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JOINT HEARING ON CERTAIN ASPECTS OF THE NEW MARKETS TAX CREDIT (NMTC) PROGRAM

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JUNE 18, 2009

Serial Nos. 111–25, 111–47

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

56–743 WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
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JOINT HEARING ON CERTAIN ASPECTS OF THE NEW MARKETS TAX CREDITS (NMTC) PROGRAM

Thursday, June 18, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
JOINT WITH THE
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittees met, pursuant to notice, at 10:00 a.m. in Room 1100, Longworth House Office Building; Hon. Richard E. Neal, [chairman of the subcommittee on Select Revenue Measures] presiding.

[The Advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Neal Announces Joint Hearing on the New Markets Tax Credit Program

June 11, 2009

By (202) 225–5522

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D–MA) announced today that the Subcommittee on Select Revenue Measures will hold a joint hearing with the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee on issues involving the New Markets Tax Credit program. **The hearing will take place on Thursday, June 18, 2009, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be limited to invited witnesses. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The hearing will focus on issues relating to the New Markets Tax Credit (NMTC) program and a recent GAO report showing that minority-owned or controlled entities are less successful than non-minority owned or controlled entities in the NMTC application process.

BACKGROUND:

The NMTC program was enacted as part of the Community Renewal Tax Relief Act of 2000 (Pub. L. 106–554) to encourage investment in low-income communities that traditionally lacked access to capital. The program awards tax credits to organizations, named Community Development Entities (CDEs), that provide capital to low-income communities, including loans and investments. Investors who make an equity investment in a CDE may claim a tax credit equal to a percentage of their investment. CDEs must invest substantially all of that equity investment into qualifying low-income communities. Through 2009, the program has awarded $21 billion of the $26 billion authorized in credits.

The Community Development Financial Institutions (CDFI) Fund, which administers the NMTC program within the Treasury Department, relies on application scores to determine which CDEs should receive an award and how much to award each allocatee. This application process focuses on four major categories: business strategy, community impact, management capacity, and capitalization strategy. The GAO found that multiple factors, including the CDEs' asset size, can influence the success rate for NMTC applicants. However, the GAO found that when controlling for CDEs' asset size, minority status was still associated with a lower probability of receiving an allocation.

In announcing the hearing, Chairman Neal stated, **"As we continue to move this economy forward, the New Markets Tax Credit program is an invaluable tool to help encourage investments in the communities that need them most. Fairness in the application process is vital to its success. I look forward to hearing the recommendations from the CDFI Director and experienced applicants as to how we might implement any changes to improve the process."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select *"Committee Hearings."* Select the hearing for which you would like to submit, and click on the link entitled, *"Click here to provide a submission for the record."* Once you have followed the online instructions, complete all informational forms and click "submit" on the final page. ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, July 2, 2009.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

Chairman NEAL. Let me call this hearing of the Select Revenue Measures Committee to order, and I hope everybody will quickly take their seats. I want to inform our witnesses as well as the interested attendees today that it looks as though we're going to be called to the floor in short order for what will be a very long day, as currently suggested up to 26 votes. So, if we can, with the cooperation of the witnesses and the members that are here try within the confines of that statement to move things along.

Let me welcome to the committee our colleagues who are joining us for this joint hearing today between the Select Revenue Measures Subcommittee and the Domestic Policy Subcommittee of the

Financial Services Committee, especially my friends Mr. Watt and Mr. Paul. Our hearing today is an examination of the New Markets Tax Credit program of which both Mr. Tiberi and I are supporters. We have seen first-hand the differences that this program can make in our districts and home states; and, as we will hear today, 88 percent of the investors in this program say they would not have invested in a low income community without the credit.

The risk of investing in a distressed community is often too high for many investors. As a former mayor I know how difficult it can be to pull together financing from every corner imaginable in order to get new investment in a neighborhood that perhaps some had given up on. And sometimes that new investment is simply to get a new grocery store, a restaurant or a retailer to locate in the heart of a blighted neighborhood. Pope John Paul said, "The community needs a soul if it is to become a true home for human beings."

I have seen many of these neighborhoods missing their souls. Investments in jobs, businesses and people can really turn these communities around and I have witnessed that as well. I believe the New Markets Tax Credit is an efficient way to target investment into the neediest communities around the country. Of course, we also need to ensure that community organizations, many which are smaller or minority owned have a fair shot at competing for these tax credits. And today we will hear from a number of experts on the subject who will share their experiences and recommendations for improvement.

Let me at this time recognize Mr. Tiberi for his opening statement.

Mr. TIBERI. Mr. Chairman, I know we are under some severe time shortages, so I would just ask that my opening statement be submitted for the record. And, thank you for this hearing and your leadership, and yield back.

[The information follows:]

Chairman NEAL. Thank you. I'd like to call on Mr. Watt for an opening statement.

Mr. WATT. Thank you, Mr. Chairman, and I would be tempted to do the same thing, but I am kind of the culprit here who started this process. So I wanted to kind of frame what we're here about. Let me first thank Chairman Neal and Chairman Rangel and the Ranking Member, both Ranking Members, for being a part of this hearing today.

The purpose of today's hearing is to examine a recent GAO report entitled, "New Markets Tax Credit: Minority Entities Are Less Successful On Obtaining Awards Than Non-minority Entities." The request for the GAO report originated, actually, in a hearing in the Financial Services Oversight and Investigation Subcommittee that I chaired in the last term of Congress on preserving and expanding minority banks.

During that hearing we learned that minority-owned banks were having difficulty obtaining New Markets Tax Credits and as a result Chairman Rangel, Chairman Neal, Chairman Barney Frank of the Financial Services Committee and I requested the GAO to investigate which firms have been receiving New Markets Tax Credits and whether any barriers exist to minority-owned firms competing fairly to obtain such allocations.

What we suspected back in the last term of Congress has now been confirmed by the GAO report. The title of the report says it all: "Minority Firms Are Less Successful In Obtaining Awards Under the New Markets Tax Credit Program." This has major significance, because the CDFI Fund award roughly $5 billion in New Markets Tax Credits annually, but only a handful of minority owned firms have received allocations in the eight-year history of the program. And so we're trying to get to an assessment of why that is the case.

I am certainly not here as a critic of the New Markets Tax Credit program. To the contrary I recognize the important contributions these credits have had on fostering economic develop in traditionally underserved areas throughout the nation. There are several of them which I won't describe in my own congressional district, in fact, so I know firsthand the importance of them. But our theoretical assumption, I think, when this program was undertaken was that minority banking institutions being based in minority communities' underserved communities would be the logical recipients of at least part of these tax credits and the GAO has gone into describing some of the reasons why problems are encountered.

I won't go into those either in the interest of time, but I do want to emphasize the third finding that the GAO made and that that was that even after controlling for the factors that could be influencing this asset size, proposed project characteristics, minority status was still associated with a lower probability of receiving an allocation and is the only factor that rated a "significant negative," and this simply shouldn't be the case.

So we are here today to try to get to the bottom of what's happening with this and I appreciate again the Chairman convening the hearing. And I hope we get a chance to pursue it without 26 votes on the floor.

[The prepared statement of Mr. Watt follows:]

[The prepared statement not available]

Chairman NEAL. Thank you, Mr. Watt.

Mr. Paul?

Mr. PAUL. Thank you, Mr. Chairman.

I thank you for calling this hearing on the topic of the New Markets Tax Credit program. I have been a consistent proponent of tax credits in a wide variety of areas. Tax credits have a successful track record as with the New Markets Tax Credit, which helps to revitalize low income areas in both rural and urban communities.

Allegations that minority entities are discriminated against are disturbing, but the solution is not to establish quotas that favor some community development entities over others. Instead, given the popularity of this program, perhaps the size and/or scope of the program should be expanded. For me, there is no such thing as too many tax credits.

Thank you, Mr. Chairman.

Chairman NEAL. Thank you very much, Mr. Paul.

Let me now introduce our witnesses. First, I want to welcome Donna Gambrell, the Director of the Community Development Financial Institutions Fund, the agency that operates the New Markets Tax Credit Program for the Treasury Department. I also want to welcome back to the committee, Michael Brostek, the director of

tax issues on the strategic issues team at GAO who was always here to offer constructive comments as well. And, our second panel, we will hear from Ron Phillips, the president of Coastal Enterprises from Wiscasset, Maine.

Let me also welcome Blondel Pinnock, the President of Carver Community Development, and the Senior Vice President of Carver Federal Savings Bank in New York City. We also want to welcome from Baltimore, Maryland, Mr. Joseph Haskins, who serves as Chairman, President and CEO of Harbor Bank; and, we welcome William Michael Cunningham, a social investing advisor at Creative Investment Research here in Washington.

And, finally, we welcome before the committee today, James Klein, the CEO of the Ohio Community Development Finance Fund in Columbus Ohio. We are very fortunate to have a panel of experts from around the country to share their experiences with the New Markets program. We look forward to their testimony today.

I want to thank you for participation. And, without objection, any other members wishing to insert statements as part of the record may do so. All written statements written by the witnesses will be inserted into the record as well. Let me recognize director Gambrell for her opening statement.

Chairman WATT. Mr. Chairman, before you do that could I make what I hope will be a constructive suggestion that maybe one possibility, since we did just get handed this notice that we're going to have 26 recorded votes on the floor, that we might just take all of the witnesses' testimony, try to get those in, and then do the questioning all as one group as opposed to, you know, at least we could try to get the testimony in; and, if necessary, then may be we could submit our questions to them in writing subsequent to the hearing.

Chairman NEAL. I think that's a very good idea. Are there any objections?

[No response.]

Chairman NEAL. Hearing none, I think that we'll accept a suggestion that's been offered by Mr. Watt.

STATEMENT OF DONNA J. GAMBRELL, DIRECTOR, COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND, UNITED STATES DEPARTMENT OF THE TREASURY

Ms. GAMBRELL. Thank you. Good morning Chairman Watt, Chairman Neal, Ranking Member Paul and distinguished members of the committee on Financial Services and the Committee on Ways and Means.

I am delighted to be here today to testify at this hearing on the U.S. Government Accountabilities Office's recent report that addresses the success rates of minority entities in the New Markets Tax Credit Program. As Director of the U.S. Department of the Treasury's Community Development and Financial Institutions Fund or CDFI Fund, I want to assure Congress that since I became director almost two years ago, I have been committed to expanding participation in all of our programs.

First, I'd like to thank Chairman Neal and Ranking Member Tiberi for recently introducing H.R. 2628, the New Markets Tax Credit Extension Act of 2009 that would extend the New Markets

Tax Credit Program through 2003 and allow New Markets Tax Credit Investments to be used as an offset against alternative minimum tax liabilities for awards made in 2009.

Last month, and just 100 days after the President signed into law the recovery act I had the privilege of joining Treasury Secretary Tim Geithner, Chairman Frank, Congressman Capuano and Governor Deval Patrick in Roxbury, Massachusetts, to announce that 32 organizations had been selected to receive $1.5 billion in New Markets Tax Credit Allocation Authority that was made available under the Recovery Act.

The event was held at the new headquarters of Project Hope, a multi-service agency that provides low-income women with children, access to education, jobs, housing and emergency services. The building is located in a predominantly African-American community and was financed with a $4.8 million investment made possible through the New Markets Tax Credit program. The new community center will significantly increase the number of local residents that Project Hope can serve. This is a great example of the type of story and community impact that is often undetected among the statistics and data program evaluations, but are the most important aspect of what we are trying to accomplish with programs like the New Markets Tax Credit Program.

Since 2002, the year of our first New Markets Tax Credit Program round, the CDFI Fund has allocated $21 billion in tax credit authority to community development entities or CDEs. Since September of 2008, investors have invested close to $2 billion into CDEs, demonstrating the resiliency of the program and even the most difficult of economic times. These investments have financed a variety of products including charter schools, healthcare facilities, performing arts centers, manufacturing companies, alternative energy companies, business incubators, grocery anchored shopping centers, substance abuse treatment facilities and facilities for the homeless.

The New Markets Tax Credit Program is highly competitive, and any given application ran, only about one in four applicants is selected to receive an award; and requests for tax credit authority have been between six and nine times greater than what's available to award. The CDFI Fund agrees with the GAO's conclusion that within this highly competitive application environment organizations that have identified themselves as minority-owned CDEs have not received allocation awards in proportion to their representation in the application pool.

The CDFI Fund does not believe that this lower rate of success for minority CDEs, or for that matter, the success rate of any category of CDE is attributable to biases in the application review or selection process. Despite the challenges that are faced by minority CDEs in the application process, the CDFI Fund believes that the New Markets Tax Credit Program has been extremely successful at bringing benefits to communities with large minority populations. Since the tracks for New Markets Tax Credit Investments have been made minority populations totaling 47 percent almost doubled the overall national average of 26 percent.

Furthermore, over 45 percent of the dollars invested under the New Markets Tax Credit Program have been invested in commu-

nities where the majority of the population is comprised of minorities. New Markets Tax Credit Projects are benefiting minority communities all over the country, even in our own back yard. Here in Washington, D.C., New Markets Tax Credit Investments have been used to finance charter schools with populations that are 100 percent minority. Minority-owned businesses, a community and cultural center in a neighborhood where 93 percent of the residents are African-American; and, in that same neighborhood, a shopping center anchored by a Giant Super Markets, the first grocery store located in that community in over a decade.

Notwithstanding the great successes we've seen benefiting minority communities, we do need to work together to increase participation by minority-owned CDEs in the New Markets Tax Credit Program. To this end the CDFI fund will focus on the following initiatives: one, continued outreach to minority-owned CDEs. The CDFI Fund will continue to vigorously pursue outreach and training opportunities that will ensure minority-owned institutions are aware of the benefits of the New Markets Tax Credit Program; and, are given every opportunity to apply for allocation rounds.

Two, solicitation of public comments: next month the CDFI Fund will be soliciting comments pertaining to the New Markets Tax Credit Application Procedures and will request comments on how it can expand the participation of minority-owned and controlled CDEs. And, three, continued dialogue with Congress: the CDFI Fund has always been responsive to instructions from Congress regarding the New Markets Tax Credit Program priorities. The CDFI Fund very much looks forward to a continued dialogue with Congress on these matters.

In closing, I hope that through these initiatives, specifically, the new outreach efforts, the CDFI Fund will be better able to reach a greater audience of potential awardees and also encourage greater collaboration with organizations and federal agencies that serve minority populations, the New Markets Tax Credit Program has been a tremendous success and low income and minority communities throughout the country. And I am confident that it will continue to be so in the future.

Thank you for inviting me here today and I look forward to answering your questions.

[The prepared statement of Ms. Gambrell follows:]

Chairman NEAL. Thank you.

Testimony By Donna J. Gambrell Director, Community Development Financial Institutions Fund, United States Department of the Treasury

Good morning, Chairman Watt, Chairman Neal, and distinguished Members of the Committee on Financial Services, and the Committee on Ways and Means. I am delighted to be here today to testify at this hearing on the U.S. Government Accountability Office's (GAO) recent report that addresses the success rates of minority entities in the New Markets Tax Credit (NMTC) Program.

My name is Donna J. Gambrell and I am the Director of the U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund. I want to assure Congress that since I became Director of the CDFI Fund almost two years ago, I have been committed to expanding participation in all of our programs.

First, I would like to thank Chairman Neal and Ranking Member Tiberi for recently introducing H.R. 2628, "The New Markets Tax Credit Extension Act of 2009" that would extend the NMTC Program through 2013, and allow NMTC investments to be used as an offset against Alternative Minimum Tax liabilities for awards made in 2009.

Last month, and just 100 days after the President signed into law the American Recovery and Reinvestment Act (Recovery Act), I had the privilege of joining Treasury Secretary Tim Geithner, Chairman Frank, Congressman Capuano, and Governor Deval Patrick in Roxbury, Massachusetts to announce that 32 organizations had been selected to receive $1.5 billion in NMTC allocation authority that was made available under the Recovery Act. Three of these 32 awardees are minority-owned or controlled entities, bringing to seven the total number of minority-owned or controlled entities that received awards under the 2008 allocation round. These seven awardees received NMTC awards totaling $489 million.

The event was held at the headquarters of Project Hope, a multi-service agency that provides low-income women with children access to education, jobs, housing, and emergency services. This new building was financed with a $4.8 million investment made possible through the NMTC Program.

Joining the Secretary for this announcement event allowed me to witness firsthand how the NMTC Program has enabled Project Hope to enrich its community and improve the lives of the local residents. Their new Community Building is a "green" building, the first one in Roxbury, and will enable Project Hope to provide services to a number of additional women and families.

At the announcement event, I also had the opportunity to visit with Shaniqua Choice, a young woman who will soon graduate from the Match School, a public charter school that prepares inner-city Boston students for higher education, including many who have no family history of college attendance. Ninety-six percent of the students at the Match Charter School are minorities. The Match School received a NMTC investment which it used, in part, to set up a tutoring program with 45 recent college graduates who were hired to live in dormitories at the high school and tutor the students.

Shaniqua lives in Dorchester in a single-parent home with a mother who, while she was growing up, only had a GED. She would get up at 4:30 am every day, traveling an hour and half on the train to make it to school on time. She entered Match High School as a freshman in September 2005 performing at a 5th grade math level. Now, four years later, she will soon become the first in her family to go to college, attending Massachusetts College of Liberal Arts in North Adams in the fall. Shaniqua says the tutoring program is essential to the Match School's success and to her success.

These are the stories and community impacts that are often undetected among the statistics and data of program evaluations but are the most important aspect of what we are trying to accomplish with programs like the New Markets Tax Credit Program.

The CDFI Fund

In 1994, Congress enacted the Riegle Community Development and Regulatory Improvement Act (P.L. 103–325) to create the CDFI Fund. Congress found that many of the Nation's distressed urban, rural, and Native American communities faced critical social and economic problems arising in part from the lack of economic growth, people living in poverty, and the lack of employment and other opportunities. The CDFI Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and economically distressed communities across the United States.

The CDFI Fund achieves its mission through five distinct competitive programs:

- *CDFI Program:* Provides Financial Assistance awards to institutions that are certified as CDFIs, which in turn provide loans, investments, financial services (including financial education) and technical assistance to underserved populations and low-income communities; the CDFI Fund also provides Technical Assistance grants to certified CDFIs and entities that will become certified as CDFIs within three years.

- *Native Initiatives:* Provides Financial Assistance awards, Technical Assistance grants, and training to Native CDFIs and other Native entities proposing to become or create Native CDFIs.

- *Bank Enterprise Award Program:* Provides monetary awards to FDIC-insured banks to increase their investment in low-income communities and/or in CDFIs.

- *New Markets Tax Credit Program:* Provides tax allocation authority to certified CDEs, enabling investors to claim tax credits against their Federal income taxes; the CDEs, in turn, use the capital raised to make investments in low-income communities.

- *Capital Magnet Fund:* Authorized under the Housing and Economic Recovery Act of 2008 but not yet funded, the Capital Magnet Fund will provide a source of

funding for CDFIs and other non-profits to finance the development, rehabilitation and purchase of affordable housing for low-income persons. The Administration has requested $80 million for this new initiative in FY 2010.

Among the beneficiaries of the CDFI Fund's programs are low-income people and/or economically distressed communities, which include, among others, populations that otherwise lack adequate access to capital and financial services. Since its creation in 1994, the CDFI Fund has made more than $949.3 million in awards to CDFIs, community development organizations and financial institutions through the CDFI Program, the Bank Enterprise Award Program, and the Native American Initiatives CDFI Assistance Program. Since 2002, the year of our first New Markets Tax Credit Program round, the CDFI Fund has allocated $21 billion in tax credit authority to CDEs, including the $1.5 billion that was awarded in May of 2009 under the Recovery Act authority.

New Markets Tax Credit Program Overview

The NMTC Program was initially authorized through the Community Renewal Tax Relief Act of 2000.[1] This unique tax credit program facilitates investment in low-income communities by permitting taxpayers to receive a credit against Federal income taxes for making Qualified Equity Investments (QEIs) in designated Community Development Entities (CDEs). Substantially all of these QEI dollars must in turn be used by the CDE to provide investments in businesses and real estate developments in low-income communities.

The credit provided to the investor totals 39 percent of the amount of the investment and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is six percent annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

A CDE is a domestic corporation or partnership that serves as an intermediary vehicle for the provision of loans, investments, or financial counseling to low-income communities. To qualify as a CDE, an entity must: 1) have a mission of serving, or providing investment capital for, low-income communities or low-income persons; 2) maintain accountability to residents of low-income communities through their representation on a governing board of or an advisory board to the entity; and 3) be certified by the CDFI Fund as a CDE. Applicants may submit CDE certification applications throughout the year and are approved by the CDFI Fund on a rolling basis.

The CDFI Fund is responsible for administering the competitive allocation of tax credit authority to CDEs, which it does through annual allocation rounds. To date, the CDFI Fund has made 386 NMTC allocation awards totaling $21 billion, through six different allocation rounds. The CDFI Fund will award an additional $5 billion of allocation authority, including $1.5 billion of allocation authority that was made available under the Recovery Act, under the 2009 allocation round. The CDFI Fund anticipates making these award announcements in October of 2009.

To date, investors have invested $13.7 billion into CDEs, or over 70 percent of the NMTC allocation authority that was awarded to CDEs through 2008. In fact, since September of 2008, investors have invested close to $2 billion into CDEs, demonstrating the resiliency of this program in even the most difficult of economic times.

Through FY 2007, the most recent year for which the CDFI Fund has complete data, CDEs invested $8.96 billion of NMTC proceeds into 1,981 businesses and real estate projects in low-income communities, supporting over $30 billion in total project costs. These investments have financed a wide variety of projects, including charter schools, health care facilities, performing arts centers, manufacturing com-

[1] The original legislation that authorized the program allowed for $15 billion in tax credit authority for the NMTC program through 2007. Pub. L. No. 106–554, App. G, § 121, 114 Stat. 2763A–587, 608 ("There is a new markets tax credit limitation for each calendar year. Such limitation is—(A) $1,000,000,000 for 2001, (B) $1,500,000,000 for 2002 and 2003, (C) $2,000,000,000 for 2004 and 2005, and (D) $3,500,000,000 for 2006 and 2007."). However, the Gulf Opportunity Zone Act of 2005 authorized an additional $1 billion of NMTC equity for qualified areas affected by Hurricane Katrina over a period of 3 years: $300 million in 2005, $300 million in 2006, and $400 million in 2007. Pub. L. No. 109–135, § 101, 119 Stat. 2577, 2592. The Tax Relief and Health Care Act of 2006 and the Emergency Economic Stabilization Act of 2008 extended the amount of NMTC authority available by $3.5 billion for 2008 and 2009, respectively. Pub. L. No. 109–432, § 102, 120 Stat. 2922, 2934 (2006); Pub. L. No. 110–343, div. A, § 302, 122 Stat. 3765, 3866 (2008). The American Recovery and Reinvestment Act of 2009 provided an additional $3 billion of NMTC allocation authority to be split equally between the 2008 (retroactively) and 2009 allocation rounds. Pub. L. No. 111–5, div. A, § 1403(a).

panies, alternative energy companies, business incubators, grocery-anchored shopping centers, substance abuse treatment facilities, and facilities for the homeless. NMTC awardees reported that, through 2007, their investments have helped to develop or rehabilitate 63 million square feet of real estate, create 240,000 temporary construction jobs, and create or maintain 45,000 jobs at businesses in low-income communities.

Success of the New Markets Tax Credit Program

One of the greatest innovations of the NMTC Program is that it combines the features of a competitive grant program with the advantages of private sector investment and decision-making. Most Federal tax credits are simply claimed by taxpayers rather than competitively allocated, and most community development programs of comparable size to the NMTC Program are administered through formula-funding mechanisms. Through competition under the NMTC Program, the CDFI Fund selects only the most qualified CDEs, and requires them to meet higher standards and achieve greater results than would otherwise be minimally required under Internal Revenue Service program rules.

For example, while all awardees are required to invest substantially all (generally 85 percent) of the qualified equity investments they receive in low-income communities, most applicants commit to making investments in areas characterized by "severe" economic distress—and are held to these commitments as part of their award agreements with the CDFI Fund. As a result, over 75 percent of NMTC transactions financed through 2007 were located in census tracts with a poverty rate of at least 30 percent, a median family income at or below 60 percent of the applicable area median family income, and/or an unemployment rate at least 1.5 times the national average.

Similarly, IRS regulations do not specify that CDEs must offer beneficial rates and terms to the borrowers and investees in low-income communities. However, as part of the application materials, CDEs generally commit to providing flexible and non-traditional product offerings, and are held to these commitments as part of their award agreements with the CDFI Fund. Through 2007, over 98 percent of the transactions offered preferential rates and terms to the borrowers. The most common features are below market interest rates (83 percent of transactions), lower origination fees (59 percent of transactions), and longer than standard periods of interest-only payments (54 percent of transactions).

CDEs are also committing to increasing their investments in low-income communities. NMTC Program regulations generally require that at least 85 percent of QEI proceeds be invested in qualified, low-income community investments. However, as part of the application materials, CDEs generally commit to investing significantly more of these funds into low-income communities. In fact, all 32 awardees recently selected to receive $1.5 billion in Recovery Act awards indicated that they would invest at least 94 percent of their NMTC proceeds into low-income communities, and 24 of the 32 awardees indicated that at least 97 percent of their QEI dollars would be invested into low-income communities.

These and other program successes were highlighted in a 2007 evaluation of the NMTC Program conducted by the GAO. As part of this evaluation, officials from the GAO met several times with officials from the IRS and the CDFI Fund. GAO officials collected documents on program status and efforts to monitor NMTC compliance; analyzed transactional data reported by CDEs to the CDFI Fund; analyzed tax return data reported by NMTC investors to the IRS; surveyed investors in the NTMC program; and compared NMTC investors with a stratified random sample of investors that did not make NMTC investments. This extensive research led to several findings pointing to the effectiveness of the NTMC Program, including:

- An estimated 88 percent of investors said that they would not have made the same investment without the NMTC.

- Of these investors who would not have made the same investment without the NMTC, 75 percent of investors also indicated that in the absence of the NMTC, they would not have made a similar investment in the same community.

- Sixty-nine percent (69 percent) of the investors making investments in CDEs in 2006 had not previously made investments in those entities.

- An estimated 64 percent of NMTC investors reported that they increased the share of their investment budget for low-income communities because of the credit.

- Communities receiving NMTC investments tend to be more highly distressed than minimally required under program rules.

These findings, among others, led the GAO to ultimately conclude that "the results of our survey and statistical analysis are consistent with the NMTC program

increasing investment in eligible low-income communities by the investors who participate in the program and with investment coming primarily from funds shifted from other uses."

NMTC Application Review Process

The successes that we've seen to date under the NMTC Program are a result of the high demand for credits, coupled with a rigorous application process. In any given application round, only about one in four applicants is selected to receive an award, and requests for tax credit authority have been between six and nine times greater than what is available to award.

Table 1

Allocation History since Program Inception (Dollars in Billions)

	Applications		**Awards**	
Round	**Number**	**Amount Requested**	**Number**	**Amount**
1 (2001/2)	345	$25.8	66	$2.5
2 (2003/4)	265	$29.6	63	$3.5
3 (2005)	203	$22.5	41	$2.0
4 (2006)	239	$27.2	63	$4.1
5 (2007)	252	$27.4	61	$3.9
6 (2008)	239	$21.3	102	$5.0
All Rounds	1,543	$153.8	396	$21.0

As part of the selection process, all CDEs are required to prepare and submit a uniform application form, which includes four key sections (Business Strategy; Community Impact; Management Capacity; Capitalization Strategy). During the first phase of the review process, each application is rated and scored independently by three different Readers, who are typically external to the CDFI Fund. Readers are selected on the basis of their knowledge of community and economic development finance and experience in business or real estate finance, business counseling, secondary market transactions, or financing of community-based organizations.

In order to maintain the integrity of the review process, all potential readers are screened for any potential or real conflicts of interest. They are brought to Washington, DC for a two-day orientation and training session. The Readers then work remotely, submitting on-line review forms, which include detailed notes and instructions pertaining to how the application must be scored. Each application write-up is reviewed by a CDFI Fund staff person to ensure that the reviewer has: (1) provided clear and substantive comments; (2) adhered to the scoring guidelines; and (3) provided scores that are consistent with their ratings.

In scoring each application, reviewers rate each of the four evaluation sections as follows: Weak (0–5 points); Limited (6–10 points); Average (11–15 points); Good (16–20 points); and Excellent (21–25 points). Applications can be awarded up to ten additional "priority" points for demonstrating a track record of serving disadvantaged businesses and communities and/or for committing to make investments in projects owned by unrelated parties. Readers are not permitted to discuss their application ratings or scores with one another. If one or more of the three Readers provides an anomalous score, and it is determined that such an anomaly would affect the outcome of the final awardee pool, then a fourth reviewer will score the application, and the anomalous score would likely be dropped.

Once all of the scores have been finalized, including anomaly score adjustments, those applications that meet minimum aggregate scoring thresholds in each of the four major review sections (as well as a minimum overall scoring threshold) are eligible to be considered for an allocation. They are reviewed by an internal CDFI Fund panel, with the Panel Manager making an award recommendation to the Selecting Official (generally the NMTC Program Manager). If the Selecting Official's award recommendation amount varies significantly from the recommendation of the Panel Manager, then the Reviewing Official (generally the Deputy Director for Poli-

cies and Programs) makes the final award determination. Awards are made, in descending order of the final rank score, until the available allocation authority for a given round is fully expended.

In any given allocation round, there are many CDEs that meet the minimum requisite scoring thresholds, but which do not receive an award because the CDFI Fund runs out of allocation authority. Each applicant that is not selected to receive an NMTC allocation award is provided with a written debriefing document. This document provides to the applicant the strengths and weaknesses that were identified by the application reviewers. The debriefing documents are very useful tools for applicants wishing to reapply in future rounds.

Application Success Rates of Minority-Owned CDEs

The CDFI Fund agrees with the GAO's conclusions that, within this highly competitive application environment, organizations that have identified themselves as minority-owned CDEs have not received allocation awards in proportion to their representation in the application pool. The CDFI Fund does not believe that this lower rate of success for minority CDEs, or for that matter the success rate of any other category of CDE, is attributable to biases in the application review or selection process. Rather, the CDFI Fund believes that it is the relative capacity of each applicant, reviewed under its own merits without regard to its ownership structure, which determines the award outcomes. As the GAO noted in its evaluation:

"The analysis does not exclude the possibility the minority status is associated with other characteristics of the CDE, such as management capacity for which we do not have independent data, which account for the lower probability. In that case, it would not be minority status per se that lowers the probability of success but its association with other factors not included in the analysis." (page 38).

Without discounting the importance of GAO's findings, it is also worth noting that the GAO relied on information self-reported by the applicants at the time of application submission, which may have resulted in an undercounting of awardees that are minority-owned CDEs.

Each applicant CDE is required to "check a box" indicating whether it, or its parent company, is minority-owned or controlled. This check-box appears alongside several other check-boxes that address the ownership structure/purpose of the CDE. It is quite likely that, in any given application round, a number of organizations that would otherwise qualify as minority-owned CDEs fail to check the box. This failure may result from simply overlooking the check-box, or it may occur because an organization did not thoroughly review the definition of a minority-owned entity that is provided in the glossary that accompanies the application.

It could be the case that many non-profit organizations which have significant minority executive control fall within the CDFI Fund's definition of a minority-owned entity, but perhaps have not been checking the box. It does not appear as though the GAO attempted to adjust for this potential under-reporting by reaching out to a sample of non-minority CDEs to determine whether they may have failed to identify themselves as minority CDEs. This type of analysis would have probably had an impact on their findings, and perhaps led them to determine that a larger number of minority-owned or controlled CDEs have received allocation awards than were initially self-identified.

Again, this observation is being raised simply to add a little more context to the GAO's findings. It should not be construed in any way as a criticism of GAO's analysis, which we believe was thorough and accurate with respect to information that was self-reported by the CDEs.

Investments in Minority Communities

Despite the application challenges that are faced by minority-owned CDEs, the CDFI Fund believes that the NMTC Program has been extremely successful at bringing benefits to communities with large minority populations. As noted in the GAO report, a 2008 study that was jointly sponsored by the CDFI Fund and the Federal Reserve Board of San Francisco found that census tracts that receive NMTC investments have, on average, non-white populations totaling 47 percent—compared with an average of 26 percent for all census tracts nationwide. Further analysis by the CDFI Fund has revealed that, through 2007, over $4.1 billion (or over 45 percent of the $8.96 billion invested by CDEs through 2007) was invested in census tracts where non-white populations exceeded 50 percent of the total population. In 2007, the most recent year for which the CDFI Fund has transaction-level data, over 51 percent of the dollars invested by CDEs were invested in census tracts with majority non-white populations.

My point here is that many non-minority CDEs are extremely successful at working with minority communities. One such example is Stonehenge Community Devel-

opment LLC, which has received three NMTC awards totaling $287.5 million. Stonehenge has formed strategic alliances with groups such as the National Urban League, the National Association of Black Hotel Owners, and the National Minority Development Council to target minority-owned businesses and other high-impact projects in minority communities. Stonehenge has used its NMTC allocation to finance an African-American owned car dealership in Lake Charles, Louisiana that suffered severe damage in the wake of Hurricane Rita; a social service center in San Antonio Texas; a health center in Kansas City Missouri; and an African-American led social service agency in New Jersey. All of these projects serve severely distressed communities with majority minority populations.

One project that really interested me, due to its historical significance, is the International Civil Rights Center and Museum in downtown Greensboro, North Carolina, which is in Congressman Watt's district. Stonehenge helped finance this $23 million dollar project, which included the conversion of the 1929 Woolworth store that was the site of the historic 1960 sit-in that helped launch the national civil rights movement. Stonehenge's role in the construction of this museum is significant, as there was a shortfall between what was raised through fundraising and the actual cost of the project. NMTCs were identified as the only source of funding that could keep the project on schedule while retaining the confidence of the investors and other supporters.

Stonehenge is of course just one of many CDEs that have significantly contributed to the economic wellbeing of distressed minority communities. The Massachusetts Housing Investment Corporation, a certified CDFI that has received four awards totaling $435 million, made a NMTC investment in the Holyoke Health Center in Chicopee, Massachusetts, in Congressman Neal's district. Holyoke Health Center serves over 16,000 patients annually, the majority of whom are Hispanic. More than 80 percent of the health center's patients live at or below the Federal Poverty Level and all of the health center's patients live below 200 percent of the Federal Poverty Level. The NMTC financing helped the lender to finance the health center at below market rates, saving the borrower $88,000 in interest expense annually. This savings allows the health center to devote more of its cash flow to direct care of its patients.

Rockland Trust CDE, a community bank headquartered in Rockland, Massachusetts, has received two NMTC awards totaling $75 million, and has made several investments benefiting minority populations in Congressman Frank's district. Most notable amongst these were a loan to support a minority-owned beauty supply business headquartered in Brockton, Massachusetts; a loan to support a minority-owned medical practice in Taunton, Massachusetts; and a real estate loan that supports a Latino health clinic in Brockton, Massachusetts.

In Columbus, Ohio, ESIC New Markets Partners, partnered with the Columbus Housing Partnership to construct and rehabilitate up to 700 affordable housing units. The entire project used $9.5 million in NMTCs and has leveraged $19 million in project related costs. The homes are targeted for households earning less than 80 percent of the area median income and are located in communities throughout Columbus.

I point out these specific projects not only for the Members of this Committee, but to demonstrate that NMTC projects and high-impact community benefits are occurring all over the country, even in our own backyards. For example, here in Washington, DC, NMTC investments have been used to finance charter schools with populations that are 100 percent minority; minority-owned businesses; a community and cultural center in a neighborhood where 93 percent of the residents are African-American; and, in that same neighborhood, a shopping center anchored by a Giant supermarket.

The construction of this grocery store is notable because for almost ten years, residents of this neighborhood had been without a supermarket. Those who did not have cars would either have to carpool to the closest supermarket with friends, find a bus, or rely on the neighborhood convenience stores for food. This project has had several positive community impacts, including the addition of 375 construction and 175 permanent jobs. Finally, the new supermarket is one of Washington, DC's largest Giants, providing residents with ready access to affordable fresh food.

Next Steps

I would now like to turn to the ways we can work together to increase participation by minority-owned CDEs in the NMTC Program. The CDFI Fund is committed to ensuring that the pool of CDE awardees represents a diversity of institutional types, and that minority CDEs are assured fair access to these scarce resources. To this end, the CDFI Fund will focus on the following initiatives:

1. **Continued outreach to minority-owned CDEs.** The CDFI Fund has been actively seeking to promote participation by minority-owned CDEs since the program's inception. Most notably, we have conducted multiple outreach sessions with the National Banker's Association (NBA), a trade association of minority-owned financial institutions, and with the Federal Deposit Insurance Corporation's Minority Depository Institution Program, and participated at the Native American Finance Officers Association conference.

Upon release of the 2009 NMTC application materials, we reached out to the NBA, the Minority Business Roundtable, and the National Black Chamber of Commerce and offered to set up conference calls with their members. Just last month, the CDFI Fund presented information about the NMTC Program at a national conference sponsored by the Department of Commerce's Minority Business Development Agency. The CDFI Fund intends to continue to vigorously pursue these outreach and training opportunities, to ensure that minority institutions are aware of the benefits of the NMTC Program, and are given every opportunity to apply for allocation awards.

2. **Solicitation of public comments.** Another component that is connected to our outreach efforts is incorporating public feedback into our work. Later this summer, the CDFI Fund will be soliciting comments pertaining to the NMTC allocation application and related implementation matters. As part of this solicitation of public comments, the CDFI Fund will ask for comments specifically pertaining to how it can expand the participation of minority-owned and controlled CDEs in the NMTC allocation process.

3. **Continued dialogue with Congress.** The CDFI Fund has always been responsive to instructions from Congress regarding the NMTC program priorities. The authorizing statute indicated that a preference was to be given to organizations with a track record of working in disadvantaged communities, and a preference as well to organizations that would invest in "unrelated entities"—entities that they would not control through ownership. Congress later instructed the CDFI Fund to ensure that a proportionate amount of investments are made in rural communities. In response to direction from Congress on these three issues, the CDFI Fund included specific protocols within its application process to ensure that Congressional intent was being satisfied. The CDFI Fund very much looks forward to continued dialogue with Congress to improve the effectiveness of the NMTC Program.

Conclusion

The CDFI Fund is committed to giving support to communities and financial institutions. We have a wide variety of programs that reach America's most underserved and underinvested communities. Our mission is not only to ensure that we serve these communities, but that we also maintain the integrity and competitiveness of these programs. I hope that through our current and new outreach efforts we will be better able to reach a greater audience of potential awardees and also encourage greater collaboration with organizations and federal agencies that serve minority populations. The NMTC Program has been a tremendous success in low-income and minority communities throughout the country, and I am confident that it will continue to be so in the future.

Never before in the history of the CDFI Fund have we been in such a strong position to be able to support and serve minority communities. Thank you for inviting me here today.

Mr. BROSTEK, will you proceed?

STATEMENT OF MICHAEL BROSTEK, DIRECTOR, TAX ISSUES, STRATEGIC ISSUES TEAM, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Mr. BROSTEK. Mr. Chairman, Ranking Members and other Subcommittee Members. Thank you for inviting me today to discuss our work done at your request on minority community development entities' participation in the New Markets Tax Credit.

During the period we reviewed, allocation rounds from 2005 to 2008, Minority CDEs were successful with about nine percent of their applications and received about four percent of the allocation dollars they applied for. Non-minority CDEs were at least three

times as successful with their applications and in obtaining allocation dollars.

Each New Markets Tax Credit application is scored by three external reviewers based on business strategy, community impact, management capacity and capitalization strategy. Each of these sections includes several subcategories. Minority CDEs generally receive lower application scores overall and in each of the four application sections. Overall, minority CDEs scored about 11 points lower than non-minority CDEs on applications.

On average from 2005 to 2008, minority CDE application scores did not meet the minimum threshold for advancing past the application round in order to be eligible for allocations. After applications are scored those that meet the threshold pass on to be considered by CDFI Fund staff for award of credit allocations. CDFI's staff generally award allocation amounts in the order of CDEs' final ranking scores. When recommending allocation amounts, staff are to consider the amount of equity investment the CDE can expect to raise within two years, the amount of investment in low income communities that can be deployed within three years, the quality of the financial products being offered and the projected impact on low income communities or low income persons.

Some CDEs that exceed the allocation threshold do not receive allocations because the amount of allocation authority is insufficient to fund everyone. Minority CDEs' receipt of only four percent of the allocation dollars they applied for is a function both of the number of minority CDEs that failed to make the application threshold and that those exceeding the threshold tended to have lower scores than other applicants and thus tended not to be funded.

Based on interviews we had with minority and non-minority CDE representatives, we identified characteristics like CDE size that are likely to affect applicant's success. To test whether minority CDEs' relative lack of success in applying for and receiving credit applications was due to their minority status or these other characteristics, we performed statistical analysis to control for those characteristics other than minority status that might be affecting outcomes.

We found that when controlling characteristics like asset size, proposed project characteristics and CDE type, minority status still was associated with a lower probability of success. Our analysis does not show why minority CDE status is associated with lower probability of receiving allocations or whether any actions taken or not taken by Treasury or the CDFI Fund contributed to this statistical relationship.

Factors we could not control for or measure, such as applicant's loan loss reserves and operating costs, may affect CDEs' success. We previously had found minority owned banks, many of which are minority CDEs, have higher loan loss reserves and operating costs than non-minority-owned banks, and this might contribute to their lack of success. Some believe that minority CDEs are better positioned to serve the communities in which they are located than other CDEs would be. If so, minority CDEs may have advantages that are not being fully utilized in the New Markets Program.

The legislative history of the credit does not indicate whether Congress intended for minority CDEs to participate at any particular level in the program. GAO is not making any recommendations for action. However, if Congress intends for minority CDE applicants to succeed at a greater rate than what we have found, it may want to consider legislative changes if the program is extended for future years. Such changes could include requiring that a certain portion of the overall amount of allocation authority be designated for minority CDEs, exploring the potential for creating a pool of New Markets Tax Credit allocation authority to be dedicated specifically for community banks to compete for it, offering priority points to minority CDEs in the application process and requiring Treasury and the CDFI Fund to explore options to provide technical assistance and training to minority CDE applicants. This concludes my statement.

I'd be happy to answer questions.

[The prepared statement of Mr. Brostek follows:]

United States Government Accountability Office

GAO

Testimony

Before Subcommittees of Ways and Means and Financial Services, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EST
Thursday, June 18, 2009

NEW MARKETS TAX CREDIT

Minority Entities Are Less Successful in Obtaining Awards Than Non-Minority Entities

Statement of Michael Brostek,
Director, Strategic Issues

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GAO-09-796T

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Accountability Integrity Reliability

Highlights

Highlights of GAO-09-795T, a testimony before Subcommittees of Ways and Means and Financial Services, House of Representatives

Why GAO Did This Study

The Community Development Financial Institutions (CDFI) Fund in the Department of the Treasury has awarded $21 billion of the $26 billion in New Markets Tax Credits (NMTC) authorized to be awarded to Community Development Entities (CDE) between 2001 and 2009. CDEs use the NMTC to make qualified investments in low-income communities. Recent congressional interest has focused on participation by minority CDEs. This testimony is based on a recent GAO report (GAO-09-830).

As requested, the report (1) identified the number of minority and non-minority CDEs that applied to the CDFI Fund and received NMTC awards, (2) explained the process by which the CDFI Fund makes awards and summarized application scores, (3) described challenges minority and non-minority CDEs face in applying for and receiving awards and, (4) identified efforts the CDFI Fund and others have taken to assist minority CDEs in applying for awards. GAO analyzed CDFI Fund application data and interviewed officials from minority and non-minority CDEs, the CDFI Fund, and industry groups.

What GAO Recommends

GAO makes no recommendations, but summarizes options Congress could consider, such as providing certain preferences or technical assistance to minority CDEs. The CDFI Fund did not comment on GAO's options, but agreed with GAO's key conclusion.

*View GAO-09-795T or key components. For more information, contact Michael Brostek at (202) 512-8510 or brostekm@gao.gov.

June 18, 2009

NEW MARKETS TAX CREDIT

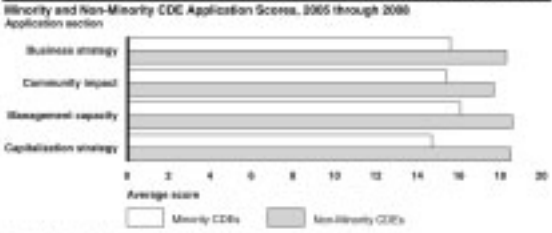
Minority Entities Are Less Successful in Obtaining Awards Than Non-Minority Entities

What GAO Found

From 2005 through 2008, minority-owned CDEs were successful with about 9 percent of the NMTC applications that they submitted to the CDFI Fund and received about $354 million of the $8.7 billion for which they applied, or about 4 percent. Non-minority CDEs were successful with about 27 percent of their applications and received $13.2 billion of the $89.7 billion for which they applied, or about 15 percent. Since GAO issued the report on which this statement is based, the CDFI Fund made 32 NMTC awards totaling $1.5 billion under authority provided in the American Recovery and Reinvestment Act. Minority CDEs received 5 of those awards, totaling $135 million.

The CDFI Fund relies primarily on its scoring of applications to determine which CDEs receive awards. As the figure shows, minority CDEs received lower scores than non-minority CDEs in each of the four application sections.

Minority and Non-Minority CDE Application Scores, 2005 through 2008



Source: GAO analysis of CDFI Fund data.

Although a CDE's resources and experience in applying are important factors in a CDE's success rate with the NMTC program, when controlling for factors that GAO could measure, minority status is associated with a lower probability of receiving an allocation. It is not clear from GAO's analysis why this relationship exists or whether any actions taken or not taken by the Department of the Treasury contributed to minority CDEs' lower probability of success. Characteristics associated with minority status of some CDEs for which data are unavailable may affect this relationship. If Congress views increased participation by minority CDEs as a goal for the NMTC program, options, such as providing certain preferences in the application process that may benefit minority CDEs, could be considered.

The CDFI Fund provides assistance that is available to all CDEs applying for awards, including a written debriefing to CDEs that do not receive awards detailing some of the weaknesses in the applications. Other stakeholders, including industry associations and consultants, hold conferences and offer services to help CDEs submit competitive applications. Should Congress view additional assistance to minority CDEs as important to increasing minority CDEs' participation in the NMTC program, it could consider requiring the CDFI Fund to provide assistance to minority CDEs.

United States Government Accountability Office

Mister Chairman, Ranking Members, and Other Subcommittee Members:

I am pleased to be here today to discuss minority Community Development Entities' (CDE) participation in the New Markets Tax Credit (NMTC) program. Congress created the NMTC through the Community Renewal Tax Relief Act of 2000[1] to encourage investors to make investments in low-income communities that traditionally lack access to capital. Conventional access to credit and investment capital for developing small businesses, retaining jobs, and revitalizing neighborhoods is often limited in economically distressed communities or in communities with large low-income populations. The Community Development Financial Institutions (CDFI) Fund in the Department of the Treasury administers the NMTC program and allocates tax credit authority—the amount of investment for which investors can claim a tax credit—to CDEs that apply for and obtain allocations. CDEs are domestic partnerships or corporations with a primary purpose of serving or providing investment capital to low-income communities or low-income persons.[2]

Our prior mandated work on the NMTC has focused on the implementation of the program, the effect of the credit on the behavior of individual and corporate investors, and efforts by the CDFI Fund and Internal Revenue Service (IRS) to ensure that CDEs and investors are in compliance with NMTC program requirements.[3] Recent congressional interest has focused on minority CDEs' participation in the program. My statement is based on our recently released report that you requested, titled *New Markets Tax Credit: Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities*.[4] As agreed, the report (1) identified how many minority-owned or controlled and non-minority-

[1]Pub. L. No. 106-554 (2000).

[2]CDEs are required to maintain accountability to residents of low-income communities by filling at least 20 percent of the organization's governing or advisory board positions with low-income community residents.

[3]GAO, *New Markets Tax Credit Program: Progress Made in Implementation, but Further Actions Needed to Monitor Compliance*, GAO-04-320 (Washington, D.C.: Jan. 30, 2004) and *Tax Policy: New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance*, GAO-07-296 (Washington, D.C.: Jan. 31, 2007).

[4]GAO, *New Markets Tax Credit: Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities*, GAO-09-536 (Washington, D.C.: April 30, 2009).

owned or controlled CDEs have applied for and received allocations and how much they have applied for and received from 2005 through 2008; (2) explained the NMTC application process and summarized NMTC application scores for minority and non-minority-owned or controlled CDEs by CDE type from 2005 through 2008; (3) described the challenges minority-owned or controlled and non-minority-owned or controlled CDEs have faced in applying for and receiving NMTC allocations; and (4) identified efforts the CDFI Fund and others are taking to assist minority-owned or controlled CDEs in applying for NMTC allocations. As requested, we identified potential policy options that Congress may wish to consider based on its interpretation of our results.

To prepare the report, we analyzed CDFI Fund NMTC application data from 2005 through 2008. The CDFI Fund did not collect data on program participation by minority CDEs before the 2005 allocation round. We also interviewed officials from a variety of similarly sized minority and non-minority CDEs that received NMTC awards and applied for but did not receive NMTC awards from 2005 through 2008, and we interviewed industry experts with knowledge of the NMTC program. The report includes a detailed description of our scope and methodology. We conducted our work in accordance with generally accepted government auditing standards.

Background

As of the time of this hearing, the CDFI Fund in the Department of the Treasury has authorized $21 billion of the $26 billion[2] in tax credit authority to be awarded between 2001 and 2009 to CDEs that manage

[2]The original legislation that authorized the program allowed for $15 billion in tax credit authority for the NMTC program through 2007. However, the Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135 (Dec. 21, 2005), authorized an additional $1 billion of NMTC equity for qualified areas affected by Hurricane Katrina over a period of 3 years: $300 million in 2005, $300 million in 2006, and $400 million in 2007. Pub. L. No. 109-432 (Dec. 20, 2006) and Pub. L. No. 110-343 (Oct. 3, 2008) extended the amount of NMTC authority available by $3.5 billion for 2008 and 2009, respectively. The American Recovery and Reinvestment Act (ARRA) of 2009, Pub. L. No. 111-5 (Feb. 17, 2009), added an additional $3 billion of NMTC allocation authority to be split equally between the 2008 (retroactively) and 2009 allocation rounds. Since we issued our report on minority CDEs' participation in the NMTC program in April 2009, the CDFI Fund has awarded $1.5 billion of the $3 billion authorized under ARRA.

NMTC investments in low-income community development projects.[6] Eligible organizations may apply for and receive NMTC allocations once they have been certified as a CDE by the CDFI Fund (a CDE that receives an allocation is often referred to as an allocatee).[7] After the CDFI Fund makes allocations to CDEs, investors make equity investments by acquiring stock or a capital interest in the CDEs, called qualified equity investments (QEI), in exchange for the right to claim tax credits that total 39 percent of their original investment over 7 years.[8] The CDEs, in turn, are required to invest "substantially all" of the proceeds they receive into qualified low-income community investments (QLICI).[9] Qualified low-income community investments include (but are not limited to) investments in businesses, referred to as qualified active low-income community businesses (QALICB), to be used for residential, commercial and industrial projects, and other types of investments, such as purchasing loans from other CDEs.

The CDFI Fund directs CDEs to classify themselves as minority if more than 50 percent of the CDE is owned or controlled by members of a minority ethnic group. In the case of a for-profit CDE, more than 50

[6]A low-income community is defined as a census tract (1) in which the poverty rate is at least 20 percent or (2) outside a metropolitan area in which the median family income does not exceed 80 percent of median statewide family income or within a metropolitan area in which the median family income does not exceed 80 percent of the greater statewide or metropolitan area median family income. After October 22, 2004, the Secretary of the Treasury was authorized to issue regulations designating targeted populations that may be treated as low-income communities and procedures for determining which entities are qualified active low-income community businesses with respect to such populations. In addition, the definition of a low-income community included certain areas not within census tracts, tracts with low population, and census tracts with high migration rural counties.

[7]Community Development Financial Institutions and Specialized Small Business Investment Companies automatically qualify as CDEs and only need to register as CDEs rather than apply for certification.

[8]Beginning in the year in which the investment is made, investors are entitled to claim the credit for a 7-year period with 5 percent of the investment claimed in each of the first 3 years and 6 percent in each of the last 4 years. Investors are allowed to carry the credit back 1 year and carry the credits forward for a 20-year period.

[9]"Substantially all" means that CDEs must use (within 12 months) at least 85 percent of investor proceeds in years 1 through 6 and 75 percent in year 7 of the investment. CDEs can satisfy this requirement by two methods: (1) direct tracing of investments to specific qualified low-income community investments or (2) showing that at least 85 percent of their aggregate gross assets (75 percent in year 7) are invested in qualified low-income community investments.

percent of the CDE's owners must be minorities; if the entity applying is a nonprofit organization, 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).[10] Representatives from several minority-owned entities and industry associations that we interviewed indicated that minority CDEs and other locally-based community lending organizations may have a better understanding of the economic conditions and availability of capital in the communities they serve than other investment organizations serving those same communities. However, in addition to minority CDEs obtaining NMTC authority and making investments in low-income communities, minority populations may benefit from the NMTC in other ways. For example, non-minority CDEs have also made investments in minority businesses that serve residents in low-income communities. Minority-owned businesses located in eligible NMTC census tracts may hire or provide services to minority residents in low-income communities. According to CDFI Fund officials, it is frequently the case that non-minority-owned businesses located in NMTC-eligible census tracts with highly concentrated minority populations could provide economic benefits to minority residents.

Since we issued the report on which this statement is based, the CDFI Fund announced on May 27, 2009 an additional 32 NMTC awards to 2008 applicants totaling $1.5 billion under authority granted by the American Recovery and Reinvestment Act of 2009 (ARRA).[11] According to our analysis, minority CDEs received three of these awards totaling $135 million. Non-minority CDEs received the other 29 of these awards totaling about $1.4 billion. The analysis presented in our report was limited to NMTC awards made from 2005 through the original 2008 awards; our analysis did not include the NMTC awards made in accordance with ARRA.

[10]For the purposes of the remainder of this statement, we generally refer to minority-owned or controlled CDEs as "minority CDEs" and non-minority owned or controlled CDEs as "non-minority CDEs."

[11]Pub. L. No. 111-5 (2009). The CDFI Fund revisited the 2008 NMTC applications and made awards to the CDEs that would have been the next CDEs to receive awards had more allocation authority originally been available. After accounting for the additional awards, minority CDEs maintained lower success rates than non-minority CDEs in obtaining NMTC awards for the 2008 allocation round.

Minority Entities Have Received Proportionately Fewer Awards Than Non-Minority Entities

From 2005 through 2008, minority-owned CDEs were successful with about 9 percent of the NMTC applications that they submitted to the CDFI Fund and received about $354 million of the $8.7 billion for which they applied, or about 4 percent. By comparison, non-minority CDEs were successful with about 27 percent of their applications and received $13.2 billion of the $89.7 billion for which they applied, or about 15 percent. Since 2005, the first year in which the CDFI Fund collected data on minority CDEs, CDFI Fund application data indicate that 68 minority CDEs have applied for NMTC allocations from the CDFI Fund for a total of 88 applications. Fifteen minority CDEs applied for NMTC allocations in multiple years. From 2005 through 2008, the CDFI Fund received 934 NMTC applications from 500 different CDEs. Of the 68 minority CDEs that applied, 6 CDEs received a total of eight NMTC allocations (2 minority CDEs each received two separate allocations).[11] Minority applicants received about 2.6 percent of the $13.5 billion in total NMTC allocation authority that the CDFI Fund awarded from 2005 through 2008.

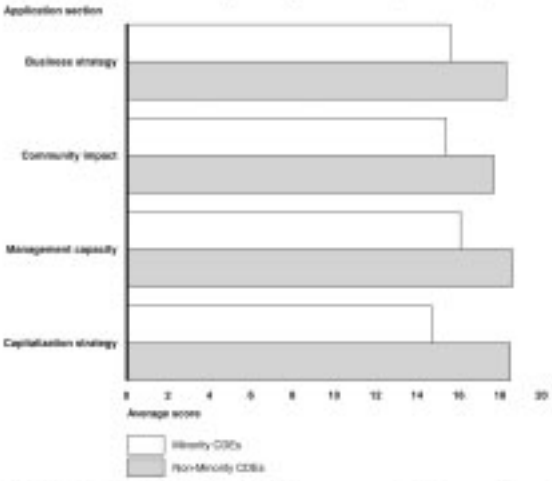
The CDFI Fund's process for making NMTC awards takes place in two phases. NMTC applications are first reviewed and scored by a group of external reviewers selected by the CDFI Fund who have demonstrated experience in business, real estate, or community development finance.[12] CDEs that meet or exceed minimum thresholds in each of the four main application sections (business strategy, community impact, management capacity, and capitalization strategy) and an overall scoring threshold (out of a total of 25 points in each application section) advance to the second phase where they are re-ranked based on their scores in the business strategy and community impact sections of the application and half of the priority points awarded to CDEs that demonstrate a track record of investing in low-income communities and investing in unrelated entities. CDFI Fund staff review the amount of allocation authority that the CDE requested and, based on the information in the application materials, award allocation amounts in the descending order of CDEs' final ranking based on their re-ranked scores.

[11] Analysis of minority CDE participation in the NMTC program is limited to reviewing information about CDEs that applied for NMTC allocations and identified themselves as minority-owned or controlled CDEs. Other investment organizations would potentially be able to obtain certified CDE status and apply for NMTC allocations. This could include minority-owned banks and other minority organizations with the primary mission of serving low-income communities.

[12] The CDFI Fund requires reviewers to disclose any conflicts of interest related to applicants with whom they have or had a relationship.

According to our analysis of NMTC application data, of the 88 applications submitted by minority CDEs, 31 applications met the minimum threshold scores to advance to the second phase of the NTMC review process from 2005 to 2008. By comparison, during this same time period 518 of the 846 applications submitted by non-minority CDEs met the minimum thresholds to advance to the second phase of the review process. Overall, non-minority CDEs scored about 11 points higher than minority CDEs on NMTC applications from 2005 through 2008. As figure 1 shows, minority CDEs' scores differed the most from non-minority CDEs' scores in the capitalization strategy section of the application, where non-minority CDEs scored 25 percent higher than minority CDEs. Non-minority CDEs scored between 15 percent and 17 percent higher than minority CDEs in the business strategy, community impact, and management capacity sections of the application.

Figure 1: Minority and Non-Minority CDE Application Scores, 2005 through 2008



Source: GAO analysis of CDFI Fund data.
Note: The average scores presented above reflect the average aggregate application scores for each section divided by three—the number of reviewers scoring the applications.

To identify challenges minority and non-minority CDEs face in obtaining NMTC allocations, we interviewed representatives from minority and non-minority CDEs, and we analyzed CDFI Fund application data. While both our testimonial evidence and statistical analysis have limitations, they generally show that a CDE's capacity, measured by asset size in this case, is associated with an increased probability of obtaining an award. CDEs we interviewed generally said it can be difficult on the NMTC application to demonstrate the capacity to effectively use the NMTC and the experience in investing in low-income communities necessary to obtain allocations. According to officials from several CDEs we interviewed, demonstrating the relative impact of NMTC projects through the NMTC application may be particularly difficult when smaller, community-based CDEs compete for allocations against large banks and financial

institutions that may have the capacity to undertake larger projects with more easily identifiable economic impacts.

Our statistical analysis of all CDEs that applied from 2005 through 2008 demonstrates that the probability that a NMTC applicant will receive an award is associated with certain factors. For example, after controlling for other characteristics, larger CDEs, as measured by asset size, appear to be more likely to receive NMTC awards, while smaller CDEs are less likely to receive awards. When controlling for factors we could, our analysis also shows that minority status is associated with a lower probability of receiving an allocation.[11] It is not clear from our analysis why minority status is associated with a lower probability of obtaining an allocation or whether any actions taken or not taken by the Department of the Treasury or the CDFI Fund contributed to this statistical relationship. Other factors for which our statistical analysis is unable to account, such as experience with the application process, may also be reasons why minority CDEs have not been as successful in obtaining NMTC allocations as non-minority CDEs.

For example, according to our 2006 report, certain minority-owned banks have higher loan loss reserves and operating costs than non-minority owned peers.[12] These types of characteristics could potentially affect the competitiveness of minority CDE NMTC applications, particularly in the business strategy and management capacity sections of the applications. Also, according to industry association representatives, minority-owned banks have traditionally had a more difficult time accessing capital markets than their non-minority peers, and our analysis of the CDFI Fund application data show that minority CDEs score lowest in the capitalization strategy section of the application. Our analysis indicates that these differences are not explained by the size of the CDE—that is, they are not problems shared, on average, by other small, non-minority CDEs that applied for NMTC allocations. However, these differences could

[11]CDE characteristics for which we could control included the CDE's asset size and whether the CDE was minority-owned or controlled, a certified Community Development Financial Institution, a nonprofit organization, a bank, or a publicly traded corporation. We also controlled for certain proposed project characteristics, including whether projects were to be non-real estate property investments or investments in severely distressed areas or urban areas.

[12]GAO, *Minority Banks: Regulators Need to Better Assess Effectiveness of Support Efforts* GAO-07-6 (Washington, D.C.: Oct. 6, 2006).

be associated with some other feature that minority CDEs share with non-minority CDEs for which we do not have data to include in our analysis.

According to CDFI Fund officials, the CDFI Fund has conducted outreach intended to reach all CDEs that may have an interest in applying for NMTCs and CDFI Fund staff have given presentations to industry associations, such as the New Markets Tax Credit Coalition; the National Bankers Association (NBA), an industry organization that represents minority-owned banks; and at FDIC conferences targeted to minority-owned institutions. According to CDFI Fund officials, they have more recently developed a relationship with the Department of Commerce's Minority Business Development Agency that they hope will lead to additional applications by minority CDEs. The CDFI Fund also provides a written debriefing to each CDE that does not receive an allocation to assist the CDE in future application rounds. This debriefing provides the unsuccessful CDE with information about its scores in each of the application sections and written comments on areas of weakness within each of the four main application sections. Officials from some CDEs we interviewed noted that the debriefing document helped them submit more competitive application materials in future rounds. Officials from a few CDEs noted that the debriefing comments were not consistent from one year to another.

External stakeholders, including representatives from industry associations we identified, hold conferences and offer varying degrees of assistance to CDEs submitting competitive NMTC applications. In addition, CDEs often hire consultants to assist them with completing their NMTC applications. Consultants offer a range of services to CDEs, including reviewing NMTC applications for completeness and depth of responses to completing the entire NMTC application for an applicant. According to CDEs we interviewed, fees charged by consultants cover a broad range based on the services that the consultant provides. For example, officials from several CDEs indicated that they paid consultants less than $5,000 to review their NMTC applications while others paid consultants as much as $50,000 for a more complete set of services.

Potential Options

The legislative history for the NMTC does not address whether Congress intended for minority CDEs to benefit directly from the NMTC program. However, if Congress intends for minority CDEs' participation in the NMTC program to exceed the current levels and Congress believes that minority CDEs have unique characteristics that position them to target the NMTC to its most effective use, Congress may want to consider legislative

changes to the program should the New Markets Tax Credit be extended beyond 2009. Potential changes that could be considered include, but would not be limited to the following: (1) similar to provisions for certain federal grant programs, requiring that a certain portion of the overall amount of allocation authority be designated for minority CDEs; (2) in accordance with information we obtained in discussions with several experts in economic development, exploring the potential for creating a pool of NMTC allocation authority to be dedicated specifically for community banks (minority banks that are certified CDEs, in most cases, would likely compete with non-minority community banks with similar characteristics for NMTC allocations); or (3) similar to other federal programs where preferences are given to targeted populations, offering priority points to minority CDEs that apply for NMTC allocations. In addition, a fourth option would be for Congress to direct the Department of the Treasury and the CDFI Fund to explore options for providing technical assistance in applying for and using NMTC allocations to minority CDEs.

Although these options could increase the amount of NMTC authority awarded to minority CDEs, in part because we could not definitively identify the reasons why minority CDEs have scored lower on the NMTC application than non-minority CDEs, the options may not address the underlying reasons for lower minority CDE success. In addition, implementing these changes would require addressing a number of issues, including legal and administrative concerns, associated with such changes in the NMTC application process.

The CDFI Fund reviewed a draft of our report and agreed with our key conclusion that minority CDEs have not received awards in proportion to their representation in the application pool, but did not comment on our options. The CDFI Fund's response letter is reprinted in appendix VII of our report. The CDFI Fund also provided several technical comments on our report, which we incorporated as appropriate.

Chairmen, this concludes my remarks. As I noted earlier, the more detailed findings and conclusions of our review of minority CDEs' participation in the New Markets Tax Credit program can be found in our recently issued report (GAO-09-536). I would be happy to answer any questions you or other members of the subcommittees may have.

Contacts and Acknowledgments

For further information on this testimony, please contact Michael Brostek at (202) 512-9110 or brostkom@gao.gov. In addition, contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. In addition to the individual named above, Kevin Daly, Assistant Director; LaKeshia Allen; Don Brown; Thomas Gilbert; Cristian Ion; Jean McSween; Ed Nannenhorn; and Cheryl Peterson made key contributions to this testimony.

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Chairman NEAL. Thank you very much, Mr. Brostek.

What we would like to do now is to have the other witnesses join us, if we could, and have an opportunity to hear from them as well.

The Chair will recognize Mr. Phillips for his testimony.

STATEMENT OF RON PHILLIPS, PRESIDENT, COASTAL ENTERPRISES, INC.; PRESIDENT, NEW MARKETS TAX CREDIT COALITION

Mr. PHILLIPS. Thank you, Representative Neal, Representative Tiberi, Representative Watt and members of the subcommittee on Select Revenue Measures.

My name is Ron Phillips. I am the current chair of the New Markets Tax Credit Coalition, 150-member, Washington, D.C. based group that advocated for the passage of the New Markets Tax Credit Program in the late 1990s and I have the honor of having been right at the get-go of this program. So I'm very glad to be here and express our point of view.

Since our passage of the legislation in 2000, our coalition has advocated successfully to extend this program in the initial seven years and increase the amount of credits that could be raised. As a result of our advocacy, even in the stimulus bill, we got an additional $5 billion. So we've got a lot of capital to access out there and very excited about it.

I am here today to respond to the GAO report on the lack of an already-owned and controlled participation in the program. I want to say right off that this report is being taken very seriously by our coalition. We discussed it earlier this week at our annual policy conference here in D.C. and at our board meeting. Many of our members and board members are also representatives of minority communities, so we are in good company to sort through how to increase participation.

What's more, I want to point out right off that we're very excited about getting to the heart of the matter, reaching out through various minority trade groups, including the National Banker's Association, Latino Organizations, Native American Groups such as Oweesta and others. Even the American Banking Association, which attended our conference, is looking for ways to engage their members. So we are in a good spot here. The reason is this credit program, which we sincerely love to be made permanent by the way, has such tremendous potential to redirect capital to worthy investments in this country, but that the more participation in it the better.

Now, I am also President of Coastal Enterprises. It's a 501(c)(3) non-profit organization based in Wiscasset, Maine; and, our primary Markets is Maine and rural communities, but we also work throughout New England and other parts of the United States. We have had five rounds of allocation valued at $481 million, and have to-date invested half those funds in primarily rural New England.

Half of these funds are already invested in 30 projects, mainly as I said in Maine and rural New England, Western Massachusetts and upstate New York. We have invested in community facilities such as an historic paper mill and timberland of Katahdin Forest management in the Millinocket region, a Gulf of Maine research facility supporting the 400-year-old fishing industry, the River Valley Markets in Northhampton, Massachusetts, an up and running new facility supplying area residents with naturally and locally grown foods of some 50 farmers and healthcare clinics such as the Plymouth Community Health Center, New Hampshire, connected to the Speare Memorial Hospital. These funds are creating and sustaining

some 7,800 jobs, over two million acres of sustainably managed forestland and spurring private capital, a ratio of $3 for every $1 of allocation investment in low-income communities.

CDFI's story is, however, only the tip of the iceberg, as stories from our field abound all across the U.S. in both rural and urban areas. As our recent report, "50 Projects, 50 States," and I hope we can get you a copy of that, notes they could be charter schools in Los Angeles, educating young kids and minorities, a LEEDs standards community service center constructed on vacant ground fill in Chicago, an ethanol plant in Minnesota owned by a group of farmers. The list is of exciting and inspiring projects is endless.

And even the story more convincing as one gets into the power of the New Markets Tax Credit to bringing together the best of community social goals and the best of private capital and investment to help make the dreams of millions of people on the margins of our society come true is because of the flexibility of the New Markets Program that we can achieve these multiple objectives. The program has been successful beyond anyone's expectations in attracting investment capital to distressed communities including many minority communities. Each year of the program so far the competitive processes require those winning allocations to agree to target their investments to area of higher distress than minimally required by the Program's statute.

Now, coming to a close here I wanted to contribute my main points here to this session this morning. One item in the GAO report that was of great concern to us and we should emphasize is that according to the CDFI Fund data the census tracks that have received New Market investments have on average non-white populations of 47 percent. So I want to note that the benefit of this program has been flowing much more largely to minorities we could presume than would meet the eye. On the other hand, that does not make up the difference in terms of the emphasis one should bring to supporting minority-owned and controlled CDEs. So that is still a challenge ahead.

The credit has made a significant contribution to improving many communities across the country, and that success should not be confused with the attributes of the CDEs that compete for and are awarded credits. A second point I want to make is that according to our analysis from the coalition, there are actually 17 CDEs that have achieved an allocation of over $1 billion, far more than what the GAO report said. So we have made some progress in that regard.

In conclusion what I want to offer are two recommendations. The central recommendation of the New Markets Coalition is that Congress establish a technical assistance program and capacity building program aimed at helping minority CDEs better prepare themselves participate in the New Markets Tax Credit Program. We believe that the best way to build a more diverse set of new markets 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 any sort of set-aside or priorities for any particular class of CDE or business sector. And the second recommendation we want to make is that H.R. 2628 be supported in terms of the extension that is critically important going forward to

ensure that the tax credit becomes in the future a permanent credit. And, also, attached to the tax credit is the AMT relief, which will allow us to open up more investment, and particularly among independent and community banks at the regional level, a sorely needed new capital flow for this program.

Thank you very much. And I'm sorry I went over my time.

[The prepared statement of Mr. Phillips follows:]

NEW MARKETS TAX CREDIT COALITION

Testimony of Ronald L. Phillips
CEO of Coastal Enterprises, Inc., Wiscasset, Maine
and Chair of the Board of Directors
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

Thursday, June 18, 2009

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Testimony of Ronald L. Phillips
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 developement organizatioens 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 - Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities. 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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Chairman NEAL. Thank you, Mr. Phillips.
Ms. Pinnock.

STATEMENT OF BLONDEL A. PINNOCK, PRESIDENT, CARVER COMMUNITY DEVELOPMENT CORPORATION, SENIOR VICE PRESIDENT, CARVER FEDERAL SAVINGS BANK

Ms. PINNOCK. Thank you.

Good morning Chairman Watt, Chairman Neal and other distinguished committee members.

My name is Blondel Pinnock and I am the President of Carver Community Development Corporation, a minority, for-profit, community development entity. I also serve as the senior vice president for Carver Federal Savings Bank, the largest minority-owned thrift in the United States, headquartered in Central Harlem in the 15th Congressional District, with nine branches throughout New York City. Deborah C. Wright, Chairman and CEO, extends her regards.

Carver is very supportive of the CDFI Fund and the New Markets Tax Credit Program. LMI communities need our investment. We are delighted to participate in the program and Carver has been successful. Carver's experience in applying for New Markets Tax Credits coincide with the findings of the April 2009 GAO report. Carver's CDE applied consecutively for New Markets Tax Credits from 2005 through 2008.

We have been successful, however, in receiving two allocations from the CDFI Fund: round 4 allocation in 2006 for $59 million, and the most recent Recovery Act allocation in 2009 for $65 million. Our $59 million allocation has allowed Carver's CDE to invest in 10 projects within low income and distressed communities throughout New York City and to develop partnerships in economic projects with more flexible terms that the bank would otherwise not be able to offer.

For example, one of our New Markets Tax Credit loans was to finance the renovation of the first state of the art privately-owned, free-standing healthcare facility in Central Harlem known as Citicare. The loan also helped preserve one of Harlem's architectural landmarks, the Jazzmobile Building. Carver provided six million in below-Markets financing for a project that serviced over 20,000 patients in the last fiscal year and is located in a census track that had over a 19 percent unemployment rate, and where nearly 50 percent of the residents lived below the poverty line.

Another project financed through our New Markets Tax Credit allocation was a $5.3 million below Markets-rate, pre-development loan to Abyssinian Development Corporation, a strong, committed community development corporation in Harlem. The loan was used for the renovation and redevelopment of their legendary Renaissance Ballroom. The building had been vacant, boarded up and a community eyesore for over 30 years. Abyssinian, with the aid of Carver's New Markets Tax Credit loan will be able to bring this historic building back into service offering community, cultural space, and up to 150 units of affordable for sale housing. The project will create hundreds of construction and permanent jobs providing economic viability and much needed services for a highly distressed area.

Through our New Markets Tax Credits we've been able to partner with a large, money-centered bank, who has invested 19 million in our allocation to finance a six-story commercial and office facility, known as Harlem Gateway. Given Carver's asset size of

800 million and a loan limit of 10 million, Carver would never have been able to put a $19 million on our balance sheet. But with our partners at J.P. Morgan Chase we helped in providing the financing for a project that created as many as 100 construction jobs and over 90 permanent jobs in addition to providing vital community and retail services in an LMI census track.

Carver agrees with the recommendations outlined in the GAO report for positioning minority CDEs to maximize New Markets Tax Credits; however, we would also suggest one giving preference to or targeting institutions who are either headquartered or have significant facilities in distressed communities, or who served as communities in an operating or programmatic basis—in other words, CDFIs and CDEs that are on the front line of LMI communities every single day—as the report recommends, providing more meaningful technical assistance in the preparation and completion of the application, specifically in the area of data collection and impact analysis required for the CDFI funds.

Three, provide treatment to major financial institutions with favorable treatment that partner with minority CDEs and/or community banks to assist with application readiness and encourage mutually beneficial collaboration. Minority CDEs like Carver are well suited to identify and finance New Markets Tax Credit projects that enhance and address local, underserved communities, and would otherwise fly under the radar of larger commercial banks and financial institutions.

Thank you very much for allowing me the opportunity to testify and I would gladly answer any questions you may have.

[The prepared statement of Ms. Pinnock follows:]

Testimony By Blondel A. Pinnock
President, Carver Community Development Corporation,
Senior Vice President, Carver Federal Savings Bank, New York, New York

Good Morning. My name is Blondel Pinnock, and I am President of Carver Community Development Corporation ("Carver CDE") & a Senior Vice President of Carver Federal Savings Bank ("Carver"), a leading community development financial institution which recently celebrated its 60th anniversary. Deborah Wright, Chairman and Chief Executive Officer of Carver extends her regards.

We are very appreciative and supportive of the CDFI Fund and the New Markets Tax Credit (NMTC) program. Low and moderate income communities need investment and we are very happy to participate in the NMTC program and have been successful.

Carver is the only African-and-Caribbean American managed thrift in the state of New York and, with assets of $812 million, we are the largest in America. Nevertheless, Carver is a very small institution in the context of money-center financial institutions.

Summary of GAO Report

Carver's experience with applying for New Markets Tax Credits coincides exactly with the 2005–2008 period studied and the Bank's success rate is 33%. The success rate of all minority CDEs relative to all applicants was 9% according to the report.

- Applied in 2005 for the first time—awarded $59 million in 2006
- Applied in 2007 for the second time – no award received in 2007
- Applied in 2008 for the third time – no award received in 2008
- 2008 application reconsidered in 2009 based on ARR Act – awarded $65 million in 2009

Our $59 million NMTC allocation in 2006 allowed Carver, through its CDE affiliate (Carver CDE) the ability to expand and offer financing products and services that the bank, as a regulated financial institution, might not be able to offer directly. The NMTC award enabled Carver CDE to invest with community and devel-

opment partners in economic projects with attractive terms including below market interest rates. These projects provide economic revitalization to the communities that Carver serves and attracts additional capital to these underserved communities.

One of Carver CDE's NMTC loans was used to consolidate, expand and upgrade an existing health care clinic and at the same time preserve one of Harlem's architectural landmarks. Jazzmobile, a non-profit founded in 1964 as a pioneer organization committed to the preservation of Jazz musical genre, was housed in a historic building in Harlem. Jazzmobile was at risk of losing its historic headquarters building. Citicare, a health care provider that has been serving residents of New York since 1982, approached Jazzmobile about acquiring the property and converting it to a community health facility. With the help of Carver CDE's NMTC financing, Citicare was able to purchase and preserve the historic structure and develop it as the first state of the art privately owned health facility in central Harlem. In addition, Citicare is allowing Jazzmobile to maintain occupancy of the building until they find a new and affordable home.

Through this project, Carver Bank and the NMTC Program have helped provide quality affordable medical services to a historically underserved, low-income community. Citicare handled more than 20,000 patient visits last fiscal year in a census tract that has an unemployment rate of over 19% and in which nearly half (49%) of all residents live below the poverty line.

The total cost of the Citicare renovation project was just under $8 million and Carver provided $6 million in the form of a NMTC loan. The debt was structured as interest only loan with a below-market interest rate of 5%.

Citicare Before and After Photos

Abyssinian Renaissance Ballroom—Before and After Photos

Carver CDE also provided a $5.3 million pre-development loan to Abyssinian Development Corporation for the pre-development related to the renovation of the legendary Renaissance Ballroom in Harlem which has been boarded up and vacant for over 30 years. Carver's NMTC loan will enable Abyssinian Development Corporation to bring the historic building back into service offering community and cultural space as well as up to 150 affordable condominium units. The project expects to create hundreds of construction and permanent jobs providing economic viability for a distressed area.

Carver provided $19 million of its 2006 NMTC allocation to finance a loan to Harlem Gateway Ventures, a New York based real estate developer who is developing a six story commercial facility in Harlem that will provide quality retail for the community and office space for two providers of vital community services and a third floor showroom for a national furniture retailer. The office spaces, which are in short supply in Harlem, will be occupied by Independence Care Systems, a non-profit home care patient services provider and the Association for Help for Retarded Children, a non-profit that serves more than 10,000 individuals with mental retardation and other developmental disabilities and their families. Utilizing NMTC allowed Carver to offer the developer a rate concession and other benefits that made the project possible and created as many as 100 construction jobs and 90 permanent jobs. The project is located in a low-income census tract that will benefit greatly from the services and job creation.

In addition, Carver has provided a $2 million loan to the Community Partnership Development Corporation to capitalize a revolving loan fund that provides no-interest pre-development loans and equity stakes to small minority-and-women owned housing builders and developers in New York City. The loans will promote the business growth of builders, including small, minority-owned contractors who need as-

sistance with equity contributions and predevelopment costs. It is expected that the loans will contribute to the development of more than 800 homes or 1,000 new affordable and workforce housing units in New York City neighborhoods. These projects are expected to leverage millions of dollars in public and private sector resources and also create hundreds of construction jobs.

In just three years, Carver CDE has placed all of its initial $59 million NMTC allocation and financed 10 businesses, all of which are located in highly distressed census tracts within Carver's service area. While the average deal size of all ten projects financed with our 2006 allocation was $6 million, the impact to the community has been measurable and lasting. Smaller deals in this size range are no less impactful to our neighborhoods by way of jobs, resources and services provided.

According to the GAO report, officials from minority CDEs identified the following as challenges that CDEs may face in applying for NMTC allocations:

- **Lack sufficient pipeline to justify NMTC capital applied for**
- **No track record for both investing in LMI communities and in large projects that would generate significant impacts**
- **No capacity to complete high impact projects**
- **Complexity of NTMC transactions translates to higher transaction costs which is favorable to larger CDEs (minority CDEs tend to be smaller in size)**
- **High application costs (consulting fees, staff time, etc.) are a deterrent**

Carver CDE responds to these challenges in the following way:

- **High application costs:** costs are much higher than estimated in report; from our experience and in speaking to fellow community banks, costs for outside consultants can run as high as $200,000.

• We also would like to point out that whether outside consultants are engaged or not, there is a very significant cost of staff time; for minority CDEs which as the report notes, tend to be small in size completing an application often means significant disruption to the Lending or Loan Operations departments to compile the necessary data for an effective application.

• The time commitment is largely related to gathering the historical data on existing loan portfolios as well as demographic information regarding the applicant's assessment area.

- **Lack of sufficient pipeline:**

• Comments from reviewers of our 2008 NMTC application stated that "*The applicant is lacking in detail regarding specifics of pipeline deals*" I think this gets back to the issue of size and staff time. There is significant time involved in sourcing deals and beginning the due diligence process. For a small staff, this means that everyone is involved or as we say at Carver "all hands on deck". We believe that there is a clear advantage to larger CDEs with staff dedicated to completing the NMTC application.

• Diversification of pipeline has also been an issue for Carver. We are limited to debt deals because that is our traditional track record; equity deals are preferred by many non-profit participants, however, they require a specific skill set and focus; further the financial risks are too great for a bank the size of Carver or smaller to absorb, we simply could not afford the loss of an equity investment.

- **No capacity to complete high impact projects:** At $812 million in assets, Carver is the largest minority CDE and community bank in the country and our deal size as a percentage of assets is capped at $10 million. This speaks to the limitations of smaller community banks as deal size is proportional to impact as qualified by the CDFI, e.g. number of housing units, number of jobs, amount of community space, etc. These financial metrics do not always correlate to impact on a neighborhood by neighborhood bases whereas a new grocery store, charter school or development of a blighted vacant lot can have a meaningful and visible impact.

The reported noted that multiple factors appear to be associated with a CDE receiving an allocation:

- **larger CDEs, as measured by asset size, appear to be more likely to receive NMTC awards while smaller CDEs are less likely to receive awards**

- We agree with this assessment whole heartedly and can attest to the fact that for a small/minority CDE to complete an application as stated earlier takes up every available resource with our without a consultant. Invariably a small team stretched beyond limitations produces a different result than would be produced by a dedicated team or set of individuals focused on completing an application.

- **after controlling for characteristics such as CDE type, asset size, and proposed projects, minority status is associated with a lower probability of receiving an allocation**

There is a direct correlation between size and minority status; minority CDEs are smaller in terms of asset size, number of employees, etc. As a result, their ability to access larger high impact projects is limited by many factors including equity capital, track record and the resources to develop a diversified pipeline. Their ability to access the capital markets and invest in their own CDEs is limited by their size and capitalization levels. However, this does not mean smaller deals have any less impact as stated earlier and can be noted from deals highlighted from our 2006 NMTC allocation.

Other key findings from the report:

- **according to industry association representatives, minority-owned banks have traditionally had a more difficult time accessing capital markets than their non-minority peers**

- Carver has had more success in accessing the capital markets given our publicly traded status. Yet raising more capital is always harder than it is for our larger competitors.

- **It was inconclusive whether it is the tendency of minority CDEs to be smaller that lowers their success rate or their minority status**.

- Again, minority CDEs are by nature smaller so it is not their minority status that lowers their success rate. This is obvious in our opinion given there are no large minority CDEs to use as a basis for comparison. Minority CDEs are smaller as measured by asset size than their counterparts. This means they are starting from behind in all the categories reviewed on the NMTC application both quantitative and qualitative.

- **legislative history for NMTC does not address whether Congress intended for minority CDEs to benefit directly from the NMTC program**

- Agree that the intention was for low-and-moderate individuals and communities to benefit directly from the NMTC program so one would presume that the institutions in these communities who know these communities best would certainly have been given greater tools to succeed.

- **However, if Congress intends for minority CDEs participation in the NMTC program to exceed the current levels and Congress believes that minority CDEs have unique characteristics that position them to target the NMTC to its most effective use, Congress may want to consider legislative changes to the program should the New Markets Tax Credit be extended beyond 2009. Potential changes that could be considered include, but would not be limited to the following:**

- **similar to provisions for certain federal grant programs, requiring that a certain port of the overall amount of allocation authority be designated for minority CDEs**
- **pool of NMTC capital dedicated specifically for community banks (minority banks in most cases)**
- **offer priority points to minority CDES that apply for NMTC allocations**

Carver agrees with these recommendations but offers the following suggested solutions to make the CDFI capital programs more accessible to minority CDEs and community banks:

1. **Make small CDFI banks a priority for CDFI Fund financing**

This goal could be achieved by targeting institutions that are predominantly headquartered or have significant facilities in distressed communities or who serve this population in an operating and programmatic basis, rather than a project to project basis. There is ample precedent for such a practice. Most CDFI NOFA's now have built in preferences (in the form of extra credit points). Recent examples include targeting geographic areas of higher distress, such as FEMA Disaster Areas, after Hurricane Katrina.

Today the lion's share of dollars granted in the New Markets Tax Credit Program, for example, is awarded to large real estate developers, money center banks/investment banks and large national non-profits. In some cases the same recipients have been awarded significant ($100 million) allocations annually for five or more years.

2. **Streamline the application process (or provide more meaningful technical assistance in completing it)**

Smaller community banks and non-profits generally do not have the infrastructure to collect the extensive data and analysis required for CDFI applications and follow up monitoring. This results in lower scores and missed financial and revenue generating opportunities. Remedies include:

— providing funding/grants for hands on assistance during the "ramp-up" period prior to application process (i.e., grant to become CARS rated (CDFI assessment and rating system operated by the Opportunity Finance Fund recognized by the CDFI, foundations and other investors); provide technical support and financial assistance for compliance reporting and data mining).

— providing favorable treatment to major financial institutions that partner with community banks to improve application readiness, thereby leveling the playing field.

— providing better training for readers; more hands on training

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Chairman NEAL. Thank you Ms. Pinnock.

Mr. Haskins, the bells that you heard mean that we have about 15 minutes, probably closer to 13 minutes, but we'll try it from there. Thank you, Mr. Haskins.

STATEMENT OF JOSEPH HASKINS, JR., CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HARBOR BANK OF MARYLAND

Mr. HASKINS. Thank you, Chairman Neal. I will try to speak quickly.

Good morning Chairman Watt, Chairman Neal, again, and members of this distinguished committee. I am delighted to say to you that I am the chairman, president and CEO of Harbor Bankshares Corporation, which is a bank holding company in Maryland that currently oversees a $300 million commercial bank.

Although the scope of the GAO is very broad, I have decided to focus my attention almost exclusively as it relates to Harbor Bank and Harbor Bankshares Corporation. However, I do have a couple of recommendations that I will share at the end of my comments. I do want to be on record to state that I believe that the New Markets Tax Credits Program under the CDFI Fund is a very important and vital tool for stimulating economic growth and development, especially as it relates to the minority or low-income communities.

The four points that I would like to make are as follows: first, that Harbor Bank has a long and distinguished record of success servicing low income people and communities. When we look back at the past five years, the period of this analysis, we find that we have deployed over $140 million in loans to the communities that we focus on, which is the low income community. The specific item that I'd like to lift here for your information is the fact that our first award, which was in round 2 of $50 million in New Markets Tax Credits, $25 million of that was allocated to one project. And one might say, why so much to one project?

This one project represented 88 acres of an urban community, a city that is among one of the highest in crime as you've heard in reports, highest in unemployment, highest in drug addiction, and so forth and so on; and, while the city is high in regards to these numbers, this community that we focus on doubles those statistics, deplorable, not to say the least. This effort of 88 acres was designed to focus on creating a new science and biotech park, building out

two million square feet of science and technology park space and to create 2,000 new and renovated homes for this low income community.

Our $25 million in this project resulted in $5 million going to a not-for-profit that focused on establishing drug rehabilitation programs, job training programs, and educational housing programs. So when we look at the impact we were significant. The other part of this is that we initiated the first building of that science park, a 300,000 square-foot building that employed in excess of 200 residents of that community through its various different phases of development. But moving quickly I want you to know that we think that our efforts have also been successful in being a stimulus as well as being an identifier of future opportunities, because we were the stimulant in a second science park on the West side tied to the University of Maryland, two very great and outstanding institutions.

I want to quickly tell you that while we were successful in the second round we applied it every single round, and of the eight different allocation periods, we received two allocations; and, that last allocation came at the end of this '08 award, which is a part of the stimulus package. Our concern here is that we have a proven track record of being able to put our money out. We have evidenced that by having our money on the street in 14 months, what is interesting, that of the allocation I received already, the $50 million that I received under the 2009 period I already have applications in excess of three times that amount, all for very relevant products and services.

I know that my colleagues have already spoke to some of the recommendations that they see as possible. I agree with some of the observations made by the GAO. What I would say to you is if you focus on lenders who have history in the communities that they've served and add that as a part of the criteria, I think we go a long ways in helping to up the number of minority applicants in this process. And, ladies and gentlemen, or gentlemen as I see sitting before you, I am available to have you witness firsthand the developments of our money and the outcomes; and, I'm available to answer any questions that you might have.

Thank you very much for the opportunity.

[The prepared statement of Mr. Haskins follows:]

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Testimony of Joseph Haskins
Chairman, President and CEO of Harbor Bankshares Corporation

June 18, 2009
Washington, D.C.

Good morning. Mister Chairmen and members of the Committees, my name is Joseph Haskins and I am the Chairman, President and CEO of Harbor Bankshares Corporation ("HBC") headquartered in Baltimore, Maryland. Thank you for the opportunity to address this joint session.

HBC is certified by the United States Department of the Treasury (the "U.S. Treasury") as a Community Development Financial Institution (a "CDFI") and as a Community Development Entity (a "CDE") and was the first financial institution in the State of Maryland to hold both certifications. HBC is minority-owned, minority-controlled and counts among its assets The Harbor Bank of Maryland, a $300 million bank.

Although the scope of today's hearing is broad, I will limit my testimony to HBC's record of securing New Market Tax Credit ("NMTC") authority, HBC's record of selling NMTCs to investors, HBC's record of making qualified investments in low-income communities ("QILC"), and a few recommendations that may yield increased minority participation in the NMTC program (the "NMTC Program").

For the record, I consider the NMTC Program a vital tool for stimulating economic development in depressed communities and I support any campaign to extend the authorization of the NMTC Program beyond 2009.

I would like to make four (4) main points:

1. HBC has a long and distinguished record of successful service to low-income people and communities that otherwise lack sufficient access to credit, capital, and financial products and services;

2. HBC continually seeks to expand its capacity to provide credit, capital, and financial products and services to underserved populations and communities;

3. The NMTC Program should increase access to credit, capital, and financial products and services through the expansion of existing entities that (a) in conjunction with its affiliates on a consolidated basis principally lend to minorities; (b) principally serve low-income, predominantly minority communities (a "Minority Service Area"); and (c) are certified by the U.S. Treasury as a CDE (such entity satisfying (a), (b), and (c), a "Minority Lender"); and

4. The NMTC Program should support small business development in underserved markets.

First, HBC has a long and distinguished record of successful service to low-income people and communities that otherwise lack sufficient access to credit, capital, and financial products and services and the NMTC Program has significantly contributed to that success.

I would like to highlight a few examples of HBC's distinguished record of infusing capital, credit, and financial products and services into low-income communities.

In the past five years alone, HBC has deployed over $140 million of loans into low-income communities. HBC deployed $25.5 million into the $100 million Life Sciences Building of the Johns Hopkins Hospital & Medical Center, $10 million into a $65 million hospitality development, and deployed $14.5 million in a scientific research building in Baltimore, Maryland. In addition, HBC was the first hotel investor in Inner Harbor East, now a hotel haven; invested on an unsecured basis in a once fledgling CDFI that has transformed 80 acres around Johns Hopkins Hospital into a mixed-use, mixed-income community valued at $1.8 billion; and provided loans to a developer that paved the way for a $500 million Bio-Tech Park.

Equally important, if not more than the actual provision of capital and credit, are the derivative communal benefits of such investment. HBC has witnessed first-hand its investment's derivative effects such as job growth, educational opportunities, and the provision of social services such as shelter, drug rehabilitation, and healthcare to residents of its financial services footprint.

Second, HBC continually seeks to expand its capacity to provide credit, capital, and financial products and services to underserved populations and communities.

HBC's success is due in part to the NMTC Program, which has awarded HBC $100 million in NMTC authority. However, the demand for HBC's NMTC allocation exceeds its supply. HBC has developed a robust pipeline of NMTC projects based upon its current involvement in the community and extensive network of community referrals and contacts. HBC recently reviewed over fourteen (14) large-scale NMTC projects having total development costs of $577 million and requiring over $176 million in NMTC financing. HBC continues to respond to small business demand for NMTC financing assistance and has devised a concept and mechanism to cost effectively deploy NMTCs into smaller transactions by participating in a small business NMTC fund (the "NMTC Fund") which allows for loan funds to flow to many projects under one NMTC closing.

Yet, despite HBC's enviable track record of serving low-income communities; despite HBC's significant investment in low-income communities; despite HBC's significant capital and human resources often drawn from the same low-income communities it serves; and despite its robust pipeline of deals, HBC has not received NMTC authority on

a regular basis. Although HBC received NMTC authority in 2003 and 2009, it, despite repeated applications, did not receive NMTC authority in 2002, 2004, 2005, 2006, 2007 and 2008.

HBC's business strategy is sound; its community impact reverberates on a daily basis; its management is tried; its knowledge base fortified. Considering HBC's demonstrated success in serving low-income communities, its efficient and effective use of NMTC authority, and given its repeated application for NMTC authority, it is not clear to me why HBC did not receive NMTC authority in six different rounds.

Third, the NMTC Program should increase access to credit, capital, and financial products and services through the expansion of existing Minority Lenders. Minority Lenders are CDEs that principally serve Minority Service Areas and that in conjunction with its affiliates on a consolidated basis principally lend to minorities.

Although a tremendous capacity exists for new capital in Minority Service Areas, Minority Lenders have infused their communities with such capital and support for decades and should not be overlooked in the public policy effort to attract external capital to highly distressed communities.

To be clear, my reference to a Minority Lender does not necessarily mean a CDE that is minority-owned or minority-controlled. Rather, a Minority Lender is a CDE who with its affiliates on a consolidated basis principally lends to minorities in a Minority Service Area. If a white-owned or white-controlled CDE with its affiliates on a consolidated basis principally lends to minorities in a Minority Service Area then that white-owned or white-controlled CDE is a Minority Lender. I believe that a CDE's status as a Minority Lender should be an added and important consideration in the overall application scoring and approval process for NMTC authority and in determining how to prioritize allocations among CDEs deemed qualified to serve low-income communities.

I propose a five-prong test for Minority Lender status that considers

1. The CDE's and its affiliates' track record of serving Minority Service Areas;

2. The historic proportion of the CDE's and its affiliates' low-income, minority investment as compared to overall investment;

3. Proven management capabilities, coupled with a comprehensive understanding of Minority Service Area risk factors, needs and cultures;

4. The CDE's Minority Service Area outreach commitment and depth of relationships and networks with others that focus on serving Minority Service Areas; and

5. Community Reinvestment Act ratings, as applicable.

I endorse the concept of assigning preference to CDEs that have demonstrated that with its affiliates on a consolidated basis it has a track record of successfully serving minority communities in Minority Service Areas. I give little credence to forward looking statements or expressed intentions to serve minority communities in the future by those who have not engaged in significant minority investment or significant minority lending activities in the past. It is important to be clear; a claim of Minority Lender status should not by itself necessitate an allocation preference; service in a Minority Service Area should not by itself necessitate an allocation preference; lending activity principally to minorities on a consolidated basis should not by itself necessitate an allocation preference; rather, actual, demonstrated significant lending activity to minorities on a consolidated basis together with principal service in a Minority Service Area should prime some factors in the selection process for NMTC authority but should not necessarily be the main determinate of allocation. For example, a controlling entity may own a CDE that maintains a service territory with a predominantly minority demographic and makes qualified investments in Minority Service Areas, but such activity does not necessarily mean that the controlling entity and the CDE on a consolidated basis have a material commitment to serving minority communities.

Furthermore, Minority Lenders are perhaps better suited to achieve the stated goals of the NMTC Program. The pass through rate of total dollars awarded in NMTC authority to low-income communities may be higher if administered by Minority Lenders because such institutions are much more dedicated to the concept of using capital infusions as stimulus for additional lending in the communities they serve. Rather than a statutorily required pass through rate of 85%, Minority Lenders are more likely to achieve a pass through rate in excess of 95%. I am not suggesting that CDEs without a minority focus on a consolidated basis cannot achieve an equally robust pass through rate but I do feel that Minority Lenders will be more prone to put extra capital to work in the communities they serve.

I recommend that Minority Lender status be an added and important consideration in the overall application scoring and approval process for NMTC authority and in prioritizing allocations among CDEs deemed qualified to serve low-income communities.

Fourth, the New Market Tax Credit Program should support small business development in underserved markets.

HBC has devised a cost effective mechanism to deploy NMTCs in smaller amounts to smaller transactions in low-income communities through the use of the NMTC Fund. Although the NMTC Fund streamlines costs associated with legal, accounting, and administrative fees that have traditionally hampered smaller projects, more can be achieved at the federal level to incent the use of revolving loan pools, an important resource for small business development. NMTC Program requirements favor large transactions that assist a large, single borrower over transactions that utilize revolving loan funds that can assist several small borrowers. NMTC financing for single, large borrowers allows a CDE to more easily satisfy and maintain compliance with deployment requirements. CDEs that use revolving loan funds face greater deployment challenges, as

the loan funds must be recycled in a regulatory compliant fashion. The complexity and burden of additional regulatory requirements together with the potential inability of CDEs to identify large, single borrowers in their investment pipeline chill the use of the NMTC Program for small business development and may yield less than full participation in a NMTC Program that places a large emphasis on deployment to single, large borrowers.

Conclusion

Mister Chairmen, thank you for holding this important hearing and for allowing me to testify on behalf of HBC. Before closing, I also want to thank each of you and your Committees for your continued support of HBC and the CDFI Fund and your support of our shared effort to serve communities that have been historically underserved.

This concludes my formal statement and I now will speak to questions.

Chairman NEAL. Thank you, Mr. Haskins.

Mr. Cunningham.

STATEMENT OF WILLIAM MICHAEL CUNNINGHAM, SOCIAL INVESTING ADVISOR, CREATIVE INVESTMENT RESEARCH, INC.

Mr. CUNNINGHAM. Thank you, Chairman Neal, Chairman Watt, Ranking Member Tiberi.

I really appreciate you inviting me here. I am going to make this very quick. Before I get started, I would like to introduce a member of my staff, Marie Cunningham Brown. She is also my mother. She worked for 30 years on Capitol Hill. In her last posting she was an assistant to Congressman Claude Pepper. If I say anything intelligent, you have her to thank. If I say anything stupid, and I will, you can blame me.

Now, one of the things I want to point out is that the misallocation of economic resources kills people. Not two days ago a homeless woman, not 1.14 miles away from where we sit today was waiting for shelter at a homeless shelter close to here, and she died, basically because the economic resources weren't available to help her out. These are the kinds of people that the New Markets Tax Credits Program was designed to assist.

In our 2008 application we created a financial instrument designed to help and address the problem of homelessness. That application was not funded. So that's part of the problem that we have with the program. We just think that, again, the misallocation of economic resources based on racial prejudice is wrong. It kills people, markets, firms and economies, and we pointed this out in numerous comments to the Securities and Exchange Commission and to other bodies. Now, with respect to kind of what our problem is with the program, we've applied in virtually every round of the New Markets Tax Credits Program.

I actually gave a speech in 1994 in San Francisco, California, where I called for the creation of New Market type vehicles to get venture capital into underserved communities. So we take great pride and credit in being one of the intellectual forefathers of this program. You know, but we just have not had a lot of success in accessing those resources for a number of reasons. Now, we concur with the statistical findings of the GAO report that's included in Appendix A in our testimony, a statistical analysis that was conducted by two interns that worked for us.

I do want to point out our 2004 New Markets Tax Credit Application in particular because we partnered with the City of Minneapolis to apply for $120 million in New Markets Tax Credits. We had a letter of commitment from Piper Jaffray, letter of commitment and a partnership with a city, and we were not funded. So, obviously, from our perspective there is a problem with this program. In our last application we partnered with an African-American individual with a net worth of $150 million, who basically supported our application to create a $50 million pool of New Markets Tax Credits that we were going to allocate to minority-owned banks.

In the review of our application, the reviewer said "We're not sure that minority-owned banks either want or can use New Markets Tax Credits." They turned around and then they gave two mi-

nority-owned banks New Markets Tax Credits when we applied to do exactly the same thing a year earlier. Again, from our perspective there is a problem with this program. Now, what we suggest you do is we suggest you look at the transaction record for the New Markets Tax Credits allocations. When I say the transaction record, what I mean is we suggest you look at the commissions paid to investment banks, consultants, lawyers and accountants.

Basically, we want to outline. We want to put some sunlight on this allocation process and determine who is benefiting up front from these New Markets Tax Credits allocations. According to the data that we have, because the spreads are so large and because this is one of the most generous Federal Government programs in the Federal Government community development inventory, the fees that we've seen go to some of the investment banks can get as high as 10 percent of the allocation. So 10 percent of the allocation goes to an investment bank before a dollar goes to the community to repay that investment bank for bringing investors into the pool. We think that's unfair.

We think that's unfortunate. In Appendix C of our testimony we have outlined further suggestions for enhancing this program. Basically, we suggest that you increase the New Markets Tax Credits for equity investments in low income businesses located in some of the more distressed areas of the country. That's the core of our recommendation.

Again, I understand the time pressure you are under. I appreciate you inviting me here to testify today. I am available to answer any questions that you have.

Thank you.

[The prepared statement of Mr. Cunningham follows:]

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Statement of William Michael Cunningham
Submitted to the

Subcommittee on Select Revenue Measures of the Committee on Ways and Means and the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee of the Financial Services Committee.

Thursday, June 18, 2009

Chairman Watt, Chairman Neal, Ranking Member Paul, Ranking Member Tiberi,

Thank you for the opportunity to participate in this important hearing. I am testifying with respect to the CDFI Fund and the New Markets Tax Credit (NMTC) program. These documents are presented so that you can fully explore the record the CDFI Fund with respect to our firm, an African American CDE.

NMTC program impact data compiled by the U.S. General Accounting Office[1] shows the program can work better: low-income persons and low income communities have yet to benefit. Another GAO report[2] on the NMTC program noted that:

> "..we infer that the most likely effect of the credit is that corporate investors, which make the majority of investments..are shifting investment into low-income communities from higher income communities."

A third GAO report[3], the focal point of this hearing, showed that the probability of receiving a NMTC award decreases if the CDE applying for NMTCs is minority owned or controlled. The study proves that, from 2005 through 2008, minority-owned and controlled CDE's had a lower probability of NMTC Program success. We concur with GAO's findings and, in Appendix A, review the statistical techniques used. We believe the study suggests that the NMTC Program can be improved.

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[1] *New Markets Tax Credit. Progress Made in Implementation, but Further Action Needed to Monitor Compliance.* GAO Report Number GAO-04-326. January, 2004.

[2] *New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance.* GAO Report Number GAO-07-296. January, 2007.

[3] *New Markets Tax Credit Program: Minority Entities Are Less Successful in Obtaining Awards Than Non-Minority Entities,* GAO-09-536, Washington, D.C.: April 30, 2009.

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Experience with the CDFI program[4]

Creative Investment Research, Inc., has applied for CDFI funding during several rounds:

- In 1998, we applied to the CDFI Fund for financing to create an on-line, internet based facility for financing women and minority owned businesses, www.minorityfinance.com. The application was not funded.

- In 1999, we applied for CDFI Fund funding to create a minority mortgage initiative. The application was not funded.

Experience with the NMTC program

Creative Investment Research, Inc. has applied for NMTC funding during several rounds. Our applications have ranged in size from $2 million to $200 million:

- In 2002, we applied, in conjunction with the National Monetary Fund (a minority-owned venture capital firm located in Oakland, California) for $200 million in NMTC funding to create a venture capital fund targeting minority and low income communities. The application was not funded.

- In 2003, we applied for $2 million in NMTC funding to purchase and renovate a vacant commercial office building located in the Minneapolis Empowerment Zone. The application was not funded.

- In 2004, Creative Investment Research, Inc. partnered with the City of Minneapolis to submit a NMTC application. The application sought $120 million in community development funding:

  > Low income community outreach and input efforts were to be managed by the Hennepin County-funded African American Men Project (AAMP). AAMP specifically focuses on underserved area partners lacking access to conventional sources of capital. We planned to use city and county funds to increase the reach and impact of their efforts.
  >
  > Legal services were to be provided by Halleland Lewis Nilan Sipkins & Johnson, a Minneapolis firm with exceptional legal expertise.
  >
  > Capital – both debt and equity - was to be provided by Piper Jaffray Public Finance, a world class investment bank headquartered in Minneapolis. Piper

[4] Appendix B provides general background information on William Michael Cunningham and Creative Investment Research, Inc.

http://www.creativeinvest.com
http://www.minorityfinance.com
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provided a ***letter of commitment*** for $120 million. Secondary letters of interest were received from Pax World Funds, a socially responsible mutual fund company, Wells Fargo Bank, and from U.S. Bank, a financial services holding company with $1.4 billion in tax credit investments.

Commercial real estate development and management tasks were to be carried out by the Ryan Companies, a Minneapolis based commercial real estate development and construction firm with over 65 years of experience, serving customers in more than 150 cities.

Loan administration and servicing were to be provided by Franklin Bank, an urban community development bank in Minneapolis.

NMTC compliance and auditing services were to be provided by Novogradic and Company, LLP, a national certified public accounting and consulting firm with eight offices nationwide.

Input from a wide variety of community based entities and groups would have been made part of our process. Some of these groups are listed below:

1) The Minneapolis Lifesciences Corridor
2) The West Broadway Business Association
3) Women Venture - national leader in technical assistance for women owned companies.
4) The Minneapolis Urban League
5) Project for Pride in Living
6) The Minneapolis Chapter of the NAACP
7) Neighborhood Development Center, Inc.
8) The Elliot Park, Ventura Village, Phillips West, and Midtown Phillips Neighborhood Associations
9) The Minneapolis Farmers Market Annex
10) Roosevelt High School
11) The University of St. Thomas
12) Hennepin County Medical Center
13) and others.

All projects in the application were high social impact real estate properties located in or near the Minneapolis Empowerment Zone. The application was not funded.

- In 2008, we applied for NMTC funding to invest in minority and community development banks. The application sought $50 million in community development funding:

http://www.creativeinvest.com
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We partnered with The Williams Group, to create a limited partnership, MBF, LP, whose mission is to make investments in minority-owned banks. MBF's three person management team is comprised of:

Elrick Williams is Founder, Chairman & CEO of Allston Trading LLC, a firm specializing in algorithmic electronic trading of stocks, Treasury bonds, currencies, futures and options, generating revenues of $150 million annually. From 1981-1991 and from 1999 to the present, Mr. Williams was/is a member of the Chicago Mercantile Exchange. He graduated from the Harvard Business School, with a concentration in Finance. He holds a BA Chemistry from Williams College.

Mr. Glenn Harvey, formerly, President and Chief Operating Officer of Broadway Federal Bank. Prior to joining Broadway Federal in 2006, Mr. Harvey was a senior vice president with Comerica Bank-California, Entertainment Group Division. Mr. Harvey received an undergraduate degree from UC Berkeley and a Masters in Business Administration and Juris Doctor from UCLA.

William Michael Cunningham. Mr. Cunningham holds a Masters degree in Economics and an MBA in Finance, both from the University of Chicago. He holds an undergraduate degree in Economics from Howard University. In July, 2004, he completed the Community Development Lending School Program and Course, sponsored by the Federal Reserve Bank of San Francisco. He is a member of the CFA Institute, formerly the Association for Investment Management and Research (AIMR) and of the Twin Cities Society of Security Analysts.

The application was not funded.

- In 2009, we applied for $50 million in NMTC funding to invest in minority and community development banks. As of the date of this hearing, the application has not been reviewed.

We believe that low income persons and areas designated for NMTC assistance can be helped by the program's efforts and funding. According to a report on the NMTC program issued on January 30, 2004 by the General Accounting Office,

> *"Although Congress authorized the NMTC program to provide credit against federal taxes for billions of dollars starting in 2001 to spur investments in community development projects, CDFI Fund officials said that it is unlikely that many projects had started by the end of 2003 and that they will not know the status of projects for all Community Development Entities (CDEs) until early 2005."*

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In fact, much of the program's monetary assistance has gone to a few favored applicants, a few investment banks (including Bear Stearns and Goldman Sachs), and a few professional service firms (real estate developers, accountants, lawyers, and consulting firms).

We suggest the Committee request details concerning all NMTC transactions. This would include reviewing pricing for NMTC transactions. We further suggest you review commission amounts paid to intermediaries, including brokers, lawyers, accountants and consultants. As the 2007 GAO Report noted,

> *"A complete evaluation of the (NMTC's) program's effectiveness also requires determining the costs of the program.."* [5]

According to the New Markets Tax Credit Coalition [6], "Most of the projects (funded by the NMTC program) are for real estate." The program as currently structured allowed real estate developers to develop projects on far more favorable terms than would otherwise be the case. Also according to the Coalition, there has been "little activity in small business lending and venture capital." We contend that this is contrary to low income community needs. In summary, the New Markets Tax Credit program may be operating in a discriminatory and unfair manner.

Even when the program operates in an administratively fair manner, the bulk of the societal and monetary benefits derived from the program are being captured by real estate developers, accountants, lawyers, and consulting firms, not low income community residents.

The program was designed to spur small business lending and venture capital investments in low income communities. It has not done so.

In the alternative, we believe the NMTC program could be modified to operate in a more consistent manner, in keeping with what we believe to be Congressional intent. We suggest that the NMTC program tax credit vary according to the following:

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5 *New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance.* GAO Report Number GAO-07-296. January, 2007.

6 *NMTC Reauthorization Working Session.* PowerPoint Presentation. NMTC Coalition Policy Conference. May 12, 2005. Washington Court Hotel.

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1. Ownership of the qualified active low income community business (QALICB) receiving an investment supported by the credits. For smaller, minority or women-owned QALICB's, the tax credit should be higher;

2. Location of the QALICB receiving the investment (income in census tract where firm is located). For QALICB's located in very low income areas, the tax credit should be higher;

3. Nature (debt or equity) of the QALICB investment supported by the credits. The tax credit should be higher for equity investments in QALICBs.

We believe these modifications will make it more likely that low-income persons and low income communities will benefit from the program. Below, in Appendix C, is a table explaining these proposed modifications. Thank you.

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Appendix A: Review of statistical techniques used in *New Markets Tax Credit Program: Minority Entities Are Less Successful in Obtaining Awards Than Non-Minority Entities*, GAO-09-536 (Washington, D.C.: April 30, 2009).

Hsiu-Jui (Sherry) Chang[7], and Jui-Kai Li[8], Interns, Creative Investment Research, Inc. Edited by William Michael Cunningham, Social Investing Advisor, Creative Investment Research, Inc.

Through New Market Tax Credit (NMTC) Program, investors claim a tax credit of 39% in exchange for investing in Community Development Entities (CDEs). CDEs reinvest in low income communities. A GAO study reviewed NMTC program participation by minority-owned or controlled CDEs. The report identifies how many, from 2005 to 2008, minority-owned or controlled and non-minority-owned or controlled CDEs applied for and received NMTCs. Further, the report described the NMTC application process and reviewed scoring for minority and non-minority-owned or controlled CDEs. Finally, the report describes challenges that minority-owned or controlled and non-minority-owned or controlled CDEs have faced. We have a number of concerns with the GAO study, and suggest the following items be addressed.

I. Model Estimation and Sampling Errors

The GAO report reviewed NMTC Program award data from the 2005 to 2008 NMTC allocation rounds. The study estimated a model of the probability of NMTC award receipt, based on several factors. The probability of receiving a NMTC Award ($Pr^{NMTC\ Award}$) was calculated as a function of the following factors:

$Pr^{NMTC\ Award}$ = [.0026 * CDE Asset Size] + [-.1520 * CDE minority owned or controlled] + [.1900 * CDE is a certified CDFI] + [.0044 * CDE conducts activities in a severely distressed area] + [.0011 * CDE conducts activities in an urban area]

Thus, statistically speaking, the probability of receiving a NMTC award increases with CDE Asset size, CDE CDFI certification, CDE activities in a severely distressed area, and CDE activities in an urban area. The probability of receiving a NMTC award decreases if the CDE is minority owned or controlled.

The US Department of the Treasury CDFI Fund, administrators and managers of the NMTC Program, did not collect data on the ethic ownership of CDEs before 2005. The first NMTC awards were issued in 2002. The GAO analysis does not explain how

[7] Master of Business Administration candidate, August, 2009, Carey Business School, Johns Hopkins University.

[8] Master of Science in Finance candidate, May, 2010, George Washington University.

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sampling error may distort the interpretation of the data. Sampling error occurs when observations are omitted. This limitation may also give rise to a specification error, whereby variables are omitted, or the relationships between the explanatory variables is misspecified.

We reviewed the model selection process, and conclude that a Fixed[9] or Random[10] Effects model and using the Hausman test[11] is appropriate. The test results show there is sufficient evidence to conclude that model estimates are not biased. Small standard errors (the standard deviation of the residuals) implies better prediction of the dependent variable (probability of receiving a NMTC Award) by the independent variables (asset size, minority status, certification as a CDFI, activities in severely distressed and urban areas).

Note that even if the model is reasonable and the small standard errors suggest that this analysis includes all possible variables, sampling error may cause statistical bias.

---

[9] The Fixed Effects Model: If we are only interested in generalizing study results, the factors (or variables) GAO included may be appropriate. But we are not trying to generalize to other factors that might have included. In a non-experimental setting, a variable may have a small number of levels. For example, suppose that we selected 10 cities at random and did a survey using cluster sampling. Normally, "city" could be thought of as a factor in the study design, with 10 levels. If we did not want to generalize our results to all of the cities that might have been selected (the 10 cities included could be regarded as a sample drawn from a larger population of cities) -- but only wanted to generalize to the 10 cities included in the survey, then "city" could be treated as a "fixed" effect.

[10] In the case of a fixed factor, we are usually interested in comparing the scores on the dependent variable among the levels of the factor: our interest is in differences between means. In the case of a random factor, we are not really interested in the specific differences from one mean level of a factor to another -- we are interested in the extent to which the random factor accounts for variance in the dependent variable. Rather than being interested in the individual mean levels across the levels of the fixed factor, we are interested in the variance of means across the levels of a random factor.

[11] Given a model and data where fixed effects estimation would be appropriate, a Hausman test determines if a random effects estimation would be as good. In a fixed-effects case, the Hausman test is a test of H0: that random effects would be consistent and efficient, versus H1: that random effects would be inconsistent. (Note that fixed effects would be consistent.) The result of the test is a vector of dimension k (dim(b)) which will be distributed chi-square(k). If the Hausman test statistic is large, one must use a fixed effects model. If the statistic is small, one may use a random effects estimation technique.
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2. **Qualitative factors not considered**

Page 13: "NMTC applications are first reviewed and scored by a group of external reviewers selected by the CDFI Fund who have demonstrated experience in business, real estate, or community development finance."

Page 25: "Our analysis indicates that these differences are not explained by the size of the CDE—that is, they are not problems shared by other small, non-minority CDEs that applied for NMTC allocations. However, these differences could be associated with some other feature that minority CDEs share with non-minority CDEs for which we do not have data to include in our analysis."

The GAO survey focused on quantitative and statistical analysis. We suggest a review of qualitative factors (such as the definitions of the categories analyzed and the scoring process used by "external reviewers"). If a problem exists with these definitions and standards, if they were biased when established, statistical analysis of the evaluation process and the results of that evaluation process is useless. For example, page 24 of the GAO study states that minority CDEs scored 25% lower than non-minority CDEs with respect to capitalization strategy. No information is provided on how reviewers compared the capitalization strategies of minority CDEs versus non-minority CDEs and no clear explanation of the large difference in capitalization strategy scoring was given.

Summary

- The GAO study proves that, from 2005 through 2008, minority-owned and controlled CDE's had a lower probability of NMTC Program success.
- The statistical evaluation process appears reasonable, but all available data, from 2002 to 2008, should be used.
- Using statistical tools to allocate NTMCs might be insufficient for minority owned or controlled CDEs, given the errors these tools generate. Qualitative factors should be considered.
- We suggest the CDFI Fund review successful minority business development programs. We caution, however, against relying on data from two sources: the US SBA 8(a) Program and minority banking trade associations. The 8(a) Program excludes financial institutions. While the "express mission of minority banks is to promote underbanked, underprivileged communities," we suggest the CDFI Fund seek independent opinions concerning the effectiveness of minority banks.

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Appendix B: Background on William Michael Cunningham and Creative Investment Research, Inc.

William Michael Cunningham registered with the U.S. Securities and Exchange Commission as an Investment Advisor on February 2, 1990. Mr. Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services.

Mr. Cunningham's understanding of capital markets is based on first hand knowledge obtained in a number of positions at a diverse set of major financial institutions. He served as Senior Investment Analyst for an insurance company. Mr. Cunningham was an Institutional Sales Representative in the Fixed Income and Futures and Options Group for a leading Wall Street firm. Mr. Cunningham also served as Director of Investor Relations for a New York Stock Exchange-traded firm. On November 16, 1995, his firm launched one of the first investment advisor websites. The Community Development Financial Institution Fund of the US Department of the Treasury certified the firm as a Community Development Entity on August 29, 2003. SBA certified our firm as an 8(a) program participant on October 19, 2005. We withdrew from the 8(a) program in December, 2008, having found it completely ineffective.

In a speech given in San Francisco, California before the Greenlining Coalition's First Annual Minority Economic Development Conference on March 5, 1994, Mr. Cunningham called for the creation of tax advantaged community development programs to provide equity capital to women and minority-owned businesses located in low income census tracts.

The firm and Mr. Cunningham have long been concerned with the ability of financial markets to meet the needs of the country:

- On July 9, 1993, Mr. Cunningham wrote an SEC Commissioner to notify the Commission about a certain specific investing "scam." A timely warning was not issued to the investing public.

- On June 18, 1998, Creative Investment Research opposed the application, approved by the Federal Reserve Board on September 23, 1998 and endorsed by the SEC, of Travelers Group Inc. to become a bank holding company by acquiring Citicorp. One Travelers subsidiary, Salomon Smith Barney Inc., (created when Salomon, Inc. merged with Smith Barney) had a history of defrauding investors and operating schemes in restraint of trade. This single fact

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should have rendered the proposed merger potentially injurious to the public welfare and, therefore, prohibited. *It did not.* On April 28, 2003, the merged firm, Citigroup Global Markets Inc., paid fines totaling $400 million. The firm was found, again, to be defrauding investors and operating schemes in restraint of trade.

- In an October 1998 petition to the United States Court of Appeals, Mr. Cunningham cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions. He went on to note that:

  > *"The nature of financial market activities is such that significant dislocations can and do occur quickly, with great force. These dislocations strike across institutional lines. That is, they affect both banks and securities firms. The financial institution regulatory structure is not in place to effectively evaluate these risks, however. Given this, public safety is at risk."*

- On June 15, 2000, Mr. Cunningham testified before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE's) of the US Congress. He suggested that the GSE's (Fannie Mae and Freddie Mac) be subject to a through "Social Audit." A Social Audit is an examination of the performance of an enterprise relative to certain social objectives. It also includes a review of ethical practices at the firm. Had they been subject to this audit, certain flaws in their operation, including ethical shortcomings, may have been revealed earlier and in a better market in which to make corrections.

- On December 22, 2003, statistical models we created using the Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure. See page 6:
  http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf

- In 2004 and 2005, we filed FOIA requests with the CDFDI Fund seeking information on the minority identity of CDEs.

- On Monday, April 11, 2005, Mr. Cunningham testified before Judge William H. Pauley III in the U.S. District Court for the Southern District of New York on behalf of investors at a fairness hearing regarding the $1.4 billion dollar Global Research Analyst Settlement. No other investment advisor testified at the hearing.

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- In 2005, Mr. Cunningham served as an expert witness for homeowners in a case against PMI Group, Credit Suisse First Boston, Moody's, Standard and Poor's, Fairbanks Capital Corporation, Select Portfolio Servicing, US Bank National Association, as Trustee of CSFB ABS Series 2002-HEI, et. al., in the New Jersey Superior Court Law Division - Monmouth County. Our testimony sought to hold corporate parties responsible for facilitating predatory lending practices.

- On February 6, 2006, statistical models we created using the Fully Adjusted Return® Methodology confirmed that system-wide economic and market failure was a growing possibility. See page 2: http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf

- We participated in a Fannie Mae and Federal Reserve seminar on measuring the social impact of banking activities, August 3, 2006: http://www.knowledgeplex.org/showdoc.html?id=188307

- Also see: http://www.usnews.com/articles/business/economy/2008/01/28/the-first-bank-failure-of-2008

- On Sunday, September 28, 2008, we wrote to US Senator Richard Shelby to comment on the financial rescue plan currently under consideration by the US House and the US Senate. In the appendix to that letter, we provided a four step plan for dealing with the crisis. See: http://www.ethicalmarkets.com//wp-content/uploads/2008/12/financialbailoutcomment1.pdf

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Appendix C: Proposed New Markets Tax Credit (NMTC) Restructuring

Type of business (QALICB) receiving NMTCs	Location of business (QALICB) receiving NMTC funding	Type of QALICB investment	NMTC (total tax credit to investors)
Minority or women owned firm	Census tract with income levels that are at or lower than 70% of the area median income	Debt	25%
Non-minority owned firm	Census tract with income levels that are at or lower than 70% of the area median income	Debt	15 %
Minority or women owned firm	Census tract with income levels that are at or higher than 70% of the area median income and at or lower than 80% of the area median income	Debt	20 %
Non-minority owned firm	Census tract with income levels that are at or higher than 70% of the area median income and at or lower than 80% of the area median income	Debt	10 %
Minority or women owned firm	Census tract with income levels that are at or lower than 70% of the area median income	Equity	60 %
Non-minority owned firm	Census tract with income levels that are at or lower than 70% of the area median income	Equity	30 %
Minority or women owned firm	Census tract with income levels that are at or higher than 70% of the area median income and at or lower than 80% of the area median income	Equity	50 %
Non-minority owned firm	Census tract with income levels that are at or higher than 70% of the area median income and at or lower than 80% of the area median income	Equity	25 %

Note: Type of business (QALICB) refers to the qualified active low income community business receiving financing. NMTC refers to total tax credit amounts received by investors over a seven year period.

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Chairman NEAL. Thank you, Mr. Cunningham.

We have two minutes on the floor. Mr. Klein, if you want to give this a quick go, we'll accept your testimony in part verbally and part written testimony, if we could.

Mr. KLEIN. I will go as fast as I can.

Chairman NEAL. You're on.

STATEMENT OF JAMES R. KLEIN, CHIEF EXECUTIVE OFFICER, OHIO COMMUNITY DEVELOPMENT FINANCE FUND

Mr. KLEIN. Thank you for the opportunity to testify specifically. Thank you to Congressman Tiberi for your invitation.

Finance Fund is a statewide non-profit in Ohio that provides services to low-income communities around the state. We work exclusively in these low-income urban and world communities, doing a number of different kinds of projects, affordable housing, childcare, learning facilities, small business community facilities and so forth.

We work with for-profit and non-profit clients around the state. We've been doing this for 22 years. We've got 15,000 units of affordable housing, 9,000 jobs, 8 million square feet of revitalized, commercial space. New Markets Tax Credits fits pretty much dead center into our mission and product mix. We provide a lot of products and services to small businesses, minority businesses, and we use a non-leveraged model. A non-leveraged model is a model which is not as complex as the primary used model in this product in this program which is the leveraged model.

The non-leveraged model allows us to do blind pools, which are investment commitments that are made without actually identifying a specific project. Now, we've gotten four allocations out of this program; 30 projects have resulted. We've got deals as small as 86,000, our largest investment has been five million.

Let me talk very briefly about the report. In my perspective the outcomes of this report are somewhat predictable. We are talking about highly distressed communities here. Highly distressed communities have specific kinds of characteristics. They have limited assets. They have limited capacity to do these kinds of complex deals that go through many public programs. We have businesses that operate in a market that is limited, depressed asset values, and so forth.

It is my opinion that the complexity of the finance model becomes a systemic barrier to minority and small CDE participation in this program because of its complexity and its cost.

[The prepared statement of Mr. Klein follows:]

Chairman NEAL. I apologize. The clock has run to zero on the House floor. I am going to recognize a suggestion from my friend Mr. Watt.

TESTIMONY BEFORE THE JOINT PUBLIC HEARING

of the

Subcommittee on Select Revenue Measures of the Committee on Ways and Means* and the *Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee

by

James R. Klein, CEO, OHIO COMMUNITY DEVELOPMENT FINANCE FUND (Finance Fund)

Concerning:

"NEW MARKETS TAX CREDIT: Minority Entities Are Less Successful in Obtaining Awards Than Non-Minority Entities" (GAO-09-536)

JUNE 18, 2009

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I. INTRODUCTION:

Chairman's Neal and Watts, Ranking Members Tiberi and Paul, and Subcommittee members, I am James Klein, Chief Executive Officer of the Ohio Community Development Finance Fund (Finance Fund), and I want to thank the Committees and specifically Congressman Tiberi for the opportunity to testify on the recently released GAO report concerning minority entities level of success accessing NMTC awards. I will be providing you with a general overview of Finance Fund followed by comments on specific elements of the report.

Finance Fund is a statewide nonprofit financial intermediary working to enable progress and inspire change within Ohio's low-income communities. By building bridges to economic development and community revitalization, we aim to create opportunities that make a better quality of life possible.

Working exclusively within low-income rural and urban communities, we connect local community development organizations and small businesses with needed funding in the form of nontraditional financial products. These resources support a wide range of projects including affordable housing, child care and early learning facilities, small business entrepreneurship, community facilities, and commercial revitalization.

Finance Fund's clients include community-based nonprofit organizations and for-profit businesses serving low-income communities statewide. As an intermediary, we form creative public-private partnerships with financial institutions, investors, charitable foundations, community organizations and federal, state and local governments in order to provide the funding clients need.

Utilizing a diverse and ever-expanding range of financial products, clients gain access to resources needed to turn struggling communities into economically healthy neighborhoods. Products include: grants for predevelopment activities, grants to supplement owner equity, flexible loans, and credit enhancements.

Finance Fund has, over its twenty-two year history, experienced steady growth from a starting asset base of $50,000 to an aggregate of $110 million. Impact on Ohio's low-income population has been tremendous with investments that have provided 15,312 homes, created 8,991 jobs, and over 8 million square feet of revitalized community space providing shopping, transportation, as well as medical and social services for residents. In over 3,000 new classrooms, Finance Fund has impacted 69,326 of Ohio's low-income children with access to early learning services, hot meals, and other health and social services while parents are at work or school. We have touched the lives of 116,000 low-income people. 2,455 projects have been approved for a total amount of $95 million that has leveraged nearly $755 million from other sources. Our strategy has always been "creating value from value created" or "supplement don't circumvent." That is, we use existing systems and structures to facilitate change.

The New Markets Tax Credit is a nearly perfect fit into our existing mission and product mix. It provided the resources and the flexibility to enhance the efforts we've been providing for the past two decades. We have received four awards from the program soliciting investment from existing investment partnerships and applying proceeds to local clients, old and new. To facilitate the use of NMTC in highly distressed neighborhoods and communities, a non-leveraged investment model has been used. This has allowed for construction of "blind pool" investments where projects are not identified at the time of the investment commitment. This has allowed for the offering of products that are fairly generic and familiar to the market.

Three of the four awards are deployed ($55 million) in 30 projects ranging from coffee shops to shopping centers, from child care space to health care facilities in urban, rural, minority and non-minority communities around the state. (See attachment) The largest NMTC investment has been $5 million the smallest $86,000.

II. GAO Report Comments:

The GAO report finds that..."minority status is associated with a lower probability of receiving an allocation. It is not clear from our analysis why this relationship exists or whether any actions taken or not taken by the Department of the Treasury contributed to minority CDEs' lower probability of success."

From my prospective this outcome is somewhat predictable. NMTC has already dealt with a similar issue when examining the urban and rural markets. These issues are not uncommon to smaller communities and neighborhoods exhibiting characteristics of economic distress. Local minority and non-minority organizations are usually smaller with limited assets and capacity to deal with the complexity of public programs. They operate in a market that is of a limited scale. As a result, they generate projects that are smaller and businesses with little or no assets enabling access to private commercial capital. Because projects are smaller, impacts are small when compared to larger single purpose transactions.

Higher economically distressed communities do not suffer from a lack of capital. They suffer from a lack of mechanisms to capture capital passing through the local economy. The need in these low-income communities is for locally-owned or controlled mechanisms (businesses) that capture and facilitate the local circulation of capital thereby stimulating the local economic environment. The lack of an unstable local economy is characterized by a lack or limited investor presence, lack of resident access to basic housing and services, and a rise in blight indicators; i.e. crime, delinquency, depressed asset values, chronic unemployment, etc. These characteristics are cyclical and tend to act as a barrier to investor yield demands and risk aversion which leads to an increase in the aforementioned blight indicators.

The need in these communities is for flexible streams of capital, initially subsidized, that provide incentive for investor participation in sustainable projects, many times small, that generate local income.

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The New Market Tax Credit program is one of the best fits to address this issue and has become a valuable tool in the revitalization of low-income communities. It is successful and increasingly attractive to investors, which has led to another potential reason for the GAO finding.

NMTC's have moved toward two prominent investment models; i.e. leveraged and non-leveraged. The primary investment model is a structured finance or leveraged model. To receive tax credits a qualified equity investment (QEI) must be made into a certified Community Development Entity (CDE). Because the credits are considered to be yield shallow and there is a perception that available equity for this type of investment is limited, investors have moved almost exclusively to this model. The leveraged model enables the QEI investment to be "prepared" for investment by using a system of soliciting debt and equity investment into an aggregating entity, which on behalf of the investors, makes the QEI. The debt investor receives yield from pricing of the loan, and the equity investor receives yield from all the tax credits. This allows equity to leverage debt and has resulted in billions of dollars of investment. The structure has other characteristics that are pertinent to the GAO report. First, it increases the complexity of legal structuring at the investor level and at the transaction level. Second, it increases the cost of structuring the project with additional legal, accounting, and timing costs. Yield expectations of the model are approximately 12% to 14% after taxes. The benefit of the model is that it enables larger investments in larger projects, enables some pricing advantage as a result of an A-B loan structure with the potential for putting equity into a transaction at the end of the term, and potentially increases the impact as the result of transaction scale. Because of the cost and complexity, the minimum size of a NMTC project is considered to be around $3 million. It is Finance Fund's opinion that the yield drive of the leveraged model systemically excludes smaller low-income community projects from accessing NMTC capital. As a result, it is less likely that minority CDEs will be able to present projects that are competitive in the application process.

A second NMTC investment type is a non-leveraged model. This approach is far less popular and is practiced by a limited number of CDEs. This is direct equity investment (QEI) by investors into the CDE. There is no debt investor, so no need for the aggregating entity. The CDE uses the proceeds of the investment to make loan/equity investments directly to transactions with qualifying businesses. The model is somewhat more flexible in that it enables development of blind pool investment; i.e. not having identified

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projects prior to investment. It is less complex, therefore less costly, and enables the offering of a recognizable product to the market; i.e. generic loan. Yield expectations are approximately 6% to 7% after taxes. It is the opinion of Finance Fund that the non-leveraged model is best suited to meet demand for small locally-owned qualifying businesses.

The report identifies no perceived system bias in the process of application, award, and administration of the program. From Finance Fund's experience, the program is well managed and provides ample training and guidance within the perspective of the administrative agent. This is not a capacity building program, and it should therefore not be the responsibility of the administrator to build the skill set of CDEs. However, it should and does provide ample and understandable guidance insuring equal access in the application process. There is an extensive and accessible knowledge base; i.e. Q&A, webinars, staff access and a well-defined programmatic system, including a well-defined and publicized application process and compliance system. Compliance requirements are well-defined and accessible. There is a well-informed staff of experts that are accessible and helpful.

The report states that the reason for the lack of access is not clear within the current level of analysis which leads to the logical question, "Is increased participation of minority CDEs a programmatic goal of NMTC?" Because it is not clear if increased access by minority CDE was part of the Congressional intent, it cannot be assumed that it was. The report focuses on successful or unsuccessful minority CDE awards. The more relevant question is "What is the status and nature of the investment in minority low-income communities, with minority-owned businesses, and/or affecting low-income residents?" The report has no analysis of the impact on minority neighborhoods by minority or non-minority CDE investment. In addition, because applicant organizations self select their minority status under the definitions provided, some CDEs may have significant focus on highly distressed minority neighborhoods or minority owned QALICBs and chose not to self select the minority CDE box.

It is Finance Fund's opinion that lack of Congressional intent, fair and unbiased program administration, and normative characteristics of low-income and/or minority communities result in award success that is systemic and has the same consequences regardless of CDE categorization.

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III. Conclusion

A. NMTC is a valuable tool in community revitalization of highly economically distressed communities.

B. It plays well with others; i.e. works well with a variety of public and private financing products.

C. It is well managed and reasonably accessible.

D. It is an open process as a result of the strategic positioning of the administrator.

E. Program shows significant impact with upward trends.

F. To more accurately assess the effect of the NMTC on minority communities, research should focus on investments in highly economically distressed low-income communities with specific emphasis on minority populations. Research should factor in the impact of the applicant self selecting minority status and non-minority CDEs that heavily invest in minority communities.

G. Yield driven investment, as it relates to transaction scale in highly distressed low-income communities, will not be affected by more award success by minority CDEs. It will be affected by programmatic recalibration making non-leveraged investment more attractive.

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Finance Fund

New Markets Tax Credit Projects
Central Ohio

Organization: King Lincoln Gateway LLC
Project Name: King Lincoln Gateway
Project City: Columbus
Funds Awarded: $2,500,000 New Markets Loan
Outcomes: Full-Time Jobs: 100, Temporary Jobs: 132; Commercial Square Footage: 54,000

Organization: W Ltd.
Project Name: Morse Heaton Complex
Project City: Columbus
Funds Awarded: $923,900 New Markets Loan
Outcomes: Full-Time Jobs: 40, Temporary Jobs: 53; Commercial Square Footage: 32,000

Organization: Whitney Young Collaborative
Project Name: Whitney Young Collaborative
Project City: Columbus
Funds Awarded: $3,000,000 New Markets Loan
Outcomes: Housing Units: 28, Full-Time Jobs: 45, Temporary Jobs: 60

Organization: Gay Street Condominiums, LLC
Project Name: Gay Street Condominiums
Project City: Columbus
Funds Awarded: $5,000,000 New Markets Loan
Outcomes: Housing Units: 256, Full-Time Jobs: 12, Temporary Jobs: 80; Commercial Square Footage: 192,000

Organization: Apex Realty Enterprises, LLC
Project Name: Urban Oasis (Ibiza)
Project City: Columbus
Funds Awarded: $4,800,000 New Markets Loan
Outcomes: Housing Units: 147, Full-Time Jobs: 125, Temporary Jobs: 165

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Finance Fund

New Markets Tax Credit Projects
Central Ohio

Organization: 1179 E. Main Street Redevelopment, LLC
Project Name: Heritage Square Redevelopment
Project City: Columbus
Funds Awarded: $1,079,770 New Markets Loan
Outcomes: Full-Time Jobs: 46, Temporary Jobs: 61; Commercial Square Footage: 18,873

Organization: Community Property Development Corporation
Project Name: St. Paul Wellness Center
Project City: Columbus
Funds Awarded: $2,272,070 New Markets Loan; $100,000 Economic Development; $500,000 Linked Deposit
Outcomes: Full-Time Jobs: 25, Temporary Jobs: 33; Commercial Square Footage: 16,075

Organization: Pomegranate Development Ltd.
Project Name: Pomegranate Health Systems
Project City: Columbus
Funds Awarded: $1,625,000 New Markets Loan
Outcomes: Full-Time Jobs: 150, Temporary Jobs: 198; Commercial Square Footage: 45,000

Organization: Silk Road International, Inc.
Project Name: Zen Cha Tea Salon
Project City: Columbus
Funds Awarded: $86,265 New Markets Loan
Outcomes: Full-Time Jobs: 10, Temporary Jobs: 13; Commercial Square Footage: 1,615

Organization: Spotlight Properties, Ltd.
Project Name: Spotlight Properties, Ltd.
Project City: Columbus
Funds Awarded: $1,004,250 New Markets Loan
Outcomes: Full-Time Jobs: 70, Part-Time Jobs: 20; Commercial Square Footage: 39,096

1.27.09

Finance Fund

New Markets Tax Credit Projects
Central Ohio

Organization: Christ Cathedral Church
Project Name: Christ Cathedral Church
Project City: Columbus
Funds Awarded: $438,780 New Markets Loan
Outcomes: Full-Time Jobs: 7, Temporary Jobs: 9; Commercial Square Footage: 23,474

Organization: Smith and High LLC
Project Name: Smith and High LLC
Project City: Columbus
Funds Awarded: $1,687,950 New Markets Loan
Outcomes: Full-Time Jobs: 25, Temporary Jobs: 33; Commercial Square Footage: 29,894

Organization: St. Joseph Montessori School
Project Name: St. Joseph Montessori School
Project City: Columbus
Funds Awarded: $2,000,000 New Markets Loan
Outcomes: Children Served: 300; Full-Time Jobs: 32, Part-Time Jobs: 18; Commercial Square Footage: 9,500

Organization: Faith Ministries, Inc.
Project Name: Faith Ministries Community Center
Project City: Columbus
Funds Awarded: $1,725,000 New Markets Loan
Outcomes: Full-Time Jobs: 10, Temporary Jobs: 13; Commercial Square Footage: 6,911; Children Served: 50

Organization: Greater Linden Development Corporation
Project Name: Point of Pride
Project City: Columbus
Funds Awarded: $75,000 Economic Development Grant; $1,985,028 New Markets Loan
Outcomes: Full-Time Jobs: 40; Commercial Square Footage: 21,014

1.27.09

Finance Fund

Heritage Square Marketplace

Save-a-Lot Grocery Store
1179 East Main Street
Columbus, Ohio 43205-1932

12th Congressional District

Distressed urban communities face many challenges, including access to affordable healthcare, childcare and housing. One often overlooked but equally important necessity is access to fresh, yet affordable groceries. Residents of the Near East Side of Columbus have been without a local grocery store since 2006.

Without access to an affordable grocery store, residents had no choice but to purchase groceries from convenience stores, which could cost nearly twice as much. As an alternative, many families arranged for taxis to grocery stores several miles away, ultimately increasing the overall price tag of their grocery shopping.

The Columbus Compact Corporation works to bring new retail goods and services to the Near East Side of Columbus. It hopes to bring more than 60,000 square feet of shopping and services, 200 jobs and $2 million in annual payroll to the neighborhood.

After several years of planning, Columbus Compact was ready to move forward with the first phase of its development plans—Heritage Square Marketplace, a shopping center in the heart of the east side of Columbus. Once all phases of the project are complete, the Heritage Square Marketplace will have cost an estimated $4.1 million and will have redeveloped 1.6 acres of land.

The first stage of this project included a Save-A-Lot grocery store and a Simply Fashions retail store. This involved the remediation of an abandoned gasoline station and Salvation Army store. Finance Fund was one of many partners who provided funding for this project. Through the New Market Loans program, they provided a substantial low-interest loan used for acquisition and construction.

In May 2008, the Near East Side enthusiastically welcomed the Save-A-Lot and Simply Fashions stores. Residents finally had a grocery store to call their own. Jonathon Beard, president of Columbus Compact Corporation, described the opening day as a "realization of a lot of people's wishes." Columbus Compact hopes to break ground on the second development phase by fall 2008.

Finance Fund provided:
- A **$1 million New Markets Loan**

The commercial development of Save-A-Lot and Simply Fashions resulted in **18,900 square feet of redeveloped space, provided 46 full- and part-time jobs**, and access to affordable groceries for a neighborhood of approximately 25,000 people.

It further enhances the commercial revitalization taking place along the E. Main strip coordinated by the Compact (which is the local administrator of the Columbus Empowerment Zone).

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Mr. WATT. Thank you, Mr. Chairman.

I reluctantly move that we not try to come back and hold these witnesses here. It will be two hours before we get through the votes and I think it would be more productive for us to just submit our questions in writing to the panelists. It would be probably more

productive for them and for us, so I move that we follow the rules. I mean, they would have to answer written questions any way, that we do all of the questioning by written question.

Chairman NEAL. Let me thank the panelists and apologize for the floor schedule today. This was not to be the case as of yesterday, but I do want to let you know that there will be some follow-up questions; and, if there are no further comments, then the hearing is adjourned.

Thank you.

[Whereupon, at 10:55 a.m., the subcommittees were adjourned.]

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