

March 10, 2003

Mr. Jeff Berg
Legal Counsel
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 13th Street, NW, Suite 200 South
Washington, D.C. 20005

Dear Jeff:

As participants in the New Market Tax Credit (NMTC) industry, we, 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 Allocation Agreement ("Allocation Agreement"). We have provided these comments in consensus. For your convenience, we have organized our comments as follows:

1. General comment on expanded tax credit recapture provisions,
2. General comments on the draft Allocation Agreement,
3. Specific comments on Allocation Agreement in order of specific articles within the draft Allocation Agreement.

Tax Credit Recapture Comment:

The draft Allocation Agreement extends the potential for tax credit recapture significantly beyond the three events that Section 45D states can cause tax credit recapture. Section 45D states that the following events can cause tax credit recapture:

1. Community Development Entity ("CDE") ceases to be a qualified CDE,
2. CDE fails to meet the substantially all test, or
3. Qualified Equity Investment ("QEI") is redeemed before the end of the tax credit period.

Under the draft Allocation Agreement, the events that can lead to tax credit recapture are numerous and so broadly defined that CDEs will find it impossible to ensure that they are in compliance with the draft Allocation Agreement. It is imperative to the success of the program that these provisions be revised. **Failure to do so will cause investors to view the NMTC as an unattractive investment and as a result will render the NMTC program commercially unviable. Investors will not invest in a transaction in which they are under constant and indefinite risk of being exposed to NMTC recapture.** It is a fact of the capital markets that the greater the perception of risk, the greater the return that investors require. The NMTC program

will not work if CDEs have to provide investors a high rate of return. As the draft Allocation Agreement is currently written, investors will perceive the risks associated with the NTMC program so high that they will give little or no value to the NMTC and as a result will not invest.

The CDFI Fund has numerous alternative penalties they can impose to ensure that CDEs are meeting the statutory requirements of the new market tax credit program. Among the penalties the CDFI Fund can incorporate in the draft Allocation Agreement are negative scoring of future allocation applications for the CDE, the exclusion from future allocations, monetary fines, and reallocation of those portions of allocations for which qualified equity investments have not yet been made. The program's participants and their investors have waited over two years and need confidence that the tax credits will actually be realized and will produce the investments in low-income communities for which the credits were designed.

General Comments:

Allocation Agreement Term: The draft Allocation Agreement does not appear to have a specified term. We believe it should expire no later than 7 years from the date of the last qualified equity investment ("QEI") issued by the CDE.

Form of Agreement: The form of the agreement appears to require that the same document be executed by the Allocatee and all Subsidiary Allocatees. We believe that this presents several problems. First, different Subsidiary Allocatees may have very different programmatic focuses and may be held accountable for complying with very different targeting standards. If a Subsidiary Allocatee is asked to execute the entire document, it would appear that they are being asked to comply with standards not necessarily relevant to them (and possibly adverse to their business or capitalization strategy) and which they may be unable to effect. Subsidiary Allocatees would be unwilling and unable to make representations and warranties about matters that are not under their control (e.g. representations and warranties about other Subsidiary Allocatees). Secondly, it is likely that different Subsidiary Allocatees will be formed at different points in time. If all Subsidiary Allocatees are required to execute the same document, it would appear that a Subsidiary Allocatee that is ready to proceed would need to wait until all Subsidiary Allocatees were formed and prepared to execute the agreement.

We recommend that each Subsidiary Allocatee should execute an agreement that is related to the "master" Allocation Agreement, but that is limited to issues of program and targeting that are relevant to that Subsidiary Allocatee. The Subsidiary Allocation agreements should be executable any time after the "master" Allocation Agreement has been signed by the Allocatee.

Specific Comments by Article:

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Article 6.9 is mis-labeled; it should be "Maintain Existence as a CDE" (not CDFI).

Article 2.6(b) and (c) Control:

We believe that the exercise of standard investor rights should be excluded from the definition of “Control”. For example, the power to remove a general partner should not be considered to be “control”, and the power to consent, or withhold consent as to major decisions should not constitute “control”.

Article 3.1: NMTC Allocation:

The first sentence states that “the Fund hereby agrees to allocate to the Allocatee, *subject to the availability of NMTC Allocations*, . . . an NMTC Allocation in the aggregate amount of _____ (\$_____).” At the point in time that the draft Allocation Agreement will be executed, the CDFI Fund will have made its allocation award based on the amount that is available. It does not make sense to make the award that is being evidenced by the agreement “subject to availability.”

The final sentence of this section gives the power to the CDFI Fund to withhold the effectuation of the agreement. The Fund should not be allowed to disallow activity under the agreement after it has been signed because investors would not be able to rely on a signed agreement as evidence that an allocation has been granted. We believe that the draft Allocation Agreement should be effectuated upon the signing of the Allocation Agreement by both parties.

Article 3.2: Authorized uses of NMTC Allocation:

This article raises numerous questions and concerns, which are addressed below. We believe that it is imperative to reiterate our point that failure to satisfy these non-statutory requirements should not trigger a tax credit recapture event. We believe the CDFI Fund has various alternative penalties at its disposal beyond recapture (as discuss further in our comments on Article 8.2).

Items that should be clarified in this section include the timing of some of these requirements, specifically Articles 3.2 (h), (i) and (j). Are these tests applied annually and what are the milestones? If the tests are not met at the annual milestones, will recapture result? If the Allocatee promised that a certain type of government program would be used, and after using its best efforts was unable to close a transaction that involved that program, we do not believe that a recapture event should result. We are concerned that if the tests must be met annually, then the order that deals are closed must be timed to ensure that the tests are met each year and may impose undue administrative and financial burdens on the Allocatee. If the test is applied only when the entire portfolio is assembled and closed, investors will not have the assurance that there will be no recapture until the last qualified low-income community investment (“QLICI”) is made. Investors will not be willing to accept this risk.

In addition, we also believe that this article should allow for flexibility in the authorized uses of the NMTC allocation. The Allocatee may have investment opportunities that, while entirely proper under the Program, may raise questions about the articulated “authorized use[s]”. A mechanism to allow for limited modification of uses (possibly subject to the consent of the CDFI fund) should be built into this section.

Article 3.2(d): Unrelated Persons:

In discussions between industry participants and the CDFI Fund, it was believed that the related parties test would be judged based on a “substantially all (85%)” standard. There is no substantially all language in this section as it is currently written. The definition of an unrelated person pursuant to this article is an entity of which a person unrelated to the Allocatee holds the majority interest. We recommend that the related party standard be based on a “substantially all” standard.

Article 3.2(e): December 31, 2005:

The draft Allocation Agreement imposes the requirement that the Allocatee must have issued “at least 80% of its Qualified Equity Investments related to its NMTC Allocation” by December 31, 2005. This imposes an additional investment requirement that is not part of the statute or temporary regulations.

Applicants submitted their 2002 NMTC Allocation Applications based on the requirement set forth in the NMTC Proposed and Temporary Regulations that the Allocatee shall issue 100% of its QEIs related to its NMTC Allocation by the end of the fifth year. By imposing an 80% milestone the CDFI Fund is in effect imposing a material change to the NMTC Proposed and Temporary Regulations. This material change can result in the numerous adverse consequences. Among them Allocatees may undertake larger or riskier projects that are above their experience level (or outside of their investment parameters) to ensure that the 80% milestone is met. Additionally, Allocatees in the early stages of the program may have resource constraints that cause them to increase staffing levels unnecessarily and/or hire consultants/outside vendors to reach the 80% milestone.

This 80% milestone is likely to be negatively received by investors. Investors may be unwilling to make NMTC investments if there are significant penalties for not reaching this 80% milestone. For example, if 79% of QEIs are issued by 12/31/05, is recapture triggered for the QEIs issued? Does a cure period exist? Will this be considered an event of default?

Furthermore, investments made by Allocatees, while subsidized by the NMTCs, must nevertheless also have a reasonable prospect of producing reasonable economic returns to investors (taking into account the benefit of the NMTCs). Investors will likely not be willing to make QEIs until the Allocatee has identified one or more QLICIs in which the investors’ funds will actually be invested and that meet the appropriate investment criteria. Whether this can

occur in time to meet this new 80% requirement is not entirely within the control of the Allocatee. General economic or market conditions may impede the Allocatee's ability to find suitable investments and could result in a default under the draft Allocation Agreement and (it appears) loss of NMTCs.

While we understand the CDFI Fund's desire to see funds invested, we believe that this provision should require, at most, demonstration of commercially reasonable efforts to meet this test. We believe the remedy for failure to meet this requirement should be limited to revocation/reallocation of the difference between the actual amount of QEIs issued and 80% of the amount allocated. For example, if 79% of QEIs are issued by 12/31/05, 1% would be revoked/reallocated and the 79 percent previously issued would remain qualified equity investments and eligible to claim NMTCs. The remedy for failure to satisfy this 80% test should specifically exclude recapture or disallowance of currently allocated NMTC. If investors could suffer recapture for the failure to satisfy the 80% test, then they will be reluctant to invest before they know that the test could be met.

Lastly, in light of delays of the NMTC allocation process we also recommend allowing the Allocatee three years from the date of the signed Allocation Agreement to issue at least 80% of its Qualified Equity Investments related to the NMTC Allocation.

Article 3.2(f): Flexible, Non-conventional, Non-conforming Terms and Conditions:

We recommend that the CDFI Fund define the various terms and benchmarks contained in this article. To begin with, "majority" should be clarified. Does the phrase "majority of loans" apply to the number of loans and/or to the dollar amount of loans. Is the "majority" to be defined as greater than 50%? Without defined terms for provisions such as "loan to value ratio that is higher than the standard ratio", "more flexible borrower credit standards", and "Debt service coverage ratios¹ that are less than standard", CDEs will be unable to substantiate that they have met the provision. This provision assumes that there are "standard" terms that can be readily ascertained, against which compliance with this Article could reasonably be measured. Considering the dire consequences of failing to comply with the draft Allocation Agreement, this is a significant concern. We request that the standards be quantified by the CDFI Fund before the Allocatee signs the Allocation Agreement. Alternately, the CDFI Fund should allow the Allocatee the opportunity to individually negotiate the definition of the terms and benchmarks during the negotiation of the Allocation Agreement

To further emphasize the need for this clarification, it would be impossible for the Allocatee to meet the record keeping and general data collection requirements of Articles 6.4 & 6.5 without defined terms. What records or information can or should an Allocatee maintain or produce to demonstrate compliance with this provision if they do not know what is the standard benchmark? What documentation would be provided as evidence of the Allocatee being in compliance?

¹ Note that the draft Allocation Agreement has a typographical error and refers to rations and not ratios.

While we understand the CDFI Fund's desire to ensure that the Allocatees satisfy the promises made in their application for NMTC and provide the subsidies indicated therein, and we understand that the CDFI Fund desires to identify and quantify the amount of subsidy that projects will receive through the NMTC program, we question whether a lender, for example, can irrevocably fix the parameters of its lending program for the entire period of time that the Allocation Agreement will apply. Lending markets may vary substantially over the seven-year NMTC compliance period. It is extremely difficult for a NMTC Allocatee to fix the terms of a new lending program that many years in advance. The Allocatees should be permitted to respond to market conditions in making NMTC debt investments.

Another question that arises is whether this article applies to each individual transaction or to the investment portfolio of the Allocatee. We believe that it would create an undue burden on the Allocatee and expose the investor to undue risk if this provision was applied to each individual transaction. We believe that this standard should be applied on the investment portfolio as a whole.

We also believe that the level and magnitude of penalty imposed for failing to meet the requirements in this section should be commensurate with the nature and magnitude of the failure and should not give rise to a NMTC recapture event.

Article 3.2(g) and (h): 1990 Census Data and QLICIs in Specific Projects:

This section assumes that the projects that the Allocatee referred to in the allocation application are still viable options. Due to the delay in the allocation process Allocatees may have had to relinquish investment rights they had on projects specifically identified in their NMTC Allocation Applications. We recommend that the Allocatee be permitted to substitute other projects for those that they identified in the application but for which have since lost their investment rights.

Article 3.2(i) and (j): 60% of QLICIs in Conjunction with Certain Programs and Services Areas:

Since the draft Allocation Application inquired about the Applicant's intentions to "principally target" certain areas or programs, we believe that it is unreasonable to now require the Allocatee to invest 60% or more of their QLICIs in these areas and programs. There is a significant difference between agreeing to principally target specific areas and programs and being required to invest at least 60% of the CDE's QLICI in such areas and/or programs. Also the application did not define principally as 60% or more. By mandating that the Allocatee invest in this manner, the CDFI Fund is limiting the investment opportunities of the Allocatee and/or quality of the investments that the Allocatee may make. Allocatees should be held to what they indicated in their Allocation Application, which was that they would "target" certain areas and programs. The Allocatee should be required to document its targeting efforts.

It is also unclear what the impact will be if an Allocatee (or any of its Subsidiary Allocatees) fails to meet one or more of the standards in this section. Since these are “targeting” standards rather than statutory standards, it should be clear that, while failure to meet one or more of these standards may subject the Allocatee to penalties (as was discussed in the beginning of this letter) it should be clear that this will **not** give rise to a recapture event. This is critical to the ability of the Allocatee to attract investors because they will require comfort on any item that has even a hint of causing recapture.

Article 3.3(b): Prohibited Activities:

Clarification is requested regarding the types of specific restrictions that will be placed on an Allocatee.

Article 3.3: (c) Transfers to Subsidiaries:

We request that this article be revised to indicate that the CDFI Fund’s approval of transfers to Subsidiary Allocatees may not be unreasonably withheld. This is a practical concern affecting the timing of closing(s) and related timing and expense of opinions. We also request clarification regarding the procedures for adding Subsidiary Allocatees to the Allocatee’s Allocation Agreement.

Article 3.3(f): Designation of QEI in Another CDE:

This Article raises a concern that was addressed in early comments by members of the NTMC Coalition. We believe that Allocatees should not be allowed to “double dip” but we believe the language provided in this Article and in Temporary Regulation Section 1.45D-1T(c)(4)(i)(B) is excessively restrictive. We believe that Allocatee should be permitted to receive equity investments from another CDE that has received an Allocation, to the extent the equity proceeds are used to make qualified low-income community investments for which NMTCs have not been previously claimed upon. For example, a CDE that fully utilized its allocation should be permitted to receive an equity investment from another CDE that has received an allocation.

Article 3.4: Availability of NMTC Allocation:

Article references Temporary Regulation §1.45D-1T(c)(3)(ii) and we believe it should also include IRS Notice 2003-9.

Article 3.5: Notice to Taxpayers of QEIs:

Does the CDFI Fund intend to provide a form to give notice to taxpayers of qualified equity investments or can the CDE provide its own form?

Article 4.1: Organization, Standing and Powers:

Partnerships and limited liability companies that are formed in states that do not provide certificates of good standing to partnerships and limited liability companies should be permitted to give alternative representations.

Article 4.6: Litigation:

The litigation representation should exclude litigation against CDFI Fund with respect to the program. It is possible that CDFI Fund could be sued with respect to the allocation process and such a suit should not preclude the execution of Allocation Agreements. The representation should incorporate a materiality standard and threatened litigation should be a “best of knowledge” standard, not a “constructive knowledge” standard. If the litigation concerns a specific investment opportunity, it should not bar participation in the program.

Article 4.7: Compliance with Other Instruments:

The compliance representation should incorporate a materiality standard with respect to loan documents or “other material agreements”. A technical default on a loan should not bar participation in the NMTC program or trigger recapture of NMTC.

Article 4.8: Disclosure:

This article is broad and of particular concern to investors because it covers not only untrue statements but omissions as well. These provisions should be deleted as they are overreaching and not central to the CDFI Fund’s mission.

Article 4.9: Disclosure to Potential Investors:

The CDFI Fund imposes on the Allocatee the obligation to make “all disclosures required by Federal or State law, including applicable securities laws, to taxpayers to whom the Allocatee has issued Qualified Equity Investments.” There is simply no reason for the CDFI Fund to impose general disclosure obligations through the Allocation Agreement, when those obligations are already imposed by other laws. The ironic result is that, if an Allocatee fails to make such disclosures and is therefore in violation of the Allocation Agreement, such violation could result in remedies being exercised against the Allocatee under the Allocation Agreement (including those that could cause the loss of NMTCs), to the detriment of the very investors that this provision was presumably designed to protect. Disclosure requirements should be dictated by investor requirements and existing law.

Article 4.10: Taxes; Debts; Bankruptcy:

This provision, as well as the other representations and warranties, should be limited to the time of the signing of the Allocation agreement. If these provisions extend throughout the recapture period, investors will be subject to risks of loss and recapture of NMTC in the event that the CDE files a late federal, state or local tax return, including property taxes, filing fees, corporate standing fees, etc. This level of risk will be unacceptable to investors.

Article 4.11: Debarment, Suspension and Other Responsibility Matters:

In the first sentence, it is unclear who will be considered to be principals.

Article 6.1: Compliance with Government Requirements:

This article imposes on the Allocatee the obligation to comply with “all applicable Federal, State, and local laws, regulations, ordinances, Office of Management and Budget (OMB) Circulars, and Executive Orders.” Similar to Article 4.9, the CDFI Fund appears to be involving itself in the enforcement of virtually every law and regulation there is, so that, in addition to all of the other penalties and consequences that an Allocatee (and as a result, its investors) might suffer as a result of any legal violations, the CDFI Fund is adding the remedies in the draft Allocation Agreement, including revocation of the allocation and loss of NMTCs.

Article 6.2: Fraud, Waste, and Abuse:

This article requires the Allocatee to notify the Office of Inspector General (OIG) for apparent existence of fraud, waste or abuse of the NMTC Allocation. This is a broadly defined requirement. What constitutes the appearance of waste? The article requires the Allocatee to report the appearance of fraud, waste or abuse without determining that fraud, waste or abuse occurred. Does this article apply not only to CDE but to the qualified active low-income community businesses as well? We believe this level of self-policing is unreasonable and unrealistic. We believe it would be reasonable to require Allocatees to report actual known acts of fraud committed with respect to the NMTC Allocation.

Article 6.3: Right to Inspect and Audit:

We believe that this article should be clarified to indicate that the right to inspect and audit does not include an obligation to disclose privileged communications or documents, such as those subject to the attorney-client privilege. Also, the article should define the statute of limitations that exists in terms of the period of time that the U.S. government can “audit” the books and records of the Allocatee. For example, generally the IRS has a 3-year statute of limitations on auditing federal income tax returns.

Article 6.4: Retention of Records:

The draft Allocation Agreement should indicate the time frame for which the Allocatee is required to retain its records. This should be no longer than the period during which tax returns of the taxpayers claiming the NMTCs through the Allocatee would be subject to audit. Additionally, we believe that nonrecurring or isolated minor failures to report or minor failures to maintain records should not trigger recapture of NMTC.

Articles 6.5 and 6.6: General Data Collection & Reports:

The reporting provisions of these two articles are extremely broad and are vaguely defined. This imposes on Allocatees an unduly burdensome level of record-keeping and reporting and will result in substantial costs for the Allocatee. In particular, the requirement in Article 6.5 that the Allocatee “maintain such records as reasonably may be necessary to . . . evaluate the results of the NMTC Program” and in Article 6.6 to “assist the Fund in evaluating the results of the NMTC Program” could include virtually anything that the CDFI Fund might consider useful, including tracking of wage and employment data for the QALICBs in which investments are made; sales, purchasing, and other transactional activity of the QALICBs and their customers, suppliers, lessors, lessees, and contractors; real estate tax valuations and sales taxes from QALICBs; general employment levels, property values and economic activity in the low-income communities where investments are made, etc. Add to this the obligations in Article 6.10 (requiring written notice to the CDFI Fund if any of a number of “material” or “material adverse” events or changes occurs), and the potential for reporting issues, costs, lapses, and violations becomes even greater. As with many of the provisions noted herein, with such vague requirements, it will be difficult for Allocatees and their investors to determine how and whether the Allocatee will comply with the draft Allocation Agreement. The scope of statistical records also requires definition.

Article 6.5(c): Evaluate Results of NTMC Program:

As discussed above, this specific sub-article requires that the Allocatee “maintain such records as reasonably may be necessary to evaluate the results of the NMTC program.” Institutional investors will be difficult to attract if data collection requirements are fairly subjective and vague and as such will cause the investor to question whether they have comfort that the Allocatee has complied with this requirement. Inevitably, they will conclude that they cannot obtain such comfort and as such, that they are exposed to recapture risk. Investors will not be willing to accept this risk. The scope of this section should be restricted and should not impose substantial burdens upon the Allocatees. See also comment on Article 6.6(iv)

Article 6.6: Reports:

Article 6.6 requires the Allocatee to assist the CDFI Fund in evaluating the results of the NMTC program. This requirement combined with the requirements of Articles 6.4 and 6.5 places an undue administrative and financial burden on the Allocatee. The Allocatee will pay an annual compliance fee to the CDFI Fund and may not have the resources to comply with additional reporting requirements in addition to successfully investing its QEIs and managing its investments. Many of the Allocatees will not have sophisticated accounting and information systems in place and these record keeping requirements will place an enormous burden on these organizations. These requirements would even place a burden on large organizations that do have such systems in place. Smaller organizations will not be geared to add additional personnel or expand their administrative systems as would be needed to comply with this requirement. The financial and administrative resources that the Allocatee would have to use to comply with this requirement would only serve to limit the resources the Allocatee could dedicate to making investments in low-income communities. These requirements would render the program financially unfeasible for Allocatees.

Further clarification is requested on the requirements for Institutional Level reports and whether the reports apply only to the Master Allocatee or will also be required for the Subsidiary Allocatees?

Article 6.6(ii)(b): Confirmation of Classification:

Clarification is requested regarding what type of confirmation of classification for tax purposes will be required. It would be financially impractical to expect a legal opinion annually for this confirmation.

Article 6.6(ii)(e): Any Other Information:

This sub-article requires that the Allocatee submit reports such as “any other information that the Fund deems appropriate.” We must repeat our concern outlined in Article 6.5(c). This requirement is vague and open to a wide degree of interpretation. For the reasons discussed earlier, institutional investors will not be willing to accept the risks that are created by this provision. We also believe that it is unreasonable to expect the Allocatee to report any other information that the CDFI Fund may deem appropriate. This is a potentially burdensome requirement. The Allocatee should know all of its reporting requirements at the time it enters into the draft Allocation Agreement.

Article 6.6(iv): Transaction Level Reports:

This sub-article states “the Allocatee shall be required to submit this (transaction-level) report at least annually.” While a minimum frequency of once annually is established, a maximum frequency is not specified. We would recommend that this state, “The Allocatee shall be required to submit this (transaction-level) report at least annually, but not more frequently than quarterly.”

Article 6.7: Equal Credit Opportunity Act:

See the comments to Article 9.14

Article 6.9: Maintain Existence as a CDE:

This section requires that the Allocatee do “all things necessary” to maintain existence as a CDE. We recommend that the word “reasonably” be inserted before “necessary”.

Article 6.10: Certain Material Events:

The term “promptly” requires definition in terms of a discrete time period as to when the Allocatee shall advise the CDFI Fund in writing of certain material events.

Article 7.1: Monitoring/Compliance Fee:

It is unclear whether the \$10,000 fee covers the Allocatee and all of its subsidiary Allocatees or if a separate fee is due from each. We believe that the maximum compliance fee that should be charged to an Allocatee, including its Subsidiary Allocatees, should be \$10,000. If separate Allocation Agreements are executed for each Subsidiary Allocatee, we believe that the Subsidiary Allocatee should be covered by the compliance fee assessed on the Allocatee and they should not be charged an additional compliance fee. Since allocations will potentially have a large range, we believe that the compliance fee should be less than the \$10,000 maximum for Allocatees that receive a smaller NMTC allocation. The full monitoring fee of \$10,000 could be financially burdensome to Allocatees with relatively small allocations and/or transaction-specific Subsidiary Allocatees with small sub-allocations.

For example, compliance monitoring for smaller projects in the Low Income Housing Tax Credit Program (“LIHTC”) Program may be less burdensome compared to a NMTC transaction of similar size. For example, the California Tax Credit Allocation Committee charges a one-time, \$410/unit monitoring fee for California LIHTC projects. If the average LIHTC property has 65 units and an average transaction size of approximately \$3.6 million² then the one-time

² These are approximations from the Ernst & Young LIHTC study, “Understanding the Dynamics: A Comprehensive Look at Affordable Housing Tax Credit Properties,” published on May 1, 2002.

monitoring fee applied in California would be \$26,650. However, the monitoring fee of a NMTC project is not determined in relation to project or investment size, which could prove burdensome in many cases. Assuming a CDE that was formed to invest in a single NMTC project with a transaction size of \$3.6 million, and if it were charged \$10,000/year for the 7-year credit period, the total compliance fee would be \$70,000. This is nearly three times the monitoring fee as a California LIHTC project of equivalent transaction size.

Article VIII: Events of Default and Remedies:

Based upon discussion between CDEs, attorneys, accountants and investors this article creates the most concern. The Events of Default are extremely broad and the penalties catastrophic. There are some real practical questions with respect to what precisely constitutes an Event of Default and gives the CDFI Fund the right to revoke the Allocation Agreement. As discussed at the beginning of this letter, we strongly believe that the only events that should lead to a NMTC recapture events are the three events stated in Internal Revenue Code Section 45D(g)(3). Those events are: the CDE ceases to be a qualified community development entity, the CDE fails to meet the substantially-all test, or the QEI is redeemed by the CDE. We believe that in all other events of non-compliance with any provision of Internal Revenue Code Section 45D, the Temporary Regulations, the Allocation Agreement, the Notice of Allocation Availability or the NMTC Allocation Application, the CDFI Fund should seek alternative remedies such as prohibition of participation in future allocation rounds, assessment of financial penalties and/or reallocation of any unused NMTC allocations. We, as a group, believe anything short of this will render the NTMC program commercially unfeasible.

We also request that the Allocation Agreement clarify whether a Master Allocatee may be affected by an event of default of a Subsidiary Allocatee and vice versa. For example, if a Subsidiary Allocatee defaults, is the Master Allocatee safeguarded from the remedies of the default of the Subsidiary Allocatee? Further do cross-default provisions exist whereby the actions of a Subsidiary Allocatee can trigger a cross-default of the Master Allocatee? We strongly believe that the actions of a Subsidiary Allocatee should not impact the Master Allocatee or another Subsidiary Allocatee.

Article 8.1(a): Fraud, Mismanagement or Noncompliance:

Further guidance should be provided as to what constitutes mismanagement and noncompliance. This article should take materiality into consideration when defining the terms. We recommend that this section include only fraud or gross negligence with respect to IRC 45D.

Article 8.1(b): Representations, Warranty, Certification:

This article refers to representations, warranty, certification, assurance set forth in the "Allocation Agreement, Allocation Application or any representation or warranty set forth in any

document...”. This is far too vague to enable the Allocatee or its investors to understand what is really being represented.

For example the “Assurances” contained in the allocation application are lengthy and involved and were given only with respect to the application and at the time the application was made. The requirement that they be reasserted as part of the Allocation Agreement is troubling because there could be changes in circumstances over time, many of which will not even be within the control of the Allocatee. This is particularly problematic if the representations and warranties are intended to be ongoing (so that they must be confirmed with each annual report to the CDFI Fund). If the representations and warranties in the draft Allocation Agreement and the Assurances are restated on an annual basis, then the investors will be taking on the risk that a lawsuit could be filed against an Allocatee, or there could be a default on a loan, which would lead to a default and potential recapture of NMTC. This type of risk will be unacceptable to investors.

We believe that the representations provided should be limited to those contained in the Allocation Agreement and made at the time of the signing of the Allocation Agreement.

Article 8.1(c): Failure to Observe:

This section of the draft Allocation Agreement raises similar issues as others we have discussed, primarily that the language is extremely broad (“any term, covenant, agreement or other provision” of a number of documents, including proposed regulations) and there is no materiality standard.

An Allocatee is in default if it fails “to observe, comply with or perform any term, covenant, agreement, or other provision contained in . . . the Application.” This provision appears effectively to incorporate the entire Allocation Application into the Allocation Agreement. The Allocation Agreement should stand by itself. This also raises substantial uncertainties about how the responses and information presented in the Allocation Agreement should be interpreted to become “terms, covenants, agreements, or other provisions” that the Allocatee must now comply with and perform. Further, what level of diligence and oversight could an Allocatee or an investor exercise to determine whether the Allocatee can and will observe, comply with, and perform the entire Allocation Application? We believe that the primary purpose of having an Allocation Agreement should be limited to incorporating those specific elements of the Allocation Application that were of the greatest significance in making the allocation award. This appears to be what Article 3.2 of the agreement is attempting to do, but Article 8.1(c) seems to undo this and to sweep in the entire Application after all.

Article 8.1(d): Failure to Conduct Business:

The failure to conduct its business in the usual and ordinary course is a vague provision and should not be part of a default section or trigger recapture.

Article 8.2: Remedies:

The remedies provided in Article 8.2 take the already extreme consequences of a recapture event as provided in the statute (full recapture with respect to the affected investment) and raise them exponentially. Under the draft Allocation Agreement, not only do investors have to worry about issues such as re-investment risk and recipients of QLICIs ceasing to be QALICBs, but now every instance of non-compliance with the Allocation Agreement (including the various provisions described above) could also result in complete recapture of tax credits, even beyond what would otherwise apply under the statute and temporary regulations. This is accomplished through the remedies that allow the CDFI Fund to revoke the approval of the Allocation Application or the Allocatee's status as a certified CDE.

It is not at all clear whether the CDFI Fund has the legal power to revoke an allocation. Nothing in the statute or regulations suggests or contemplates that, once an allocation has been made and (more importantly) investments have been made based on that allocation, the CDFI Fund can take back an allocation it previously granted. The statute is very specific about what events can lead to a recapture of tax credits, and revocation of an allocation is not listed among them. Yet, recapture would seem to be the only logical consequence of revoking an entire allocation. It may be reasonable to revoke an allocation to the extent it has not already been used (i.e., qualified equity investments have not yet been made based on the entire amount allocated), but not to revoke the entire allocation so that it applies retroactively to disqualify previous qualified equity investments.

While it is clear that there is a recapture event if a CDE ceases to be a CDE, it is not clear that the CDFI Fund has the legal power to revoke the qualification of a CDE based on factors unrelated to the basic tests for qualifying as a CDE. Again, the statute and regulations are clear on what it takes to be a qualified CDE. By creating an Allocation Agreement that contains a multitude of obligations (a number of which are not even related to IRC Section 45D) and then including revocation of CDE status as a remedy, the CDFI Fund has gone far beyond the statutory requirements.

For example, a CDE might breach the Allocation Agreement by failing to meet one or more of the investment requirements contained in Article 3.2 of the draft Allocation Agreement, or perhaps by failing to comply with some law unrelated to NMTCs or even tax laws in general (which, as the draft Allocation Agreement now reads, would also constitute a default). Such actions have absolutely nothing to do with whether the CDE still meets the requirements for being a CDE. This is crucial, because the violation might relate only to a particular investment or a particular investment fund. Yet, if the CDE has made multiple investments or is involved in more than one NMTC investment fund, the revocation of CDE status would presumably cause recapture of all NMTCs under all allocations or sub-allocations in which the CDE was involved, even if the breach arose only from a single investment.

Indeed, taken to its logical conclusion, the draft Allocation Agreement as a whole and the particular remedy of revoking CDE status makes CDE qualification almost entirely discretionary in the CDFI Fund. If the CDFI Fund can include virtually anything it wants to include in the draft Allocation Agreement and can elect to revoke CDE status based on any violation of that agreement, then CDE qualification ceases to be subject to any meaningful standards. The CDFI Fund should be able to revoke CDE status only if the CDE ceases to meet the primary mission or accountability requirements.

As we stated above, we strongly believe that the only events that should lead to a NMTC recapture events are the three events stated in Internal Revenue Code Section 45D(g)(3). Those events are: the CDE ceases to be a qualified community development entity, the CDE fails to meet the substantially-all test, or the QEI is redeemed by the CDE. We believe that the remedies imposed by the CDFI Fund for all other events of non-compliance with any provision of Internal Revenue Code Section 45D, the Temporary Regulations, the Allocation Agreement, the Notice of Allocation Availability or the NMTC Allocation Application should be limited to alternative remedies such as prohibition of participation in future allocation rounds, assessment of financial penalties and/or reallocation of any unused NMTC allocations. We also believe that these remedies should be applied on a graduated scale based on the severity of the event of non-compliance and the frequency of non-compliance.

This article also gives the CDFI Fund the right “in its sole discretion” to impose any one or more of the remedies. We believe that an Allocatee should have access to a formal appeals process, despite the statement to the contrary provided in Article 8.5.

Investors will not take comfort in an “all or nothing compliance policy” with the consequences of full recapture for minor circumstances (whether NMTC related or not), having nothing to do with the three recapture events specified in the statute, that technically places the Allocatee out of compliance with the Allocation Agreement.

Article 8.5: Prior Notice to Allocatee of Sanctions:

We believe that the CDFI Fund should give the Allocatee written notice and an opportunity to respond to that notice, in all cases, before exercising or imposing any remedy. These notices should also be sent to all taxpayers who have made a qualified equity investment in the CDE. Investors can be the CDFI Fund's agent in policing and returning the CDE to compliance.

Although the draft Allocation Agreement provides the Allocatee with a right to notice and cure “to the maximum extent practicable”, the 15 *calendar* day cure period is unreasonably short. We believe that the Allocatee should be required to respond to the CDFI Fund's notice within 15 *business* days. We believe that the Allocatee must be given more time to cure the incidence giving rise to the default. We recommend extending the cure period to 90 days and the right of extension for diligent pursuit of cure. In the LIHTC Program, as per Section 1.42-5 of the IRS Regulations, the correction period for non-compliance is 90 days, with the possibility of a six-

month extension. The CDFI Fund should consider adopting this more realistic cure period for circumstances of non-compliance. CDFI Fund should also be permitted to waive defaults as provided in the regulations and to adjust the remedies or penalties as warranted.

Lastly, the CDFI Fund should allow the Allocatee the right to a formal or informal hearing in all cases.

Article 9.4: Successors:

This section permits CDE's to merge or to be acquired, subject to the consent of the CDFI Fund. The CDFI Fund should provide some guidance as to the types of mergers and acquisitions that will be approved, and whether a merger or acquisition could be a cure for a default.

Article 9.14: Compliance with Non-Discrimination Statutes:

This section requires compliance with various nondiscrimination statutes. While we all endorse nondiscrimination, violation of these statutes should not trigger recapture or loss of NMTC. The offending party should be penalized, not innocent investors in the NMTC program. The possibility of recapture because of an indiscretion of an officer or director of a CDE is a risk that investors will not accept.

Schedule A: Form of Opinion of Legal Counsel:

The required legal opinion to be submitted in Schedule A appears to be far reaching. We are concerned that a legal opinion of such scope will unnecessarily burden financially the Allocatee. In addition, Schedule A does not mention what level of opinion is required. For example, is an "Acceptable Opinion of Counsel" a "will" opinion or is a lesser level of opinion satisfactory?

A legal opinion may be duplicitous and unnecessary for numerous reasons. First, the CDFI Fund has already certified the CDE after reviewing the required document submissions. The CDFI Fund has reviewed the CDE's Allocation Application. Furthermore, under Article IV of the draft Allocation Agreement, the Allocatee is expected to make representations and warranties similar to those the CDFI Fund is requiring of the Allocatee's legal counsel in Schedule A.

Some tax credit programs, such as the LIHTC Program, do not require a legal opinion to receive an allocation of tax credits. For example, the California Tax Credit Allocation Committee administers the LIHTC Program in California. The housing developer in receipt of LIHTCs only has to file a brief (two-page) Annual Owner Certification, a Project Ownership Profile, and Annual Operating Expenses. Only the Annual Owner Certification document has to be reviewed by a third party. However, it is a notarized document; it does not require a legal opinion.

Mr. Jeff Berg
Community Development Financial Institutions Fund
March 10, 2003
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Furthermore, the form of the opinion as presented contains both tax opinion items and non-tax opinion items. Generally, these would be separate counsel and as a result it may not be possible to obtain the opinion from legal counsel as it is currently drafted.

Conclusion:

We are excited by the opportunities that the New Markets Tax Credit programs presents and are anxious to see investments made that benefit low-income communities. We are optimistic that we will be able to work together to create an allocation agreement that ensures the goals of the program are met while at the same time is commercially practical. 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,

Mark T. Diachok
Bank of America

Joseph Stark
Bear, Stearns & Co. Inc.

Craig W. Stanley
CBO Financial, Inc.

Frank Altman
Community Reinvestment Fund

Thomas G. Tracy
Hunter Chase & Company

David G. Carr
KHC New Markets CDE, LLC

Lewis M. Horowitz
Lane Powell Spears Lubersky LLP

William E. Einstein
Meridian Investments, Inc.

Lisa Richter
National Community Investment Fund

James F. Mingey
National Economic Opportunity Fund

Herbert F. Stevens
David F. Schon
Nixon Peabody LLP

Michael J. Novogradac
Owen P. Gray
Novogradac & Company LLP

Norris Lozano
Portland Development Commission

Jerome A. Breed
Michael I. Sanders
Powell Goldstein Frazer & Murphy, LLP

Scott A. Lindquist
Sonnenschein Nath & Rosenthal

José Villalobos
The East Los Angeles Community Union Industries, Inc.