ALASKA GROWTH CAPITAL
An ASRC Company

Alaska Growth Capital, BIDCO Response to Request for Public Comment FR-Vol.76, No.215, 11/7/11

***Q1. Low-Income Communities and Areas of Higher Distress** - The NMTC Program statute requires that NMTC investments are made in low income communities, including target Populations, and through the application and regulation process regulations and the CDFI Fund areas experiencing greater economic distress, the CDFI Fund provides an opportunity for applicants to score more highly by committing to making investments in Areas of Higher Distress.*

The CDFI Fund has relied upon decennial census data in determining whether census tracts meet these qualifications, and deems as eligible those census tracts which meet the statutory criteria, provided that the decennial census data shows that the ''population for which poverty is determined'' is greater than zero.

a) *Should the CDFI Fund consider using different standards or methodologies for determining whether census tracts meet the statutory definition of low-income communities?*

   Yes. We recommend the following language be added to the authorizing statutes. In addition to census tract designation, eligibility to New Market Tax Credits should be automatically eligible on lands designated as Substantially Underserved Trust Areas (7 USC 936f). This eligibility would provide access to capital to Native communities who have traditionally been underserved and our unable to access the NMTC program due to economies of scale and lack of financial resources available.

b) *In the allocation award process, should the CDFI Fund increase the commitment percentage from 75 percent of investments made in Areas of Higher Distress in order to receive the highest scores for this sub-section of the Community Impact score? Should the CDFI Fund include additional distress indicators, alter or eliminate any existing indicators?*

   No. Maximizing the impact of the NMTC requires flexibility and adaptability. CDEs are already trending toward investments in areas of higher distress. Mandates for a higher QLICI percentage in certain areas will decrease the flexibility for which CDEs can deploy their allocation and will decrease the potential for innovative projects. Further, areas of higher distress can be served by qualifying census tracts which act as a hub for services. These hubs may need large infrastructure to meet the needs of several highly distressed tracts, which would distort a score on an allocation application with strict mandates on percentages but would indeed be benefitting the poorest of geographies.

   One additional area of major reform is the qualification of census tracts. The CDFI Program identifies targeted populations, but the NMTC does not necessarily follow suit through the IRS code. As such economic development programs administered by the CDFI do not necessarily complement each other. This increases costs for an economic development entity and reduces the available tools for financing important projects in certain areas. We suggest making areas populated by more than 50% of a CDFI Program Low Income Target Population eligible for NMTC, or at the very least making this factor a marker of high distress.

Q2. Treatment of Certain Businesses *The NMTC Program statute provides the definition of a Qualified Low-Income Community Business (QALICB), including certain types of businesses that cannot qualify based upon the nature of their operations (i.e., any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises).*

(a) Are there certain other types of businesses that should be discouraged or barred from receiving NMTC investments? If so, what types of businesses, and what administrative means could be utilized to discourage such investments?

(b) Should the CDFI Fund provide additional opportunities in the allocation award process for applicants to score more highly by committing to invest in certain business types over others (e.g., small business or rural investment, operating businesses vs. real estate projects, etc.)?

(c) Are there specific administrative or regulatory changes that would facilitate the financing of specific types of businesses while preserving public policy objectives and safeguards?

No. Flexibility in deploying NMTC in communities is a major strength of the program. Businesses that create jobs and attract investment to low-income communities and assist in economic development should be judged by their outcomes, not by their class. With the exception of existing prohibitions, the CDFI Fund can judge the merits of each investment during application rounds, which allows the nuances of one business to be seen over another.

3. Community Accountability *- The CDFI Fund has requested comments on the current standards used to measure and monitor the community accountability of CDEs. Specifically:*

a) Should the CDFI Fund increase the community accountability standards for an entity to qualify as a CDE?

Yes. We suggest that the Fund revise this policy to increase the proportion of low-income community representatives to at least 40%.

b) Should CDE community accountability standards differ for CDEs depending on whether they use governing or advisory boards to demonstrate accountability?

No. The standards should be the same for CDEs who use governing boards and advisory boards to demonstrate accountability.

c) Should the CDE be required to have Low-Income Community Representatives approve of investments made by the CDE?

Yes. We suggest documentation that the board demonstrate accountability to low-income communities and approves the investments made by the CDE.

d) Should CDE activities be required to be coordinated with community stakeholders? If so, how should this coordination be conducted and demonstrated?

No. For every project there is an inherent coordination with community stakeholders. Requiring coordination and demonstration will not change this.

e) Should the CDFI Fund implement measures to increase the transparency of CDE activities?

Yes. Certain measures can be acceptable to increase transparency. Such measures as the composition of the governing board, information on vote tallies (without specific members' vote) and other factors describing the board and operations may be acceptable. Certain measures such as meeting minutes are not appropriate due to the discussion of proprietary business during meetings. We welcome clarification from the CDFI on this topic before providing a full response.

f) If a CDE has a Controlling Entity, should the CDFI Fund require that the Controlling Entity of the CDE also meets community accountability requirements? If so, what requirements should be applied?

No. Controlling entities may or may not be structured to engage in the NMTC program. Further, controlling entities may not be in the major business of NMTC investing or like businesses. Requirements for utilizing NMTCs were formulated and businesses adopted the required structures; changing the structure could drive certain existing CDEs out of the market that could otherwise compete and win allocation. That scenario would inhibit NMTCs from being utilized by an otherwise winning applicant for the benefit of the low-income communities.

g) Should CDE community accountability requirements differ for allocatee CDEs and non-allocatee CDEs?

No. All CDEs should demonstrate the accountability similarly because of their similar missions to developing low-income communities.

h) Are there other ways in which CDEs can enhance their accountability to the Low-Income Communities in their respective service areas?

4. Transaction Costs - *The CDFI Fund has requested comments on whether additional rules, restrictions, and requirements should be imposed related to fees and expenses charged by CDEs. Specifically:*

(a) Should there be greater disclosure of (and perhaps limitations on) the fees and other sources of compensation and profits that NMTC applicants propose and NMTC allocatees and their

affiliates charge to or receive from the borrowers, investors or other parties involved in NMTC transactions?

No. The NMTC program already has an inherent cap with the requirement that 85% of a QEI must remain invested in the QALICB during the compliance period. Industry events such as conferences and strong networks of investors, CDEs and other NMTC professionals allow QALICBs to present their projects to multiple CDEs to discover the best financing scenario.

(b) *Should such information be made available by applicants and allocatees directly or through the CDFI Fund to the public or remain excluded from disclosure as proprietary business information?*

No. Information on fees and pricing are proprietary to business.

(c) *Should the CDFI Fund provide an opportunity for CDEs that commit to limit fee and other forms of compensation to earn a higher score in the allocation award process? If so, please provide specific standards that could be used.*

Yes. Agreeing to limit fees should yield a higher score in allocation applications. Total fees and transactions costs place a burden on smaller projects relative to larger projects. Limits on total fees will increase the funds available to flow directly to projects and QLAICBs. CDEs that are able to close transactions with lower fees and costs should be in a better position for an award of NMTCs and continue to deploy NMTCs in a more cost effective manner. For the CDFI Fund to have an accurate depiction of total fees, the financial model or forecast from the accounting firm should be made available to the CDFI Fund during applications for allocation awards.

(d) *Are there specific administrative or regulatory changes that would reduce transaction costs while preserving public policy objectives and safeguards?*

Lack of clarity on the Economic Substance Doctrine and Internal Revenue Code (IRC) Section is a source of significant cost to CDEs and investors. Under current practice, most investors are advised by counsel to get tax opinions on how both the Economic Substance doctrine and IRC Section 183 apply to **every** transaction. Clarifying that **neither** applies to NMTC will result in lower transaction costs.

→ ***Economic Substance Doctrine***: The current misinterpretation of how the Economic Substance Doctrine is applied to a NMTC transaction is the source of a significant cost in many NMTC transactions. In recent years Congress has become concerned that many taxpayers are engaging in transaction simply to secure favorable tax treatment and these transaction might meet the technical requirements of the law, the results of such activities were not intended by Congress. The essence of Economic Substance Doctrine is that taxpayers should only engage in activities for profit and any tax beneficial consequence should be of a secondary nature.

However, Congress has been clear that in cases in which the realization of tax benefits is consistent with Congressional intent, then the tax benefit should not be disallowed under economic substance. Most recently in the Joint Tax Committee's Revenue provisions related to the Affordable Care Act (March 21, 2010,JCX-18-10), the Committee noted in footnote 344 that *"it is not intended that a tax credit (e.g., section 42 (low-income housing credit), section 45 (production tax credit), section 45D (new markets tax credit),section 47 (rehabilitation credit), section 48 (energy credit), etc.) be disallowed in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage. <u>In short, the doctrine of economic substance does not apply to New Markets Tax Credits.</u>*

→ **IRC Section 183 -** Section 183 of the Code is intended to curtail abusive tax shelters by requiring that equity investors enter into business transactions with the expectation that they will secure a profit. Section 183 presents a problem for investors involved in a leveraged transaction that may be largely driven by the Credit and less by the economics of the deal. Though Section 183 applies only to the activities of individuals and S Corporations, the Coalition is requesting that the IRS clarify that section 183 not be applied to NMTC transactions. In light of the recent legislative history we request that IRS issue a notice clarifying that Section 183 not be applied to the NMTC. *<u>A similar ruling has already been issued for Low Income Housing Tax Credits.</u>*

The cost of NMTC transactions would also be reduced if Treasury could provide clarification regarding the application of true debt analysis to NMTC investments. The current true debt analysis create an impediment to closing deals in low income communities where the appraised value of a property in frequently far below the true development costs. For example, in Alaska, the cost of construction in very rural areas is often higher than the appraised value of property and improvements. This creates the potential for projects to fail a true debt analysis.

For example, assume a CDE is looking to finance a project costing $10 million with 2 separate QLICIs, a $7 million "A" Note and a $3 million subordinated "B" Note. Assume that the property appraises for only $8 million because of location. Tax counsel for the NMTC investor is likely to claim that the "B" Note is not true debt because it is not supported by the appraised value of the property, cannot be backed up by collateral, and this claim forces the CDE to craft documents that conform to the true debt analysis, which leads to a protracted negotiation with tax counsel and adds significant time and considerable cost in legal and accounting fees to a project. The additional transaction cost leads to a reduction in the benefit flowing to the QALICB and the community.

*5. **Evaluation of Financial Products** - The CDFI Fund provides an opportunity for allocation applicants to earn a higher score in the Business Strategy section if the CDE commits to provide equity, equity equivalent financing, debt with below-market interest rates, or debt with certain flexible terms. The CDFI Fund has requested recommendations on best to evaluate the quality of a CDE applicant's financial products. Specifically:*

(a) Should the CDFI Fund use a defined Effective Annual Percentage Rate (EAPR) for purposes of the application and compliance measurement? Should the CDFI Fund alter the flexible rates and terms question to base the scoring preference on a basis point reduction from a market benchmark determined by the CDE (or a standard metric such as LIBOR) instead of a percentage? Should the benchmarks be raised?

No. Allocation applications are detailed in their request for information. Financial products, rates and terms are discussed here and also in the allocation agreement. These provide the necessary information for CDFI Fund to monitor a CDEs financial products. Implementing a national standard or benchmark reduces the programs flexibility; financing needs can vary widely region to region depending on the presence of large financial institutions. Financing needs also vary from business to business, with some businesses preferring longer amortizations and some preferring shorter amortizations. The NMTC program allows CDEs and QALICBs to tailor a financing solution to their needs, which is a major strength of this program.

(b) Are there specific administrative or regulatory changes that would facilitate the provision of specific financial products while preserving public policy objectives and safeguards?

No.

6. Use of Other Federally Subsidized Financing in Conjunction with NMTCs *– Some CDEs and NMTC investors are using federal financing tools (e.g., historic tax credits, Section 108 loan guarantees) to finance NMTC transactions. In some cases these federal financing tools have been used in addition to the Qualified Equity Investment (QEI), as part of a leveraged debt transaction, and in other cases at the project-level where a CDE uses NMTC financing and other federal financing products to complete a project. Currently, the only restriction against commingling of federal funds is that NMTCs may not be used in conjunction with Low Income Housing Tax Credits.*

(a) Should there be any additional restrictions in the allocation award process regarding the use of NMTCs with other sources of federally subsidized financing? If so, are there certain types of federal financing that should be disallowed? Should it matter whether the financing is made as part of the QEI investment (e.g., through the leveraged debt structure) or at the project level?

No. Coordinated efforts provide more resources for an economic development project to succeed. Starting up is often the most difficult period in the lifecycle of a business or project, with operations reaching a stabilization point within one to two years. Utilizing NMTCs with other resources allows many projects to overcome the difficulties in start up and reach the stabilization point which is when community impacts become a regular effect (such as services delivered, steady jobs held by community members, etc…).

(b) Assuming that it is appropriate for any other source of federally-subsidized financing to be used in conjunction with NMTC investments, would it be prudent for the CDFI Fund to limit, as part of the allocation process, the overall amount of QEI dollars or project level investments that may be supported with other sources of federal financing?

No. The CDFI Fund collects information on projects during applications for new allocations. Setting a "hurdle rate" on any one category of resources makes it impossible for CDFI Fund to weigh variable factors from transaction to transaction, such as the incredible community need in one area or the availability of innovative financing in one area but not another. With demand for NMTCs that is much higher than supply, CDFI Fund weighs these issues and others in making allocations already.

(c) Are there specific administrative or regulatory changes that could facilitate the coordination of other federally subsidized financing in conjunction with NMTCs while preserving public policy objectives and safeguards

Yes. Facilitating coordination and providing guidance on how USDA and SBA guarantees can be used with NMTCs would greatly increase the ability to deploy NMTC to projects. The government guarantees have a much smaller budget outlay than federal direct cash grants. Guarantees also provide leverage lenders a level of surety to engage NTMC transactions as the leverage lender. Further, these leverage loans provide benefits to projects since they will have more flexibility in their cash positions.

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