

August 28, 2006

Sent Via Mail and E-Mail

Matt Josephs
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 Matt:

As participants in the New Markets Tax Credit (“NMTC”) industry, Novogradac and Company LLP along with the undersigned, have joined together to provide the Community Development Financial Institutions Fund (the “CDFI Fund”) our comments on the New Markets Tax Credit Program draft Allocation Agreement (“Allocation Agreement”). For your convenience, we have provided specific comments in order of specific sections within the Allocation Agreement. In the future, we believe it would be very beneficial if the CDFI Fund could provide a black-line copy of all of the changes made to the prior round’s allocation agreement.

Section 2.20 Reinvestment

We believe that the term “reinvestment” should be interpreted consistent with the rules set forth in the Internal Revenue Code (“IRC”) and Regulations. As such, we recommend adding the following language to the end of the current definition: “...as set forth in IRC § 45D(b)(1)(B) and 26 C.F.R. 1.45D-1(d)(2).”

Section 2.21 Repayment

We believe that the term “repayment” should be interpreted consistent with the rules set forth in the IRC and Regulations. As such, we recommend adding the following language to the end of the current definition: “...as set forth in IRC § 45D(b)(1)(B) and 26 C.F.R. 1.45D-1(d)(2).”

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Section 3.2(f) Authorized Uses of NMTC Allocation

Section 3.2(f), if applicable, provides that the Allocatee must demonstrate that any Qualified Low Income Community Investment (“QLICI”) it makes is flexible and non-conventional. Many participants in the industry use an “A/B” structure when making QLICIs because that structure is very useful in a leveraged model transaction. The “A” portion is typically a loan that mirrors the leveraged lender’s loan to the investment fund including its terms and conditions. The “B” portion may be in the form of a loan, which generally has an extremely low interest rate and is deeply subordinated, or in the form of an equity investment, and it is this “B” portion that provides the benefit of the tax credit subsidy to the QALICB. In most cases, this A/B combination is offered as one product and their terms and conditions on a combined basis meet the flexible, non-conventional, or non-conforming requirements outlined in this section of the Allocation Agreement. We believe that language should be added so that it is clear that Allocatees will be entitled to treat loans and/or equity investments made together as part of a combined facility as though they were one QLICI, for purposes of satisfying the requirement that any QLICI be flexible, non-conventional or non-conforming. We suggest the following:

“For purposes of this Section 3.2(f), if two or more QLICIs are made by the Allocatee to a CDE or QALICB (or set of related CDEs or QALICBs) as part of a combined financing and/or investment facility, then the Allocatee will be deemed to meet the applicable criteria set forth in this Section as to such QLICIs if such QLICIs, viewed together as a whole, satisfy such criteria.”

In addition, as part of the upcoming Allocation Agreement Q&A, we recommend that guidance be provided on the types of acceptable documentation to prove that the requirements listed in Section 3.2(f) (b) or (c) have been satisfied.

Furthermore, in the last paragraph of Section 3.2(f), it states that an Allocatee “shall require that a Recipient CDE” make loans or investments with the same requirements regarding flexible, non-conventional or non-conforming terms and conditions as the Allocatee. We believe that the term “shall require” is unclear as to the requirement placed upon the Allocatee. As part of the upcoming Allocation Agreement Q&A, we request clarification that if the Allocatee requires a Recipient CDE to make loans or investments in accordance with Section 3.2(f) and provides penalties if the Recipient CDE fails to do so, then the Allocatee will not be in default of its Allocation Agreement if the Recipient CDE fails to make loans or investments in accordance with Section 3.2(f).

Section 3.2(h) Authorized Uses of NMTC Allocation

We recommend that the Allocation Agreement allow for QLICIs made to qualified active low-income businesses (“QALICBs”) with respect to Targeted Populations to qualify as meeting the deeper targeting requirements of Section 3.2(h) by satisfying higher

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thresholds for QALICB requirements with respect to Targeted Populations. We recommend that the following be added to Section 3.2(h) as item (xvi):

“(xvi) For Allocatees that choose to make QLICIs to QALICBs for Targeted Populations, the required percentages to satisfy the gross income, employee or ownership requirements shall be 60 percent, 50 percent and 60 percent, respectively.”

We recommend that this suggested Targeted Populations item be added to the requirements of part (3) of Section 3.2(h) in the following manner:

“...or (3) characterized by item (xv) or (xvi) on the list below...”

We also recommend that 3.2(f)(xv) be changed to allow the initial project investment period for projects located in major disaster areas not located within the GO Zone be extended to 24 months. Allowing an Allocatee more time to make its initial investment in a disaster declared area will allow investors to make more coordinated investments with the overall recovery plans of the local area.

Section 3.2(j) Authorized Uses of NMTC Allocation

We recommend that the phrase “related to” be removed from the second paragraph relating to the investment requirements of a Recipient CDE. The term “related” has not been defined previously and to add it here may generate confusion as to its meaning. We believe that the term Control in of itself, as defined in Section 2.6 of the Allocation Agreement, is sufficient.

Section 3.3(h) Restrictions on the Use of NMTC Allocation

We believe, in general, this provision suffers from many of the same kinds of problems that caused the IRS to withdraw its regulation regarding “substantial improvements” because it is vague, ambiguous, and creates serious impediments to the use of New Markets Tax Credits for real estate projects. Some of the questions it presents are:

- How much “new construction” or “substantial rehabilitation” must occur and how is it measured?
- Is there any time frame within which such “new construction” or “substantial rehabilitation” must occur?
- What is a “take-out financing”?
- What is a “substantial rehabilitation”?

We recommend that guidance to the questions above be given in the upcoming Allocation Agreement Q&A.

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Section 3.3(i) Restrictions on the Use of NMTC Allocation

We believe that the last sentence of this section will precipitate many questions to the CDFI Fund as to what falls within the generally consistent parameters as deals change from the original proposals in the allocation application. It is unclear if generally consistent refers to the type of transactions, including percentage of allocation used in various types of transactions (real estate loans versus equity investments in start-up businesses), community impact, or something else.

Moreover, the term “strategies” could refer to any or all of a wide range of things covered in the application, *e.g.*, methods and sources of raising capital, types of products (debt vs. equity), terms of products (rates, maturities), targeted uses (real estate vs. non-real estate, types of target businesses), targeted geographic areas, community impacts, etc. Much of the information that applicants are asked to provide (such as the projections in Tables B1 through B7) are merely goals or best estimates, yet this provision raises a concern that applicants are now somehow bound to adhere to them.

Our preference would be that the CDFI Fund delete this sentence entirely. To the extent that there are specific elements of the Allocatee’s business plan as set forth in the application that the CDFI Fund wants the Allocatee to comply with, such elements should be listed in Schedule 1. This language will generate significant concerns for investors as to compliance with the Allocation Agreement due to (i) the lack of clarity and guidance on what “generally consistent” means and what the “strategies” are that the Allocatee must conform to, and (ii) the fact that, because this provision applies globally to all of the Allocatee’s investments taken as a whole, investors for each particular QLICI would be subject to the immediate and ongoing risk of whether all of the Allocatee’s investments comply with this provision.

As an alternative, we ask that the CDFI Fund at least consider revising the language in a manner that removes some of these uncertainties. We offer the following suggested revision:

“In its use of the NMTC Allocation as authorized in Section 3.2 of this Allocation Agreement, at such time as the Allocatee has made 100 percent of its QLICIs or September 30, 2009, whichever is earlier, Allocatee shall demonstrate that it has made, or used commercially reasonable efforts to make, substantially all of its QLICIs in a manner reasonably consistent with the types of products, targeted uses, and targeted markets identified in its responses to Question 17 and Question 18(b) of the Allocation Application.”

It appears that there has been a typographical error in this section because in prior allocation agreements, the control language of the first sentence has been included in

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Section 3.3(h) and the “generally consistent” language was included in Section 3.3(i) by itself.

Section 6.2(b) Fraud, Waste and Abuse

We believe the language in this section is too broad in scope and will cause much uncertainty. We believe that the language should more closely approximate the language in Treasury Regulation 1.45D-1(g)(1).¹ Specifically, we believe that the language should be as follows:

“If a principal purpose of a transaction or a series of transactions is to achieve a result that is inconsistent with the purposes of section 45D, the NMTC Program Income Tax Regulations, the Notice of Allocation Availability (70 FR 41075 and as amended 71 FR 12423), or this Allocation Agreement, the Fund may treat the transaction or series of transactions as causing an event of default subject to the remedies available under Section 8.3 of this Agreement.”

This suggested language omits the parenthetical “or if the outcome of such transaction(s) does achieve...”. This omission makes the above language consistent with Treasury Regulations. We believe that a transaction or series of transactions should only violate the Allocation Agreement if the transactions were designed with a purpose of being inconsistent. We believe that intent should be a necessary prerequisite to violating the Allocation Agreement. If an Allocatee in good faith designs a transaction or series of transactions to be in compliance with the purposes of section 45D, the NMTC Program Income Tax Regulations, the Notice of Allocation Availability (70 FR 41075 and as amended 71 FR 12423), and the Allocation Agreement, then the transaction structure should not be subject to subsequent review and arguments that a transaction or series of transactions when viewed in alternative ways, may arguably violate the provisions of this newly proposed Section 6.2(b).

Please note that the above language replaces “the Act”, with “Section 45D”. The Act, as defined in Section 2.1, includes more than Section 45D. For purposes of this provision, we believe that Section 45D is the relevant provision of the Act.

The above language also removes the parenthetical “in its sole discretion”. This omission makes the above language consistent with Treasury Regulations. We believe that if the phrase “in its sole discretion” is left in that it will generate significant concerns with investors who will feel uncertain about how the CDFI Fund will determine whether a

¹ Treas. Reg. Sec. 1.45D-1(g)(1) states “Anti-abuse. If a principal purpose of a transaction or a series of transactions is to achieve a result that is inconsistent with the purposes of section 45D and this section, the Commissioner may treat the transaction or series of transactions as causing a recapture event under paragraph (e)(2) of this section.”

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series of a transaction or series of transactions cause an event of default under Section 8.3 of the Allocation Agreement.

Section 6.5 Reports

We believe the 90 day reporting requirement for the Institution-Level and Transaction-Level reports is not enough time for an Allocatee to deliver the information currently requested by the CDFI Fund. In many instances, the requirement will be overly burdensome on prior round Allocatees that will have differing reporting requirements of 90 and 180 days. Also, it is unlikely that audited information will be available within 90 days to be used in completing the Institution-Level and Transaction Level reports. As such the reports will be based on un-audited information and may not be accurate. We recommend that the reporting requirements be 180 days after the Allocatee's fiscal year so that it can provide the CDFI Fund with accurate information.

Section 6.9(g) Advise the Fund of Certain Material Events

We believe that this specific section should be removed from the Allocation Agreement as it causes an Allocatee to be in default for an event that an Allocatee rarely has foreseeable control over. At some time during the compliance period, it is reasonable to assume key management officials may leave a company for various reasons. We believe that the Allocation Agreement should not give power to the CDFI Fund to determine that the Allocatee is in default due to these changes or, in effect, to assert control over the employment decisions and circumstances of Allocatees.

Section 6.11 Common Enterprise

We believe that the calendar year referenced in this section is a typographical error and should be 2006 rather than 2005. It appears that 2005 was not changed from the prior allocation agreement.

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Conclusion:

We are excited about the New Markets Tax Credit Program being able to reach and benefit more businesses and individuals who lack adequate access to loans or equity investments. 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 and Company LLP



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