CCML CEI CAPITAL MANAGEMENT LLC

Mr. Matthew Josephs
Manager, NMTC Program
CDFI Fund
601 13th St. NW, Suite 200 South
Washington, D.C. 20005

October 2, 2009

Dear Mr. Josephs:

Coastal Enterprises, Inc (CEI) and its designated New Markets subsidiary CEI Capital Management LLC (CCML), collectively referred to herein as CEI, are writing in response to the CDFI Fund's ("the Fund" August 3, 2009 request for public comment on the New Markets Tax Credit (NMTC) application.

Coastal Enterprises, Inc. (CEI) is a 501c3 private non-profit community development corporation (CDC) and community development finance institution (CDFI). 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 provides financing and technical assistance to small, medium and micro enterprises, natural resource ventures in the farm, fish and forest sectors, community facilities such as health and child care, and affordable housing. CEI also engages in state and federal policy research and development fostering policies that create resources for the CDC/CDFI field and promote triple bottom line investing practices that combine financial returns with social and environmental benefits.

One of the nation's leading rural CDC/CDFIs, CEI creates assets for people with low-incomes, while benefiting the wider economy and residents of the communities in which it operates. CEI's development philosophy is based on strategically combining the market interventions of finance, development assistance and policy for social and environmental benefit. Since inception in 1977, CEI has provided over $460.7 million in financing to 1,989 enterprises with 23,266 jobs; created/preserved 1,261 units of affordable housing; provided training and counseling to 29,931 individuals and small businesses; created/preserved 4599 child care slots; and provided leadership on a range of policy initiatives, including one of the nation's most stringent laws regarding predatory mortgage lending. Overall, CEI has mobilized and leveraged $1.8 billion in private and public capital.

CEI was awarded $481 million of investment capacity under Rounds I, II, IV, V and VI of the NMTC program. As of this date, CEI has utilized $323 million of this capacity in 32 projects triggering total private capital investment of over $929.9 million that directly supports the intent of the NMTC program to invest capital in low-income communities and meets CEI's triple bottom-line or "3E" criteria: Economic progress, social Equity, and Environmental sustainability. CEI has a national service area under the NMTC program and is known for its focus on rural areas.

CEI is also a founding member of the NMTC Coalition which is a national membership organization that advocates on behalf of the NMTC Program. The Coalition membership includes Community

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Development Entities (CDEs), investors, and other community development professionals using the NMTC to revitalize distressed urban neighborhoods and rural areas.

We appreciate the opportunity to respond to the CDFI Fund's request for comment on the NMTC application. Our comments focus on specific questions posed in the "Notice and Request for Comments as published in the Federal Register (Vol. 74, No. 147, August 3, 2009) which concern CEI as a mission-based, rurally focused applicant for Allocation. CEI has also contributed suggestions to the comments being submitted by the NMTC Coalition and the Opportunity Finance Network (OFN). CEI supports the NMTC Coalition and OFN comments which represent the general concerns of the membership of those two groups.

The Fund requests comments on the following matters (numbered questions are excerpted for brevity):

1. Whether the collection of information required by the application is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility.

CEI believes that the Fund is generally collecting the right kind of information and that such information is necessary to evaluate the relative strengths of applicants, including the value and impact of their proposed business strategy, expectations for community impacts, management competence and capitalization strategies. We do not believe the application is overly burdensome. While common base level data should continue be collected and accumulated to allow trend analysis, the practice of relying on individual applicants to provide their own detailed descriptions of how they have created impact should continue.

2. Are the thresholds contained in Question 17 of the Application appropriate given current economic conditions…..?

CEI believes these thresholds are appropriate. For example, capital markets have changed dramatically in the past two years. A range that was 50% below market two years ago may be less than or greater than that now for a given capital market segment such as mezzanine capital or first position commercial debt. This points to the need for allocatees to have flexibility in determining the true level of risk in a given transaction and the appropriate funding sources for market comparisons for any given transaction. A simple basis point reduction below a comparable market rate would be less meaningful in a high rate environment, but could be impossible to meet in a very low rate environment. Having a combination of below market interest rates with additional indicia for flexible terms and conditions as currently described in the application is appropriate.

The question analysis may be made more robust by asking applicants to better define how they determine and document "market" rates. There is, by necessity, some extrapolation or estimation. Assuming the "but for" test is being met, NMTC projects have a different risk profile versus "market projects" that have access to over the counter "market " financing.

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3. This question ties to "related parties" within the meaning of I.R.C. section 267 (b) or 707 (b)(1). The Fund poses the question about timing relative to when a Qualified Equity Investment (QEI) is made into a Community Development Entity (CDE). Currently the Fund makes its related party tests after the QEI is made into the CDE.

As noted in the response provided by the NMTC Coalition: "The statute authorizes the Secretary to give priority to any applicant ''(B) which intends to satisfy the requirement under subsection (b)(1)(B) by making qualified low-income community investments in 1 or more businesses in which persons unrelated to such entity (within the meaning of section 267(b) or 707(b)(1)) hold the majority equity interest."" CEI suggests that the Fund approach this test in two ways:

- 1) test prior to the QEI for the tax credit equity investor; and

- 2) apply the test in such a way that regardless of the ownership interests in the CDE after the QEI has occurred, the tax credit equity investor is not a majority owner of the Qualified Active Low Income Community Business (QALICB) that receives a Qualified Low Income Community Investment (QLICI) from the CDE.

This two-pronged test meets the intent of the code as we understand it, which is to avoid having tax credit investors receive credits while simultaneously taking advantage of the lower cost of funding into a project for which they also own a majority interest. This change effectively looks past the CDE to the QALICB benefitting from the NMTC funding. It does this by connecting the relationship between the tax credit investor and QALICB. It is particularly relevant to the so called "leveraged structure" where a tax-credit investor is clearly isolated from the leveraged loan components of the transaction. For example, CEI has participated in several leveraged transactions where developer loans were used to help provide gap financing. These were very important as subordinate loans to an upper tier investment fund. This capital was junior in position to third party senior leveraged debt and the sources were completely unrelated to the tax credit investor funding. However, this created significant structuring issues once the QEI was made into a CDE which then made QLICIs into a QALICB. In these cases the sources of the developer loans by definition also had some level of ownership interest in the QALICB. In these cases the tax credit investor had no ownership interest in the QALICB and simply received tax credit benefits. However, the developer loans had to be carefully structured to avoid taking any additional interest in the CDE or QALICB via the QLICIs. This structuring which included management around "true debt" measures and third party subsidiaries adds significant cost to the transaction and discourages additional private capital investment which can be critical to filling a capital gap that senior leveraged lenders are unable or unwilling to fill. For example, one aspect of the structuring demanded by these constraints and the IRS requirements that all QLICI debt be "bone fide" debt is to reduce the flexibility to make equity QLICI investments in projects.

We believe these changes would eliminate a substantial barrier to CDEs interested in making venture capital investments in QALICBs, as it would be a test between the QALICB and the tax credit investor, not the CDE. The current "related parties" test also creates problems for CDEs that combine the NMTC and the federal historic tax credit (HTC) which can put HTC credits at risk. CDEs looking to use the two credits together will often use a pass through lease structure that enables the QALICB to pass through the historic tax credits to its tenant rather than its owners. This structure generally requires that the CDE own 100% of the "master tenant entity" which leases the property from the QALICB. Again, since the test would look to the relationship of the investor and the QALICB, such master lease arrangements would not be affected.

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We are supportive of the Coalition's suggestion and current efforts to convene a roundtable of practitioners to help better define the problem and seek satisfactory resolution.

4. Whether the Fund should make changes in how it collects data for and measures economic and community impacts… and whether more or less emphasis should be put on community development outcomes;

Since the NMTC program's inception, it has become increasingly clear that NMTC transactions allow for a great deal of flexibility in the types of economic and community benefits they can provide. Virtually every project that CEI has completed has had unique features and benefits. For example, in two recent expansions of operating businesses resulted in permanent job creation opportunities and the introduction of job-training for local immigrants and extremely low-skilled workers building on CEI's experience in creating community partnerships with social service entities. The training will be offered both to potential employees of these two companies and to the broader communities as a whole, extending the impacts beyond the projects themselves. A flexible application supports a more nuanced and essential description of how impacts are achieved.

CEI supports the collection of jobs data but strongly urges the Fund to continue to allow the text explanations provided for under Question 30. Job creation in knowledge-based economies remains vitally important, but it is not the only measure of successful community impacts. The intent of the program is best served by tailoring projects to meet specific community needs. This community component has the potential to have the greatest impact on individuals' lives and seems consistent with the policy goals of the program. CEI considers building community as a core part of its mission and as an essential part of the program.

It should also be noted that CEI now typically uses third-party generated IMPLAN© analyses for its projects to better understand direct and indirect econometrics. As these data are collected for multiple projects over time, a clearer picture of these impacts will be developed and should help us enhance impact prediction capabilities.

5. Whether Question 56 and Table F1 of the current application captures all sources of compensation and profits that the applicant and its affiliates receive in connection with NMTC transactions and whether fees should be included in the Allocation Agreement;

CEI discloses its typical fee structure in detail through its written responses to Question 56. However, CEI's NMTC subsidiary (CCML) was created solely to build the specialized capacity needed to support NMTC transaction, compliance, and asset management work. CEI/CCML is not a traditional bank in any sense and does not have significant internal capital sources to fund either leveraged debt or tax credit investments. CEI has developed a robust and diverse network of third party capital sources to fund its NMTC transactions. Unlike a bank, CEI has no deposit base and no ability to offset business development and operating costs by using a "spread" between its internal cost of funds and the interest or dividends charged for loans or investments made through an NMTC structure. CEI is not alone; more than 50% of NMTC allocatees are non-banks. Those that are banks, typically have large corporate infrastructures with dispersed overhead costs and the ability to recoup transaction and monitoring costs by lending money into transactions at a rate that is greater than their cost of funds (typically a spread of 4% or more). This creates annual earnings on those funds which are normal in the banking industry, but almost

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never exist for CEI and the majority of other CDFI's who have received awards. CEI believes that the different earnings abilities stemming from the varying nature of allocatees needs to be recognized. CEI uses the application to describe its fee structure and its uses in detail. However, CEI asks that the Fund take the bank or non-bank structures into account when comparing fee structures among allocatees. CEI suggests the Fund ask application readers to educate themselves and become aware of differences between depository institutions and CDFI's, especially in relation to revenue sources. It may make sense to divide the question respondents along the lines of internally funded (banks) and externally funded CDE's.

CEI does not think stated fee structures, as shown in Table F1, should be made hard and fast through inclusion in the Allocation Agreement, since the contents of applications are considered part of the Allocation Agreement. However, allowing CDE's some flexibility on a transaction by transaction basis can be important to the success of a specific deal. For example, CEI has reduced standard fees for nonprofit projects to help cash flow, or redirected additional fees earned in other deals to our "working partners", i.e., local CDFI's working in a project's community, or used fees to fund regional revolving loan programs as an added community benefit.

CEI believes in an equitable sharing of NMTC benefits amongst community organizations, working partners, entrepreneurs and developers etc. (the market sets the investor's "share") – not just CDE and developer. Each deal is different and CEI strives to tailor benefits streams – providing incremental program benefits to low-income communities (LICs). A "hard wired" fee structure would hamstring CEI. There should be clear reporting / disclosure of benefits by category, for example by:

(i) CDE / allocatees
(ii) Other LIC focused not-for profit enterprises
(iii) Community or local businesses
(iv) LIC individuals

6. Whether, when looking at a prior applicant's use of previous allocations, the QEI issuance test should be replaced with data on the transactions completed;

CEI agrees with the current and past recommendations made by the NMTC Coalition that the Fund change the QEI issuance test to a test based on the dollar amount of QLICIs deployed by the CDE rather than the amount of QEIs issued by the CDE. Thus, data on transactions which have commenced the development and construction process, as well as those which are completed would be collected. CEI believes that measuring the amount of cash that a CDE has been able to deploy is a stronger barometer of success than the CDE's ability to secure investors. Recasting the test would also create a level playing field for CDEs that are affiliated with an investor and those like CEI that are not. For example, banks or others with affiliated investors (or internal funding sources) can self issue QEIs just to meet the CDFI threshold even if they have not yet identified a QLICI.

7. Whether the Fund should consider much larger awards, for example $250 million, in return for an agreement an applicant would not apply again for some period of time;

CEI has been successful both in receiving significant awards and in deploying them in a timely manner. From a solid business planning perspective, a larger multi-year award would be very beneficial to allocatees by allowing the CDE to manage staffing and allocation placement

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strategies more efficiently. It would encourage capital investments in building high-performance NMTC organizations by eliminating the risk from the annual allocation application process while still keeping CDEs strongly incented to place as much of any prior allocation awards as quickly as possible in order to qualify for future awards.

We recommend that the Fund use a pilot program to test either the feasibility of a three-year award of $300 million or a two-year award of up to $250 million. In either case, the multi-year awardees should be able to apply for additional allocation the year prior to the termination of the multi-year award. This will allow continuity of allocation, assuming the applicant is deserving and successful in applying.

Among the many details to be considered with a pilot program would be the cost to the CDE of making an application and an allowance for those applicants seeking multi-year awards to be eligible to reapply the next year if they were refused an award or the allocation awarded was equal to or less than the award cap set for single-year applicants.

8. What steps the Fund should take to increase the number of minority CDEs applying for and receiving the Credit, based on the recent GAO report;

As provided in its testimony to Congress earlier this year, CEI recommends that a technical assistance (TA) program aimed at building the capacity of small and emerging minority CDEs be developed in order to prepare these organizations to successfully compete for Credits directly and/or participate in the NMTC program with other CDE partners. CEI is not advocating for a program that would simply assist a minority CDE to write a competitive and compelling application. Rather, CEI is recommending the establishment of a TA program that offers intensive and comprehensive assistance to minority CDEs, and or minority owned or controlled community based organizations that are looking to become CDEs

Technical assistance could include training on raising and managing capital from private sector sources, building a track record of lending and investing in NMTC eligible communities, planning, implementing and managing a lending and investment program financed through the Credit, and measuring impacts across a range of projects. This type of training could be carried out through customized curriculum and/or one-on-one technical assistance. Technical assistance could include assessments of minority CDEs, identification of capacities to be strengthen, and customized business plans, all leading to the development of NMTC business strategies. Both previously unsuccessful minority CDE applicants as well as those new ones could participate. A recent Government Accountability Office (GAO) report notes that success is more likely the more often an organization applies, increasing to 90% if an applicant applies four times.

Further, CEI recommends that the technical assistance not just be limited to minority CDEs but be expanded to include small and emerging community based organizations that either have formed or are interested in forming a CDE to compete for NMTC allocation. Establishing a technical assistance program designed to build the capacity of small and emerging CDEs working to bring capital to low income communities will help to develop and maintain a strong and diverse network of community based organizations that can put the NMTC to work in highly distressed communities.

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9. Whether there are steps the Fund could take to diversify the uses of the credit to a broader set of investments, such as small business lending, loan purchases, investments in other CDEs, including CDFIs, and so forth; and

CEI would like to be able to use the program more effectively with small businesses. It has developed NMTC loan pools for that purpose. However, there are challenges to deploying the pool given the burden and uncertainties put on small businesses to refinance nearly the full amount of the funding after seven-years. This challenge stems mostly from the requirement that "substantially all" of the Qualified Equity Investment (QEI) made to a CDE be placed in a QALICB and remain in that QALICB for the full seven year NMTC tax compliance period. In general, as prescribed in Section 45D of the Internal Revenue Code, "substantially all" is defined as 85% of the QEI. This means that, at an absolute minimum, 85% of the funds must flow to the QALICB and remain there for the compliance period. Interest can be paid by the QALICB during this period, but none of the corpus of the investment can be returned in an amount greater than 15% (except for an additional 5% loan loss reserve), and even then only to the CDE and not the investors. The substantially all requirement is a valuable tool for insuring that the distressed community truly benefits from the influx of capital for the full compliance period in which the investor is benefitting from the tax credits. However, this inability to amortize the original loan or investment creates significant risk to investors and lenders who will seek a return of at least a portion of this capital at the end of the compliance period. It creates uncertainty for the borrower in difficult capital markets where there is no assurance of finding refinancing after the seven-year period.

As a practical matter, this is the reason why most NMTC transactions are real estate based: the real estate collateral is more likely to hold value and not diminish over time like equipment that depreciates or working capital that is supported by current assets. So while smaller transaction sizes may benefit small businesses seeking real estate loans, the majority of those seeking equipment and working capital will not benefit. Therefore as a means to stimulate more small business lending to businesses in highly distressed communities, CEI is suggesting the following limited change to the substantially all rule for NMTC:

> *Allow amortization of QLICI principal back to the CDE of up to $750,000 (in aggregate for all QLICIs made to any single QALICB) or 15%, whichever is greater, with minimum amortization schedules of seven years or greater.*

This allowance of amortization for small transactions would allow risk mitigation by formation of reserves at the CDE level that can collateralize funding of certain equipment or working capital. Mathematically, this change would still require all QLICIs greater than $5,000,000 to conform to the existing 15% cap at all times and no QLICIs greater than $750,000 would be fully amortized at the end of the seven-year compliance period. This type of amortization allowance for smaller transactions would address the challenge but limit its impact to small businesses. It would make equipment and working capital funding on smaller transactions less risky for lenders and allow more application to small business needs for permanent working capital and equipment than is possible now. Reducing repayment risk will generate more deals in this economic environment than otherwise. There is precedent for this in the existing code which allows NMTC funding for farming when assets are below $500,000 but not for large farm projects with assets greater than $500,000. In this example, the authors clearly gave consideration to smaller businesses.

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CEI believes this suggestion maintains the spirit of the program as a whole by limiting amortization greater than 15% to relatively small transactions and the portion of the program that now accounts for less than a quarter of its overall volume. However, as a further limit on this change, consideration could be given to requiring that this mechanism only be used on the "leveraged loan" portion of leveraged transactions to assure that absolutely none of the NMTC equity is amortized. One could then show that the original subsidy generated by the tax credit remained in the business for the full compliance period. This would eliminate any concern that the subsidy itself was being de-risked in this process.

10. Whether there are other sources of data, that is more current than the decennial census, that the Fund should use to verify what census tracts are "severely" distressed.

CEI is strongly supports utilizing more current sources of census data to identify qualifying census tracts. This could include Department of Labor data from federal, state and tribal sources which has been vetted by the agency and are part of regular reporting mechanisms available to the general public. This will be very important to most allocatees given the changes in the economy over the last two years. It is especially important to rural areas that are highly dependent on a single industry, such as Maine communities that rely heavily on the paper-making industry. In the last six years, three towns have faced the shutdown of a paper mill that was the major employer. Unemployment rates quickly rose to exceed the national average because there were no alternative sources of employment, and the declining mill payroll adversely affected the service sector as spending on cars, food and other services came to an abrupt halt. However, because decennial census data from 2000 was the benchmark required in the NMTC program, the current unemployment rates could not be used as a measure of higher distress.

In addition to the questions posed above by the CDFI Fund, CEI offers the following additional suggested changes to the NMTC program. We are aware that it is outside of the scope of the application but feel strongly that it should be considered and wish to use this forum to reiterate our concern to the Fund:

The "county-based" definition used to define metropolitan and non-metropolitan census tracts established in the enabling legislation as amended in 2006 is extremely flawed. It should be revised to provide a more rational approach to selecting non-metropolitan (also referred to in the industry as "rural") areas.

The current definition used by the program is based on the Office of Management and Budget (OMB) rural/urban definitions which are based on metropolitan statistical areas (MSA). An MSA includes one or more counties containing a core urban area of 50,000 or more people, together with any adjacent counties that have a high degree of social and economic integration (as measured by commuting to work) with the urban core. OMB does not specifically use the term rural, but typically its non-metropolitan categorizations are used as proxies for rural areas. Therefore micropolitan statistical areas defined as urban areas with at least 10,000 but no more than 50,000 people or non-classified areas (those with less than 10,000 people) are often used to map "rural areas" using the OMB definitions.

CEI and other rural CDEs have identified several specific problems they have encountered making this definition work. The purpose of the 2006 amendment was to better target NMTC assistance to rural populations in small towns and farming communities. Information for the

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Economic Research Service (ERS) indicates that over half of rural residents live in metro counties, yet the operative definition now required for NMTC is the county-based OMB methodology noted above. This hurts the ability to target NMTC benefits to many rural people. A prominent example of this problem is Millinocket, Maine located in Penobscot County. This paper mill is located within the seven million acre industrial forest of Northern Maine. Yet, because Millinocket is located in Penobscot county where Bangor, Maine's second largest city, is, Millinocket is classified as metropolitan even though with a population of 5,200 people, it is extremely rural and is 86 miles away from Bangor.

CEI recommends the use of the U.S. Department of Agriculture's (USDA) more rational approach to defining rural tracts which under its Economic Research Service (ERS) has developed a multi-factor definition using OMB data called Rural-Urban Commuting Area Codes or RUCA. Measures of population density, urbanization, and daily commuting are used to identify metropolitan, micropolitan, and small-town urban cores, adjacent tracts that are economically integrated with those cores, and outlying rural tracts. The use of census tracts instead of counties provides a different, more robust, and more detailed geographic pattern snapshot that ties much more closely to how NMTC defines distressed low-income communities.

Thank you for this opportunity to provide input based on our direct experience with the program. CEI remains available at any time to follow-up with additional explanations or to answer any specific questions you may have.

Sincerely,

Charles J. Spies III
Senior Vice President, Coastal Enterprises, Inc.
Managing Director, CEI Capital Management LLC

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