate.edu](mailto:ben@sig.msstate.edu)



Map 1: Map of NMTC Allocation by State of Recipient's Domicile 2002 - 2006



## New Markets Tax Credit Investments\*



Source: CDFI Fund, U.S. Department of the Treasury (Oct. 19, 2006)

\* Location of Qualified Active Low Income Community Businesses (QALICBs) financed by NMTC through Fiscal Year 2005. Total amount invested is approximately \$3 billion.

Map 2: Map of NMTC Investments

At-risk equity investment is a major driver of economic growth. A discussion paper published by the Federal Reserve Bank of Boston<sup>3</sup> found that secondary cities outside of the 40 largest metro areas fail to attract capital due to the inequitable geographic distribution of equity and financial investment, thereby excluding these areas from a major factor in economic growth and job creation. Factors that impact the ability to attract equity capital and investment are institutional, professional, and personal networks of accountants, lawyers, and financial institutions that are knowledgeable and experienced with tiered equity investment structuring, regulatory and reporting guidelines, multiple investment and tax credit vehicles, and access to network channels for securing equity investors. Investors rely upon these established networks when they are sourcing deals. In areas that do not have these developed networks there exist significant obstacles to attracting investment and leveraging existing resources, local and state economic development entities lack the financial tools to attract or create new business and industry – frequently missing opportunities or failing to maximize the use of financial incentives. The absence of these investment related institutional, professional, and personal networks has acted as a significant historic barrier to the growth low-income communities and states with high poverty such as the state of Mississippi. Exclusion from the ability to develop these networks and to build localized expertise in structuring tiered equity investments and barriers to the development of direct channel networks with equity investors will impede Mississippi's recovery from Hurricane Katrina, obstruct the development of localized wealth creation strategies, and negatively impact the state's future economic growth potential. These are the problems that New Market Tax Credits were designed to address.

Geographic accessibility and lack of knowledge of local markets act as a barrier to investment. The high costs of traveling to remote areas to find deals, the uncertainty related to a lack of knowledge of local markets, unfamiliarity with investment networks, and the cost of ongoing relationships and communications with target investment companies act as barriers to investment. This is further illustrated by the lack of interest expressed by CDEs nationwide prior to the announcement in 2005 of \$1 billion in GoZone New Market Tax Credits in making investments in the state of Mississippi.

Hurricane Katrina hit Mississippi and Louisiana on August 29, 2005 with NMTC allocation applications being due on September 21, 2005 at 5:00 p.m. The Hurricane Katrina Gulf Opportunity Zone Act (H.R. 4440) expanded the New Markets Tax Credit program's initial allocation authority of \$3.5 billion annually for the 2006 and 2007 New Market Tax Credit Program by an additional \$ 300 million for specific use in the Gulf Opportunity Zone in 2005, \$300 million in 2006 and \$400 million for 2007 to be allocated among qualified community development entities to make low-income investments within the Gulf Opportunity Zone. The Gulf Opportunity Zone is defined as those areas of Mississippi, Louisiana, and Alabama that were Presidential Declared Disaster Areas warranting both public and private assistance from FEMA by reason of Hurricane Katrina. On September 9, the CDFI Fund posted a notice on its website, and updated the 2006 NMTC Allocation Application Q&A Document, to address circumstances brought about by the recent natural disasters in the United States. The Notice and revised Q&A document explain the process by which certain organizations could an extension of the September 21, 2005 deadline for submitting an NMTC allocation application. Subsequent to passage of H.R. 4440, the Treasury Department issued a notification regarding the allocation of Katrina related NMTC on March 2, 2006. This letter indicated that \$600 million of the \$1 billion of Hurricane Katrina related NMTC would be consolidated (the \$300 million additional Katrina 2005 allocation plus the \$300 million additional Katrina 2006 allocation) and that **only** CDEs who had previously submitted NMTC allocations in the September 2005 round would be eligible to receive these applications. This action effectively blocked any Mississippi domiciled CDEs from making application for a New Market Tax Credit for a two year period. Two entities domiciled in Mississippi had applications submitted in 2005 – the Enterprise Corporation of the Delta and the Meridian Community Development and Investment Corporation.

A review and analysis of the CDFI New Market Tax Credit database indicates that prior to the issuance of the

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<sup>3</sup> Carlson, Carol and Prabal Chakrabarti, Venture Capital Investment in Secondary Cities: Issues and Opportunities for Impact, Community Issues Discussion Paper, Federal Reserve of Boston, March 2007.

Gulf Opportunity Zone New Market Tax Credits only two entities identified Mississippi or even mentioned the state of Mississippi as being within their service area: 1) the Enterprise Corporation of the Delta and 2) the Southern Appalachian Fund LP domiciled in London, Kentucky, but identifying its service areas to include the states of Alabama, Georgia, Kentucky, Mississippi, and Tennessee. The announcement that \$1 billion in New Market Tax Credits would be available for allocation for CDEs investing in Mississippi generated interest across the United States, and as indicated in the map below, \$600 million in NMTC were geographically disbursed to CDEs across the nation – with the only Mississippi domiciled CDE – Enterprise Corporation of the Delta – receiving \$15 million; this represented .0036% of the total \$4.1 billion in NMTC allocations for 2005. Given this fact, a question arises as to whether those applicants that were provided with the opportunity to modify their NMTC allocation application to now include the State of Mississippi as being within their service area could, in fact have “the primary mission of serving, or providing investment capital for, low-income communities or low-income persons” within the state of Mississippi, or “maintain accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory boards.”

Map 3 on page 9 identifies the geographic location of the state of domicile of CDE applicants that received 2006 allocations of Hurricane Katrina “Gulf Opportunity Zone” New Market Tax Credits. A review of the profile of these organizations cannot accurately identify whether these recipients’ intended investments are aligned with the hurricane recovery needs of the state of Mississippi, however there is no question that the Congressional intent of the Gulf Opportunity Zone NMTC program was to achieve this purpose. The geographic distribution of Hurricane Katrina NMTC raises serious questions as to the ability of recipient CDEs to be responsive to the needs of Katrina impacted communities and low-income residents.

The current guidelines for NMTC QLICs is based upon making investments in qualifying census tracts, an brief analysis of the distribution of NMTC based upon the state of domicile of recipient CDEs for the 2002 to 2006 NMTC allocations, using total population living in poverty at a state level illustrates that the distribution of these allocations is disproportional across states (see Map 4, page 10.)

### **Prioritizing the Needs of the Community**

If Congress intended the primary beneficiaries of the NMTC program to be the low-income residents of communities, the current selection and allocation process is flawed. The selection process is skewed toward large financial institutions that have traditionally not served low-income communities and their residents. The geographic location of investors is not a critical decision criteria for the allocation of QEIs, but the geographic location of allocates is critical to achieving the Congressional intent of the Community Renewal Tax Relief Act of 2000 to enable low-income communities and states to build the institutional, professional, and personal networks that are vital to overcoming institutional obstacles to investment within these communities. In order to meet the criteria of “principally serving” non-metropolitan areas, applicant CDEs should be required to demonstrate that at minimum state and local governments have reviewed and approved their investment plans to be in compliance with state and local revitalization strategies. Applicant CDEs should be required to demonstrate that they are responsive to and knowledgeable of the needs of local communities and their residents. As a result, consideration should be given to the state of domicile of applicant CDEs and the geographic location of where the CDE is located with the objective of achieving some level proportionality in the geographic distribution of allocations.

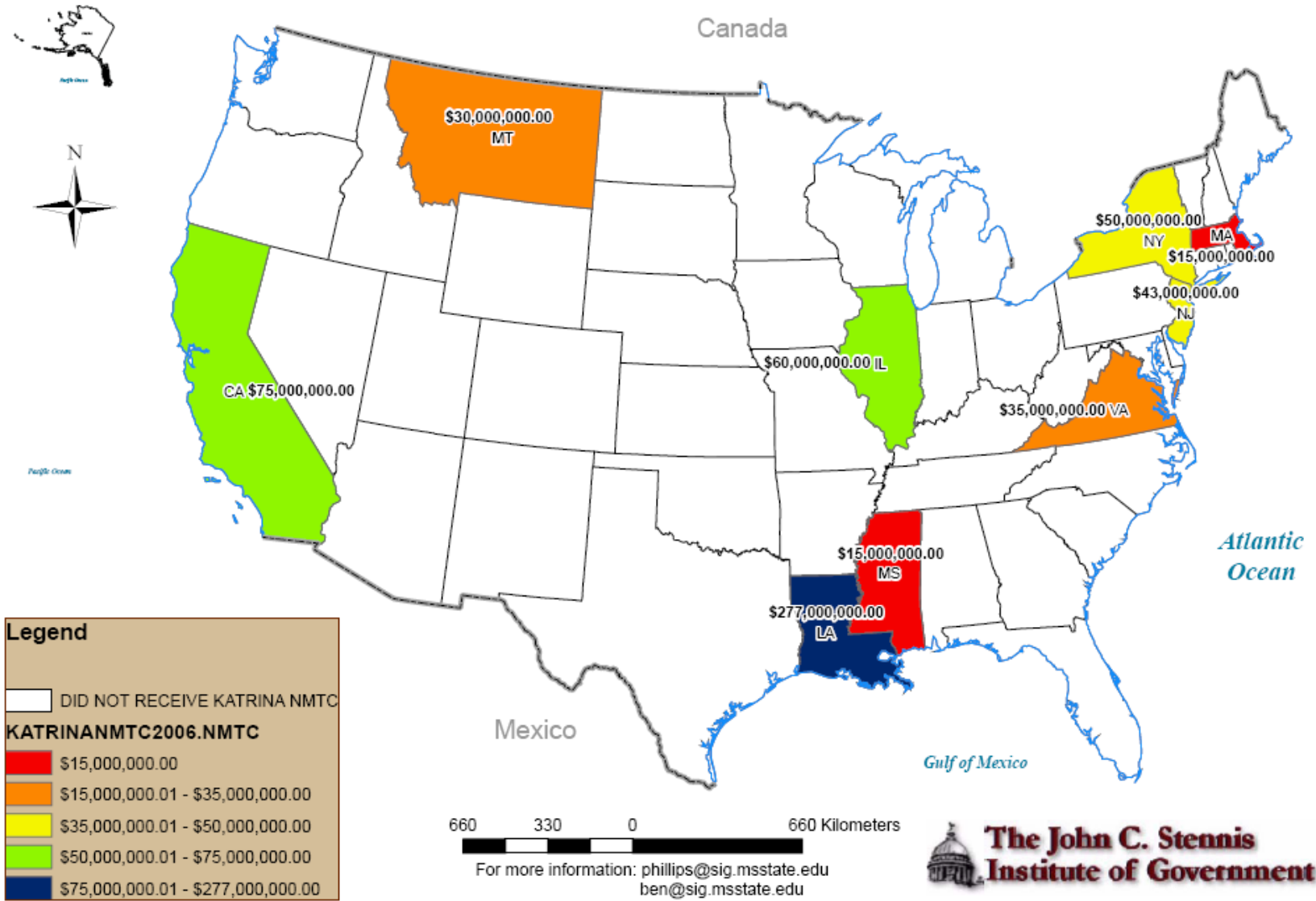
Although authorizing legislation does not stipulate stringent criteria for the receipt of a New Market Tax Credit allocation, the administratively established review criteria and application scoring criteria may be inherently skewed against new, small, local, or non-profit entities probability of receiving a New Market Tax Credit allocation. The NMTC allocation application scoring criteria should provide compensatory scoring opportunities for small, new, local or non-profit entities. Re-ranking of applicants that are partnering or joint-venturing with “start-up, local and non-profit CDEs” to leverage equity investment and financial expertise might be considered.

NMTC allocation review criteria must assure that recipient CDEs are truly responsive to the needs of the communities and low-income residents they identify in their applications, at minimum this should require certification or validation by a state-level entity such as the Governor’s office or state economic development agency or certification or validation by a local-level entity such as a County Board of Supervisors or Mayor’s office to assure that the proposed investments are aligned with the real needs of the community.

Alternatively, to refocus the program towards high priority investments that will build the wealth of communities rather than building only the wealth of investors may require a policy that directly allocates New Market Tax Credits to state governments based upon poverty per capita. Under this policy, state governments could act in consultation with the CDFI to accept competitive applications for NMTC allocations for specific projects within their states – introducing a more transparent and objective competition process that would maximize the leveraging of financial resources into communities and assure that NMTC investments are actually responsive to the needs of states and localities.

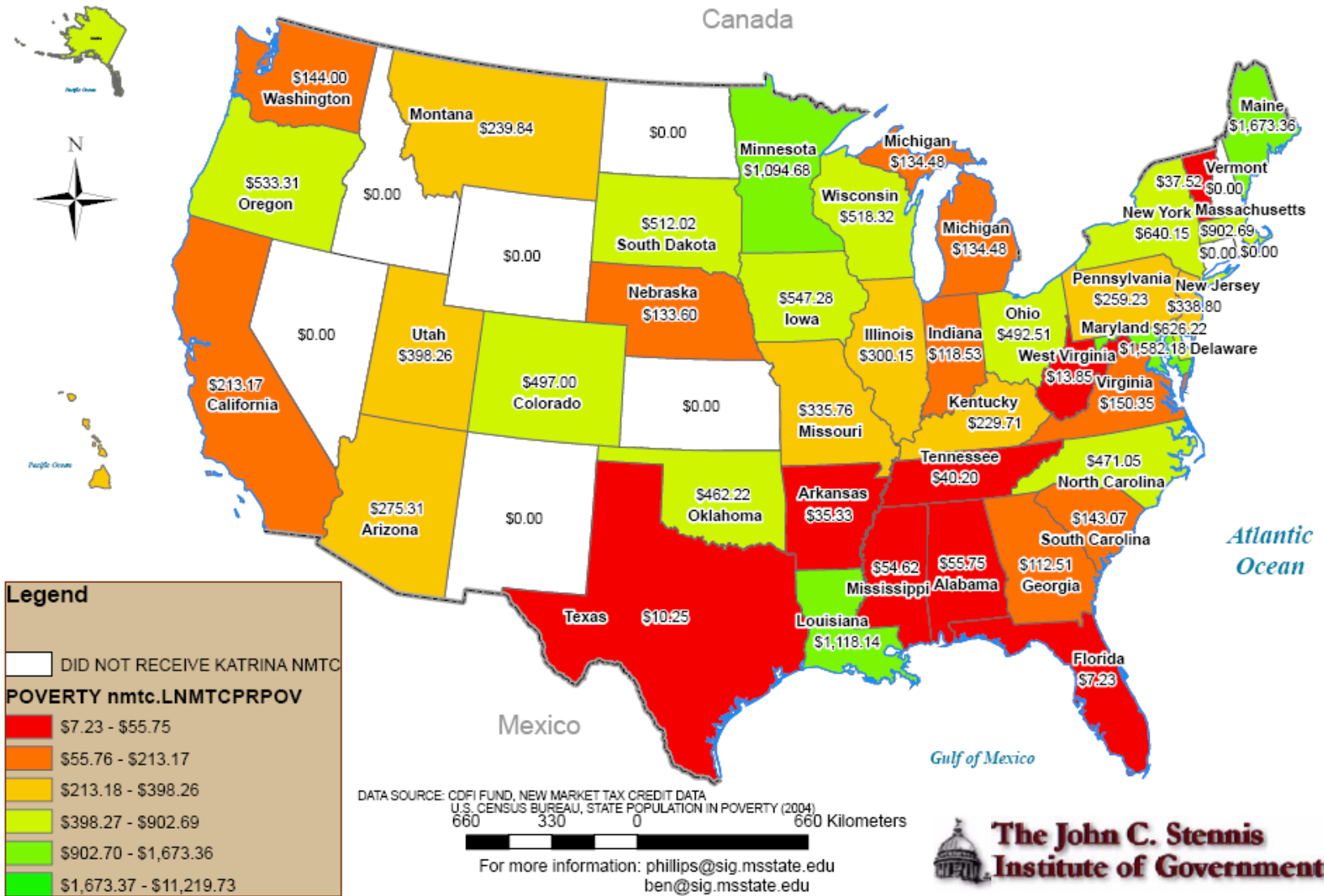


**2006 ALLOCATION OF HURRICANE KATRINA "GULF OPPORTUNITY ZONE" NEW MARKET TAX CREDITS BY RECIPIENT ORGANIZATION'S STATE OF DOMICILE**



Map 3: 2006 Allocation of Hurricane Katrina NMTC by state of domicile of CDE recipient

**TOTAL NEW MARKET TAX CREDIT ALLOCATIONS 2002 - 2006  
ALLOCATION PER CAPITA OF POPULATION IN POVERTY  
BY RECIPIENT ORGANIZATION'S STATE OF DOMICILE**



Map 4: Allocation of NMTC Per Capita of Population in Poverty by Recipient CDE's State of Domicile