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Capital for Communities –
Opportunities for People℠

September 2, 2011

CC:PA:LPD:PR (REG-101826-11)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir/Madam:

On behalf of Community Reinvestment Fund, USA, ("CRF"), I appreciate this opportunity to comment on regulations proposed by the Internal Revenue Service, ("IRS"), to modify the New Markets Tax Credit (IRC Section 45D) to facilitate and encourage investment in non-real estate businesses in low-income communities. Our comments respond to the IRS' Notice of Proposed Rulemaking published in the *Federal Register* on June 7, 2011.

BACKGROUND

CRF is a nationally certified CDFI, and the nation's leader in channeling resources from the capital markets to support community development financing activities. Our mission is to transform the community development finance system by accessing capital markets on behalf of local lending organizations so that together we can create long-term sustainable jobs, finance the businesses that generate jobs, and strengthen the social ecosystem that supports them – particularly in low-income communities. Since 1988, CRF and its affiliates have delivered nearly $1.3 billion in capital, primarily to small businesses located in more than 750 communities across the country. This lending has, in turn, leveraged $1.3 billion in additional funds for total project resources. In collaboration with our network of 157 local lending partners, we have funded a total of 2,310 loans located in 46 states and the District of Columbia. Through these activities, CRF has directly assisted more than 500,000 families, including financing 17,465 homes of which 17,138 are affordable, providing credit to 1,300 small businesses, creating or retaining almost 44,000 jobs and funding community facilities that serve 426,000 families.

CRF was founded on a vision improving the lives of people living and working in economically disadvantaged areas by creating a secondary market for community development loans. For more than 23 years, we have fulfilled this vision by purchasing and pooling loans from community development financial institutions ("CDFIs") and other community-based nonprofits, as well as governmental and quasi-public lending agencies. We transform these loan pools into securities that are sold to banks, thrifts, insurance companies, pension funds and other qualified institutional investors. In this way, we bring capital from Wall Street to Main Street.

As the first nonprofit financial intermediary to issue securities collateralized by community development loans, we continually seek to connect underserved communities to new sources of capital. Since 1989, we have issued nineteen series of Community Reinvestment Fund Revenue Notes totaling $325.3 million and three securities backed by affordable housing loans. In 2004, CRF marked a major milestone, by issuing two rated debt offerings; one secured by a pool of affordable housing loans, and the second collateralized by small business loans. In both cases, the highest class of certificates or tranches received a "AAA" rating from Standard & Poor's. Subsequently, we have issued two more rated debt offerings that brought more than $100 million in capital to low-income communities.

In keeping with our commitment to finance businesses in distressed communities, CRF was an early and strong proponent of the New Markets Tax Credit ("NMTC") Program. We were instrumental in shaping this new program because we saw the potential of the tax credit to support the credit needs of business borrowers. Using our very first allocation, we pioneered the development of our own NMTC loan product that provides long-term, flexible, credit at below-market interest rates for both for-profit and non-profit businesses seeking to purchase operating facilities or equipment for their operations. This type of capital has become increasingly difficult to access in the wake of the Great Recession, yet it is *essential* for businesses to create jobs and growth – particularly in economically challenged communities.

Since the inception of the NMTC Program in 2000, CRF has established a powerful and proven track record of originating and managing tax credit investments to underserved businesses located in low-income communities across the country. Together with its affiliate, National New Markets Tax Credit Fund, Inc., ("NNMTCF"), CRF has become one of the largest allocatees in the country, receiving tax credit allocations in six of the eight funding rounds totaling $674.5 million and investing $52.5 million on behalf of other allocatees. Working through our local lending partners, CRF has used tax credit resources *exclusively* to make flexible loans to businesses and community facilities located in highly distressed low-income communities. To date, we have funded 370 NMTC loans totaling $679.4 million, which have created or retained 17,212 jobs and served more than 296,000 low-income people and residents of low-income communities in 187 cities in 34 states. No other CDE is deploying New Markets Tax Credits specifically for business lending purposes on this scale.

It should also be noted that NNMTCF has funded more Qualified Low-Income Community Investments, ('QLICIs"), than any other Community Development Entity, ("CDE"). According data collected by the CDFI Fund at the end of 2009, NNMTCF's portfolio of 264 individual QLICIs was more than 20 times larger than the average CDE's portfolio of 13 QLICIs.[1] The second largest portfolio consisted of 98 QLICIs, or only 37% the size of our portfolio.

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[1] See report on NMTC Program Projects Financed through 2009 at http://www.cdfifund.gov/docs/nmtc/nmtc_qlici_2009.jpg.

GENERAL COMMENTS

We would like to express our appreciation to the Internal Revenue Service for their efforts to encourage greater New Market Tax Credit investment in operating businesses. Nothing is more important to the health and well being of our economy than supporting businesses that can create living wage employment opportunities and economic growth in low-income and underserved communities. We must use all "tools in our tool box" to jump-start our economy by helping business borrowers gain access to appropriate credit and capital. We whole-heartedly support efforts to modify the NMTC program regulations to make it easier for CDEs and their Investors to provide capital to operating businesses.

As noted above, CRF's affiliate, NNMTCF, is a national leader and perhaps the CDE most active in using the tax credit to provide credit to operating businesses. This financing activity is at the very core of our business model and how we deploy NMTC resources. We designed our NMTC loan product with flexible terms to support operating companies of all sizes, regardless of how the financing is used. Our objective is to ensure that operating companies get access to the financing they need to conduct their on-going business activities. We do not place restrictions on the purpose or use of the loan. Delivering the benefits of the tax credit more effectively and efficiently to operating businesses is one of the best ways to ensure that we make capital available to the "engines" of economic growth in our economy, i.e. businesses that can create jobs and get the country moving again.

We are greatly encouraged by this opportunity to suggest modifications to the NMTC regulations and would like to offer the following recommendations to enhance the ability of CDEs to make more non-real estate investments.

The first order of business is to clearly define the types of loans and/or investments these regulatory modifications seek to facilitate. In our view, ***the goal is to promote greater use of the tax credit for loans and/or investments to non-real estate operating companies that can create jobs and growth in low-income communities.*** However, these loans and investments should be available to meet *any* financing needs of an operating company. Except for those uses specifically excluded by statute, there should be *no* restrictions placed on how the resources are used, *only* that these funds *must* be used to support firms whose predominant business activity is *NOT* the development, management or leasing of real estate.

The proposed regulations define ***"….a non-real estate qualified active low-income community business as any business whose predominant business activity (measured by more than 50 percent of the business' gross income) does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate."*** The language proposed restricts the type of loan or investment to one which is not ***".….connected to the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate."***

We agree with the first part of the proposed definition, but oppose the limitation placed on the purpose of the loan. CRF has a successful track record of making NMTC loans to operating businesses for the purchase, rehabilitation, construction of their facilities, the acquisition of large equipment and general working capital purposes. Virtually all of our tax credit allocations have been used to support operating businesses and we understand their need for flexible financing. With this in mind, the regulations should seek to encourage financing for non-real estate operating companies, (and any Special Purpose Entities, ("SPEs"), they may establish), *solely* on the basis of the predominant business activity of the firm. If the objective is to increase the availability of NMTC resources to meet the financing needs of operating businesses so that they can create growth and jobs in low-income communities, then the regulations *should not* proscribe the purposes for which these resources may be used. Operating businesses need the greatest latitude to deploy the tax credit proceeds in a way that helps the company to grow and provide employment and economic opportunities for residents of underserved communities.

We propose the following modified language to reflect a more flexible approach to defining a non-real estate qualified active low-income community business.

(9) <u>Non-real estate qualified active low-income community business</u> – (i) Definition. The term <u>non-real estate qualified active low-income community business,</u> ***("NRE QALICB")****, means any qualified active low-income community business (as defined in paragraph (d)(4) of this section)* ***(or a Special Purpose Entity established by the non-real estate qualified active low-income community business solely for the purpose of holding real estate or equipment)*** *whose predominant business activity (measured by more than 50 percent of the business' gross income) does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate. The purpose of the investment or loan must not be connected to the development (including construction of new facilities and rehabilitation/enhancement of existing facilities* ***except for facilities used primarily in such operating business****), management, or leasing of real estate."*

As part of the definition of a "non-real estate qualified active low-income community business," we also propose that the 12-month safe harbor period providing that funds which are to be used for construction are to be considered "working capital" be extended to 18 months. This longer time frame is more appropriate for an operating business which when involved in a construction project is also conducting its normal trade or business. Accordingly, the construction time is often longer for an operating business to complete a construction project as opposed to a real estate developer who has no other concerns than completing construction.

In addition to clearly defining a "non-real estate qualified active community business," the IRS must address the primary disincentives to using the NMTC for non-real estate operating companies: the 7-year term of the tax credit combined with investor concerns related to the reinvestment and "substantially all" requirements (IRC 45D – 1(c)(5).

The 7-year term presents a problem for tax credit investors because operating businesses typically take the form of amortizing loans or investments with shorter maturities. In the event that principal on amortizing loans is repaid during the seven year period, the CDE is required to redeploy the principal repayments within a specified period of time or trigger "recapture" of the tax credit. Investors are keenly aware of the severe penalties associated with recapture should a CDE fail to meet the "substantially all" requirement at any point during the 7-year compliance period. The risks and uncertainties associated with reinvesting principal repayments cause investors to be extremely hesitant to make qualified equity investments ("QEIs") in CDEs engaged in financing operating businesses. Instead, investors prefer make NMTC investments in CDEs that can guarantee that a QEI will remain fully invested in a qualified low-income community investment ("QLICI") for the full term of the tax credit. These requirements discourage CDEs from offering flexible financing products that operating businesses need, such as revolving lines of credit, working capital and equipment loans.

To encourage greater NMTC investment in non-real estate operating businesses, CRF supports the recommendation proposed by the New Market Tax Credit Coalition, ("NMTC Coalition")[2] that the IRS provide a special rule, or "safe harbor" protection for any community development entity, ("CDE") organized to make Qualified Low-Income Community Investments, ("QLICIs") in operating businesses.[3] Under this "safe harbor" protection, CDEs investing in operating businesses that receive a return of investment, such as amortized principal repayments, will not trigger recapture penalties if they are unable to re-invest in another operating business. Inability to redeploy the return on investment would not constitute a failure to comply with the "substantially all" requirement that, in turn, activates recapture of the tax credit. This safe harbor rule would address investor concerns about making QEIs in a CDE that provides financing to non-real estate operating businesses by removing the possibility of recapture due to principal or other possible repayments.

We support the language proposed by the Coalition with a few highlighted modifications, which requires a CDE seeking safe harbor protection to:

1. Satisfy the substantially all test as defined in paragraph 1.45D-1(c)(5), with the initial deployment of the Qualified Equity Investment (QEI) into one or more (Qualified Low Income Community Investments (QLICIs) made in one or more Qualified Active Low Income Community Businesses (QALICBs) as long as the ***predominant activity of the*** business ***does not include*** the ***development, management or*** leasing of a real estate project or projects; and

[2] CRF is both a founding member and a prior Chair of the New Markets Tax Credit Coalition.
[3] See New Markets Tax Credit Coalition letter to Mr. Michael Mundaca, Acting Assistant Secretary for Tax Policy, U.S. Department of Treasury, March 23, 2010.

2. Any amounts received by the CDE as a return of capital, equity or principal with respect to such a QLICI must either be reinvested in another qualified non-real estate business or retained by the CDE for the remaining term of the 7-year credit period.

To implement this "safe harbor" protection, the Coalition suggests that the CDFI Fund amend its Allocation Agreement to ensure that any CDE using this exemption is required to make a reasonable effort to re-deploy any principal that is returned within the compliance period and present evidence of such effort. Existing IRS anti-abuse provisions would also be applied to any CDE transactions.

Investors in a CDE that fails the proposed test would not be subject to recapture. However, the CDE would be subject to the range of remedies set forth in the Allocation Agreement, which could include debarment from receiving further NMTC allocations and/or participating in other CDFI Fund programs. We share the view of our Coalition colleagues that the safe harbor proposal would encourage investors to work with CDEs that have experience and a business plan in place to provide flexible debt and/or equity products, including working capital and equipment loans, to non-real estate operating businesses.

<u>SPECIFIC COMMENTS</u>

The IRS and the Treasury Department invite taxpayers to submit comments on issues relating to how a CDE can make a qualified low-income community investment into a non-real estate qualified active low-income community business. In particular, the IRS and the Treasury Department encourage taxpayers to submit comments on the following issues:

1. Will the proposed rules allowing a payment from a non-real estate qualified active low-income community business to be invested in a certified CDFI facilitate loans to, or equity investments in, non-real estate businesses? Should the rule take into account whether a loan to the non-real estate business is an amortizing or non-amortizing loan, the loan period, and the loan repayment schedule?

Unfortunately, like our colleagues at the New Market Tax Credit Coalition, we do not think the proposed rules to allow a payment from a non-real estate qualified active low-income community business to be invested in a CDFI will result in more CDE lending and investing in these types of operating businesses. We agree that the proposed rules could foster greater investment in CDFIs and this is clearly a beneficial outcome. However, we do not believe it will reduce the barriers or disincentives that currently exist to greater use of the tax credit to meet the financing or credit needs of non-real estate operating businesses. We discuss these challenges and present our recommendations for addressing them above in the General Comments section.

3. Is the definition of a non-real estate qualified active low-income community business sufficient for CDEs and investors to rely on? Are the "more than 50 percent gross income" requirement and activity limitation the appropriate ways to define a non-real estate qualified active low-income community business?

No, in our opinion, the definition of *"non-real estate qualified active low-income community business"* is too narrowly drawn. We concur with the requirement that the predominant business activity should not include the development, management, or leasing of real estate. However, we believe loans made for the purpose of acquiring, developing, expanding, and/or rehabilitating facilities for use by an operating company that is not predominantly engaged in real estate development, should be permitted under the definition of a *"non-real estate qualified active low-income community business."* See our comments above on how non-real estate QALICBs should be defined for the purpose of the NMTC program.

4. Will CDEs be able to determine whether an entity satisfies the requirements to be a non-real estate qualified active low-income community business without incurring unduly burdensome costs?

CRF does not believe that the additional procedures related to qualifying a borrower as a non-real estate qualified active low-income community business will involve unduly burdensome costs.

5. Should a payment from a non-real estate qualified active low-income community business be permitted to be invested in entities other than a certified CDFI (or qualified low-income community investments)?

We are not sure this is a relevant question since, in our view, allowing a payment from a non-real estate qualified active community business to be invested in certified CDFIs will only partially address the barriers to encouraging more investment in non-real estate QALICBs. See our comments above in General Comments section.

6. Should a qualified equity investment made before the effective date of the final regulations be eligible for designation as a non-real estate qualified equity investment?

A QALICB determination status is made at the time of origination or purchase of a loan. CDEs are required to document QALICB status at closing. Thus, we support the approach that a real estate versus a non-real estate designation should be determined at the closing for purposes of election and on-going compliance.

CONCLUSION

We appreciate this opportunity to share our views and recommendations on regulatory changes that could stimulate greater NMTC investment in operating businesses. The tax credit should be an effective tool for helping businesses, especially those located in low-income communities, to access the capital and credit that will enable them to grow and create jobs in this challenging economic environment.

We commend the IRS for their dedication and commitment to enhancing this program to meet the needs of non-real estate business borrowers. Please do not hesitate to contact me with any questions regarding comments included in this letter.

Sincerely,

Frank Altman
President and CEO