

National Community Investment Fund

7051 SOUTH JEFFERY BOULEVARD • CHICAGO, ILLINOIS 60619 • 773.753.5112 • FAX 773.753.5880 • www.ncif.org • info@ncif.org

June 29, 2001

Mr. Jeffrey C. Berg
Acting Director
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 13th Street, NW
Suite 200 South,
Washington, DC 20005

Dear Mr. Berg:

The National Community Investment Fund appreciates the opportunity to provide comment on the CDFI Fund's Guidelines on the New Markets Tax Credit (NMTC).

NCIF is a \$23 million, independent, nonprofit trust and certified CDFI intermediary that accepts investment from bank and institutional investors and reinvests equity and debt in regulated depository CDFIs with between \$5 and \$500 million in assets. NCIF's mission is to increase the number and capacity of domestic, depository CDFIs that are both effective agents of local economic development and sound financial institutions.

With \$16.70 million of its \$23 million in assets committed to 22 institutions, NCIF is to our knowledge the mostly broadly invested private sector underwriter of domestic, FDIC-insured development banks and larger community development credit unions. Sixty-one percent (61%) of the dollar amount of NCIF's investments are in minority-owned institutions; seventy-two percent (72%) are in urban institutions and 28% in rural institutions. NCIF estimates that its investments have leveraged \$34 million in equity and equity-like debt, which can fuel over \$340 million in development lending. In addition, the institutions that NCIF funds are generally the primary source of retail financial services in the low to moderate urban and rural income communities where they operate.

In addition to investing in the depository CDFI sector, NCIF operates an information sharing Network among senior managers of approximately 110 of these institutions. At a recent NCIF Network Conference, development bankers expressed great interest in the NMTC program, but also concern about establishing guidelines that will allow the program to be effective in the markets they serve.

NCIF's investors are exclusively private sector and include the Bank of America, which provided the initial capital of \$15 million, MBNA America Bank NA, Washington Mutual and the Ford and John D. and Catherine T. MacArthur Foundations.

NCIF's investors and investees, as well as the communities that these institutions serve, stand to benefit enormously from NMTC. Our comments below are informed by the desire to see NMTC fulfill the statutory intent of catalyzing investment in businesses and community development entities serving low income communities.

We believe that the critical issues to achieving success include regulations and process that truly catalyze the private sector and impose minimal administrative burden. Market dynamics, including relatively low

yields for investors and significant compliance costs for CDEs, will in general operate in favor of attracting investors and practitioners to the NMTC program who will operate in good faith to achieve statutory objectives. The process will most effectively release private sector energy if it takes into account the need to make investments in CDEs competitive with other investor choices in terms of predictable and streamlined processes for closing investments and ensuring that CDEs operating in good faith can maintain certification and minimize investor recapture risk.

We provide responses to the CDFI Fund's specific questions below:

1. ***IRC 45D(f)(2) requires that in making allocations of NMTCs, priority be given to (a) any applicant that has a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities or (b) any applicant which intends to satisfy the Substantially All Test by making Qualified Low-Income Community Investments (QLIIs) in one or more businesses in which persons unrelated to the CDE hold a majority equity interest.***

(a) How should the Fund implement this policy? For instance, should the Fund incorporate preference points into the scoring? Should the Fund make awards to organizations that are deemed competitive and meet one or both of these criteria before providing an allocation to any other applicant?

These provisions are designed to ensure that NMTC allocations result in the flow of capital to a range of qualified opportunities in low income communities. This will be accomplished if NMTC allocations are awarded to institutions that have proven effectiveness in investing in low income communities or will proactively seek a range of independent, qualified low income community investments in which to invest. Applications should receive preference points for meeting one of these criteria and the CDFI Fund should make awards to competitive organizations that meet ^{at least} one of these criteria before providing an allocation to any other applicant.

(b) What specific factors should the Fund consider when evaluating whether an applicant meets the requirements for priority treatment?

The CDFI Fund should gauge track record by looking at: years in operation, average annual volume of transactions in qualifying communities (aggregate, including all subsidiaries and affiliates), pipeline for reinvesting proceeds of intended new Qualified Equity Investments (QEI), and financial counseling and other services provided in combination with financing. Some information suggesting the degree to which the type of financing provided by the CDE has otherwise been unavailable would also be useful.

The CDFI Fund should gauge intention to Make QLIIs in One or More Businesses in Which Persons Unrelated to CDE Hold Majority Equity Interest by looking at: pipeline (including contact names for spot reference checking) and qualifications of staff to generate and meet demand for a significant volume of QLIIs. Historical track record should be considered here. Finally, the evaluation should assess whether the applicant may invest QEI proceeds into one or more subsidiaries that intend to meet the "substantially all" test by making QLIIs in one or more businesses in which persons unrelated to the CDE hold a majority equity interest.

(c) Should more weight be given to one priority category over the other and should an applicant be allowed to receive preference points under both priority categories.

More weight should not be given to one priority category over the other. We do not believe, however, that applicants should be allowed to receive preference points under both priority categories. Community Development Corporations (CDCs) and CDFIs routinely take majority equity positions in real estate projects they are developing in low-income communities. In fact, in many cities CDC ownership is a key factor in receiving additional state and local subsidies for the project. Real estate focused CDEs that are sponsored by CDCs and CDFIs would presumably be given preference points on the basis of their track record. To give preference points under both priority categories, however, would in effect give priority to loan funds and venture capital funds over CDC-sponsored real estate developers. In fact, we believe that real estate development was a key activity envisioned by the drafters of the NMTC statute, and that it should not in effect be given lower priority through allowing preference points under both priority categories.

2. ***Should there be limits as to the amount of a NMTC allocation that may be awarded to an applicant in a calendar year?***

It is important to demonstrate qualified demand for NMTCs in the early years of program operation. Experience with other tax credit programs such as the Low Income Housing Tax Credit also suggests that investors prefer working with entities that can generate a substantial volume of QLIIs. Therefore, in the early years of the program, NCIF does not recommend limits on the annual amount of NMTC allocation for any applicant. Early market experience will indicate whether limits are needed to ensure that the credits flow to a range of CDE types and markets.

3. ***During the evaluation process of NMTC applications, the Fund will request that applicants provide information on their track records for providing capital or technical assistance to Low-Income Communities and disadvantaged businesses and the effect that such investment/technical assistance has had on such Low-Income Communities or businesses. Applicants may also be required to describe the social underwriting criteria that they will use when deciding which companies to invest in. If an applicant receives a NMTC allocation, it will be required to report to the Fund on the ways in which Qualified Equity Investments are used to benefit Low Income Communities.***

(a) ***What indicators should the Fund assess when evaluating the community development impact of an applicant's prior activities or the social underwriting criteria of its loan policies?***

The most objective measures of impact would be: a) number and dollar amount of loans or investments made to borrowers operating in low income communities as defined in the statute, and b) underwriting criteria or marketing outreach that result in CDE making loans or investments that would not be readily available through other financing entities.

(b) ***On what basis should the Fund judge how "successfully" capital or technical assistance has been provided?***

The success of capital investment and technical assistance efforts should be evaluated on the basis of broad economic development objectives as follow. Measures should be simple and quantifiable.

For capital investment:

- Number and dollar amount of investments or loans funded.
- Asset growth of investees.
- Sales growth of investees.

- Square feet of commercial space developed in low income neighborhoods.

For technical assistance:

- Number of clients served at facilities developed.
- Objectives achieved by clients served (i.e., increased profitability or sales)

(c) *What information should the Fund request from allocation recipients as indicators for evaluating the effectiveness of the NMTC Program (e.g., number of jobs created or retained, increases in revenues or businesses receiving Qualified Low-Income Community Investments, rates of return to investors from Qualified Equity Investments, or number of clients served at facilities developed)?*

The same indicators as for (b), above.

In addition to the questions above, NCIF has the following concerns regarding the process outlined in the CDFI Fund's Guidance:

Directly Serving Low Income Communities. NCIF strongly agrees with the analysis and position of the New Market Tax Credit Coalition that the final guidance specify that a CDE can satisfy the 'primary mission test' by either directly or indirectly serving low-income communities.

Community Accountability. NCIF strongly agrees with the analysis and position of the New Markets Tax Credit Coalition that community accountability should be able to be met by having representatives of the "target market" on their governing board or use other approaches, such as an advisory board, focus group or community meetings, and that the guidance definition of "representative of low-income community" be expanded to include people whose primary job or activity is serving or working in such areas, such as a pastor, business owner or CDC director, who may live elsewhere, but is representative of the community and aware its needs. NCIF further agrees that CDEs should be treated as meeting the accountability test if a majority of their governing or advisory board (if they employ such an approach) meets the "representative test."

Allocation Application and Allocation Agreement Procedures. The Application process for tax credit allocations requires the CDE to supply a Comprehensive Investment Plan that provides historical information and a minimum five-year investment strategy. CDEs receiving NMTC allocations must enter into an Allocation Agreement with the CDFI Fund. There is substantial investors and CDFI practitioner concern that both the Application and Allocation Agreement processes will be onerous, substantially delay the availability of NMTCs, and potentially impede market-driven transactions from being able to take advantage of the NMTCs as intended. There are also investor concerns that a CDE's unintentional violation of an Allocation Agreement due to failure to meet certain performance criteria might trigger recapture, even where there is no bad faith. Investors and CDFI practitioners have indicated that, if recapture were to be triggered by violations of individualized Allocation Agreements, there might not be a uniform standard or recapture or rational means for managing recapture risk. Finally, there is concern that Allocation Agreements might constrain a CDE's flexibility to adjust its business plan or geographic focus as needed to respond to market forces and remain successful over time.

Recommendations:

Eliminate the Allocation Agreement and incorporate necessary reporting requirements from CDEs in the Notice of Allocation Availability and in the NMTC application itself, so that nothing remains to be negotiated after a CDE receives a tax credit allocation.

If there must be an Allocation Agreement, create a boilerplate document that focuses on the mechanics of tax credit allocation and reporting, rather than financial, development impact, business or geographic targets. (The matter of overriding concern with respect to NMTC, the CDE's obligation to meet the "substantially all" test, should be addressed in agreements with investors and in an annual compliance statement to the IRS.) Create a process that ensures that a CDE does not trigger recapture through violation of its Allocation Agreement, unless there is bad faith.

Ensure that the time from filing an Application to completing an Allocation Agreement and receiving NMTC allocations is less than one year.

Allow a streamlined application process for CDEs that have already submitted a Comprehensive Investment Plan for a similar NMTC business model, or a relevant Comprehensive Business Plan under any other CDFI Fund program.

Availability of Bank Enterprise Award monies for a) bank investments into CDEs, and b) Qualified Low Income Community Investments by banks that are CDEs. There is precedent in the combination of Low Income Housing Tax Credits and Historic Preservation Tax Credits for the use of two sets of Federal resources simultaneously to accomplish a community development purpose. The markets served by QLII's under NMTC have long deferred investment and credit needs. Meeting these needs will most rapidly and reliably be accomplished by allowing the BEA incentive along with NMTC. Furthermore, the census tracts that qualify for BEA purposes are more restrictive than the census tracts that qualify for NMTC purposes. Thus, there is a strong policy rationale for providing additional subsidies for these "poorest of the poor" census tracts that are the most difficult to serve.

Recommendation: Bank investments into CDEs, and QLII's by banks that are CDEs, should be eligible for Bank Enterprise Awards.

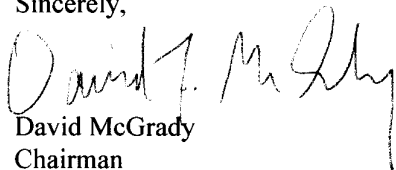
Availability of Business Trusts as qualifying CDE structure.

We also request clarification that business trusts can be used as a CDE vehicle, so long as they are taxable as a partnership.

Recommendation: Business trusts that are taxable partnerships should be an eligible CDE form, as they are commonly used in securitization programs, and are an important vehicle for attracting conventional investors to low-income communities.

Please contact me at 301-588-6410 if you have any questions on these comments.

Sincerely,


David McGrady
Chairman

cc: IRS
Eric Solomon, Senior Advisor for Tax Policy, U.S. Department of Treasury