

NEW MARKETS TAX CREDIT COALITION

July 24, 2008

Donna Gambrell
Director
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 Thirteen Street, NW
Washington, DC 20005

Dear Donna:

I am writing on behalf of the New Markets Tax Credit Coalition with comments and suggestions on the New Markets Tax Credit (NMTC) Allocation Application. These comments relate to the 2008 Allocation Application as well as the Notice of Allocation Availability and the Q&A document released by the CDFI Fund in 2008.

The comments outlined below focus on issues we have discussed with the Fund over the last year and most are intended to ensure that the application is crafted to provide a level playing field for all qualified community development entity (CDE) applicants whether affiliated with a mission driven nonprofit or a profit-driven institution, whether a national organization or a neighborhood based entity, whether self-investing or seeking outside investors.

Part I. Business Strategy

Question 15

The Coalition supports the Fund's effort to limit the length of responses in the application. However, we recommend that the response to Question 15 be expanded to allow at least 5,000 characters in order to ensure that a CDE can provide a complete overview of its business strategy.

This is one of the few questions where a CDE applicant is asked to describe its target market and there needs to be adequate space for a CDE to provide details on its market, access to capital and financial services, and information on the poverty, income and unemployment statistics of the area.

In addition, we recommend that Question 15 be expanded to ask that a CDE applicant briefly describe how its overall business strategy relates to the business strategy of its parent or controlling entity.

Question 24

This question asks a CDE to describe how a NMTC Allocation would add value to the work of a CDE applicant – by either increasing the volume of its activity and/or by allowing the CDE applicant to undertake activities of greater risk.

By definition, a CDE affiliated with a nonprofit, mission driven community development organization assumes more risk than a CDE affiliated with a for profit, regulated financial institution. While the NMTC may allow a nonprofit mission driven CDE to take on “greater risk” it is important to note that

these CDEs are generally created to engage in high risk lending that for profit, regulated lenders can not take on.

It is unclear whether a CDE applicant, affiliated with a regulated financial institution, would receive a high score in its response to Question 24 because it could show that the NMTC would significantly increase the risk profile of its portfolio. Whereas a CDE applicant, affiliated with mission drive nonprofit, would receive a lower score because the risk profile of its NMTC portfolio would be similar to the risk profile of the loan portfolio managed by its controlling entity.

While we recommend keeping Question 24 in the application we recommend that the response not be scored or used to add or detract from the total score that a CDE applicant is awarded by a reader.

Question 25

This question asks a CDE applicant whether over the past five years at least 50 percent of its total activity has been directed to non-metropolitan counties. If a CDE answers 'yes' it is deemed to be a rural CDE for purposes of the application.

It is assumed that a CDE applicant can refer to the experience of its parent or controlling entity in answering this question but that is not stated clearly in the question, or clarified in the Tip, or in the Q&A documents. We recommend that a CDE be able to reference the track record of its parent or controlling entity in applying for rural CDE status and we recommend that the application clearly state that.

Question 26

A CDE applicant is granted priority points if it intends to use "substantially all" of its QEI proceeds to make investments in qualified active low income community businesses (QALICBs) in which the CDE does not hold the majority equity interest. The Q&A document accompanying the application clarifies that a CDE applicant can only earn these priority points if persons unrelated to the CDE will hold a majority equity interest in the business after the CDE makes its investment in the QALICB. This means that a CDE engaging in venture capital investing would not be able to secure these priority points if it planned to assume more than a 50 percent equity interest in any QALICB in which it invested. This puts CDEs engaged in venture capital at a distinct disadvantage in applying for a NMTC allocation..

Therefore, the Coalition recommends that the "unrelated entity" test be revised to be a pre-QLICI test rather than a test that is applied after the CDE makes its investment in the QALICB. This would eliminate a substantial barrier to CDEs interested in making venture capital investments in QALICBs but would discourage a CDE from investing in a business venture that it already controlled.

The current "unrelated entity" test also creates problems for CDEs that combined the NMTC and the federal historic tax credit (HTC). CDEs looking to use the two credits together will often times use a pass through lease structure that enables the QALICB to pass through the historic tax credits to its tenant rather than its owners. This structure generally requires that the CDE own 100% of the "master tenant entity" which leases the property from the QALICB. The CDE does not use the QALICB property and it does it manage the master tenant. The structure is simply in place to facilitate the pass through of the HTC to the CDE investor. We recommend that language be included in Question 26 and in the Q & A accompanying Question 26 to indicate that in a situation where the CDE holds the majority equity interest in a lessee of a QALICB in order to facilitate the pass through of a federal historic tax credit, the transaction is not considered to be between related entities for purposes of the NMTC.

Part II. Community Impact

Question 28 and Tables in Exhibits A and C

A CDE applicant is awarded priority points if it, or its controlling entity, can demonstrate a successful track record providing the types of QLICI activities it plans to pursue with an allocation of NMTCs. The CDFI fund allows a newly established CDE to point back to its controlling entity when demonstrating a track record for its allocation application. This is clearly necessary since a newly established CDE without an allocation has no track record to draw on. However, when a CDE applies for a subsequent allocation of Credits it is forced to make the decision as to whether it continues to rely on the established track record of its parent or whether it refers to the more limited track record of the CDE.

Throughout the narrative sections of the application a CDE is permitted to reference the track record of both its controlling entity as well as the CDE itself, but in filling in the Tables an applicant must choose to reference either the controlling entity or the CDE.

In reading a variety of debriefing letters received by CDEs that were not awarded allocations, it seems clear that readers give significantly more weight to the information recorded in the Tables than they do to an applicant's narrative responses.

Therefore, we recommend that the Tables, particularly those in Exhibits A and C, be amended to allow an applicant to report on the track record and the community impact history of its controlling entity and of its CDE separately. Collecting data from both entities will enable readers to evaluate the capacity of CDE allocatees as well as that of their controlling entity.

Part IV. Capitalization Strategy

It is important that questions in the Capitalization Strategy section of the application are crafted to ensure that a CDE applicant with a related investor is not given an unfair advantage over a CDE applicant that plans to issue its QEIs to unrelated investors.

It is considerably easier for a CDE to secure a commitment letter from a related investor than it is for a CDE to secure an investment commitment from an unrelated investor. It is also worth noting that as investor interest in the NMTC market grows it appears it may be easier to secure investor letters but at the same time it is more difficult to secure exclusive or definitive letters of commitment as investors' hedge their bets in a competitive NMTC allocation environment.

Questions 55 and 56 and Table F-1

Questions 55 and 56 and Table F-1 request that a CDE applicant describe how it will finance the cost of its NMTC operations and disclose its fee structure. Just as questions in the Business Strategy section were designed to determine how a CDE would use its allocation to benefit a QALICB, the questions in this section are designed to determine how a CDE's allocation will be used to benefit the CDE.

However, while this section of the application is intended to reveal the true value of the NMTC to a CDE and encourage transparency in terms of the 'sources and uses' of funds, the application questions are not asked in a way to guarantee that all CDEs provide comparable financial information.

At base, the problem lies in the fact that not all CDEs have the same relationship with investors. If a CDE secures its investment from a related entity, the costs, fees, and the ultimate financial benefits of the NMTC transaction would not necessarily be reflected in Table F-1 because the table does not request information from the controlling entity. Alternatively, a CDE that issues QEIs to an unrelated investor generally assumes the costs associated with the transaction, administers the fees and retains the benefits of a NMTC transaction. In this case, Table F-1 is set up to record such a transaction.

Until the CDFI Fund can accurately account for and compare the true costs and benefits that a CDE derives from the Credit, we recommend that readers be instructed not to consider Questions 55 or 56 or Table F-1 in determining the score of a CDE applicant.

QEI Investment Thresholds

Lastly, we would like to recommend, as we have in the past, that the Fund recast the minimum threshold requirements for CDEs applying for additional Credits. The Fund has always required that a CDE document that a set percentage of its QEIs are issued or committed in order for the CDE to apply for an additional allocation of Credits. The Coalition recommends that the threshold be based on the dollar amount of QLICIs deployed by the CDE rather than the amount of QEIs issued by the CDE.

We suggest that measuring the amount of cash that a CDE has been able to deploy is a stronger barometer of success than the CDEs ability to secure investors. Recasting the test would also create a level playing field for CDEs that are affiliated with an investor and those that are not since affiliated investors can self issue QEIs just to meet the CDFI threshold even if they have not yet identified a QLICI.

On behalf of the Coalition, I want to thank you for this opportunity to submit comments on the Allocation Application. I would be happy to follow up and discuss any of the issues raised in this letter.

Sincerely,



Robert A Rapoza