FR-Vol. 76, NO. 215
Bob Ibanez
Manager, New Markets Tax Credit Program
CDFI Fund, Department of the Treasury
601 13th Street NW Suite 200 South
Washington, DC 20005

February 6, 2012

Dear Mr. Ibanez:

We, The Undersigned, all Community Development Financial Institutions, would like to express our support for the NMTC Coalition's comments regarding FR-Vol. 76, NO. 215, which seeks suggestions and comments germane to the mission, purpose and implementation of the NMTC Program.

In addition, The Undersigned are also pleased to provide comments and suggestions that highlight and address a number of issues specific to our shared experiences as mission driven CDFIs and potential or current NMTC allocatees. As such, these comments, immediately following this letter, were prepared with the intention of increasing the alignment of the NMTC Program with its intended goals and mission to "spur new or increased investments into operating businesses and real estate projects located in low-income communities" and to place and emphasis on CDEs accountable to and with a primary mission of serving low-income communities or low-income persons.

We thank you for this opportunity to comment on FR-Vol. 76, NO. 215. If you have any questions, please do not hesitate to contact Don Hinkle-Brown, President and CEO of The Reinvestment Fund and representative to the Undersigned, at 215-574-5829.

Sincerely,

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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?*

We are supportive of using more current data but we preface this with the fact that the CDFI Fund needs to make any new data indicators or methodologies easily accessible on its website and through its mapping system as any ambiguity in qualification will inevitably lead to higher transaction costs.

The CDFI Fund's reliance on decennial census data in determining whether census tracts meet the qualifications under Section 45D(e) of the IRC is understandable given the definitive nature of this data. However, census data soon becomes outdated for the purposes of the NMTC program. For example, using data from the 2000 census to determine whether census tracts meet NMTC qualifications in 2010, calls into question the "definitive" nature of this data.

Therefore, given that the Census Bureau recommends using the 5-year ACS data for small units of geography and that the ACS estimates will be updated annually, we recommend that NMTC census tract eligibility should be determined by the most recent 5-year ACS data and updated annually.

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?*

We do not recommend that the CDFI Fund increase the commitment percentage from 75 percent of investments made in Areas of Higher Distress. A project in an Area of Higher Distress does not necessarily have higher impact than other qualified projects; increasing the committed percentage in Areas of Higher Distress risks discouraging investment in eligible and high impact projects solely because they are not located in Areas of Higher Distress.

However, as the objective of this question is to ensure and increase investments in Areas of High Distress, we recommend less emphasis on high distress based on geographic indicators and suggest two alternative methods to achieve the high distress classification:

1. QLICIs made by CDEs that are also CDFIs should be considered an additional distress indicator. CDFIs are mission-driven and mandated to serve low-income communities. This is further evidenced by the fact that CDFIs were grandfathered as CDEs and recent regulations that allow CDEs to invest recaptured proceeds in CDFIs for the remainder of an NMTC term.
2. Nonprofit QALICBs should be considered an additional distress indicator. Recent IRS regulations regarding targeted populations make NMTC very difficult to use for many community services projects such as charter schools. We recommend an additional high distress indicator that takes into account the nature of the QALICB and whether it is a nonprofit with a primary mission to serve low-income populations.

In addition, the NMTC program definition of non-metro is different from and more restrictive than the definition of rural for many other federal programs. We recommend using the USDA Economic Research Service Rural Urban Commuting Area Codes, with codes 4-10 classified as rural.

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?

We agree that the NMTC Program should maintain the current statute's definition of Qualified Low-income Community Business (QALICB) with regard to the barring of certain businesses from participating in the NMTC program, such as those businesses listed in this question.

(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.)?*

Yes, we recommend the CDFI program provide additional opportunities in the allocation award process by:

I. Giving CDFIs higher scores, especially in the Community Accountability section, for their inherent and mission-driven commitment to invest in businesses located in hard-to-serve low-income communities

II. Giving bonus points or higher scores to CDFI controlled CDEs.

(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?*

Award Bonus Points to CDFIs and CDFI Controlled CDEs

Yes, we recommend allocating a higher score or bonus points to CDFIs and CDFI controlled CDEs due to their inherent and mission driven commitment to invest in businesses located in hard-to-serve low-income communities, including those located in rural areas.

Expand the Definition of QALICB to Include CDFIs

When a non-CDFI CDE wants to use its NMTC-derived capital to invest in a CDFI CDE, it cannot underwrite the CDFI because it is not currently by definition a QALICB. Consequently, every project financed by a CDFI must be independently confirmed as a QALICB that is NMTC-eligible – a costly and duplicative requirement given that mission-driven, certified CDFIs must lend to projects benefiting low income places and populations. By treating CDFIs as QALICBs, the Fund would remove a layer of concern for investors and create an incentive for non-CDFI CDEs to invest in CDFIs that are currently unable to use NMTC equity proceeds.

Additional suggestions for Administrative or Regulatory Changes to the NMTC Program that would Encourage Investment in Specific Types of Businesses

In order to encourage more NMTC transactions be targeted for QLICIs to multiple small businesses, we would like to propose that the CDFI Fund and the IRS consider amending the NMTC related regulations to include an expansion of the definition related to equity investments in or loans to qualified community development entity. In particular, we propose that the regulations be expanded to allow for the provision that if a second CDE is also a certified CDFI or a subsidiary of a certified CDFI, and funds totaling at least 85 percent of the related QEI are segregated in a fund created solely for investing in, or lending to, qualified active low-income community businesses, or for providing financial counseling and other services in low-income communities then the investment in the CDE would be considered a QLICI and no further tracing will be required. **This issue is further articulated in the addendum to this comment letter.**

Q3. 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 recommend that the CDFI Fund increase the Community Accountability Standards for an entity to qualify as a CDE by adding the incentive of allocating the highest scores and bonus points to organizations with mission-based parents such as CDFIs with a primary mission and history of serving Low-Income Communities.

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

   We do not recommend that CDE Accountability standards differ for CDEs depending on whether they use governing or advisory boards to demonstrate accountability.

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

No, these representatives do not, in most cases, have the skill to underwrite these transactions, and they are not held accountable or liable for these decisions.

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

Regulating coordination with community stakeholders can be incredibly difficult. The best test to determine if a CDE is coordinating its activities with community stakeholder should be its certification as a CDFI. As mission-driven entities, CDFIs are committed to serving low-income communities and coordinating their activities with community stakeholders. Additionally, we recommend increasing the percent of community stakeholder requirement for the board or advisory board of a CDE from 20 percent to more than 50 percent, or the majority of members. NMTC legislation clearly states that community representation is an important mechanism to ensure that the use of the NMTCs is primarily directed to benefiting the community. By increasing community stakeholder representation within the board or advisory board of a CDE, the potential for the NMTC benefits to be channeled to the appropriate community stakeholders is increased.

e) Should the CDFI Fund implement measures to increase the transparency of CDE activities?
The CDFI Fund already requires extensive reporting through CIIS. We do not recommend additional requirements.

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

We recommend that controlling entities be required to meet community accountability requirements through the structure of the community advisory committee or similar body, made up of potential investees and representatives of low-income communities. As such, we also recommend that the highest scores for community accountability should be reserved for cases in which both the CDEs and their Controlling Entity both meet community accountability requirements.

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

No, CDE accountability requirements should not differ for allocate CDEs and non-allocatee CDEs. Both should be held to the same standard if they are to be certified as a CDE by the CDFI Fund.

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

Priority points should be awarded to CDFIs or other CDEs that can demonstrate accountability to their low-income communities throughout their corporate structure and including their parents. Given that a high level of community accountability is inherent within the mission and statutory requirements of the CDFI certification process—as well as within maintaining CDFI certification—we recommend that the highest scores for community accountability be reserved for CDFI CDEs.

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?

The Undersigned do not wish to comment.

(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?

The Undersigned do not wish to comment.

(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.*

The Undersigned do not wish to comment.

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

A CDFI's mission to serve Low-Income Communities also translates to a commitment to ensuring as low transaction costs as possible. CDFIs are required to balance fees with social impact and overall benefit to the communities they serve; the result is often transaction fees that are among the most reasonable required by CDEs.

We also recommend that CDFIs be defined as QALICBs. This will enable CDFIs not currently involved in the NMTC program to efficiently deploy credits to investees or borrowers of all sizes and types, without the addition of expenses associated with verifying the qualifications of the project, and without many of the legal hurdles related to meeting the requirements of the IRS code for real estate investments.

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 welcomes comments on the CDFI Fund's evaluation of the quality of an 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?

The Undersigned do not wish to comment.

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

Administrative or Regulatory Changes in the Review Process

The public policy objective of the NMTC program is to bring capital into low-income communities. Evaluating the quality of products is dependent on the quality and training of the reviewers—specifically, their knowledge and ability to fully understand local conditions and the intent of the proposed allocate, and incorporate that into their review.

Today the process is at the mercy of the outside reviewers assigned to particular applications. Reviewers typically have limited knowledge of the applicant; the application has also become removed from the actual work of the applicants, not taking into account their own strategies, conditions in their local communities, and their need to plan. All that is evaluated is the application, removed from the context of the organization or the community and its characteristics.

In addition to improving quality and training of the reviewers, we recommend a significant increase in transparency within the scoring of awardees and non-awardees. Increased transparency will allow applicants to understand how their products have been evaluated and valued, which would allow for applicants to make the necessary adjustments in their strategy, financial products and applications so that they may increase their likelihood of being awarded tax credits. In particular we recommend that the CDFI Fund provide:

1. All applicants with their combined scores from the reviewers on each section of the application and
2. A complete listing of all reviewer comments referenced to the section to which each of them apply.

Changing How the Program Defines Benefit

The allocation application and many in the industry assess the benefit of NMTC loans based on a simple assessment of the amount of equity retained by the QALICB, with greater amounts of equity (or higher "C pieces") being understood as more beneficial. This method fails to recognize differences amongst QALICBs and CDEs. Keeping in mind the NMTC program goal to benefit low income places, a more nuanced view is called for. Equity retained by a for profit real estate developer doing a one off project in a low income place only benefits that low income place to the degree it is necessary to getting the deal done. Equity retained by a service provider in a low income community, even beyond what is necessary to surpass the but-for hurdle, is likely to lead to additional benefits to that low income community by way of expanded services or lower costs, for example. Therefore, the understanding that a higher C piece is, in and of itself, a better outcome for the program and for low income communities is inaccurate. Equity retained by CDEs (which is an alternative to equity being retained by QALICBs) is generally considered a fee, with higher fees (or higher "B pieces") being understood as less beneficial. Equity retained by CDEs with for profit parent companies should rightly be understood as a fee given those dollars are more likely to benefit goals other than additional investment in low income communities. Equity retained by CDEs with parent companies that have missions to serve low income places, like CDFIs, should be understood to provide an ongoing benefit to these communities, thus amplifying program impact rather than diminishing it.

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?

The Undersigned do not wish to comment.

(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?

The Undersigned do not wish to comment.

(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

The Undersigned do not wish to comment.

Addendum

a. Current Problem for loans or investments to small businesses

Equity investors in the NMTC program have become comfortable with the risk they are taking with regard to recapture. They routinely implement several techniques to mitigate this risk:

1. Requiring legal tax opinions on all parts of the initial transaction, including an opinion with regard to the "qualified" status of the QALICB.

2. Structuring the loan (and it almost always is a loan) to the QALICB so that there is minimum principal repayment during the credit period, in order to reduce or eliminate the need to reinvest the funds in another QALICB.

3. Gaining a comfort level from the minimal requirements for CDEs.

4. Requiring indemnifications from all the other parties involved in the transaction.

Given these commonplace requirements and others, NMTC transaction sizes are rarely lower than $5 million, QEIs rarely fund more than one QLICI, and the time required to underwrite and close transactions is routinely longer than 6 months. Catering to equity investor concerns about recapture risk has led to the development of an inefficient and costly process.

Any proposed regulatory changes aiming to address these issues must also address the perceived recapture risk of the equity investors.

b. Current Requirements Related to QLICIs into CDEs

Section 45D(d) of the IRC details the four eligible uses for a "Qualified Low –Income Community Investment". Part (D) of this section allows for "any equity investment in, or loan to, any qualified community development entity."

The initial temporary regulations interpreted this section as follows:

"Any equity investment in, or loan to, any CDE [is eligible], but only to the extent that the CDE in which the equity investment or loan is made uses the proceeds of the investment or loan in a manner—

(A) That is described in paragraphs (d)(i)[Investment in a qualified business] or (iii)[financial counseling and other services] of this section; and

(B) That would constitute a qualified low-income community investment if it were made directly by the CDE making such equity investment or loan."

The current regulations allow for the addition of third and fourth tier CDEs, but ultimately the funds must be used as described above.

The regulations undoubtedly added these additional requirements as a result of a review of the congressional conference report. Note 21 on the conference report that directly references this part of the legislation reads as follows:

If at least 85 percent of the aggregate gross assets of the CDE are invested (directly or indirectly) in equity interests in, or loans to, qualified active businesses located in low-income communities, then there would be no need to trace the use of the proceeds from the particular stock (or other equity ownership) issuance with respect to which the credit is claimed.

Tax policy interpreted this note to extend the safe harbor from Section 45D(b)(3) to second, third and fourth tier CDEs, but also that without this safe harbor, these second, third and fourth tier CDEs must use (and then trace) the proceeds of the QLICI into them for one of the eligible purposes under Section 45D(d)(1) although the regulations specifically exclude Section 45D(d)(1)(B) and limit Section 45D(d)(1)(D) to four tiers of CDEs. One can assume that this was a decision made based on the practical consideration of managing and monitoring the program.
One can also assume that the requirements for second, third and fourth tier CDEs was added into the regulations because of policy considerations to not allow CDEs to be created, receive a QLICI from another CDE (related or not), and then do whatever they want with the funds. Theoretically, this issue should be handled under the mission and accountability tests for the CDE. However, the certification practice has taken a rather minimalist approach to both the mission and accountability tests – in order to provide equity investors a degree of certainty regarding their investment.

c. Proposed Regulatory Change Related to this Section

It is apparent that Note 21 of the conference report was used to ensure that the safe harbor in Section 45D (b)(3) be extended to the lower tier CDE. It does not, however, require that, lacking the safe harbor, proceeds of the QEI must be traced down to the QALICB.

Given the policy imperative that the funds do reach low-income communities, it is understandable that the regulations include the additional requirements. However, the same policy imperative can be achieved if QLICIs invested into CDEs could be determined eligible under different scenarios as well.

In light of the lack of NMTC investments in small businesses, caused primarily by the interests of equity investors, an addition to the regulations that can provide more certainty for these investors, while also ensuring that the proceeds of NMTC investments end up in low-income communities, would be significant. Such an addition would provide a second safe harbor specifically for QLICIs into CDEs.

In this regard we propose that the amended regulations read as follows:

(iv) *Investments in other CDEs*—(A) *In general.* Any equity investment in, or loan to, any CDE (the second CDE) by a CDE (the primary CDE), but only—

(1) To the extent that the second CDE uses the proceeds of the investment or loan in a manner—

(i) That is described in paragraph (d)(1)(i) or (iii) of this section; and

(ii) That would constitute a qualified low-income community investment if it were made directly by the primary CDE;

(2) To make an equity investment in, or loan to, a third CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(1) of this section; or

(3) To make an equity investment in, or loan to, a third CDE that uses such proceeds to make an equity investment in, or loan to, a fourth CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(1) of this section

d. Purpose of each item of the Amendment

We are proposing that the additional safe harbor apply only to certified CDFIs, primarily because it is extremely easy for anyone to create a CDE and have it certified. The certification process for CDFIs is, on the other hand, more difficult, and requires that the organization direct most of its activities in low-income communities or to a targeted population.

We are also proposing that any NMTC funds be dedicated solely for investing in, or lending to QALICBs or for providing financial counseling or other services in those same communities. This will ensure that the funds are used for purposes intended by the statute. However, we do propose that a similar "reasonable expectation test" be applied here for the benefit of the investors. If the QEI is used to make a QLICI into a CDE/CDFI that has setup a separate fund for the NMTC purposes, and if the primary CDE has a reasonable expectation that the second CDE will utilize the funds in a way consistent with the NMTC program, then if the second CDE falls out of compliance, that would not constitute a recapture event. We propose that the reasonable expectations test could only be used if the primary CDE does not control the second CDE.