

June 27, 2011

Sent Via E-Mail

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

Dear Bob:

On behalf of the members of the New Markets Tax Credit ("NMTC") Working Group, we would like to express practical concerns and recommendations regarding the implementation of the provisions of Section 9.13 of the template Allocation Agreement ("Allocation Agreement").

The members of the NMTC Working Group are participants in the NMTC industry who work together to resolve technical NMTC Program issues and create recommendations to make the NMTC Program efficient in delivering the most amount of benefit to the end users. Our group includes allocatees, nonprofit and for profit community development entities (CDEs), investors, accountants and lawyers.

Many NMTC transactions are now nearing the end of the 7-year NMTC compliance period ("Compliance Period"), and the Compliance Period for some transactions has already expired. As the industry has gained experience with the maturity of Qualified Low-Income Community Investment ("QLICP") loans and the unwinding of NMTC transactions upon expiration of the Compliance Period, significant concerns have come to light about the proper interpretation of Section 9.13 of the Allocation Agreement. We present these comments to explain those concerns and to recommend solutions that will contribute to the efficiency of the NMTC program and reduce costs to the Qualified Active Low-Income Community Business ("QALICB") Borrower, the intended beneficiary of the NMTC program.

Section 9.13 of the Allocation Agreement

Section 9.13 of the Allocation Agreement provides as follows:

9.13 Termination. Unless otherwise mutually agreed upon in writing by the parties hereto, this Allocation Agreement shall terminate at such time that:

- a. The CDFI Fund determines that the Allocatee has submitted to the CDFI Fund all reports required by this Allocation Agreement covering the 7-year credit period (as defined in 26 C.F.R. Part 1.45D-1(c)(5)(i)) after the Allocatee issues its last Qualified Equity Investment related to its NMTC Allocation; and

- b. The CDFI Fund determines that the NMTC Allocation has been used as permitted hereby or two years after the 7-year credit period (as defined in 26 C.F.R. Part 1.45D-1(c)(5)(i)) after the Allocatee issues its last Qualified Equity Investment related to its NMTC Allocation, whichever date is earlier. [Emphasis added].

Section 9.13 does not make clear whether the term "Allocatee," as used in that Section, is intended also to apply to each Subsidiary Allocatee of an Allocatee ("Sub-Allocatee").

Although probably not anticipated when the termination section of the Allocation Agreement was drafted, the vast majority of NMTC transactions involve a Sub-Allocatee that is a single purpose entity formed for the sole purpose of undertaking a single NMTC transaction. As a result, when that transaction reaches the end of its Compliance Period, QLICI made by the Sub-Allocatee generally matures and is repaid, with the proceeds distributed by the Sub-Allocatee to its investor. In the case of longer term QLICIs, the investor typically has the right under the NMTC transaction documents to require the redemption of its interest in the Sub-Allocatee after the end of the Compliance Period by distributing the QLICI loan documents to the Investor. There is typically a put-call arrangement between the investor and another transaction party (the "Put Party"), often an affiliate of the QALICB Borrower, which, if exercised, may result in the Put Party exercising the redemption right.

In any event, the result in most cases will likely be that, after the end of the Compliance Period, the Sub-Allocatee no longer has an interest in the QLICI loan, and probably will have no assets at all. Moreover, because the Sub-Allocatee typically is a single purpose entity whose sole purpose was to undertake the NMTC transaction, the Sub-Allocatee has no reason to continue its existence after it no longer holds its QLICI. Its parent Allocatee, however, may well continue to have an existence and activity through other Sub-Allocatees for many years. Under the Allocation Agreement, the CDFI Fund could continue to monitor and exercise remedies against the Allocatee even after some of its Sub-Allocatees have dissolved.

Practical Concerns

Section 9.13 of the Allocation Agreement creates several practical problems for a Sub-Allocatee that, after the end of its Compliance Period, no longer has any assets or any reason (or even any organizational authority) allowing it to continue its existence:

1. Section 9.13(a) provides no procedure for evidencing the CDFI Fund's determination that the Allocatee has submitted all reports required by the Allocation Agreement for the 7-year Compliance Period after the Allocatee issues its last Qualified Equity Investment ("QEI"). If this requirement also applies to each Sub-Allocatee, there is no clear way to determine when this requirement has been satisfied and the Sub-Allocatee will be required to maintain its existence for an indeterminate period.
2. Section 9.13(b) of the Allocation Agreement provides that the Allocation Agreement continues in effect until the earlier of (1) the date the CDFI Fund determines that the NMTC Allocation has been used as permitted by the Allocation Agreement, or (2) two years after the Allocatee issues its last QEI. Again, if this applies to each Sub-Allocatee, the Sub-Allocatee may be forced to continue its

existence for up to two years after the end of the Compliance Period (assuming the CDFI Fund does not make the required determination earlier).¹

3. If Section 9.13 applies to each Sub-Allocatee, and a Sub-Allocatee with no ongoing interest in a QLICI is required to maintain its existence for the additional two-year period, it is not clear what provisions of the Allocation Agreement would continue to apply to it during the two-year "tail". For example, must it comply with Section 6.8 and maintain its existence as a CDE? Must it continue to maintain an Advisory Board and cause the Advisory Board to meet annually even though it no longer has an outstanding QLICI and no longer has any allocation authority? Must it continue to obtain audited financial statements even if it has no activity? Must it continue to submit Institution Level and Transaction Level Reports even if it has no activity? The CDFI Fund has issued guidance that states that these requirements continue for Allocatees and Sub-Allocatees until the Allocation Agreement terminates². Would the Sub-Allocatee continue to be subject to all of the Events of Default under the Allocation Agreement, even though many of them relate to matters that are meaningful only during the Compliance Period? Compliance with these requirements seems to serve no purpose for a Sub-Allocatee whose Compliance Period has terminated. Moreover, continued compliance by Sub-Allocatees that have no further activity is an unnecessary and possibly costly administrative burden.

4. Finally, if a single purpose Sub-Allocatee that no longer has any assets is required to maintain its existence for an additional two years after the end of the Compliance Period, and to comply with the terms of the Allocation Agreement, it will incur annual costs for tax returns, annual filing and state franchise tax fees, and the preparation of audited financial statements, among other costs. It is likely that these costs will be passed on to the QALICB Borrower under the terms of the NMTC transaction documents or as a condition to the unwind of the transaction, thus diminishing the benefit to the QALICB Borrower, the intended beneficiary of the NMTC transaction.

Recommendation

We suggest that most, if not all of these issues would be resolved if the conditions to termination of the Allocation Agreement set forth in Section 9.13 were interpreted to apply to the Allocatee but not to its Sub-Allocatees. Although the text on the signature page of the Allocation Agreement provides that each Sub-Allocatee agrees to all of the terms and conditions of the Allocation Agreement and agrees that all such terms and conditions apply to each Sub-Allocatee to the same extent as they apply to the Allocatee, the CDFI Fund has issued guidance to the effect that certain provisions of the Allocation Agreement apply only to the Allocatee. For example, the May 2009 FAQ provides that the CDFI Fund will monitor compliance with Section 3.2 of the Allocation Agreement on a consolidated basis for the total allocation amount and not separately for each Sub-Allocatee³. The CDFI Fund has also provided that only Allocatees are required to submit audited financial statements to the CDFI Fund. However in lieu of collecting each Sub-Allocatee's audited financial statement, the CDFI Fund will require each

¹ It should be noted that, since the Sub-Allocation to the Subsidiary Allocatee will have been "used" when the QEI is made at the beginning of the 7-year Compliance Period, it is not clear why it is necessary to wait until the end of Compliance Period to determine if it was used properly.

² New Markets Tax Credit Compliance Monitoring and Frequently Asked Questions (May 2009) (the "May 2009 FAQ")

³ Q&A 19, May 2009 FAQ

Allocatee to simply certify that each Sub-Allocatee has obtained an "unqualified" opinion on its most recent financial statements⁴.

We suggest that, to address the concerns set forth in this letter, the CDFI Fund issue guidance analogous to the above guidance, to the effect that the conditions to termination of the Allocation Agreement set forth in Section 9.13 will apply on a consolidated basis for the total amount allocated to each Allocatee and not separately for each Sub-Allocatee, and the Allocation Agreement will terminate as to a Sub-Allocatee upon expiration of the 7-year credit period after the Sub-Allocatee issues its last Qualified Equity Investment [or the earlier occurrence of an event of recapture], provided that the Sub-Allocatee has submitted to the CDFI Fund all reports required by the Allocation Agreement for such 7-year period.


Because the conditions on termination of Section 9.13 would stay in place with respect to Allocatees, the CDFI Fund would continue to have the ability to monitor performance of the Allocatee and its use of its Allocation, itself or through its Sub-Allocatees, and to exercise remedies against the Allocatee for Events of Default.

We are excited about the positive impact that the NMTC Program is having on the nation's low-income communities and low-income persons and the potential for future success. However, we believe that the program can become even more efficient and deliver more subsidy to the end users within low-income communities. Thank you in advance for your time and consideration.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,

Novogradac & Company LLP

by 
Michael J. Novogradac,
along with the undersigned

Novogradac & Company LLP

by 
Brad Elphick,

cc: Trefor Henry

Rosa Martinez

⁴ Q&A 32, May 2009 FAQ