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February 6, 2012

Mr. Robert Ibanez
NMTC Program Manager
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 13th Street, N.W., Suite 200 South
Washington, DC 20005

Dear Mr. Ibanez,

We commend the CDFI Fund's ("Fund") administration of the New Markets Tax Credit ("NMTC"). We believe that the program's track record, as administered, has effectively and efficiently met its legislative purpose to deliver subsidy to qualified low-income businesses ("QALICBs) in low-income communities. By design, the program's inherent flexibility has provided critical subsidy to a diverse array of QALICBs around the country while simultaneously creating community benefit in low-income communities. Furthermore, over time the program has become more effective and efficient. Many of the perceived issues with the program amounted to "growing pains" that are associated with any new and developing program and have been addressed by effective regulation by the CDFI Fund, IRS and U.S. Department of Treasury in conjunction with competitive market forces, standardization and experience.

As effective as the program is, we believe there are still opportunities to make a successful program even better. NH&RA's New Markets Tax Credit Steering Committee ("NH&RA") welcomes the opportunity to respond to the CDFI Fund's request for comments posted in the Federal Register, Volume 76, Number 215, on November 7th, 2011. Our comments will focus on areas where existing regulatory barriers could be streamlined to create more efficiency in how the program is administered and subsidy is delivered.

Formed in 1971, NH&RA is a professional association of individuals who are involved in affordable housing, historic rehabilitation and New Markets Tax Credit development. NH&RA's New Markets Tax Credit Council brings together active participants in New Markets Tax Credit transactions including CDE executives, investors, developers, lenders, government officials, consultants and legal and accounting professionals to discuss the most pressing legislative, regulatory, financial and transactional issues facing the industry and build consensus on solutions. The council is an active advocate for the extension of the of the New Markets Tax Credit program on Capitol Hill and meets regularly with key Department of Treasury staff.

Accountability
NH&RA believes that community accountability is an important aspect of the NMTC. In the majority of cases, CDE advisory boards provide important guidance to CDEs in their transaction selection and their low-income community representatives provide important insight into the communities they serve. We do not believe that additional steps need to be taken at this time to increase community accountability. We have explored internally additional proposals to increase the role and profile of the advisory boards but ultimately feared that additional potential benefits would be outweighed by the negatives. In particular, new responsibilities and additional meetings may be overly taxing for the community representatives, create additional costs in the administration of the CDE and slow down transaction timelines.

Improving Program Efficiency
NH&RA supports efforts to improve the efficiency of the NMTC program through managing transaction costs and has been working diligently for many years to identify strategies to achieve this goal. We are pleased to observe that as the program ages and documents become more standardized due to the improved knowledge of professionals including CDEs, investors, QALICBs, counsel and accountants, transactions costs have also begun to trend downwards. It is also important to note that perceived transaction cost issues from earlier NMTC rounds are being addressed in current transactions due to changes implemented by CDFI Fund by improved CIIS Reporting.

Structuring Transaction Costs
Efficiency of transactions costs is an important goal; however, we observe that transaction costs are a necessary part of the program; they pay for critical program oversight including effective due diligence and compliance monitoring, amongst other roles. We believe that transactional costs to be incurred over the expected life of a NMTC investment are generally reported at closing as a cost. Periodic transactional costs incurred under other programs frequently are not included in the estimate of transactional costs. The effect of this inconsistent analysis is to overstate NMTC costs when compared to other programs. We believe that additional efficiencies can be achieved but urge the Fund to proceed cautiously. NH&RA advises that the Fund pursue an approach that balances efforts to decrease transaction costs while maintaining the inherent flexibilities that are a hallmark of the program. We believe that the ultimate goal should be a multipronged approach that ultimately focuses on increasing the net benefit of NMTC subsidy to QALICBs.

As with most complicated financings, many NMTC transaction costs (legal, accounting, audit, compliance monitoring, etc...) are essentially fixed regardless of overall transaction size. Moreover, transaction costs in many NMTC transactions arise from combining the NMTC program with other regulated or governmental funding sources, and in these cases increased transaction costs are often attributable to the other funding sources. We strongly believe that combining funding sources should be encouraged.

NH&RA believes it is possible that over-regulation could result in lost programmatic flexibility, which in turn creates less diversity in transaction size and type. Similarly, changes that address fees associated with the administration of the program must be considered very carefully. We recognize that this is an area where program participants have benefited from a great deal of streamlining over time. Competition and market forces have addressed perceived issues in this area and the CDFI Fund has effectively encouraged greater efficiency through improved program reporting requirements. As with the discussion regarding transaction costs, we caution that a one-size fits all approach to fees may have unintended consequences including but not limited to preventing smaller CDEs from participating in the program and/or preventing deeper subsidy and benefits from flowing to QALICBs.

OID, Non-Qualified Financial Property and Redemption Issues
NH&RA believes that significant decreases in transaction costs (in particular legal and accounting) can be achieved by addressing technical structuring issues resulting from a series of tax and regulatory issues. We refer the CDFI Fund to previously submitted comments from NH&RA in July of 2011 to the IRS, CDFI Fund and Department of Treasury addressing Original Issue Discount (OID) issues, Non-Qualified Financial Property and the creation of a redemption safe harbor (see Appendices I, II, and III respectively).

Integrated Unit Test
Clarifying the "integrated unit test" on projects involving multiple buildings could also reduce some structuring and compliance costs. As you are aware, to be a qualified business within a low-income community less than 80 percent of the owner's rental income may be derived from residential rental property. NH&RA supports clarifying that this income test may always be applied on a project wide basis for contiguous real estate as opposed a facts and circumstances based approach to multiple building projects.

Management & Control
Clarification of the definition of a "management control rules" in the September QQ&A for the purposes of NMTC allocation applications can help decrease operational costs by allowing smaller CDEs to engage more experienced and efficient service providers to help with the administrative and day-to-day management of their activities. NH&RA recommends adopting the interpretation outlined in our whitepaper "The Ability to Enter into Contracts Related to the Day-to-Day Management and control of CDEs", which was transmitted to the CDFI Fund in June of 2007. (See Appendix IV)

Reasonable Expectations Test
NH&RA applauds the CDFI Fund's changes in 2010 to the timing of the related party test. Prior to the CDFI Fund adopting these changes in its 2010 NMTC Q&A document, the timing of the related party test was a major deterrent for CDEs to make equity investments in QALICBs. As a result, the bulk of NMTC transactions were structured as debt, which, in our view is not always the most efficient use of capital. The CDFI Fund's revised Q&A makes significant strides towards encouraging CDEs to make equity investments in QALICBs. Unfortunately, as we observed in a letter to the Treasury Department on September 1, 2010, the application of the reasonable expectations test as defined by Treasury Regulation §1.45D-1(d)(6) would impact equity investments in QALICBs in conjunction with the changing of the timing of the related

party test. We urge the Treasury department to adopt the changes to the reasonable expectations test recommended in our September 1, 2010 letter (see appendix 5). Equity is the most patient form of capital and in many cases is a more efficient subsidy delivery device for QALICBs.

We believe that this issue can be resolved by clarifying the definition of "control" for the purposes of the reasonable expectations tests to be based solely on the CDE's ability to actually control the QALICB's status as a QALICB through voting or management rights. Specifically, this can be achieved by removing the reference to the equity value-based test and clarifying that "control" for the purposes of this test should be based solely on the CDE's ability to make changes to the QALICB's operations and business activities that would put it out of NMTC compliance.

Conclusion
NH&RA appreciates the opportunity to provide you with this feedback and look forward to the opportunity to discuss these comments with you further at your convenience. Please do not hesitate to contact me at 202-939-1753 or tamdur@housingonline.com with any questions.

Sincerely,

Thom Amdur
Executive Director

cc: Matt Josephs
Rosa Martinez

Appendix I

Original Issue Discount Proposal

Previously Submitted by
NH&RA's New Markets Tax Credit Steering Committee
July 18, 2011

Much time and effort is being expended in structuring new markets tax credit ("NMTC") transactions to avoid inadvertently triggering the original issue discount ("OID") rules relating to aggregation of separate but contemporaneous loans made by qualified community development entities ("CDEs") to qualified active low-income community businesses ("QALICBs"). Treas. Reg. Section 1.1275-2(c)(1) provides that "debt instruments issued in connection with the same transaction or related transactions (determined based on all the facts and circumstances) are treated as a single debt instrument for purposes of sections 1271 through 1275 and the regulations thereunder". Consider the following example of how that aggregation rule impacts the structuring of NMTC transactions.

In a leveraged transaction, a leverage lender makes a $7,500,000 loan (the "Leverage Loan") to the leverage fund (the "Leverage Fund") at an interest rate of 6% per annum with interest-only payments due until the final maturity at year 7. Upon the Leverage Fund's making of a $10,000,000 qualified equity investment ("QEI") into a CDE, the CDE makes two loans to the QALICB: a $7,500,000 "A" loan with an interest rate and other payment terms identical to terms of the Leverage Loan, and a $2,500,000 "B" loan (which effectively represents the NMTC equity contributed to the Leverage Fund by the NMTC investor) with a maturity of 30 years and an annual interest rate of 0.5%. The intent of the parties is to be able to distribute all CDE's A loan receipts to the Leverage Fund to make scheduled debt service payments on the Leverage Loan, and to utilize all of the CDE's B loan interest receipts during the seven-year NMTC compliance period to pay CDE level fees and expenses. A reasonable interpretation of Treas. Reg. Section 1.1275-2(c)(1) would require aggregation of the CDE's A and B loans, and under that interpretation those loans would be treated as issued with OID because the overall blended loan interest rate would decrease after the maturity of the A loan bearing interest at 6% because the B loan with a 1% interest rate would remain outstanding for another 23 years. Under that example and assuming that it is proper to aggregate the CDE's A and B loans for purposes of Treas. Reg. Section 1.1275-2(c)(1), the CDE's taxable income from the A and B loans would be less than the amount of cash loan payments it receives from those loans during the NMTC compliance. As a result, the CDE would not be permitted to fully distribute to the Leverage Fund all the cash loan payments remaining following payment of its CDE level fees and expenses because the CDE's "operating income" (computed in accordance with Treas. Reg. Section 1.45D-1(e)(3)(iii)) would reflect a smaller amount of taxable income from the loans than the CDE's loan receipts. A portion of the CDE loan receipts become "cash trapped" at the CDE level, and the Leverage Fund defaults on its Leverage Loan payment obligations. In addition, if the aggregation rule applies a portion of each loan payment would be treated as a payment of principal rather than interest, thereby lowering the QLICI amount.

A typical response to that structuring challenge has been to restructure the transaction to provide for a blended, identical interest rate on the CDE's A and B loans (in the example above, the blended rate would be 4.625% per annum). While that solves the issue of the "cash trap", it results in the QALICB paying more interest over the term of the loans than would otherwise be required. Requiring the intended beneficiary to pay additional loan interest in order to avoid a technical tax issue does not seem to advance the policy purposes of the NMTC program, but often CDEs acting out of an abundance of caution are often forced to adopt this structure.
We propose that the Service provide guidance that, solely for computing a CDE's "operating income" for purposes of Treas. Reg. Section 1.45D-1(e)(3)(iii) and for the principal repayment rules of Section 1.45D-1(2)(i), contemporaneous QLICI debt instruments issued by a CDE to a QALICB are not required to be aggregated under Treas. Reg. Section 1.1275-2(c)(1) as long as (1) one of the QLICI debt instruments has identical payment terms to the corresponding leverage loan and (2) the leverage loan does not require any scheduled repayment of principal during the 7 year NMTC compliance period.

Appendix II

Nonqualified Financial Property

Previously Submitted by
NH&RA's New Markets Tax Credit Steering Committee
July 18, 2011

The term, qualified active low income community business ("QALICB") requires, inter alia, that "less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property. See IRC Section 45D(d)(2)(A)(v). The term "nonqualified financial property" typically means liquid assets, but there is an exception for a reasonable amount of working capital held in cash, cash equivalents or debt instruments "with a term of 18 months or less." See Treas. Reg. Section 1.45D-1(d)(4)(i)(E). However, there is a specific rule regarding the construction of real property. It provides that the proceeds of a capital or equity investment or loan by a CDE that will be expended for construction of real property within 12 months after the date the investment or loan is made will be treated as a "reasonable amount of working capital."

Many commentators believe that the aforesaid exception is a "safe harbor" rule, although others conclude that the above-described language sets forth a bright line. Because the construction of real property often extends well beyond 12 months – to perhaps 18 to 24 months -- the regulatory language is a disincentive to community development entities to make qualified low-income community investments to fund many legitimate projects because the construction period extends beyond the limits. Accordingly, it is recommended that Treas. Reg. Section 1.45D-(d)(4)(i)(E)(2) entitled "Construction of real property", be described as a "safe harbor" and further modified to extend from 12 months to 24 months after the date the investment or loan is made in order to be treated as a reasonable amount of working capital. Currently, if a Community Development Entity (CDE) wants to make a loan to a QALICB involved in the construction of real estate and anticipates that the construction period will exceed 12 months, they generally have two options.

1. They can receive the QEI from their investor, but wait nearly 12 months to advance the money to the QALICB.
2. Their investors can make multiple QEIs over a span of 12 to 24 months.

Both these approaches unnecessarily cause an increase in transaction costs.

<u>Retention of Cash by CDE</u>
If the cash is retained by the CDE, then the CDE may incur negative interest rate arbitrage by holding the funds at the CDE level and then lending the money to the QLICI over the next 12 months. Furthermore, the CDE will incur actual transaction costs as it makes each disbursement.

<u>Multiple QEIs</u>
If the CDE accepts multiple QEIs, then the CDE may avoid negative interest rate arbitrage by holding the funds at the CDE level, but will incur additional transaction costs with each QEI it receives, in addition to the actual transaction costs as it disburses the funds to the CDE.
A longer safer harbor period would help reduce these costs and allow more subsidy to benefit the borrower. One potential concern with a longer safe harbor might be that the funds would not be benefitting the QALICBs for a longer period of time. We note that the CDE has no incentive to hold the dollars nor does the QALICB. We also note that when the dollars are in escrow at the QALICB level, they provide added assurance to other lenders and reduce borrowing costs.

We believe that the CDE does not have a compelling incentive to delay making the loan, nor does the borrower have incentives to delay using the funds. We also note that a QALICB has 3 years to generate revenue. Such a rule contemplates start-up businesses and implicitly recognizes that some QALICBs have longer start-up periods, including the real estate construction period with multi-year construction periods.
In the alternative, we would suggest that the IRS provide additional guidance as to the definition of 'reasonable" working capital for a real estate construction project that exceeds 12 months.

Appendix III

Redemption Safe Harbor Proposal

Previously Submitted by
NH&RA's New Markets Tax Credit Steering Committee
July 18, 2011

The Internal Revenue Service has taken the position that redemption or return of capital of any portion of a qualified equity investment triggers a recapture of one hundred percent of the New Markets Tax Credit ("NMTC") claimed as well as loss of future NMTC with respect to that qualified equity investment. Section 45D(g)(3)(C) of the Internal Revenue Code of 1986, as amended (the "Code"). Treasury Regulation Section 1.45D-1(e)(3)(iii) created a safe harbor with respect to the distribution of income from a CDE taxable as a partnership to its partners. The regulations permit distribution of an amount equal to the operating income for such year. Proposed Regulations modified the annual test by permitting distribution of amounts not in excess of the accumulated operating income for the current and prior year. Proposed Treasury Regulation Section 1.45D-1(e)(3)(iii). Some CDEs have accumulated amounts received from QALICBs for periods in excess of two years. Whenever this happens, such amounts become trapped at the CDE level until the end of the seven year recapture period and cannot be distributed without triggering a redemption prior to termination. We cannot identify any sound policy reason why a CDE could not distribute the entire amount of its accumulated operating income through a particular point within the recapture period in a single distribution.

Accordingly, we recommend that the following language be included in Treasury Regulation Section 1.45D-1(e)(iii). "In the case of an equity investment that is a capital interest in a CDE that is a partnership for federal income tax purposes, a pro rata cash distribution by the CDE to its partner based upon each partner's capital interest in the CDE during the taxable year will not be treated as a redemption for purposes of paragraph (e)(2)(iii) of this Section provided that either the distribution does not exceed the CDE's operating income for the taxable year or the sum of the current year distributions and all prior distributions does not exceed the CDE's cumulative operating income for all years within the recapture period up to and including the date of distribution."

In addition, in the event that a CDE is a corporation that has received multiple QEIs, the CDE should be permitted to trace distributions made to particular QEIs upon the termination of the seven year recapture period with respect to such QEI. In the absence of an ability to trace a return of capital to a particular QEI, amounts received upon the repayment of a QLICI at its maturity likely would exceed the accumulated earnings and profits of the CDE and accordingly would be trapped at the CDE until the end of the recapture period of the last QEI received by the CDE. We do not believe that the return of QLICI principal received after the recapture period with respect to an identified QEI from which such QLICI was funded violates any policy of the NMTC program. Accordingly, we recommend that the following language be included at the end of Treasury Regulation Section 1.45D-1(e)(i). "Upon the termination of the recapture period for an identified QEI, the CDE shall be permitted to distribute the proceeds received with respect to any QLICI funded from the proceeds of such QEI without such distribution being treated as a redemption pursuant to paragraph 1.45D-1(e)(3)(i)."

The adoption of these recommendations would achieve consistency between the treatment of corporate and partnership CDEs with respect to the characterization of distributions as a redemption without permitting a premature distribution of capital with respect to a QEI.

Appendix IV

The Ability to Enter into Contracts Related to the Day-to-Day Management and Control of CDEs

Previously Submitted by
NH&RA's New Markets Tax Credit Steering Committee
June 5, 2007

Background:
The Community Development Financial Institutions Fund ("CDFI Fund") modified the rules relating to the management and investment control of community development entities ("CDEs") beginning with the fourth round of New Markets Tax Credit ("NMTC") allocations. The 2006 and 2007 NMTC Allocation Applications state that a "Controlling Entity" of a CDE must control of the day-to-day management and operations (including investment decisions) of the CDE. Prior NMTC Allocation Applications merely recommended that an applicant CDE designate an entity with the power to control the management and investments of the applicant as the Controlling Entity.

The CDFI Fund's decision was likely motivated by a desire by the CDFI Fund Administrators to protect CDEs, particularly smaller and less experienced CDEs, from being controlled by larger players in the marketplace. Notwithstanding these good intentions, this change has restricted the options available to CDEs by potentially requiring each CDE to refrain from obtaining third party assistance in critical areas by requiring an increased level of involvement from the Controlling Entities in the day-to-day management of the CDEs. Depending on how these requirements are interpreted, the change may prohibit or discourage smaller CDEs from securing professional assistance from more experienced and efficient service providers capable of assisting with the administrative and day-to-day management of their activities. This negatively impacts smaller CDEs. The change could also, if narrowly interpreted by the CDFI Fund, diminish the success of the NMTC Program.

Proposal:
The NMTC Steering Committee believes that this new rule should be interpreted in a manner that allows for CDEs and their Controlling Entities to contract with service providers or asset managers capable of efficiently assisting them in the management of their operations without triggering control issues under the NMTC Program. Service contracts which provide discretion to providers do not necessarily cede investment control to the service providers. Rather, investment control would remain the responsibility of the CDEs and the service providers/asset managers would provide assistance with the day-to-day management and administrative tasks for the CDEs.

The new rule appearing in the 2006 and 2007 NMTC Allocation Applications does not expressly prohibit Controlling Entities and CDEs from entering into such contracts with asset managers or service providers with the expertise to manage the day-to-day affairs of CDEs, but the extent to which the CDFI Fund would permit such contracts is unclear. The NMTC Steering Committee believes that the NMTC program would benefit from clear guidance from the CDFI Fund with respect to this issue. Guidance with respect to this issue will provide greater certainty to CDEs looking for effective and experienced management of many aspects of their operations. The NMTC Steering Committee therefore suggests the CDFI Fund adopt the proposal set forth herein.

It has been suggested that service contracts which permit the CDE to terminate the agreement at any time without cause would be necessary to meet control requirements in rounds 4 and 5. This sounds good but is not practicable or workable. Service providers will not undertake start up costs and ongoing commitments to staff, facilities and the like if they can be terminated without cause without a significant termination fee. The CDEs and Controlling Entities need to be able to include termination for cause only provisions in service contracts without running afoul of CDFI rules. The inclusion of termination for cause provisions would still provide CDEs with the ability to oversee the actions of the service providers. Service agreements will carefully layout the responsibilities of the service providers. If these responsibilities are not met, the agreements can be terminable by the CDEs for cause.

The NMTC Program would benefit as a whole under this approach since NMTC investors are more likely to acquire credits from CDEs that have experienced service providers and will pay better prices for the credits. Smaller CDEs will benefit the most from this approach because their position in the marketplace will be enhanced and NMTC investors will have more confidence in the smaller CDEs.

Conclusion:
The NMTC Steering Committee would like to find a balance under the new rule that (i) allows CDEs and Controlling Entities to enter into management agreements related to the daily operations of CDEs and (ii) ensures that the CDEs retain control over key decisions. In particular, each CDE needs to be able to maintain control over its basic initial investment activities, while still being able to develop a management system that works for it and provides the CDE with an appropriate level of oversight. By allowing the Controlling Entities and CDEs to enter into management agreements that are terminable only for cause, CDEs will be able to secure efficient, competent and experienced management teams that would otherwise be unavailable. Under this approach, the Controlling Entities and CDEs would retain the critical right to make investment decisions and to terminate the management contracts if a service provider fails to perform as expected. This approach offers flexibility and still protects the interest of the NMTC Program.

Appendix V

Reasonable Expectations Test

Previously Submitted by
NH&RA's New Markets Tax Credit Steering Committee
September 1, 2010

National Housing & Rehabilitation Association (NH&RA) is a national trade association primarily comprised of real estate developers who utilize federal tax credit programs to develop affordable housing, redevelop and preserve historic structures and spur community development. In particular, our members use the New Markets Tax Credit and Historic Rehabilitation Tax Credit as vehicles to make investments in low-income communities and would like to provide you with the following set of comments pertaining to Treasury Regulation §1.45D-1(d)(6)ii)(B).

Background
Over the past several years, NH&RA worked closely with the CDFI Fund urging regulatory changes that would make it easier for CDEs to make equity investments in QALICBs. In particular, NH&RA urged, and the CDFI Fund eventually opted to change the timing of the test for relatedness after the Qualified Equity Investment (QEI) is made in the CDE but before the CDE uses the proceeds of that QEI for making its initial Qualified Low Income Community Investment (QLICI) in the QALICB.

Prior to the CDFI Fund adopting this recommendation in its 2010 NMTC Q&A document, the timing of the related part test was a major deterrent for CDEs to make equity investments in

QALICBs. As a result, the bulk of NMTC transactions were structured as debt, which, as explained below, in our view is not always the most efficient use of capital.

We applaud the CDFI Fund's recent change in the timing of the related party test. The CDFI Fund's revised Q&A makes significant strides to towards encouraging CDEs to make equity investments in QALICBs. . Regrettably, in our focus on CDFI Fund regulations and the timing of the related party test, we overlooked how the application of the reasonable expectations test as defined by Treasury Regulation §1.45D-1(d)(6) would impact equity investments in QALICBs in conjunction with the changing of the timing of the related party test. We apologize for not bringing this to your attention sooner and would like to point out the following concern, outlined below.

Reasonable Expectations Test

Under Treasury Regulation §1.45D-1(d)(6), a CDE is able to avoid a recapture event if a QALICB fails to maintain its QALICB status during the compliance period if it can document it had a "reasonable expectation" that the QALICB would remain in compliance. However, a CDE may not rely on the reasonable expectations test if the CDE "controls" the QALICB, through either direct or indirect ownership based on the value of its equity interests or through controlling management rights.

The reasonable expectations test as crafted was designed to:

1. Safeguard that helps insure the QALICB stays a QALICB during the program's 7-year compliance period; and
2. Provide a reasonable safe harbor for the tax credit investor.

The reasonable expectations test provides an effective (and desirable) safe harbor for NMTC debt transactions. Unfortunately, it is less effective for equity transactions and as a result contributes to discouraging equity investments in QALICBs. We believe this could be easily remedied administratively.

The problem arises because of a lack of guidance in §1.45D-1(d)(6) on how to value equity as it relates to control of a QALICB that received NMTC equity. Absent any guidance it is uncertain whether a CDE that contributes more than 50 percent of the equity in a NMTC transaction is deemed by the IRS to be a controlling entity of the QALICB.

For practical purposes, CDE's making equity investments in QALICBs are limited partners. Their equity functions differently than what we may think of as traditional equity—it confers upon them different and more limited rights and responsibilities. NMTC partnerships are typically structured so that the equity investor does not have management or voting rights that would allow them to control the QALICBs status, even if they have a majority stake in the equity of a project.

Without the safe-harbor of the reasonable expectations test, investors have indicated that they will not take the recapture risk associated with QALICB noncompliance for the entire 7-year period. This will dramatically reduce the amount of equity that can be invested in a project; and, for investors negate their participation entirely. As currently structured, the regulations governing the ability to rely on reasonable expectations do not take this into account, and as a result the reasonable expectations test presently acts as a deterrent to equity investments in QALICBs.

Why Equity Is Important

Given the nature and goals of the NMTC, we think it is very important that there is a viable equity investment option. Equity is the most patient form of capital and in many cases is a more efficient subsidy delivery device for QALICBs. Logically, the more equity that can be raised for a project the less debt the project has to bear. A QALICB with limited or no equity will have to generate proportionately more cash flow to service the debt. More debt implicitly means more debt service, which in turn requires higher rents—rents that cannot be supported in highly distressed communities.

QALICBs serve social/community purposes that are not served or cannot be financed with market rate financial products but for the NMTC subsidy. They are often very tightly underwritten with little margin for error. The types of ventures financed by the NMTC are very often start-ups and are in challenging low-income markets. The option for patient equity financing gives the QALICBs time to establish themselves without over-leveraging. Given the current credit crunch, equity is also often a more efficient and economical financing option as opposed to increasing difficult-to-access debt products. It is also notable that reducing the size of the equity contribution CDEs can make also reduces the QALICBs' ability to leverage other state and federal tax credits like the historic and solar tax credits.

The Solution

We believe that this issue can be resolved by clarifying the definition of control for the purposes of the reasonable expectations tests to be based solely on the CDE's ability to actually control the QALICB's status as a QALICB through voting or management rights. Specifically, this can be achieved by removing the reference to the equity value-based test and clarifying that "control" for the purposes of this test should be based solely on the CDE's ability to make changes to the QALICB's operations and business activities that would put it out of NMTC compliance.

We further concur with other industry comments that the only type of control based on voting or management rights that should be of concern in the context of the reasonable expectation test is control based on rights that enable the CDE to either:

1. Cause the QALICB to take actions that result in the QALICB failing to remain an QALICB or;
2. Allow the CDE to override or block actions by the QALICB when the authority to take such actions is necessary to enable the entity to remain a QALICB

The ability to exercise management or voting control on other issues would not seem to bear on whether the CDE should be allowed to rely on its own reasonable expectations of compliance as a safe harbor.

Conclusion

NH&RA believes that, if adopted, these proposed changes will have an immediate and positive impact on the program, attracting new equity investors, creating new efficiencies and better meeting the intentions of the program as it was initially conceived and enacted. Thank you for your time and consideration. Please feel free to contact me if you any questions regarding these comments or if I can be of any further assistance.