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September 29, 2009

Matthew Josephs
NMTC Program Manager
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 13th Street, NW, Suite 200 South
Washington DC 20005

Re: Notice and Request for Public Comment - New Markets Tax Credit Program Allocation Application

Dear Mr. Josephs:

The National Trust Community Investment Corporation ("NTCIC") respectfully submits to the CDFI Fund ("the Fund") its request for public comments on the FY 2009 New Markets Tax Credit Program ("NMTC") Allocation Application ("NMTC Application"). NTCIC has been fortunate enough to be granted $280 million in NMTC allocation authority since Round 1 of the NMTC Program, and the proceeds of the qualified equity investments ("QEIs") have been used to make equity investments and low-interest loans to real estate qualified activity low-income community businesses ("QALICBs") that rehab strategic commercial properties for uses that meet locally identified low-income community ("LIC") needs. The subsidy value of these loans and investments has been augmented by combining the 39% NMTC, the 20% federal rehab tax credit (RTC) and the applicable state RTC.

NTCIC understands that the CDFI Fund may not be able to implement each suggestion into the 2010 NMTC Application. However, we would like for the Fund to give higher priority and programmatic consideration to the comments on related party transactions (Question #3), NMTC fee structures (Question #3), and flexible financing criteria (Question #2).

NTCIC's responses to questions posed by the CDFI Fund follow below:

Question #1: Is the information that is currently collected by the Application necessary and appropriate for the Fund to consider for the purpose of making award decisions? Please consider each question and table in the Application. Are there questions or tables that are redundant and/or unnecessary? Should additional questions or tables be added to ensure collection of more relevant information?

Question #1 Response: NTCIC has submitted NMTC Applications for Rounds 1, 3, and 4-7. The quality of the applications has improved considerably over the years and we applaud the Fund for its efforts in this regard. We offer the following suggestions for the Round 7 questions:

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1. Applicant Information
    a. Question 10 (Geographic areas): For CDEs that have a National service area, it is unclear why it must identify the 7 states with the largest amount of projected activities. At the time of application submission, a CDE may select the 7 states as a priority due to its current pipeline. However, geographic distribution may change as a result of project due diligence, a CDE's best efforts to close deals in a timely manner to meet QEI and QLICI deadlines, or in response to changing investor underwriting requirements. For these reasons, we believe the CDFI Fund has wisely excluded these priority states from the Allocation Agreement. We wonder however, whether the publication of these priority states for National CDEs may set up unrealistic expectations in those states or in Congress as to where National CDE allocations will be invested.

2. Business Strategy
    a. Question 16 (Flexible or non-traditional product offerings): For those CDEs that offer multiple product types and/or leverage transactions, it is difficult to accurately describe the underwriting criteria for each product type given the 2,000 character limits. NTCIC suggests that the sub-questions be reformatted to answer the question by product type. For example, a CDE would first choose its business loan products and then answer the applicable flexible underwriting standards relative to that product type. Then it will choose its next product type, and choose the relative flexible financing criteria.

    b. Question 25(c)(Non-Metropolitan Counties): A response to this sub-question should only be required if the CDE plans to invest at least 10% of QLICIs in non-metro counties. If the CDE does not have the capacity to focus a sizeable percentage of its portfolio and efforts to rural areas, then this question is not material or relevant.

3. Community Impact
    a. Question 30 (Targeted impacts): For CDEs that select several of the targeted impacts, the methodology and assumptions used to derive the projections are often the same. The CDE is therefore entering duplicative responses for each targeted impact, which is of no added value to the reader. We suggest that some of the data be in a chart format, and include a summary question of how the methodology and assumptions are derived. This would give the reviewer a better visualization of the community development impacts of the investment.

4. Management Capacity
    a. Tables D1 - D4: NTCIC suggests that the CDFI Fund consider consolidating these tables because the data entered is highly duplicative. An expanded table might list each staff person and their respective duties and responsibilities relating to experience deploying capital, raising capital, asset/risk management, and program compliance experience. A consolidated table would be easier to review during the Reader's Meeting.

    b. Question 44(b) (Allocatee justification for additional Allocation): This question is redundant with question 19(b). Both questions focus on the historical track record of financing QLICIs.

5. Capitalization Strategy

a. Question 49 (Using QEI leverage structure): The CDFI Fund should be more clearer whether it wants the CDE to describe the projects in its pipeline that will involve a leverage structure, or if it simply wants it to describe a typical project involving leverage. Also, the character limits for this question should be increased, especially if the Fund wants a description of deals in a pipeline. Each project may include a different leverage structure, investor, sources of capital, and the % of equity vs. non-equity. Even one typical leverage structure is difficult to describe in only 2,000 characters.

Question #2: Are the thresholds contained in Question 17 of the Application appropriate, given current economic conditions? If not, what should the criteria include? Should the Fund provide a range of flexible product commitments based on a discount of interest rates below market as defined by basis point reductions (or other product flexibilities) or continue to present commitment options in percentage terms?

Question #2 Response: Given the current economic environment, the thresholds contained in Question 17 could be improved. Due to the low-interest rate environment, it is difficult to benchmark interest rates based on percent reductions. Instead of focusing on interest rates at a certain percentage below market, NTCIC suggests that it should be based on basis point reductions. Due to today's difficulties obtaining credit, and the higher return requirements of investors in the market, it is imperative that CDEs are able to more precisely price its debt products and achieve a realistic spread. In addition to higher costs of capital, CDEs' underwriting criteria have become more stringent in an effort to mitigate risks. Given all of these market factors, a CDE may not be able to offer as wide a range of the flexible financing indicia, especially in the cases whereby the QEI investor is not the leverage lender.

Therefore, for question 17, we suggest that a CDE should score "excellent" if the blended rates are 100 bps below market and offers at least 4 indicia of flexible or non-traditional rates and terms (sub-question "a"); "good" at 75 bps below and offers at least 3 indicia of flexible or non-traditional rates and terms (sub-question "b") ; "average" at 50 bps below and offers at least 2 indicia of flexible or non-traditional rates and terms (sub-question "c") ; and "below" average at 25 bps below market and offers at least 1 indicia of flexible or non-traditional rates and terms (sub-question "d").

Question #3: A CDE is entitled to earn five "priority points" for committing to invest substantially all of its QEI proceeds in businesses in which persons unrelated to the CDE hold the majority equity interest (within the meaning of I.R.C. section 267(b) or 707(b)(1)). With respect to the timing of this test, the CDFI Fund has determined that it is to be applied after the initial investment is made, and for the life of the seven-year compliance period (though an exception is permitted if events unforeseen at the time of the initial investment cause the CDE to have to subsequently take a controlling interest in the business). Is it appropriate that this test is applied after the investment is made, or should the CDFI consider applying this test before the investment is made? If the test is to be applied before the investment is made, then how should the Fund treat circumstances whereby the receipt of the QEI and the investment in the business is essentially a simultaneous transaction, particularly when the CDE may not have any owners identified prior to the QEI closing?

Question #3 Response: In regard to making NMTC allocations, IRS §45D(f)(2) states that the, "Secretary shall give priority to any entity - (A) with a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities, or (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." The CDFI Fund's programmatic interpretation of the statute is that an Applicant may only earn the 5 priority points if persons Unrelated to the CDE will hold a majority equity interest in the business **after** the CDE makes a QLICI in the business. Due to the fact that the test is applied **after** the CDE makes a QLICI in the QALICB, CDEs are forced to structure their investments as debt instead of equity in order to ensure that it does not have a 50% interest in either the capital or the profits of the qualified business after the transaction closes. This approach is counter to the original intent of the NMTC Program, which is to provide access to affordable equity capital, not debt, to low-income communities and to QALICBs. The related party test requires QALICBs participating in leveraged transactions to take on more debt than the project can support and precludes exit strategies for the investor that would leave more NMTC value with the low-income business. In an effort to mitigate these impacts of the related party test, QALICBs typically spend hundreds of thousands of dollars in legal and accounting fees.

Therefore, NTCIC recommends that the CDFI Fund apply the related party test **before** the investment in the QALICB. This position is based on the following:

1. Transactional Costs – NMTC investments are not cookie cutter transactions, and hence involve intricate legal structures and underwriting. This complexity is due in part to the reliance on legal professionals and tax accountants to ensure that there are no related party concerns or to structure around related party problems that exist. The additional closing costs associated with structuring these investments to meet the related party test are substantial and must be absorbed by the investor, CDE, and/or QALICB. These costs plus typically high CDE fees make these transactions unattractive to the developer because such a small percentage of the NMTC value stays with the QALICB.

2. True Debt Analysis – As a result of the related party test, QALICBs--especially those sponsored by nonprofit entities that raise substantial grants and donations--must assume more debt than originally intended. By forcing more debt into the deal, it causes issues for the true debt analysis. "True debt" is debt that the borrower (i.e., QALICB) has a *contractual obligation* to repay as well as the *ability* to repay. Debt that fails to meet this definition cannot earn the NMTC. In making the determination if a QLICI is indeed true debt, the analysis must based on the following considerations:

    - whether there is an unconditional promise on the part of the QALICB to pay a fixed sum on demand or at a fixed maturity date that is in the reasonable foreseeable future,
    - whether the CDE has the right to enforce the payment of principal and interest,
    - whether the CDE's rights are subordinate to rights of general creditors,
    - whether the instruments give the CDE the right to participate in the management of the QALICB,
    - whether the QALICB is thinly capitalized,
    - whether the stockholders or partners of the CDE are related to the QALICB's owners,
    - the label placed upon the instrument by the parties, and
    - whether the instrument is intended to be treated as debt or equity for non-tax purposes, including regulatory, rating agency, or financial accounting purposes.

    For investments in nonprofit sponsored deals and financing for community facilities, the ability to meet the true debt test poses a special challenge. Specifically, the nonprofit sponsors may be thinly capitalized, and demonstrating that (1) the value of the property owned by the QALICB exceeds the amount of the secured debt and (2) that the QLICI loan can be repaid at maturity typically present issues for meeting the true debt analysis.

If it is determined that the loan does not represent true debt and the investment is not a QLICI, then the loan amount will not be considered for purposes of the substantially-all requirement under IRC §45D(b)(1)(B), and could pose a recapture event.

On a more practical level, it is painful to watch nonprofit-sponsored QALICBs participating in a leveraged transaction convert grants and donations that they have struggled to raise to unnecessary loans to meet the related party test. These loans generate unnecessary interest payments--debt service that can be paid by escrowing part of the value generated by NTMCs. These additional economic pressures on nonprofit transactions increase the potential for project default.

3. Exit Strategy – It makes sense for CDEs to leave as much of the NMTC value with the QALICB at the end of the compliance period. This allows the CDE to pass on the benefits of the NMTC to the QALICB. Absent the related party test, a CDE could structure a loan as convertible debt, essentially converting debt to equity at the end of the compliance period. However, if this debt is converted to equity before the end of the compliance period, the QLICI would most likely violate the related party test if the equity is in excess of 50%. Also, if the debt is forgiven, rather than converted to equity, the QALICB is subject to IRC §§ 61(a)(12), 108, and 1017, which specifically includes the discharge of indebtedness as taxable income. This results in an unforeseen tax burden to the members of the QALICB which significantly reduces the value of the original NMTC subsidy.

Question #4: The Application currently collects outcome information on the applicant's historic community impacts and projected economic development impacts in Table C1 and Table C2, respectively, and collects information on projected community development impacts in Question 30. Are there changes that should be made in the way projected economic development is currently measured? Are there other outcomes/impacts for which the Fund should be collecting information to ensure effective use of the NMTC? Should the Fund have a greater focus on community development outcomes impacts? Alternatively, should the Fund focus exclusively on economic development outcomes/impacts?

Question #4 Response: NTCIC believes that the Fund should have a greater focus on community development outcomes/impacts. This makes sense due to the fact that the majority of the QLICIs are for commercial real estate projects, which have substantial community development benefit. We agree that job creation, total developed or rehabilitated space, and clients served are appropriate measures of economic development outcomes/impacts; however, without measures of community development impact, the real estate CDE is unable to provide a complete portrayal of the demonstrable impact of its investments in Tables C1 and C2. Even though the CDE can discuss other impacts in narrative form in the Community Impact section, it is not conveyed as well to the reviewer. Therefore, we suggest that Tables C1 and C2 get expanded to include some of the following data on historic and projected financing:

- minority- and women-owned businesses
- community facilities - including charter schools, health care facilities, libraries, and museums
- commercial real estate – including office, retail, and other types of space
- nonprofits – including those that offer social services, health care, wealth/asset building, and educational initiatives
- affordable housing – including first-time homebuyers and foreclosure prevention counseling

Question 32 requires the CDE to discuss the catalytic impacts of its investments. The question should be more targeted, and require the CDE to identify specifically the number of adjacent development that has been completed or underway by unrelated entities, the jobs created, types of services provided and impact on the municipal tax base. The CDE should be required to survey the developers of this catalytic activity in order established clear cause and effect.

Question #5: Do Question 56 and Table F1 of the Application capture all sources of compensation and profits that the applicant and its affiliates receive in connection with NMTC transactions? How can collection of this information be improved? How should the Fund use this information? For example, should the Fund make the applicant's stated fees a specific condition of the Allocation Agreement, and should the Fund set limits on fees in the Allocation Agreement?

Question #5 Response: NTCIC appreciates the CDFI Fund's efforts to document and control NMTC transactional fees by having CDEs identify their fee structures in the NMTC Application. Given the variety of products, preferences and geographic footprints of each CDE, the NMTC program generates very limited competition for deals. The market therefore cannot be relied upon to moderate fees. NTCIC suggests that the CDFI Fund publish an acceptable fee range based on product type and other pertinent data. With this type of input from the Fund, NTCIC would agree that a CDEs' fee structure should be included in the Allocation Agreement.

Table F1 does not allow for any flexibility in a CDE describing its fee structure. The fees associated with a transaction may vary based on product type (i.e., debt vs. equity), size of the transaction, the investor, and type of QALCIB (i.e., non-profit vs. for-profit). NTCIC suggests that Table F1 be revised to capture these elements. Also, the CDE should not report on any 3rd party expenses such as audits that are required by the CDFI Fund.

Question #6: In any given Application round, the Fund requires applicants that have received awards in previous rounds to demonstrate that they have been able to raise minimum threshold amounts of QEIs from their prior awards (see the 2009 NOAA for the current minimum threshold requirements). Are these current minimum threshold requirements sufficient? Should the Fund consider using different measurements, such as the amount of QEIs that have been deployed as investments in low-income communities?

Question #6 Response: NTCIC requests that the CDFI Fund not base NMTC eligibility solely on QEI thresholds for multiple allocatees. Instead, eligibility should be based on a combination of NMTC commitments based on closed deals, QEIs raised, and QLICIs issued. The purpose of the NMTC Program is to provide patient capital in the form of equity QLICIs to QALICBs. After a deal is closed and the funds are legally committed for venture capital and historic tax credit deals, equity is typically paid in over time, up to18 - 24 months, based on a performance-driven pay-in schedule. Thus, a significant portion of the QEIs from its investors and QLICI pay-ins are not made until benchmarks are met, which allows the CDE to mitigate recapture risks and the investors to mitigate construction and operational risks. Therefore, CDEs should be allowed to include the total dollar amount of closed deals whether or not the QEIs have been fully funded. NTCIC suggests that Tables in Exhibit A include a row for the dollar total of closed deals.

Due to the related party test, more QLICIs are in the form of debt. Typically, 100% of the QEIs and QLICIs are funded at closing. This allows the CDE to incrementally meet the QEI threshold.

In order to meet the current eligibility thresholds, some CDEs may request advance QEIs from investors, which may pose a recapture risk if the CDE is unable to investment that capital as a QLICI within 12 months. Also, such haste to meet the thresholds may increase the overall transactional cost to the CDE. For example, an investor may require a return on its investment at the point in the time the QEI is made regardless of the fact that a potential QLICI is not identified. The CDE may have to absorb this cost and/or forego income derived from interest bearing accounts. Finally, the QEI barometer may unfairly advantage lending institutions that receive QEIs from an affiliated entity.

In closing, the success of a CDE is not contingent on one factor but rather a combination. Therefore, multiple round allocatees should be given greater flexibility in demonstrating their eligibility for NMTC consideration.

Question #7: The Fund generally caps award amounts to any one organization in a given round. In the 2009 Application round, this cap was set at $125 million. Is this an appropriate amount? Should the Fund consider raising the cap significantly (*e.g.*, to $250 million), and prohibit a CDE that receives such a large allocation award from applying again for an established period of time?

Question #7 Response: The Notice of Allocation Availability (NOAA) for the CY 2009 Allocation Round stated that in order to receive an allocation in excess of the $125 million cap, an applicant, at a minimum, will need to demonstrate that: (i) No part of its strategy can be successfully implemented without an allocation in excess of the applicable cap; or (ii) its strategy will produce extraordinary community impact. Given the current economic environment, it is imperative that those CDEs that have the capacity to create even greater demonstrable impact should be afforded the opportunity to do so. Therefore, NTCIC supports raising the award amount cap with the caveat that the allocation is a multi-year award, and the CDE is prohibited from applying for awards during the subsequent funding round. For example, if a CDE is granted $200 million in allocation authority, it will receive 50% of the award at closing, and will receive the other 50% once it meets certain performance benchmark criteria. These requirements should be included in the CDE's allocation agreements. The prohibition allows for the application process to remain equally competitive, and will ensure that larger, more sophisticated CDEs do not receive a disproportionate amount of awards.

Question #8: In April 2009, the Government Accountability Office released a report titled: "New Markets Tax Credit: Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities" (GAO–09–536). Are there actions that the Fund should take in order to increase the number of minority CDE applicants and allocatees?

Question #8 Response: NTCIC recommends that the CDFI Fund implement continued outreach and education initiatives in order to increase the number of minority CDE applicants, which may increase the number of minority CDE allocatees. However, NTCIC does not recommend that the CDFI Fund set-aside a specific percentage of the NMTC allocation authority for minority CDEs, similar to the rural set-aside. The ultimate success of the NMTC program is to ensure that LICs, LIPs, and minority populations have access to private equity investments. Donna J. Gambrell's testimony before the Committee on Ways and Means and the Financial Services Committee on the GAO Report indicates 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." Based on the distribution of QLICIs, non-minority CDEs have made substantial NMTC investments that have provided economic benefits to minority populations (i.e., employment opportunities, goods and services, etc.), and thus these efforts should be deemed a success.

Question #9: 9. Are there changes that can be made to the application process or elsewhere, that will increase the amount of Qualified Low-Income Community Investments that support activities that have not traditionally received large scale financing from NMTC investment proceeds (*e.g.,* loans and investments for small business operations; loans to and investments in other CDEs, including CDFIs; purchase of loans from other CDEs; etc.)?

Question #9 Response: NTCIC does not recommend any changes to the application that would favor a specific type of QLICI. We believe that the competitive application process should dictate the types of product types that are financed by QLICIs.

Question #10: Currently, the Fund uses economic distress factors from the most recent decennial census to qualify eligible census tracts and to verify, when applicable, that awardees are serving "severely" distressed communities. Are there other public sources of data on economic indicators (*e.g.,* American Community Survey three- and five-year estimates for poverty rate, area median income, and unemployment rate) that are updated more frequently and readily available that the Fund should accept?

Question #10 Response: NTCIC suggests that the CDFI Fund accept other public sources of data on economic indicators that are updated more frequently. The Federal Financial Institutions Examination Council's ("FFIEC) website offers a Geocoding System (http://www.ffiec.gov/Geocode/default.aspx) that is used for Community Reinvestment Act and/or Home Mortgage Disclosure Act data, and it includes demographic information based on the decennial census and the last three calendar years. Specific demographic information includes income, house, and population data. Because this data is updated annually, it provides a real-time assessment of the census tract and a more accurate reflection its demographics.

The CDFI Fund should also consider demographic data derived from state or municipal government sources.

We thank you in advance for your consideration of these ideas. These suggestions are meant to be constructive. Overall, NTCIC believes that the Fund has done an outstanding job managing the NMTC program, especially with its maintenance of a politically unbiased application process. Please feel free to contact me at (202) 588-6064 or to ask for a meeting to discuss these comments in more detail.

Sincerely,

John Leith-Tetrault

John Leith-Tetrault
President, NTCIC