

# CAPITAL POLICY: THE IMPACT OF THE NEW MARKET TAX CREDITS IN THE INNER CITY<sup>1</sup>

## SUMMARY

- The New Markets Tax Credit (NMTC) program has been very successful at incentivizing investments to inner cities. From 2004 to 2008, inner cities received about \$6.1 billion from the program, about half of all NMTC dollars allocated.
- Most NMTC money deployed in the inner city is used for real-estate transactions. Only 9% of NMTC dollars are used to finance inner city businesses. While some aspects of the NMTC program favor real-estate projects over business investments, such as the seven-year term, structural factors do not fully explain the dominance of real-estate projects in inner cities.
- Anecdotal evidence suggests that the capacity and sophistication of local players such as lenders and Community Development Entities (CDEs) may be one determinant of the NMTC program's success in distressed communities.

---

<sup>1</sup> Summary developed from "Lynch, T. and Rho, L. (2011). Capital Availability in Inner Cities: What Role for Federal Policy?"

## Background

The New Markets Tax Credit program is designed to encourage investment in low-income areas by creating a 39% tax credit, taken over a seven-year period, for investments in qualifying projects. The program was inaugurated with bipartisan support in 2000, as part of that year's Community Renewal Tax Relief Act. Through the end of 2008, a total of \$25 billion in tax credits had been granted. In order to qualify for NMTC treatment, projects must meet a number of criteria designed to ensure that the tax credits benefit low-income areas. These criteria address the physical location of the project and its employees, the nature of the project and the length of the proposed investment.

## Analysis

Some 2,630 NMTC projects were launched between 2004 and 2008. Nearly half of those (42%) were located in the inner city. When measured by dollar amount, \$6.1 billion—half of the total dollars allocated—went to inner city projects.

Inner cities receive such a large share of NMTC funding partly because inner city projects are more likely to be real-estate related, and real-estate projects tend to be larger than business-related projects. The average real-estate project is \$6.3 million, while the average business-focused project is just \$2.7 million. In inner cities, 66% of projects are real-estate related, compared to just 42% of projects outside of metropolitan areas.

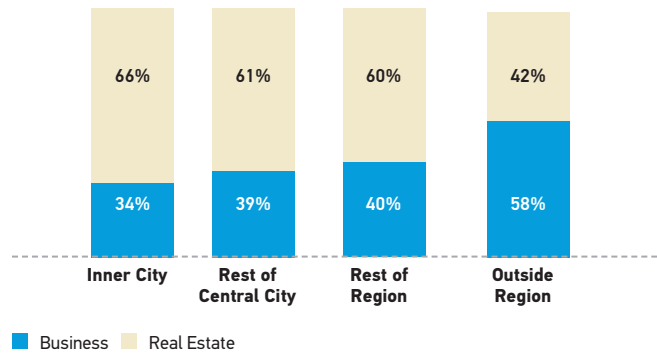
When measured by the dollar value, the impact of real-estate projects' greater size becomes apparent: In the inner city, 82% of NMTC investments are for real-estate projects, compared to 62% outside the major regions. The high transaction costs of NMTC projects may favor larger deals, which may help account for the preponderance of real-estate transactions across all geographies in the inner city.

## Scarcity of Business-Purpose Investments in the Inner City

Business-purpose investments, as a category, include projects, such as educational facilities (including charter schools), religious organizations and medical facilities, that are quite different from those typically undertaken by inner city entrepreneurs. Excluding these often-subsidized projects, the share of truly business-focused projects in the inner city falls to just 23%. The share of NMTC dollars allocated to them sinks to just 9%. While such projects provide

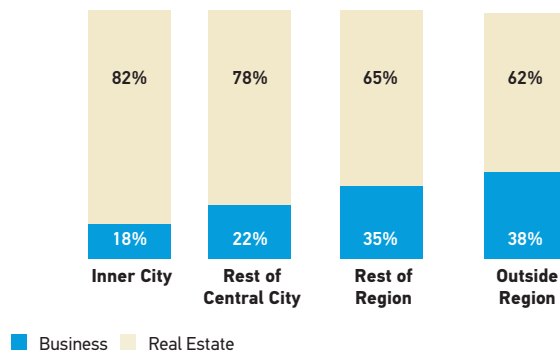
public-use facilities, which are often lacking in distressed urban communities, they are also criticized by some to not be the best use of the NMTC program because they do not create self-sustaining businesses that can generate permanent, living-wage jobs.

### NMTC PROJECT BREAKDOWN BY PURPOSE (BY NUMBER OF PROJECTS), 2004-2008



Source: Community Development Financial Institutions Transaction Level Report data; ICIC analysis • Note: Excludes "other investments"

### NMTC PROJECT BREAKDOWN BY PURPOSE (BY TOTAL INVESTMENT AMOUNT), 2004-2008



Source: Community Development Financial Institutions Transaction Level Report data; ICIC analysis • Note: Excludes "other investments"

One reason for the higher propensity toward real-estate transactions is the structure of the New Markets Tax Credit Program, according to a 2007 report from the U.S. Government Accountability Office. Since real-estate investments are by their nature fixed in location, investors consider them less likely to fall out of compliance with the program's restrictions on the location of the project. For example, if a business moves out of a Low-and-Moderate Income (LMI) community and into a more affluent area that is not approved for NMTC investments, it may fall out

---

of compliance and may trigger recapture of credits.<sup>2</sup> Additionally, it is often easier to pair real-estate projects with other federal, state and local tax incentives or historical tax credits.

This reasoning, however, does not fully explain why real-estate projects are more prevalent in inner cities than in other areas, especially because NMTC programs must meet identical criteria. There does not seem to be any particular reason that a business-purpose investment in the inner city would be more likely to fall out of compliance than a similar investment in a rural area. One explanation may be that some distressed urban areas consist of insufficient banking infrastructure – in particular, the lack of headquarters banking functions and the limited capacity of local branches – which effectively throttles the volume of leveraged and other complex NMTC transactions that can be completed in certain cities. Another is that expertise in revitalizing inner city areas is stronger in real estate than it is in business development, a legacy of strong federal commitments to housing in low-income areas. Finally, real-estate availability in distressed urban areas can be the bottleneck for attracting more business investment rather than real-estate investment.

## Recommendations

The NMTC program is effective in driving investment to low-income areas, with inner cities winning a substantial share of NMTC dollars. In inner cities, such investments are much more likely to go to real-estate development projects than to business projects. We support a number of recommendations that have been presented to increase the use of NMTC for business purposes, such as allowing shorter-term (less-than-seven-year) investments, instituting changes in the allocation process to steer Community Development Entities (CDEs) toward business investments and even separating the NMTC application pools between real estate and business.<sup>3</sup>

---

<sup>2</sup> The <http://www.frbsf.org/publications/community/wpapers/2008/wp08-04.pdf>

<sup>3</sup> Lauren Lambie-Hanson. "Addressing the Prevalence of Real Estate Investments in the NMTC Program" Fall 2008.

---

**ICIC'S MISSION** IS TO DRIVE ECONOMIC PROSPERITY IN AMERICA'S INNER CITIES THROUGH PRIVATE SECTOR INVESTMENT TO CREATE JOBS, INCOME AND WEALTH FOR LOCAL RESIDENTS.

---



**ICIC**

Initiative for a Competitive Inner City

200 High Street, Third Floor ■ Boston, MA 02110 ■ [www.icic.org](http://www.icic.org) ■ [twitter:@icic.org](https://twitter.com/icic.org)