

June 18, 2007

Sent Via Mail, E-Mail and Facsimile

Mr. Matt Josephs  
NMTC Program Manager  
Community Development Financial Institutions Fund  
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Dear Matt:

Members of the New Markets Tax Credit Working Group have joined together to respectfully submit comments and recommendations for your consideration on the Compliance and Monitoring Frequently Asked Questions document dated November 2006 ("FAQ"). We have organized our comments in order of the questions within the FAQ for your convenience. We appreciate the time and effort that the CDFI Fund has taken to provide guidance on many of the issues surrounding the compliance requirements of the New Markets Tax Credit ("NMTC") Program. It is a very substantial document and is providing much benefit to participants in the NMTC industry.

Question 1 - Does the Fund impose an annual monitoring/compliance fee?

If the CDFI Fund elects to impose a monitoring/compliance fee in the future, we request that it only apply to allocation agreements signed after the decision to impose the fee. For many projects that are existing or in progress, an additional fee that had not been previously contemplated would be a financial burden that could possibly cause it to become financially infeasible as CDEs do not know whether they should be structuring transactions to have sufficient cash flow to pay such a fee.

Question 3 - When is compliance measured and for what period will the Fund measure compliance?

The NMTC Allocation Agreement Q&A Document, dated January 2005, question 12 provided guidance regarding the compliance requirement for investments in unrelated entities as defined in Section 3.2 of an allocation agreement. The Q&A guidance stated (with emphasis added):

***12. How will the Fund monitor compliance with the unrelated entity requirement in Section 3.2 of the allocation agreement?*** This sub-section of Section 3.2 requires certain allocatees to meet the IRS's "substantially all" requirement by making investments in entities that are unrelated to the allocatee. Allocatees will be required to indicate in the transaction level report whether each QLICI made was to a related or unrelated entity. **At no time can the**

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**percentage of QLICIs made to related entities exceed 15% of the allocatee's total allocation amount.**

With this guidance, Allocatees have been complying with the unrelated entity test by measuring the percentage of QLICIs to the Allocatee's total allocation amount rather than on a QEI basis as prescribed in Question 3 of the FAQ.

In order to maintain symmetry with previously issued guidance on the allocation agreement, we request that the FAQ be revised from measurement on a QEI basis to measurement on a total allocation basis for the unrelated entity test. We have included suggested wording for Question 3 of the FAQ:

In general, compliance for most items under section 3.2 of the allocation agreement is triggered by the earlier of two events: 1) a specific date found in the allocation agreement; or 2) when an allocatee has made 100% of its Qualified Low-Income Community Investments (QLICIs). One notable exception is the unrelated entity test -- which requires certain allocatees to invest substantially all (generally 85%) of their Qualified Equity Investments (QEIs) in unrelated entities. ~~This test is measured on a QEI-by-QEI basis.~~ **At no time can the percentage of QLICIs made to related entities exceed 15% of the allocatee's total allocation amount.**

*Question 4 – Can a Community Development Entity (CDE) that has received an allocation provide a QEI to another allocatee?*

We believe that this guidance will result in additional administrative costs and time incurred by CDEs in order to set-up new entities for each investment and allocation. These additional costs cause the NMTC to lose its efficiency and the overall subsidy to the QALICB to be reduced.

In the example provided in the FAQ, ABC Bank becomes a victim of their own successful allocation award and is unable to continue making QEIs in Main Street CDE. Ownership of existing entities will need to be restructured and new entities may need to be created, which will cause the CDE to incur additional transaction costs and time. These additional costs and time required will dilute the subsidy that would have been provided had ABC Bank been allowed to continue making investments after receiving its own allocation.

We recommend that an entity that invests in an allocatee and subsequently receives its own allocation be allowed to make additional QEIs after the effective date of its allocation agreement, so long as the Allocatee CDE does not receive any QEIs.

*Question 12 – What activities are permissible activities with respect to Financial Counseling and Other Services (FCOS)?*

Since it's not defined in the FAQ, we request further clarification on what is intended by the requirement that a portion of the monies be spent within one year of receipt of a QEI in order to qualify as a QLICI. What constitutes a portion? We suggest that the term "portion" be removed from the FAQ and replaced with a specific percentage requirement of 25% to avoid any confusion on the amount that must be spent. We also recommend that there be no "look-through"

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provision if the monies are paid to a third party regarding when the third-party actually performs the FCOS activity. Also, the one year requirement is overly burdensome based on the types of FCOS activities and the size of the transactions. We recommend that it be lengthened to two years. Finally, we recommend that this guidance related to the time period when QEI proceeds must be spent only apply to Allocatees who sign their allocation agreements after the guidance was released. The lack of clarity in the guidance currently provided creates confusion in the structuring of NMTC transactions.

Question 13 – What is the definition of a “real estate QALICB” versus a “non-real estate QALICB”?

The definition provided here is not consistent with those provided in the 2007 NMTC Allocation Application (the “Application”) and in the CIIS instructions. The TIP for question 14 of the Application discusses transactions with regards to real estate versus non-real estate QALICBs. The TIP indicates that “investments in real estate businesses (development, management or other) in support of general business operations (as opposed to a specified project or projects) are considered non-real estate business transactions.

This seems to contradict the response to question 13 of the FAQ, which states that “loans or investments in businesses whose principal activities are the development or leasing of real property are considered “real estate QALICBs”. The CIIS instructions seem to support this idea in Question 13 as well.

We suggest that the TIP in the following application cycle be updated to match the requirements outlined in Question 13 and the CIIS program.

Question 19 – How will the Fund monitor compliance with the unrelated entity requirement in Section 3.2 of the allocation agreement?

See our response to Question 3 above and the suggested changes we recommended.

Question 20 – How will the Fund determine compliance with the better rates and terms requirement of the allocation agreement and/or the investing in areas of higher distress requirement? For a transaction to meet either of these thresholds, does it have to meet each of the criteria listed in each respective section or just one? Additionally, is there any particular supporting documentation that allocatees should retain?

As demographics change every year, so do the needs of different communities. In order to fully address communities with the greatest needs, especially those that did not meet the higher distress requirements in 2000, it would be helpful if the Allocatee could use the most recent information to determine which communities have the greatest need. As we get into the latter part of the decade, the information from the 2000 census, which the CDFI Fund requires Allocatees use, will likely become less accurate in numerous areas.

Also, we recommend that additional guidance be provided related to investments in QALICBs that qualify under the Targeted Populations guidance and what documentation Allocatees should retain. Currently, there are several issues that are unclear to many investors. For example, what

documentation of low-income individuals should be obtained to support that the QALICB has derived at least 50 percent of its gross income from those low-income individuals? Another issue related to investments in Targeted Populations is what type of documentation or certifications are required to document that employees or owners are low-income individuals. For purposes of counting employees to determine compliance with the percentage employee requirement, how and when should employees be counted? Should all employees, including temporary or seasonal employees, be counted? We recommend that the measurement be calculated using total hours worked during a taxable year by employees who are low-income persons divided by total hours worked by all employees. Without further guidance, investors are having difficulty structuring investments directed to Targeted Populations.

Question 27 – All allocatees are required to invest substantially all (generally 85%) of their QEIs as QLICIs. Section 3.2(j) of the Allocation agreement may require an allocatee to invest an even higher percentage of QEIs (e.g., 95%; 100%) as QLICIs, based on representations made by the allocatee in its application. How does the CDFI Fund monitor compliance with Section 3.2(j) of the Allocation agreement?

We recommend that you add to the guidance that any principal or equity received that is sufficient enough to trigger reinvestment be required to be reinvested rather than just stating that principal must be reinvested. We have provided suggested wording to the applicable sections of Question 27 below:

(B) If an allocatee subsequently receives repayments of principal **or return of capital** from the QLICIs (e.g., amortizing loan payments and distributions), but consistent with applicable IRS regulations does not reinvest these proceeds into other QLICIs, then the allocatee will be treated as fulfilling the requirements of Section 3.2(j) – notwithstanding the fact that the allocatee is no longer “fully invested” at the initial percentage.

*Example:* An allocatee received QEIs totaling \$1 million, and is required in its allocation agreement to invest 100% of its QEIs as QLICIs. It makes a loan of \$1 million to a QALICB. In accordance with the terms of the loan, the QALICB makes interest-only payments for two years, and beginning in year 3, some small payments of principal along with the interest payments. At the end of the seven-year compliance period, the principal payments total less than \$150,000 – or 15% of the \$1 million loan to the QALICB. This amount of repayment is sufficiently minimal as to not trigger reinvestment requirements under the IRS regulations. The allocatee is in compliance with 3.2(j).

(C) If an allocatee subsequently receives repayments of principal **or return of capital** from the QLICIs that are sufficient enough to trigger reinvestment requirements under the IRS regulations, the allocatee is required to reinvest those proceeds in the same percentage as is required in the allocation agreement.

*Example:* An allocatee received QEIs totaling \$1 million, and is required in its allocation agreement to invest 100% of its QEIs as QLICIs. It makes a loan of **\$500,000 to and an equity investment of \$500,000** in a

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QALICB. The QALICB repays the entirety of the loan **and distributes all of the equity** after two years. The allocatee must reinvest the entire \$1 million into a QLICI within the timeframes required under IRS regulations in order to be compliant with Section 3.2(j).

Question 29 – Do I need to contact the Fund if I fail the substantially all test or have a recapture event?

We recommend that the response to this question should clarify that recapture alone should be considered a Material Event under Section 6.9 of the Allocation agreement rather than both recapture and failure of the substantially all test. It should be noted that failure of the substantially all test is not considered a Material Event.

Question 30 – Is a Tax Basis financial statement acceptable in lieu of generally accepted accounting principles (GAAP) prepared financial statements?

In the fourth sentence, it appears cash basis financial statements are referred to in error. We recommend that it state “tax basis financial statements” throughout the response to avoid confusion.

Question 32 – If an allocatee has no activities, does it still have to submit an audit?

We believe that it is unclear how an Allocatee that has signed an allocation agreement can have no activity. An Allocatee that has signed an allocation agreement will have incurred some legal fees upon signing an allocation agreement. We recommend that the guidance be revised to define activity as the time at which QEI proceeds are received by the CDE or a subsidiary CDE. This will eliminate the administrative and financial burdens for those allocatees that have not received a QEI.

Question 39 – Can allocatees rely on data from the CDFI Fund’s Information and Mapping System (CIMS) for the purposes of determining whether transactions are located in NMTC eligible low-income communities?

We recommend that a process be created to allow CDEs who have identified incorrect data within CIMS to appeal to the CDFI Fund to make the correction so that a census tract can be correctly identified as either eligible or ineligible. The formal appeal process should be created to allow the CDE to submit documentation to the CDFI Fund supporting the correction and receive a response within 15 business days. The appeal process will ensure the accuracy of the CIMS program and further prevent census tracts from being incorrectly labeled as either eligible or ineligible low-income census tracts.

Question 43 - How will an allocatee maintain their CDE Certification status?

It appears there is a typographical error in the last sentence of the second paragraph and that the word “no” had been inadvertently omitted. We believe that it should be “If the Fund determines

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that an allocatee can **no** longer meet the CDE certification requirements, it will be found in default and an event of recapture declared.”

Question 45 – If a CDE loses its status as a CDE, will it be offered an opportunity for a cure period?

We recommend that the guidance be reworded to state that the cure period will be 180 days from the time the CDE knew or should have known that the CDE had lost its status as a CDE. Since CDEs are not required to meet each quarter, 180 days is a less burdensome timeframe for most CDEs to ensure that they meet the requirements of a CDE.

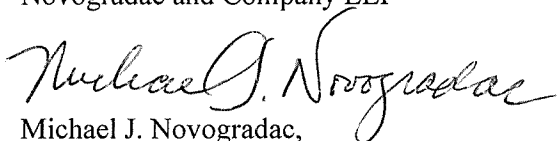
New question – If a CDFI no longer wants to meet the requirements to be a CDFI, will it maintain its CDE status if a CDE application is submitted and approved?

Internal Revenue Code Section 45D(c)(2) grants automatic qualification of Community Development Financial Institutions (CDFI) as qualified CDEs. An entity that wishes to be certified as a CDFI by the CDFI Fund must meet several requirements that differ from the requirements to be a CDE. There are situations in which a previously qualified CDFI no longer wants to meet the requirements to be a CDFI but would like to continue as a CDE instead. Because the CDFI automatically qualifies as a CDE, it will not have submitted a CDE application. We request that a CDFI that no longer meets the requirements to be a CDFI be allowed to submit a CDE application for approval by the CDFI Fund. Submission and pending approval of the CDE application will allow the CDFI to maintain its status as a qualified CDE until its CDE application is approved or denied. If the application is approved, then the entity will not be required to cure its CDE status. If the application is denied, the CDFI should have the same opportunity to cure its status as outlined in the guidance in question 45.

Conclusion

We look forward to continue working with the CDFI Fund as it strives to ensure the success of the NMTC Program. It is with that shared goal in mind that we thank you in advance for your time and efforts when considering our comments above regarding the FAQ. As participants in the industry, we have experienced the tremendous benefits NMTCs can provide to distressed communities nationwide and the low-income residents that reside in them. If you have any questions regarding any of the recommendations or comments made above, please feel free to contact me.

Yours very truly,  
Novogradac and Company LLP



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Along with the undersigned

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