
February 6, 2012

Mr. Robert Ibanez
NMTC Program Manager
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 13th Street, N.W., Suite 200 South
Washington, DC 20005

Dear Bob:

On behalf of the members of the New Markets Tax Credit (NMTC) Working Group, we submit the following comments, considerations, and recommendations regarding existing NMTC rules and regulations, which we believe will increase the effectiveness and efficiency of the NMTC Program. The members of the NMTC Working Group are participants in the NMTC industry who work together to help resolve technical NMTC Program issues and provide recommendations to make the NMTC Program even more efficient in delivering benefits to qualified businesses located in low-income communities around the country. Our group includes allocatees, nonprofit and for profit community development entities (CDEs), consultants, investors, accountants and lawyers.

We appreciate the opportunity to comment on ways to further enhance the good being done by the NMTC Program, and we also appreciate the level of commitment, dedication and outreach that has been shown and continues to be shown by the CDFI Fund, the Internal Revenue Service (IRS) and the Treasury's Office of Tax Policy in implementing and managing the NMTC Program. The CDFI Fund, IRS and Treasury have proven to be capable managers of the NMTC Program. This is evidenced by the tremendous success the NMTC Program has enjoyed since its inception in 2000. Low-income communities across the country have benefitted from targeted investments of nearly \$21 billion dollars. We applaud the various offices within Treasury that have worked with all those involved in these transactions to ensure that those dollars get into highly distress communities as efficiently as possible.

Since the program's inception, the knowledge, understanding and experience among participants in the NMTC Program has been continuously rising, as has the demand and competition for the NMTC among participants in the NMTC Program, including investors, lenders, Community Development Entities (CDEs) and qualified businesses. The interaction of these and other factors has led to ever greater efficiencies and effectiveness of the NMTC Program in delivering much needed subsidy to qualified businesses¹. These factors have also helped direct a greater portion of the NMTC Program to the nation's most distressed low-income communities and to qualified businesses generating even greater community impacts.

We believe that one of the most effective ways to further improve the efficiency of the NMTC Program requires a statutory change – that is to make the credit permanent or, at a minimum, provide a

¹ See "Reports Indicate that NMTC Program Improves with Age," Novogradac Journal of Tax Credits, July 2011, Volume II, Issue VI.

long-term extension. Uncertainty in any aspect, especially as it relates to the future of funding of the NMTC Program, limits the number of investors and potential CDEs willing to participate, and also limits the level of long-term investment that existing investors and CDEs are willing to make. Willingness by investors to participate in the NMTC Program would also be greatly enhanced if a long term or permanent extension of the NMTC included a provision that allows the NMTC to offset the alternative minimum tax (AMT)². A long term extension of the NMTC with an AMT offset provision would put the NMTC Program on par with Low-Income Housing Tax Credits, Historic Tax Credits and certain Renewable Energy Tax Credits, and would increase the demand by investors for the NMTC. With more demand by investors, the pricing of NMTCs would rise and would lead to an even greater amount of subsidy reaching qualified businesses. In addition to higher credit pricing, if the NMTC Program was made permanent or received a long-term extension, CDEs and other NMTC Program participants would dedicate more resources to the NMTC Program and generate even greater efficiencies. Due to the economic downturn, the financing of qualified businesses has become increasingly complicated, requiring industry participants to become progressively more creative in transaction structuring, while simultaneously ensuring that as much subsidy from the NMTCs as possible reaches Qualified Active Low-Income Community Businesses (QALICBs).

We believe that the following comments, considerations, and recommendations regarding existing NMTC rules and regulations, if pursued and adopted, will increase the effectiveness and efficiency of the NMTC Program. That said, we believe one regulatory change rises above all others in its potential to positively impact the NMTC Program – the manner in which tax credit recapture is determined. By imposing the risk of full recapture, plus interest and penalties, for the full term of the investment for all potential causes of recapture, the NMTC Program has created a level of compliance analysis and transaction structuring unrivaled by other tax credit programs. A reduction in tax credit recapture risk during the term of the investment would lower overall transaction costs and help facilitate the financing of specific types of businesses that tax credit investors are reluctant to make currently. Please see Exhibit A for our complete discussion regarding changes to the recapture rules.

The following comments, considerations, and recommendations specifically relate to low-income communities and areas of higher distress, treatment of certain businesses, community accountability, transaction costs, evaluation of financial products, and the use of other federally subsidized financing in conjunction with NMTCs. We have organized our comments in the order that they were presented in the request for comments published in the Federal Register, Volume 76, Number 215, on November 7, 2011. Our comments reflect the work of 50 member organizations participating on numerous conference calls and countless drafting sessions over several months. We trust you will find our comments useful and instructive. Many of our comments have been previously submitted in response to other requests for public comment. All of the NMTC Working Group's comments regarding these issues, as well as many others, can be found on our website at www.nmtcworkinggroup.com. We would be happy to meet with you to discuss our comments in further detail.

² For further discussion of AMT implications, see §2.16 of Novogradac & Company New Markets Tax Credit Handbook, 2011.

1) Low-Income Communities and Areas of Higher Distress

- a) *Should the CDFI Fund consider using different standards or methodologies for determining whether census tracts meet the statutory definition of low-income communities?*

The NMTC Working Group recommends keeping the current measures of poverty and income for determining the statutory definition of qualified census tracts. However, we recommend increasing the frequency with which the data for these measures is collected and updated to every five years rather than every ten years as is the case now. We recommend the data not be updated more than every five years as a more frequent update may discourage some investments in worthy qualified businesses that may take longer to close. We applaud the CDFI Fund for its efforts to include American Community Survey (ACS) data with the 2010 decennial census data. We believe this will increase the CDFI Fund's ability to gather census data more frequently and release updated census tract information more often. By updating the data more frequently, NMTC investments will be made in census tracts that are highly distressed based upon more current indicators, reducing the risk that investments would be made in census tracts that were once highly distressed, but are no longer highly distressed when the investment is made.

In addition to increasing the frequency with which data is collected and updated, we recommend that the CDFI Fund create a standard transition period that will be in effect anytime the census data is updated. We believe it would be extremely helpful for NMTC Program participants to understand the process the CDFI Fund will implement well in advance of the data being made publicly available so that they can proceed with transactions with this understanding. Absent such guidance, some community development entities will likely begin delaying their consideration of certain investments in and loans to qualified businesses until such time as the transition rules are better understood. Such uncertainty would reduce the efficiency and effectiveness of the NMTC Program.

More particularly, as the release date of the updated decennial census data nears, businesses, lenders and investors will be forced to consider whether or not to proceed with potential high impact NMTC transactions that may not close prior to the release date of the updated decennial census data that the CDFI Fund will use to determine whether census tracts qualify. The transition from previous decennial census data to the updated decennial census data creates potential problems for NMTC investments in progress that are in a qualified census tract currently but may not be qualified under the updated data.

There is precedence for a transition rule. Before the release of the 2000 census data, the CDFI Fund issued guidance in the 2002 application materials on grandfathering NMTC investments that were not foreseen to close before the release of the 2000 census data. The CDFI Fund also recognized that the 2000 U.S. census data was not available in sufficient detail prior to the time that an applicant submitted its 2002 Allocation Application to the CDFI Fund, and that applicants were relying upon 1990 census data to identify transactions and obtain investor commitments. At the time, the CDFI Fund determined that an NMTC applicant could use the 1990 census data for any proposed Qualified Low-Income Community Investment (QLICI): (i) that was closed (meaning all parties were legally committed to funding the investment) by December 31, 2002; or (ii) that was specifically identified in Question #33 of its 2002 Allocation Application and closed by the applicant by December 31, 2003.³ If an applicant used 1990

³ See #22 in the NMTC Allocation Application Q & A Document dated August 5, 2002, which can be found at http://www.novoco.com/new_markets/resource_files/application/NMTC_allocation_app_QA_080502.pdf.

census data for a QLICI, it was required to use 1990 census data for the entire period of the specified investment.

We believe similar guidelines should be implemented to ensure that the transition to updated data doesn't cause a delay in NMTC investments reaching low-income communities. Our recommendations for transitioning data, including the grandfathering of any NMTC investments that will not close prior to the release of the updated data, are summarized here for your review.

We recommend that a transition period exist for transactions that have not closed involving qualified businesses located in census tracts that were qualified according to previously available census data but have been deemed located in a nonqualified tract due to the release of updated census data published by the CDFI Fund. The transition period would allow transactions to close using the data that was available before the release of the new data. In order to take advantage of the transition rules, the CDE would need to follow the recommended rules below:

A CDE has the option to use the previous period's census tract data for any qualified low-income community investment (QLICI) that is:

- a) closed (meaning all parties are legally committed to funding the investment as evidenced by loan and/or equity documents) within 12 months after the month in which new census tract data is released by the CDFI Fund;

or

- b) closed (meaning all parties are legally committed to funding the investment as evidenced by loan and/or equity documents) on or before December 31st of the year following the year in which new census tract data is released by the CDFI Fund if the qualified business is identified in a transaction participant's NMTC Allocation Application.

If an applicant uses the previous census data for a QLICI, it may use such data for the entire period of the initial specified investment as well as any follow-on investment. Other than in such cases as outlined above, all QLICIs must be made using current census data as provided by the CDFI Fund.

We believe the grace period recommended above takes into consideration historical time frames for a NMTC transaction to close from start to finish. In addition, permitting follow-on investments to borrowers who remain located in a transitioning census tract will provide multiple benefits to CDEs and borrowers: signaling to other capital providers that the CDE still supports the company, ensuring a project can be completed through additional financing or preventing dilution of a CDE's prior equity investment, and allowing the CDE to provide new capital to QALICBs when needed to help those companies survive, maintain employee base and create new job opportunities. If follow-on investing is not allowed, many CDEs will not make an initial investment in certain qualified businesses for fear the CDE would be limited in its ability to provide additional financing to the business in the future if additional financing is needed. This would penalize qualified businesses in areas that are showing signs of economic improvement. It would also hinder investment in many distressed areas merely because the area is showing signs of economic improvement.

We further believe that this transition period should be implemented for any update in the census data that the CDFI Fund uses, regardless as to whether the update is performed every ten years in conjunction with the decennial census or is updated more often using American Community Survey (ACS) data. We recommend that the transition period be consistent for each update to the census data so NMTC participants can reliably plan which transactions they will pursue and to avoid the additional complexity and cost that would be involved in tracking multiple transition rules.

We encourage the CDFI Fund to release a transition rule as soon as possible. While the parties involved in NMTC transactions continue to share a common goal of creating an investment that will generate significant community impact in our nation's most distressed low-income communities, the forthcoming release of new census data makes it difficult for the parties to plan accordingly without any guidance on a transition period. Without such guidance, we believe that Allocatees and investors may avoid high impact businesses that are difficult to finance and take a long time to close for fear that the investment will no longer qualify when updated census data is released. We believe these recommendations are necessary to preserve this common goal and to provide a smooth transition in implementing updated census data.

- b) *In the allocation award process, should the CDFI Fund increase the commitment percentage from 75 percent of investments made in Areas of Higher Distress in order to receive the highest scores for this sub-section of the Community Impact score (See question 25(a) of the 2011 application)?*

We recommend that the minimum commitment percentage for investing in Areas of Higher Distress remain at 75%. From its inception, the success of the NMTC Program has been its flexibility in how and which types of businesses are financed. Keeping the minimum commitment level at 75% allows a degree of flexibility for CDEs in their investment selection process and business operations. Periodically, there are higher impact investments directed to qualified businesses that are in areas that, while distressed, are not recognized as Areas of Higher Distress under the predefined criteria. One such example would be a qualified business with exceptional community impacts that is located on the border of a census tract that meets the criteria of Area of Higher Distress, but not within that census tract. Another example would be a qualified business in an area that has high distress using a number of distress measurements, but doesn't qualify using the predefined distress criteria adopted by the CDFI Fund. In short, the predefined criteria can be a barrier to funding high impact qualified businesses situated in areas of significant need⁴. If the minimum commitment percentage were increased, CDEs would be required to skip over these worthy businesses.

We also note that since 75% is the minimum amount, as CDEs select their investments, they invariably exceed the 75% commitment level. Seldom do one or more investments that they choose to make equal exactly 75%. Furthermore, many CDEs already encourage or impose a higher percentage.

Increasing the minimum commitment percentage would disadvantage high impact qualified businesses located in high distress areas outside the predetermined Areas of High

⁴ See "Navigating the Details of Higher Distress Requirements," Novogradac Journal of Tax Credits, April 2011, Volume II, Issue IV.

Distress without adding any significant measurable impact on the amount of NMTC investments being made within the predetermined Areas of High Distress, all the while imposing additional burdens, limitations, and costs on CDEs. Raising the minimum commitment percentage also places added pressure on the CDFI Fund to ensure that the predefined criteria for qualifying as an Area of Higher Distress includes the entire universe of geographic areas worthy of NMTC subsidized investment.

- c) *Should the CDFI Fund include additional distress indicators, alter or eliminate any existing indicators?*

We recommend adding a new indicator for federal educationally underserved or disadvantaged areas to the extent the QLICI activities apply to investments focused on educational and community facilities providing supplemental educational services, excluding private post-secondary institutions. This new indicator would be similar to the federal medically underserved areas and the healthy foods financing initiative / designated food deserts criteria. The criteria established for defining these areas of educationally underserved or disadvantaged areas would be based on the Education Commission of the States No Child Left Behind Database's list of failing schools. The current accessibility of this data would help to reduce the additional resources required for implementation of this indicator, keeping program administration costs to a minimum.

We would also recommend that the CDFI Fund provide additional guidance to clarify how to document State Enterprise Zone programs and other similar state/local programs targeted towards particularly economically distressed communities, which is included in number 13 of question 25 in the 2011 NMTC Allocation Application. Without a clear understanding of the documentation the CDFI Fund considers to be adequate for this distress indicator, CDEs may incur additional transaction costs to provide documentation that may not be necessary. We recommend providing a list of acceptable forms of documentation for this indicator to decrease uncertainty (and thereby increase the efficiency of the NMTC).

We also note that implicit in this question is recognition that there may be additional distress indicators that are not included in the existing indicators used to define Areas of Higher Distress. This recognition reinforces our recommendation in 1(b) above that the minimum commitment percentage should not be raised above 75%. Keeping the minimum commitment percentage at 75% ensures that CDEs retain a small buffer to accommodate previously unidentified high distress indicators.

2) Treatment of Certain Businesses

- a) *Are there certain other types of businesses that should be discouraged or barred from receiving NMTC investments? If so, what types of businesses, and what administrative means could be utilized to discourage such investments?*

In enacting the NMTC statute, Congress did bar some types of businesses. We recommend that the CDFI Fund **not** discourage or bar any additional types of businesses from receiving NMTC investments. The NMTC was designed to be a flexible program to allow for a very diverse group of investments. This flexibility is one of the most desirable attributes of the NMTC Program, and any further restrictions would threaten the NMTC Program's ability to serve its intended purpose of attracting capital to low-income areas that have traditionally lacked

adequate access to capital. The current oversight and competitive nature of the program encourages participants to self-monitor and select the most impactful investments in order to stay accountable to low-income communities and remain competitive in future allocation rounds. We recommend that no additional restrictions be placed on qualifying businesses. The existing statutory rules prohibiting investment in certain types of businesses are sufficient.

- b) *Should the CDFI Fund provide additional opportunities in the allocation award process for applicants to score more highly by committing to invest in certain business types over others (e.g., small business or rural investment, operating businesses vs. real estate projects, etc.)?*

We believe the CDFI Fund should **not** provide additional opportunities in the allocation award process for applicants to score more highly by committing to invest in certain business types over others. The strength of the NMTC Program is the flexibility in the types of businesses that can receive investments. Providing the opportunity to score higher based on the type of business will constrict the program. The CDFI Fund currently asks applicants if they will commit to investing a certain percentage of their allocation in non-metropolitan counties, higher distressed areas, as well as providing at least 20% of developed units as affordable housing units. We believe these current preferences are sufficient. Further preferences will reduce the flexibility CDEs currently have in choosing which qualified businesses to invest in. Again, because of the limited amount of the subsidy, CDEs must choose QLICs that meet economic criteria as well as community benefit criteria, and they must also fit within the many structural and compliance limitations already imposed by the NMTC Program. The market is better able to determine which types of qualified businesses are most in need and most worthy of NMTC financing due to factors such as community impact and capitalization needs. Imposing more preferences for certain types of businesses would distort this process and lead to greater inefficiencies in the program. The country's low-income communities are extremely diverse with many different types of economic development and community services needs. The NMTC's flexibility in financing many different types of qualified businesses allows CDEs to target their investments to the types of qualified businesses appropriate to a particular community. As such, the types of businesses in which a CDE can invest shouldn't be constricted.

- c) *Are there specific administrative or regulatory changes that would facilitate the financing of specific types of businesses while preserving public policy objectives and safeguards?*

We present below recommendations that describe specific administrative and regulatory changes that would facilitate specific types of businesses while preserving public policy objectives and safeguards. Our recommendations address: recapture risk, the frequency and transitioning of updated census data, the definition of control, the definition of a non-real estate QALICB, partnership allocations of NMTCs and the definition of reasonable working capital.

Recapture Regulations

While changes in the NMTC Program could be made to encourage more investments in certain business types over others, we do not believe that any changes will cause a substantial change in the types of investments made until a single component of the program is changed that affects all investments – tax credit recapture. By imposing the risk of full recapture, plus interest and penalties, for the full term of the investment for all potential causes of recapture, the NMTC Program has created a level of compliance

analysis and transaction structuring unrivaled by other tax credit programs. Furthermore, it has fostered a strong bias in favor of long-term, asset-based lending (especially for real estate), and against equity investments and more flexible forms of business lending, because the former kinds of investments present far less compliance and recapture risk than the latter.

While this level of structuring and underwriting no doubt helps to ensure that the requirements of the NMTC Program are complied with, it also leads to lower pricing of the NMTC, higher fees that CDEs need to charge, and higher overall transaction costs, as well as restricting the types of investments that investors are willing to make. Thus, it does not necessarily serve the ultimate goals of the program. A reduction in tax credit recapture risk during the term of the investment would help facilitate the financing of specific types of businesses that tax credit investors are reluctant to make currently. Please see Exhibit A for our complete discussion regarding changes to the recapture rules.

Census Data and Transition Rules

As previously discussed in our comments in section 1(a) above, increased frequency in updating census data will help prevent investments in qualified businesses that appear to no longer be located in an eligible tract and may help prevent a negative public perception for certain investments. It will also allow investments to be made in areas in economic decline that become eligible after the 2010 Census and before the 2020 Census. Our recommendations for transitioning rules, including the grandfathering of any QLICs that will not close prior to the release of the updated data, are summarized in detail in section 1(a). Again, these transition recommendations are generally consistent with the transition guidelines used for the 2000 census data and should be implemented to ensure that the transition to updated data does not cause a delay in NMTC investments reaching low-income communities.

Definition of Control

We have previously provided comments on the issues regarding equity QLICs: most recently in a letter dated September 8, 2011, to the Internal Revenue Service in response to a request for comments on the advance notice of proposed NMTC regulations issued June 7, 2011, and in a letter to Mr. Michael Mundaca dated August 20, 2010. As articulated in those letters, we believe changes in the so-called “reasonable expectations test” are needed to reduce transaction costs and better facilitate both real estate and non-real estate investments. If these changes are adopted, it is likely that equity transactions could be structured in a manner that would attract investors by successfully addressing the issue of control and providing CDEs with the ability to rely on the reasonable expectations test. Without such a change, it is likely that investors will continue to avoid investing in CDEs that intend to make equity investments, thereby preventing the most patient form of capital, equity investments, from being made available to QALICBs. For your convenience, we have provided the body of those comments in Exhibit B, because we believe the changes we recommended in 2010 and 2011 are still applicable today.

Non-Real Estate Businesses

In a letter dated September 8, 2011, to the Internal Revenue Service in response to a request for comments on the notice of proposed NMTC regulations issued June 7,

2011, the NMTC Working Group provided comments on (i) whether the definition of a “non-real estate QALICB” is sufficient for CDEs and investors to rely on and (ii) whether the “more than 50% gross income” requirement and activity limitation are the appropriate ways to define a non-real estate QALICB. For your convenience, we have provided the body of those comments below, because we believe the changes we recommended in 2011 are still applicable today.

Generally, the definition is sufficient. However, it is not uncommon for non-real estate investments to have a portion of the proceeds used for the development of real estate in conjunction with other operating business uses. The following sentence in the proposed definition may present issues regarding certain uses of QLICI proceeds:

“The purpose of the capital or equity investment in, or loan to, the non-real estate qualified active low-income community business **must not be connected to** the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate.” (emphasis added)

It is unclear what “must not be connected to” means. For example, does a non-real estate QALICB, “whose predominant business activity does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate,” fail to be a non-real estate QALICB if it has a small portion of “enhancement” expenditures for its existing building? We believe this limitation is not appropriate or consistent with the overall purpose of this definition, and that the language regarding the purpose of the investment should be removed, so that the definition solely relies on the 50% gross income requirement of the business activity.

Partnership Allocations (Internal Revenue Code § 704(b))

We have previously provided comments on the issues regarding the allocation of NMTCs in a partnership. It is currently unclear as to how a partnership allocates NMTCs among its partners. Internal Revenue Code §45D and §704(b) provide no specific reference on how the NMTC should be allocated among partners in a partnership⁵. The NMTC is a unique credit that doesn’t generate a readily identifiable expense similar to other credits like the low-income housing tax credit, which subsidizes construction costs that generate depreciation expense. In the absence of current specific guidelines, we believe that NMTCs should be allocated among the partners in a partnership in a manner that is most consistent with the existing §704(b) partnership allocation regulations. Therefore, the NMTC should be allocated in the same manner as the NMTC basis reduction which in turn should be allocated in the manner agreed to by the partners of the partnership and that is consistent with the partnership allocation safe harbor rules under existing Treasury Regulations⁶. Guidance on this issue would be very helpful, particularly to CDEs seeking to make venture capital investments.

⁵ See “Reconciling the Different Interests of Equity Investors and Lenders in NMTC Investment Funds,” Novogradac Journal of Tax Credits, August 2004 Volume III, Issue VIII.

⁶ For further discussion of the allocation of NMTCs, see §7.06 of Novogradac & Company LLP New Markets Tax Credit Handbook, 2011.

Non-Qualified Financial Property

Finally, further regulatory clarification around the “non-qualified financial property” limitation, particularly in regard to what is (and is not) “reasonable working capital,” would be very helpful. Aside from extending the safe harbor period for QLICI and non-QLICI funds held for construction (which we understand is under consideration by the IRS), more basic guidance is needed. Neither the Internal Revenue Code nor the Regulations (under Section 45D or elsewhere) provide any definition of “working capital,” much less “reasonable working capital.” The analysis and structuring that is currently required to deal with these issues leads to higher transaction costs, and it creates a serious impediment to many kinds of financing, particularly for operating businesses, which typically need to retain and manage funds in a wide range of amounts for a wide variety of purposes. With no guidance to help define reasonable working capital, investors and CDEs are often unwilling to take the risk of having to simply guess whether a particular amount of capital held for a particular type of business fits within this limitation.

We believe these specific administrative and regulatory changes would facilitate the financing of specific types of businesses while preserving public policy objectives and safeguards.

3) Community Accountability

- a) *Should the CDFI Fund increase the community accountability standards for an entity to qualify as a CDE? For example, (1) increase the minimum percentage of Low-Income Community Representatives required on the board (governing or advisory) that is providing accountability for the CDE; or (2) require some minimum of Low-Income Community Representatives to be locally based, such as local residents and/or government officials?*

We recommend that the CDFI Fund double the percentage of Low-Income Community Representatives required on any board (governing or advisory) that is providing accountability for the CDE from 20% to 40%. We understand the importance of community accountability but also realize that an increase to a level greater than 40% would fundamentally change the dynamics of the business operations of many CDEs. Generally, CDEs prefer to have a percentage that is higher than the minimum, which provides some cushion in case a member of the board leaves. As a result, any percentage higher than 40% would be impractical for many CDEs and would reduce a CDE’s flexibility in structuring its board, increase risk of recapture, increase transaction costs, and may ultimately reduce the range of transactions that can be funded by the NMTC Program.

Further, we recommend that any changes to community accountability be made in the CDE certification application rather than through changing the NMTC allocation application, and that such changes be applied prospectively, or that a reasonable transition period be provided so that existing CDEs have time to make changes to their boards. In addition to a transition period, we also recommend that a safe harbor cure period be provided so that CDEs are able to replace or fill vacant board positions in the future in order to meet the higher percentage without fear of recapture. We believe that a CDE should have a reasonable amount of time to cure any changes that are out of its control regarding a board member’s accountability to low-income communities.

We recommend that the CDFI Fund not require a minimum number of LIC representatives be locally based. This requirement would be impractical for most CDEs (other than ones with a limited service area). It would likely drive up transaction costs if a locally based representative were required for each project or business the CDE would finance, since for most CDEs it would mean that they would need to add new members to the board for the location of each such project or business (because it would be highly unlikely that their existing board members would happen to be based in that location). But there is a more serious flaw in such a requirement. Advisory boards (as well as governing boards) will typically be called upon to consider a number of potential investments in different locations. In order to provide for local representation in this process, a CDE with, say, a national service area would have to have local representation for every location where they are considering making an investment -- even for those investments that they might ultimately choose to make -- otherwise, the investment recommendation will already have been made before the local representative is appointed, which makes very little sense. This would be enormously burdensome and entirely unworkable for at least most CDEs.

Generally, CDEs are already tracking whether the QALICB has engaged the community and received its support for a particular investment. Therefore, we believe the current accountability requirements are sufficient.

- b) *Should CDE community accountability standards differ for CDEs depending on whether they use governing or advisory boards to demonstrate accountability?*

We do not believe that community accountability standards should differ for CDEs depending on whether they use governing or advisory boards to demonstrate accountability. Although the level of responsibility is different for governing and advisory boards, any additional requirements imposed on CDEs related to board representation would be an inefficient and unnecessary level of compliance. We believe this would add an additional level of difficulty to the program and likely increase transaction costs.

- c) *Should the CDE be required to have Low-Income Community Representatives approve of investments made by the CDE?*

While Low-Income Community Representatives should be actively involved in the due diligence and investment decision processes, we recommend that the CDFI Fund not require that advisory boards approve investments. The competitive nature of the allocation process for NMTCs provides sufficient incentives for CDEs to approve investments with the greatest community impact and with the endorsement of its low-income community representatives, while still ensuring that the investment has adequate business viability. Because the NMTC subsidy constitutes only a portion of an overall investment, investment decisions must be based on economic criteria as well as community impact criteria, and as such, the final decision should rest with those responsible for the investment as a whole, not with a board designed only to evaluate community impacts. Generally, CDEs do not proceed with QLICIs lacking endorsement by the advisory board. Requiring approval from an advisory board changes the dynamics and business structure of the CDE and could result in less viable investments, and increased overall risk, which in turn could increase the potential liability exposure to advisory board members for approvals they may give or may not give. An increase in personal liability will likely mean a decrease in the willingness of individuals to serve as advisory board members and an increase in advisory

board members seeking compensation, ultimately impeding the accountability of CDEs and potentially increasing overall transaction costs or reducing the number of highly qualified low-income community representatives.

- d) *Should CDE activities be required to be coordinated with community stakeholders? If so, how should this coordination be conducted and demonstrated?*

We do not believe that CDEs should be required by the CDFI Fund to coordinate their activities with community stakeholders. We believe that any additional requirements imposed upon a CDE will provide little additional benefit compared to what is already a common practice among CDEs. Any additional requirement will likely increase overall transaction costs, reducing the net benefit to qualified businesses. Generally the QALICB sponsor will coordinate activities in which community stakeholders are involved, and generally, CDEs are already tracking whether the QALICB has engaged the community and received its support for a particular project or business. Also, NMTC real estate investments are commonly financed in part from a local or municipal source, indicating that municipality's support of the project or business. The competitive nature of the allocation process for NMTCs provides sufficient incentives for CDEs to work with community stakeholders when deciding which projects and businesses to approve in order to ensure that they are serving the needs of the low-income community. Also, in the case of CDEs that finance operating businesses, it would be difficult to define an appropriate role for community stakeholders. We believe any additional requirements on CDEs would not make the NMTC Program more efficient.

- e) *Should the CDFI Fund implement measures to increase the transparency of CDE activities? For example, should it (i) require CDE board meetings to be open to the public and require advance public notice of such meetings; (ii) require CDEs to keep and publish minutes of board meetings; or (iii) require CDEs to make board member contact information readily available to the public?*

We recommend that the CDFI Fund not implement any measures aimed at increasing the transparency of CDE activities by requiring it to conduct its activities in public. CDEs are not public bodies, so requiring public notice is inappropriate. Many CDEs are pre-existing entities that conduct other business and their governance is not designed to conduct public meetings. Moreover, we believe it would be very difficult to make CDE meetings open to the public for several practical reasons. First, though generally one major meeting will be in person, other meetings will often be conducted via teleconference. For national CDEs, this type of flexibility is especially important because their boards tend to be spread out across the U.S. Second, it would be inappropriate to have potential projects or businesses discussed in a public arena before all the financing issues have been resolved, and such discussions will typically involve confidential or proprietary business information of either the CDE or the QALICB (or both), which should not be made available to the public in any event. Third, CDEs may need the option to act quickly and should be able to access their boards without public notice if immediate input is required.

We believe the same is true with regard to publishing CDE minutes for public inspection. Again, much of what a CDE does involves its own proprietary or confidential business information and/or proprietary or confidential business information of prospective QALICBs, and therefore cannot be made available to the public. Finally, we believe that CDEs should not be required to make their board member's contact information available to the public. Board members of CDEs that are not publicly traded and that are not public entities should not be

subject to public contact and communications unless they choose to do so. For many board members, particularly advisory board members, this is not their sole job, and the risk of being inundated by public communication may have a chilling effect on the willingness of many qualified individuals to serve on these boards. Often, these will be the very people who are involved in the types of activities in low-income communities that make them perfectly suited to serve on such boards as low-income community representatives. Also, public scrutiny does not always guarantee that the interests of a low-income community will be represented. The current accountability requirements CDEs must abide by are effective and efficient in ensuring that a low-income community's interests are understood. We believe any additional requirements on CDEs in an attempt to increase transparency would impair the ability of CDEs to function and increase transaction costs and risks, and are unnecessary for the reasons mentioned above.

- f) *If a CDE has a Controlling Entity, should the CDFI Fund require that the Controlling Entity of the CDE also meets community accountability requirements? If so, what requirements should be applied?*

We recommend that the CDFI Fund not impose any requirements for the controlling entity of a CDE. The CDE certification allows a controlling entity to create an affiliate that can fulfill the requirements of a CDE without having to change its current organizational structure. Requiring such changes may result in an additional financial and time consuming burden on the controlling entity that is already borne by the CDE and is not necessary to ensure community accountability.

- g) *Should CDE community accountability requirements differ for allocatee CDEs and nonallocatee CDEs?*

We recommend the CDFI Fund not impose additional or different requirements for allocatee CDEs and non-allocatee CDEs. We do not believe that different requirements would allow one type of board to be more accountable than is already required. Furthermore, increasing and differentiating the requirements between the allocatee and non-allocatee CDE boards will create additional burdens and administrative costs for the CDEs, and thus be counterproductive to the efforts to create efficiencies in the program.

- h) *Are there other ways in which CDEs can enhance their accountability to the Low-Income Communities in their respective service areas?*

We recommend that the CDFI Fund not impose additional requirements, as discussed throughout this letter, but encourage additional recommended practices to enhance the competitive environment in the NMTC Program. Accountability and stakeholder involvement is difficult to standardize because of the variety of types of investments and the geographic areas covered by a CDE. For example, while many community residents might support a new grocery store development for its job creation and fresh food options, you might also find some local residents opposing it for increasing traffic or noise levels. Further, it can be difficult and time consuming to find overwhelming public support for a loan made to an operating business that already may never be in the public eye. It is impossible to use such a limited resource to satisfy every need, and therefore opening up each investment decision to unlimited public scrutiny could cause such a debate that nothing would ever get accomplished. The existing system of allocating

NMTCs based on a competitive application process to groups that must demonstrate accountability to their service areas sufficiently ensures that the subsidy and benefits of the program go to the businesses and areas that are most deserving. We believe the majority of the investments done to date reflect that the current accountability requirements are adequate. We further believe that the competitive nature of the NMTC application, which includes various questions specifically focused on community accountability, involvement of the advisory/governing accountability boards, discussion of past investments financed and engagement of community stakeholders, provides a tremendous incentive for CDEs to continue to use their NMTC allocations to finance businesses and projects that meet the most pressing needs of the communities they serve.

4) Transaction Costs

- a) *Should there be greater disclosure of (and perhaps limitations on) the fees and other sources of compensation and profits that NMTC applicants propose and NMTC allocatees and their affiliates charge to (or receive from) their borrowers, investors or other parties involved in NMTC transactions? Should such information be made available by applicants and allocatees directly or through the CDFI Fund to the public or should it remain excluded from disclosure as proprietary business information?*

We recommend that the CDFI Fund **not** impose any additional requirements for greater disclosure of fees and other sources of compensation and profits that NMTC applicants propose and NMTC allocatees and their affiliates charge to their borrowers, investors or other parties involved in NMTC transactions. The CDFI Fund already collects sufficient CDE fee data through the allocation application and CIIS. Generally, CDEs regulate their own fees to stay competitive in the application process and to stay within their fee ranges for CIIS. Any additional requirements would be inefficient and burdensome.

The flexibility of the program allows for creative funding of investments that would otherwise go without financing. Further, this creative structuring takes additional time by all parties involved to determine that all sources of financing will work together without causing harm to the NMTC compliance requirements or the requirements for these other sources, which also leads to increased transaction costs. As discussed in further detail below and throughout our comment letter, we believe these recommended changes will have a more dramatic effect in decreasing the transaction costs for NMTC structures than adding any additional requirements or limiting fees charged by CDEs would have.

The NMTC Program is a limited subsidy, so it is frequently used as a companion piece of financing together with other sources of capital, each of which has its own rules and requirements. While the NMTC piece may add to an already complicated transaction, other types of subsidies are often essential to fill the funding gap or lower interest rates and allow the financing to proceed. Common examples of these include federal historic tax credits, state historic tax credits, state new markets tax credits, tax-exempt bonds, federal loan guaranty programs, and state and local agency loans and grants. In many cases, these other sources, not the NMTC component, are the primary drivers of complexities that lead to higher transaction costs.

If a project or business were to use these other sources of financing absent NMTCs, it would still incur substantial transaction costs in order to obtain such financing. When this same financing is combined with the NMTC structure, the same transaction costs are incurred and then

additional costs are incurred to ensure that the financing works within the NMTC compliance requirements (and vice versa). Thus, while the overall costs of the transaction may be high, only a portion of the total transaction costs should be attributed to the NMTC component of the transaction. Any evaluation or comparison of transaction costs for NMTC deals is flawed and misleading if it fails to take this into account. Moreover, if transaction costs were somehow limited, we believe this would impede the ability of QALICBs to use multiple sources of funding, which would mean there would be less overall financing available to qualified projects and businesses.

One of the great strengths of the NMTC Program is its flexibility. CDEs can create custom financial products tailored to the exact needs of businesses that lack access to affordable conventional financing. While a “one size fits all” NMTC product would lend itself to standardized financial and legal documents and lower transaction costs, it would only work with a type of project or business that fits within the one-size-fits-all box. We believe that such rigidity would prohibit many worthy projects and businesses from receiving financing.

The transactions done to date point in the opposite direction from a one-size-fits-all approach. Parties typically need to create specific structures tailored to the funding sources available and to negotiate individual terms of transaction documents in order to receive the most benefit. As a result, the incremental time of tax, legal, and accounting professionals adds to the transaction costs. If limitations on transaction costs were imposed, or if CDEs were evaluated based on their transaction costs, this would impede the ability of CDEs, investors, and QALICBs to undertake unique high impact transactions, limiting CDEs from undertaking exactly those deals that are the most deserving and beneficial.

We also recommend that such information remain excluded from disclosure as proprietary business information. CDE fees are an important part of the business strategies of many, if not all, CDEs. Making this information public would decrease the competitive atmosphere created by the current system in place. Public disclosure of CDE fees would lead to categorizing a CDE simply based on the level of fees it charges which would not be a clear indication of the total value the CDE is providing to the community. As discussed further below and elsewhere in this letter, we offer a number of recommendations for how policy and regulatory changes to the program could provide much-needed clarity or simplification of issues that currently cause NMTC transactions to incur more transaction costs.

- b) *Should the CDFI Fund provide an opportunity for CDEs that commit to limit fee and other forms of compensation to earn a higher score in the allocation award process? If so, please provide specific standards that could be used.*

We recommend that the CDFI Fund **not** provide an opportunity for CDEs that commit to limit fees and other forms of compensation to earn a higher score in the allocation award process than is already included in the allocation application. If the CDFI Fund chooses to set limits on the fees or make them a specific condition of the Allocation Agreement, we believe that it will discourage applicants from funding more difficult and more complex transactions. The more difficult and complex transactions are the types of transactions that often don't have any other chance of being financed unless NMTCs are available, even though they often provide greater community impact. We believe that the “generally consistent” language in the allocation agreements is sufficient to ensure that applicants don't veer too far from the fees they described but allow for enough flexibility for an applicant to fund any transaction it may come across.

The application already promotes competition in fee levels by requiring the applicant to disclose its fee structure and what the fees will be used for. In order to provide a standard or limit for CDE fees, the CDFI Fund must be able to compare CDEs on an equal level. We believe this is nearly impossible to achieve. No two CDEs are alike; therefore it is very difficult to establish a standard. For instance, some CDEs are dependent on their fees to continue operations while other CDEs are funded by their Controlling Entities and are more flexible with the level of fees they can charge (and sometimes even charge no fees at all). Imposing any kind of percentage or other fixed limitation would effectively discriminate against CDEs who are not so situated. The current process allows the flexibility to take such differences into account and has already had the effect of generally reducing fees and compensation to CDEs. Similarly, every transaction is different, so fee structures can often vary to accommodate the uniqueness of each transaction. One could also argue that simply categorizing a CDE on the level of fees it charges is not a clear indication of the total value the CDE is providing to the community, the level of work performed by the CDE, or a fair evaluation of the amount of risk a CDE may be undertaking. For example, many non-profit CDEs use the fees they earn to support their general operations or service other aspects of their missions. Requiring a CDE to limit the fees it can charge on transactions will mean that certain high impact, but challenging projects, or riskier types of investments such as small business lending or equity investments, might not be considered due to the fact that such investments might take more time and cost more money to structure, document, close, and monitor or might present too much risk to the CDE. Currently, the market also shapes the amount of fees a CDE is able to charge.

We recommend that Table F1 be removed from the allocation application because it does not provide enough flexibility for applicants to quantify their fees. We further recommend that an applicant be allowed to provide a longer response of 10,000 characters to both (a) and (c), and 5,000 characters for (b) of question 42 of the allocation application due to the complexity and flexibility associated with the way fees are structured in NMTC transactions. This will allow applicants to more fully describe the rationale for their fee structure and enable a reviewer to better understand the reasons for an applicant's fee levels. This change would be particularly important for applicant's that have multiple product lines with different fee structures.

The NMTC Working Group recommends that the CDFI Fund, in conjunction with the IRS and the Office of Tax Policy, convene a NMTC advisory group to include a representative cross-section of CDEs, investors, and other NMTC professionals to discuss the costs associated with executing a NMTC business strategy. An advisory group of NMTC professionals could be a valuable resource to the Treasury Department's NMTC team in helping to address the questions on fees and compensation and where possible develop industry accepted practices and standards for NMTC transactions. We would be available to participate in such a group.

- c) *Are there specific administrative or regulatory changes that would reduce transaction costs while preserving public policy objectives and safeguards?*

We recommend several administrative and regulatory changes that would reduce transaction costs while preserving public policy objectives and safeguards. As discussed further in Exhibit C, we make a number of recommendations for how policy and/or regulatory changes to the program could provide much-needed clarity or simplification of issues that create unnecessary costs. We believe these recommendations would greatly increase the overall efficiency of the NMTC.

We believe that transactions would experience greater efficiencies from greater competition if the tax credit was given a long-term extension. The continual one year extension creates uncertainty for investors and makes it less desirable to invest internally to set-up investment operations. With a long-term extension, investors as well as CDEs would likely be more inclined to participate in the NMTC Program. With additional competition, there will be increased efficiency and lower transaction costs. On the other hand, any further limitations will only limit the allocations to the most viable investments, not necessarily the investments that need the program allocations.

Recapture Risk

As discussed in detail in Exhibit A, while we agree that changes could be made in order to encourage more investments in certain business types over others, we do not believe that any changes will cause a substantial increase in investments made until a single component of the program is changed that affects all investments – tax credit recapture. Moreover, because the recapture penalties are so severe, a considerable amount of time is devoted by all industry participants to plan business strategies and structures to minimize the risk of recapture. A decrease in recapture risk will ultimately decrease transaction costs. Of course, this is a point that would need to be addressed by the IRS through regulations.

Redemption Safe Harbor for Partnership CDEs

In a letter dated April 24, 2006, we submitted comments and suggested language for the Treasury Regulation on redemption (Treasury Regulation § 1.45D-1(e)(3)) regarding the timing of distributions and distributions made for prior years' accumulated profits. We believe these recommendations will aid in decreasing transaction costs. We have provided our previously submitted comments in Exhibit C.

Portions of the Business Requirements

The “portions of the business” provisions of the regulations (Treasury Regulation §1.45D-1(d)(4)(iii)) have become a very useful tool in structuring investments. In order to make use of these provisions, (i) a “complete and separate set of books and records” must be maintained with respect to the applicable portion of the business, and (ii) the proceeds of the CDE's loan or investment are treated as a QLICI only to the extent that such proceeds are used in such portion of the business. We have provided our previously submitted comments in Exhibit C that request clarification on several issues related to the portions of the business requirements. We believe these recommendations will aid in decreasing transaction costs.

Transition Rules for New Census Data

As discussed in question 1(a) above, we realize that the 2010 census data is not available at this time but we believe it would be extremely helpful for NMTC Program participants to understand the process the CDFI Fund will implement well in advance of the data being made publicly available so that they can proceed with transactions with this understanding. Absent such guidance some CDEs will likely begin delaying their consideration of certain investments in and loans to qualified businesses until such time as the transition rules are better understood.

More particularly, as the release date of updated decennial census nears, businesses, lenders and investors will be forced to consider whether or not to proceed with potential NMTC

transactions that may not close prior to the release date of the updated decennial census data that the CDFI Fund will use to determine whether census tracts qualify for NMTC purposes. The transition from previous decennial census data to the updated decennial census data creates potential problems for NMTC investments in progress that are in a qualified census tract currently but may not be qualified under the updated data. The uncertainty created by the lack of guidance for transitioning rules leads to higher transaction costs. By implementing our recommendations above, there will be less uncertainty about the release of new census data which will enable practitioners to proceed with investments in a more efficient manner.

Program Related Investments and NMTC Transactions

Additionally, we recommend changes to the Regulations related to Program Related Investments which will decrease transaction costs discussed in detail below. In a letter to Ms. Emily S. McMahon, Acting Assistant Secretary (Tax Policy), dated November 14, 2011, the NMTC Working Group made recommendations regarding guidance under §4944 Treasury Regulation § 53.4944-3 and on Program Related Investments. We have provided our comments below to recommend new language be added to the Regulations for §4944 to provide a safe harbor for investments in NMTC transactions.

We request that Treasury provide a program-related investments safe harbor for private foundations that make loans to or equity investments in an entity that makes a qualified equity investment, as defined in §45D(b)(1). For purposes of determining the amount of NMTC allowable under § 45D of the Internal Revenue Code, the amount of the qualified equity investment (QEI) made by a limited liability company (LLC) classified as a partnership includes cash from a nonrecourse⁷ or recourse⁸ loan to the LLC that the LLC invests as equity in a qualified community development entity. It has been our experience that private foundations are generally hesitant to make a loan to or equity investments in an entity that will use the proceeds to make a QEI because, under the regulations related to program-related investments under Treasury Regulation § 53.4944-3, it is unclear if such an investment would meet the requirements. We believe that the intent of the NMTC Program to provide below-market rate investments to qualified businesses in low-income communities meets the intent of the exceptions provided for program-related investments that do not jeopardize the carrying out of exempt purposes of a private foundation as described in Treasury Regulation § 53.4944-3. Therefore, we recommend that the following safe harbor be added to Treasury Regulation § 53.4944-3(a)(2)(i):

(A) A loan to or equity investment in an entity that makes a qualified equity investment in accordance with section 45D(b)(1) shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B).

We also recommend a similar safe harbor be added to Treasury Regulation § 53.4944-3(a)(2)(iii):

(A) A loan to or an equity investment in an entity that makes a qualified equity investment in accordance with section 45D(b)(1) shall be presumed to not have as a significant purpose the production of income or the appreciation of property.

⁷ Revenue Ruling 2003-20.

⁸ Revenue Ruling 2010-17.

We believe that such guidance will give private foundations the comfort necessary to make direct investments in an entity that will use the investment to make a QEI. Without such guidance, private foundations are likely to avoid NMTC transactions or incur additional structuring costs to make the investment, diluting the overall benefit that can be passed on to qualified businesses located in low-income communities.

We believe that further guidance, as requested by this letter, will expand the NMTC Program to better serve its intended purpose, bringing capital to communities that have historically had inadequate access to capital, by lessening the current risk to private foundations due to the uncertainties of the qualification of certain investments in a NMTC structure as program-related investments, ultimately decreasing transaction costs.

Changes to the Allocation Agreement Section 9.13

In a letter to Mr. Robert Ibanez, dated June 27, 2011, we made recommendations regarding the implementation of the provisions of Section 9.13 of the template Allocation Agreement. We believe these recommendations will aid in decreasing transaction costs. We have provided our previously submitted comments in Exhibit D.

De Minimis Rule

Under Treasury Regulation §1.45D-1(d)(5)(iii)(B), a qualified business for a Community Development Entity (CDE) excludes several types of business. The regulation specifically provides:

(B) Certain other trades or businesses. The term qualified business does not include any trade or business consisting of the operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

In Internal Revenue Code Section 1400N, certain tax benefits, including an expansion of available new markets tax credits, were made available to investments made to Gulf Opportunity Zone (GO Zone) properties. In Section 1400N(p)(3)(A)(i), “qualified Gulf Opportunity Zone Property” specifically excluded “any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises” and such property was not eligible for GO Zone tax benefits. Although applicable only for purposes of Section 1400N(p)(3)(A)(i), in Internal Revenue Bulletin 2006-33, Notice 2006-77, the IRS provided the following guidance: “a taxpayer’s trade or business that has less than 10% of its total gross receipts derived from massages, tanning services, or a hot tub facility is not treated as, respectively, a massage parlor, suntan facility, or a hot tub facility.” For purposes of this guidance, “only gross receipts from the taxpayer’s trade or business activity that includes the massages, tanning services, or hot tub facility are taken into account.”

We recommend that Treasury Regulation §1.45D-1(d)(5)(iii)(B) be revised to incorporate the following language:

(B) Certain other trades or businesses. The term qualified business does not include any trade or business, (i) **from which more than 10 percent of its total gross receipts are**

derived from, the operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or (ii) consisting of any store the principal business of which is the sale of alcoholic beverages for consumption off premises. **In determining whether this less than 10 percent test is satisfied, only gross receipts from the taxpayer's trade or business activity that includes operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, are taken into account.**

We note that this is consistent with the Internal Revenue Bulletin 2006-33, Notice 2006-77, in which the IRS provided similar guidance for properties considered in the GO Zone. We recommend that the additional language mentioned above be added to the Treasury Regulation §1.45D-1(d)(5)(iii)(B) and be applicable to all new markets tax credit properties (not just GO Zone properties).

5) Evaluation of Financial Products

- a) *Should the CDFI Fund adopt the use of a defined Effective Annual Percentage Rate for purposes of the application and compliance measurement?*

We recommend that the CDFI Fund **not** adopt the use of a defined Effective Annual Percentage Rate for purposes of the application and compliance measurement. As discussed throughout this comment letter, the flexibility of the NMTC Program enables creative solutions for financing projects and businesses that would otherwise not receive funding. Because every deal is unique, it is difficult to establish a standard benchmark to provide a meaningful basis to evaluate CDEs and their performance. This rate would also be skewed based upon whether the CDE is funded by its controlling entity and does not charge any fees, as most large financial institutions with CDEs do. If you were to compare such a CDE to a non-profit CDE who charges reasonable fees to support its charitable activities, we believe it would be an unfair comparison. Moreover, the interest rate charged by a CDE on a particular transaction is largely a reflection of the sources of financing for the investment in the CDE (i.e., whether some or all of that financing comes from market lending sources (at higher rates) or from mission-based lending sources, grants sources, or affiliates of the QALICB (at lower and often nominal rates). CDEs have very little control over this, and it would be unfair to compare them based on a standardized rate that does not account for differences in the cost of the CDEs' funding sources. Further, adopting a nationwide standard would be at odds with the program's main advantage: its flexibility. The range of borrower types and relevant benchmarks is simply too wide to be captured by one benchmark. The application requires sufficient detail on product favorability and it is already included in the allocation agreement. This gives the CDFI Fund and the NMTC investor adequate enforcement and monitoring mechanisms to ensure quality self-policing.

- b) *Should the CDFI Fund alter the flexible rates and terms question (question 15 of the 2011 application) to base the scoring preference on a basis point reduction from a market benchmark determined by the CDE (or a standard metric such as LIBOR) instead of a percentage? Should the benchmarks be raised?*

We recommend that the CDFI Fund alter the flexible rates and terms question to provide an additional option to base the scoring preference on a basis point reduction instead of just a percentage. We further believe that the basis point amounts included in our recommendation

below is sufficient. In a letter to Ms. Rosa Martinez, dated October 25, 2010, the NMTC Working Group submitted comments as it related to question 16 of the 2010 NMTC Allocation Application which was question 15 in the 2011 NMTC Allocation Application. We have updated these previous comments to apply to the 2011 application.

Question 15 requires the Applicant to commit that 100% of its QLICs will have one of five levels of flexible or non-traditional terms. The current choices available to an Applicant related to debt with below market interest rates are interest rates that are a certain percentage below market. We believe that if an Applicant must commit to interest rates at a specific percentage below market, loan products subsidized with NMTCs may become financially infeasible as interest rates change over time.

To illustrate our concern, please consider this example. A CDE is able to offer market rate loans at a 30 Day LIBOR rate + 2%. In Year 1, the 30 Day LIBOR is 2%, so market rate loans would be 4%. The CDE uses the NMTC subsidy to offer a loan product that is 200 basis points below market. With the NMTC subsidy of 200 basis points, the CDE is able to make QLICs at 2%, which is 50% below market. This would satisfy a 50% below market requirement. In Year 3, the 30 Day LIBOR rate increases to 6% which causes the market rate to be 8%. The amount of NMTC subsidy will remain constant since it will not be affected by changing interest rates over time. Using the 200 basis points of NMTC subsidy, the CDE will be able to make QLICs at 6%, which is only 25% below market rates. In this scenario, the CDE will be unable to satisfy the 50% below market requirement over time due to the increase in the cost of funds.

We recommend that a specific amount of basis points below market be included as a threshold **in addition to** the options for percentages below market and indicia of flexible or non-traditional rates and terms in subsections (a) – (d) of question 16.15. We suggest that the amount of basis points below market be for subsection (a) debt with interest rates 300 basis points below market, subsection (b) debt with interest rates 250 basis points below market, subsection (c) debt with interest rates 200 basis points below market, and subsection (d) debt with interest rates 150 basis points below market. We believe that this will allow the Applicant to continue to provide below market loan products without the risk of changing interest rates causing a loan product to be infeasible or causing the allocatee to be in default of its NMTC Allocation Agreement.

- c) *Are there specific administrative or regulatory changes that would facilitate the provision of specific financial products while preserving public policy objectives and safeguards?*

Changing the definition of control for purposes of the reasonable expectations test is a regulatory change that may encourage more equity investments. As discussed in greater detail in section 2(c) above, we believe changes in the reasonable expectations test are needed to reduce transaction costs and better facilitate both real estate and non-real estate investments. As a result of the broad definition of “control” under the reasonable expectation test, investors in the current market are unlikely to allow the CDE to acquire a majority equity interest in a QALICB. If a CDE cannot rely on the reasonable expectation test, investors perceive the compliance risk as too great and most are unwilling to enter into such a transaction. This outcome is unfortunate since equity investments are generally the most patient form of capital and would also reduce the burden of ensuring that the subsidy can remain at the QALICB.

If the changes previously outlined are adopted, it is likely that equity transactions could be structured in a manner that would attract investors by successfully addressing the issue of

control and providing CDE's with the ability to rely on the reasonable expectations test. Without such a change, it is likely that investors will continue to sit on the sidelines when it comes to investing in CDEs that intend to make equity investments and will continue to effectively prevent the most patient form of capital, equity investments, from being made to QALICBs.

Administratively, we recommend that the CDFI Fund return to its earlier methodology of evaluating flexible rates and terms on the overall NMTC financing package rather than on an individual QLICI basis. While the ability to use a blended interest rate on the A and B pieces for purposes of determining the percentage below market was intended to fix this problem, it still does not address the issue across the board when the A piece is derived from bank debt. In this case, it may still be difficult to achieve a 50% below market interest rate, in which case each individual QLICI must meet 5 flexible terms. The most attractive feature of an A-B note structure to a QALICB is the ability to obtain a large upfront subsidy to fill a financing gap, but that subsidy cannot be obtained without the enhancement of some form of investment capital. One could also argue that the ability to obtain bank debt at all as part of an NMTC financing is also a large benefit, particularly given the fact that there is no comparable product with 7 years interest only terms. Therefore, we believe that an evaluation of the entire NMTC financing package is far more relevant than an evaluation of each individual QLICI.

6) Use of other federally subsidized financing in conjunction with NMTCs

- a) *Should there be any additional restrictions in the allocation award process regarding the use of NMTCs with other sources of federally-subsidized financing? If so, are there certain types of federal financing that should be disallowed? Should it matter whether the financing is made as part of the QEI investment (e.g., through the leveraged debt structure) or at the project level?*

We recommend that there not be any additional restrictions in the allocation award process regarding the use of NMTCs with other sources of federally-subsidized financing. In fact, we recommend that the CDFI Fund work with other federal agencies to identify ways to increase the compatibility of other sources of federally-subsidized financing to encourage combining as many other sources with NMTCs. The credit is a shallow subsidy by itself, and projects and businesses often require numerous sources, such as loans and grants, to make a project or business feasible. Particularly in today's financing environment, where conventional bank debt is still quite difficult to obtain, and when obtained, subject to strict underwriting standards, it is typical that financing stacks include multiple layers of private and public funding sources. The layering of the loans and other subsidies is what makes underwriting development possible for many projects and businesses that, but for the NMTC, could not pencil out. There should be no difference whether the financing is made as part of the QEI or at the QALICB level. We believe a strength of the program is that it can be combined with other federal funds to maximize investments in LICs.

All of the CDFI Fund's policies and procedures are targeted toward providing the lowest-cost-possible products to the most-highly distressed communities. If additional restrictions were created to try to isolate the NMTC from other sources of federally-subsidized financing used by organizations in highly distressed communities that need low-cost products, the result would be the failure of delivering the lowest cost of capital to qualified businesses. Non-profit organizations and small businesses are already aware of and regularly use numerous types of financing and other assistance from HUD, SBA, and other agencies. These businesses often still

have gaps that the NMTC can fill. We recommend the CDFI Fund to promote more coordination, not less, with other federal economic development programs.

- b) *Assuming that it is appropriate for any other source of federally-subsidized financing to be used in conjunction with NMTC investments, would it be prudent for the CDFI Fund to limit, as part of the allocation process, the overall amount of QEI dollars or project level investments that may be supported with other sources of federal financing?*

We recommend that the CDFI Fund not limit the overall amount of QEI dollars or project and business level investment that may be supported with other sources of federal financing. If the goal is to spur investment in Low-Income Communities and also to help rebuild those communities, then there should be no restriction on how much of the total capital stack is from federally-subsidized financing and how much is from NMTCs and other private investment or other sources of funding. As discussed below, industry participants and administrations should promote other forms of federally-subsidized financing to be used in conjunction with NMTC investments and find ways to enhance compatibility in order to decrease transaction costs. We firmly believe the success of the NMTC is rooted in its flexibility. The NMTC Program is considered one of the federal government's most innovative because it allows the end users of the program, themselves, to be innovative. Placing more restrictions on how they use the funds will undermine this goal. Furthermore, the CDFI Fund, through the application process and CIIS, has reporting mechanisms that require CDEs to disclose in detail its QLICIs, including amounts, terms and community impacts. These reporting features create built-in incentives for CDEs to finance worthy businesses and projects and determine the appropriate level of NMTC allocation.

- c) *Are there specific administrative or regulatory changes that could facilitate the coordination of other federally subsidized financing in conjunction with NMTCs while preserving public policy objectives and safeguards?*

From its inception, the flexibility of the NMTC has promoted creative financing structures and pairing of federally subsidized financing in conjunction with NMTCs while preserving public policy objectives and safeguards. We believe there are administrative and regulatory changes that could further facilitate the coordination of other federally subsidized financing in conjunction with NMTCs. As discussed in greater detail above in question 4(c), we recommend in a letter to Ms. Emily S. McMahon, Acting Assistant Secretary (Tax Policy), dated November 14, 2011, that Treasury provide guidance under §4944 and Treasury Regulation § 53.4944-3 on Program-Related Investments. These recommendations for new language to the Regulations for §4944 would provide a safe harbor for investments in NMTC transactions.

It has been our experience that private foundations are generally hesitant to make a loan to or equity investments in an entity that will use the proceeds to make a QEI because, under the regulations related to program-related investments under Treasury Regulation § 53.4944-3, it is unclear if such an investment would meet the requirements. We believe that the intent of the NMTC Program to provide below-market rate investments to qualified businesses in low-income communities meets the intent of the exceptions provided for program-related investments that don't jeopardize the carrying out of exempt purposes of a private foundation as described in Treasury Regulation § 53.4944-3. Therefore, we recommend that the following safe harbor be added to Treasury Regulation § 53.4944-3(a)(2)(i):

(A) A loan to or equity investment in an entity that makes a qualified equity investment in accordance with section 45D(b)(1) shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B).

We also recommend a similar safe harbor be added to Treasury Regulation § 53.4944-3(a)(2)(iii):

(A) A loan to or an equity investment in an entity that makes a qualified equity investment in accordance with section 45D(b)(1) shall be presumed to not have as a significant purpose the production of income or the appreciation of property.

We believe that such guidance will give private foundations the comfort necessary to make direct investments in an entity that will use the investment to make a QEI. Without such guidance, private foundations are likely to avoid NMTC transactions or incur additional structuring costs to make the investment, diluting the overall benefit that can be passed on to qualified businesses located in low-income communities.

In addition to changes to the NMTC Program itself, changes to other governmental programs could be instrumental in attracting more NMTC financing to needy businesses. For example, the US Department of Agriculture has recently provided guidance on how CDEs can participate in the USDA Business and Industry loan guaranty program. Combining NMTCs with government-guaranteed loan programs creates a synergistic effect: on the NMTC side, CDEs are able to attract additional sources of leverage capital which in turn can be used to finance multiple smaller transactions at a lower cost, and on the other agency's side, additional lenders who are experienced at identifying and underwriting businesses located in low-income areas are brought into the program. We would encourage other federal agencies, such as the SBA, to consider similar policies that would facilitate additional lending in low-income communities.

Conclusion

We commend the CDFI Fund and the Department of the Treasury for its continued efforts to improve the effectiveness and efficiency of the NMTC Program. We believe that these recommendations will contribute to the efficiency of the NMTC Program specifically as it relates to low-income communities and areas of higher distress, treatment of certain businesses, community accountability, transaction costs, evaluation of financial products, and the use of other federally subsidized financing in conjunction with NMTCs.

Mr. Robert Ibanez
February 6, 2012

NMTC Working Group
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We are excited about the positive impact that the NMTC Program is having on the nation's low-income communities and low-income persons and the potential for future success. However, we believe that the program can become even more efficient and deliver more subsidy to the end users within low-income communities. We appreciate the opportunity to submit our recommendations for increasing the efficiency and effectiveness of the NMTC Program. Thank you in advance for your time and consideration. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,

Novogradac & Company LLP



by

Michael J. Novogradac

Novogradac & Company LLP



by

Brad Elphick

cc: Matt Josephs
Rosa Martinez

Attachments

Exhibit A

Risk of Recapture

When trying to determine what changes can be made to improve the NMTC Program, many suggestions can be made about individual aspects of the Program's regulations. Depending on what outcome is desired, certain changes can be made to achieve that outcome. While we agree that changes need to be made in order to encourage more investments in non-real estate qualified active low-income community businesses ("QALICBs"), we do not believe that any changes will cause a substantial increase in investments made until a single component of the program is changed that affects all investments – "tax credit recapture". By having full recapture risk, plus interest penalties, for the full term of the investment, the NMTC Program has a level of compliance and transaction structuring unrivaled by other tax credit programs. This level of structuring and underwriting ensures that the goals of the NMTC Program are ultimately achieved but at a cost that is incorporated into the overall price of the NMTC and the types of investments that investors are willing to make. A reduction in tax credit recapture risk during the term of the investment would certainly lower the discount of the NMTC applied by investors and broaden the types of investments that tax credit investors are willing to make, including non-real estate QALICBs.

Currently, if \$1 of an investor's qualified equity investment is redeemed during the seven year compliance period, many believe full recapture is triggered. It does not matter if this redemption occurs in year one or year six, the result is the same – 100 percent of the new markets tax credits must be recaptured (plus interest) by both the investor who purchased the qualified equity investment from the CDE and by all subsequent holders of that investment, to the extent of the NMTCs allowed and used by each investor.¹ In many other tax credit programs, the level of recapture risk decreases over time. The recapture risk for NMTCs does not decline during the seven year compliance period. With the low-income housing tax credit ("LIHTC"), only the accelerated portion, on a downward sliding scale, is recaptured. If recapture occurs before year 12, only 1/3 of the previously claimed LIHTC is recaptured. During years 12, 13, 14 and 15, 4/15, 3/15, 2/15 and 1/15, respectively, is subject to recapture. The impact of total recapture of the NMTC is amplified because the investor must also pay interest on the underpayment of tax for each prior taxable year, beginning on the due date of the tax return for such prior taxable year.²

Recapture risk is a greater concern for investors in CDEs where the investors' qualified equity investment ("QEIs") will be used for non-real estate investments in a QALICB that is an operating business. Operating businesses typically don't need investments with a 7 year term or longer. These operating businesses typically have a need for a much shorter term investment. Also, investments in operating businesses may require some control features as opposed to real estate investments that do not generally require control. The risk to the investor is related to the reinvestment and reasonable expectations requirements of the NMTC Program. If an investment is made with a term shorter than seven years, the CDE must be able to reinvest the proceeds of the qualified low-income community investment ("QLICI") within 12 months in order for them to be considered continuously invested for purposes of the substantially all requirement. If they are unable to reinvest all or a portion of the QLICI(s) and fall below the 85% substantially all requirement, recapture may be triggered. In practice, investors have generally favored the simplicity and security of seven-year NMTC investments rather than taking the inherent recapture risks involved with a reinvestment scenario. Prior to the addition of a limited right to cure an investment, investors generally avoided the shorter-term investments solely because of the recapture risk. Today, investors also focus on economic considerations in deciding to invest in shorter-term investments. These considerations include drag on yield when liquidated monies are in temporary

¹ IRC §45D(g)(1); Treas. Reg. §1.45D-1(e)(1).

² IRC §45D(g)(2).

Exhibit A

investments (i.e., awaiting reinvestment) and the uncertainty on what economic yield might be available on such reinvestment.

Whether recapture is triggered by redemption or failure of the substantially all test, the risk is that a \$1 mistake can cause total recapture. If the goal is to promote changes to the program to encourage more investments in operating businesses, we believe changes to the calculation of the amount of recapture triggered by these recapture events needs to be changed to a less draconian approach. We recommend a proportionate calculation rather than total recapture. For example, if \$10 of the investor's QEI is redeemed in year 6, only those credits associated with the redeemed amount and previously claimed are subject to recapture plus interest penalties.

Example:

ABC makes a \$1 million investment in CDE that in turn invests in XYZ business. ABC receives \$50,000 in annual credits in 2011, 2012 and 2013. ABC reduces its tax liability by \$50,000 in 2011, 2012 and 2013. In 2014, CDE redeems \$100,000, or 10%, of ABC's QEI.

Based upon our recommendation to make recapture proportionate to the amount that caused recapture, ABC would recapture 10% of all credits it received. Therefore, ABC must report recapture tax of \$15,000 with interest accruing from 2011 (on \$5,000), 2012 (on \$5,000) and 2013 (on \$5,000).

Using the same set of facts, if a CDE fails the substantially all requirement by \$100,000, or 10% of ABC's QEI, the result would be the same.

Without substantive changes to reduce the recapture risk of NMTC transactions, we believe that any changes made to other parts of the regulations will achieve limited results and will not cause investors and CDEs to significantly increase the amount of investments made with non-real estate operating business QALICBs.

Without substantive changes to reduce the recapture risk of NMTC transactions, we believe that any changes made to other parts of the regulations will achieve limited results and will not cause investors and CDEs to significantly increase the amount of investments made with non-real estate operating business QALICBs. We recommend that the CDFI Fund not deviate from the current statutory mandate of priority points.

Exhibit B

Definition of Control

In several comment letters submitted over the years, the NMTC Working Group has recommended changes be made to the CDFI Fund's related party test definition and measurement in order to encourage CDEs to make majority equity investments in qualified active low-income community businesses ("QALICBs"). This year, the CDFI Fund made changes consistent with the NMTC Working Group's recommendations that would allow a CDE to make majority equity interest investments without violating its allocation agreement so long as it had committed to investing substantially all of its proceeds in entities that were considered unrelated before it invested. This change was a significant step and one that the industry applauds the CDFI Fund for making.

However, it is unlikely that many CDEs will make majority interest equity investments because of an issue related to the reasonable expectations test defined in Treasury Regulation §1.45D-1(d)(6). The Regulations provide that if a CDE:

"...reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business [for the term of the investment...]"

then the QALICB will continue to be deemed a QALICB even if it falls out of compliance at a later time. This provision permits a CDE to avoid suffering a recapture event if the QALICB ceases to qualify as a QALICB during the recapture period for reasons that are outside the control of the CDE.

However, the Regulations further require that if the CDE has or obtains control of the QALICB, it generally must ensure that the entity remains a QALICB for the entire 7-year compliance period and cannot rely on its reasonable expectation at the time the investment is made to avoid a recapture event.

Investors do not want to be subject to strict liability for recapture merely because they acquire a majority equity interest in the QALICB if they do not also have management or voting rights that would allow them to control QALICB status. As a result of the broad definition of "control" under the reasonable expectation test, investors in the current market are unlikely to allow the CDE to acquire a majority equity interest in a QALICB.

If a CDE cannot rely on the reasonable expectation test, investors perceive the compliance risk as too great and most are unwilling to enter into such a transaction. This outcome is unfortunate since equity investments are generally the most patient form of capital and would also reduce the burden of ensuring that the subsidy can remain at the QALICB.

The current definition of control in Treasury Regulation §1.45D-1(d)(6)(ii)(B) states (emphasis added):

"Control means, with respect to an entity, **direct or indirect ownership (based on value)** or control (based on voting or management rights) of more than 50 percent of the entity. For purposes of the preceding sentence, the term management rights means the power to influence the management policies or investment decisions of the entity."

The problem for equity investors is the imputation of control based on "direct or indirect ownership (based on value)". Currently there is no clear guidance on how to calculate direct or indirect ownership "based on value". It is unclear to us how value is determined and how it is relevant to whether or not the CDE is controlling the QALICB. We believe that the concept of control should be based solely on the CDE's ability to control the QALICB's status as a QALICB through voting or management rights.

Exhibit B

It would also be helpful to clarify the meaning of “control” given the variety of possible equity structures and documentation used in New Markets transactions. The potential for confusion is compounded by the fact that the CDFI Fund has adopted its own definitions regarding “control” in the NMTC arena -- definitions that do not necessarily work well for this purpose.

We believe that the only type of control based on voting or management rights that should be of concern in the context of the reasonable expectation test is control based on rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB failing to remain a QALICB, or (ii) allow the CDE to override or block actions by the QALICB when the authority to take such actions is necessary to enable the entity to remain a QALICB. The ability to exercise management or voting control on other issues would not seem to bear on whether the CDE should be allowed to rely on its own reasonable expectation of compliance as a safe harbor.

We note that there are some areas where a CDE’s actions could indirectly affect compliance decisions by the QALICB, and one important example would be the right to remove a general partner of a partnership, the managing member of an LLC, or a majority of the directors of a corporation. Removal rights are commonly required by investors in scenarios in which a CDE is making equity investments in a QALICB. We believe that the existence of such rights in the CDE to remove **for cause** a managing member, general partner, or other party or parties with management control should not, by itself, be deemed to confer voting or management control on the CDE. Where removal is limited to “for cause” events (i.e., failure of the general partner, managing member, or majority of directors to comply with their obligations under the organizational documents), the threat of removal would not represent a mechanism for influencing management decisions that is tantamount to direct management control. Moreover, removal provisions typically contemplate the appointment of a substitute managing member, general partner, or directors, rather than entitling the CDE to manage the QALICB itself. In such a case, so long as the CDE does not actually “control” the substitute management, then the CDE could still satisfy the control test as we have recommended it be changed herein.

Accordingly, we recommend that the definition of “Control” contained in Treasury regulations be updated to remove the reference to a value based test and clarify voting and management rights that should be considered. Specifically, we recommend the following change to Treasury Regulation §1.45D-1(d)(6)(ii)(B):

“Control means, with respect to an entity, ~~direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity based on~~ of voting or management rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB failing to remain a QALICB, or (ii) to override or block actions by the QALICB that are necessary to enable the entity to remain a QALICB.

- (a) The existence of rights in the CDE to remove for cause a managing member of a limited liability company, a general partner of a limited partnership, or majority of directors of a corporation by substituting a new managing member, general partner, or majority of directors with control would not, by itself, be deemed to give the CDE ‘control’ for purposes of this provision.”**

If these changes are adopted, it is likely that equity transactions could be structured in a manner that would attract investors by successfully addressing the issue of control and providing CDE’s with the

Exhibit B

ability to rely on the reasonable expectations test. Without such a change, it is likely that investors will continue to sit on the sidelines when it comes to investing in CDEs that intend to make equity investments and will continue to effectively prevent the most patient form of capital, equity investments, from being made to QALICBs.

Exhibit C

SPECIFIC COMMENTS ON THE PROPOSED REGULATIONS

Economic Substance Doctrine

In the Health Care and Education Affordability Reconciliation Act of 2010 (the “Act”), the economic substance doctrine was codified in Section 7701(o) of the Internal Revenue Code of 1986, as amended (the “Code”) effective for transactions entered into after March 30, 2010. In a technical explanation prepared by the Joint Committee on Taxation (“JCT”) explaining revenue provisions of the Act, footnote 344³ clarified that the codification of the economic substance doctrine is not intended to disallow tax benefits in a transaction that achieves the basic purpose or plan for which the tax benefit was designed by Congress. The NMTC community, as well as other tax credit communities, applaud the explanatory guidance provided by this footnote since it recognizes and is consistent with the Congress’ legislative intent in codifying the economic substance doctrine as well as Congress’ legislative intent in enacting tax credits that provide incentives for investment in affordable rental housing, historic properties, underserved economic areas, and renewable energy resources.

We request that Treasury provide guidance that it will follow the documented legislative intent included in footnote 344. While we believe that case law and historical Treasury guidance is generally consistent with the interpretation provided in footnote 344, we also believe that industry participants and practitioners can more readily rely on written guidance from Treasury expressing Treasury’s agreement with the explanatory statements provided in footnote 344. Such guidance from Treasury would receive greater deference by a court interpreting the economic substance statute than the JCT explanatory footnote.

Redemption Safe Harbor for Partnership CDE’s

In a letter dated April 24, 2006, we submitted comments and suggested language for the Treasury Regulation on redemption (Treasury Regulation § 1.45D-1(e)(3)) regarding the timing of distributions and distributions made for prior years’ accumulated profits. The NMTC Working Group requests that the suggested language offered in our previous letter be further considered. We still believe that our suggested changes will lessen the unnecessary administrative burden for Community Development Entities (“CDEs”) as well as the undue risk of recapture faced by investors in CDEs. By lessening the administrative burden to CDEs, more of the NMTC subsidy can be made available to qualified businesses. Similarly, by lessening the undue risk of recapture to investors, more equity capital can be raised and invested in qualified businesses. We commend the Department of Treasury for its efforts in proposing changes to the regulations. However, we still request that our recommendations be considered as an alternative to the proposed changes in the Regulations. For your convenience, we are resubmitting our comments below from our previous letter with certain changes made to incorporate the proposed changes in the Regulations.

Final Regulation Section 1.45D-1(e)(3)(iii) provides a safe-harbor for CDEs that are considered a partnership for Federal tax purposes. The Regulation specifically states:

“ . . . a pro rata cash distribution by the CDE to its partners based on each partner's capital interest in the CDE during the taxable year will not be treated as a redemption for purposes of paragraph (e)(2)(iii) of this section if the distribution does not exceed the CDE's operating income for the taxable year.”

³ Joint Committee on Taxation Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act”, JCX-18-10, March 21, 2010, page 152.

Exhibit C

Timing of distributions

The Final Regulation then defines Operating Income.⁴ However, the Final Regulation implies that the distribution must be made in the same taxable year to which the Operating Income is attributed. By requiring that the distribution be made in the same year, CDEs are required to estimate Operating Income before the end of the taxable year. This is because in the normal course of business, a CDE will not have its books and records for a given month closed and adjusted until after the end of the month. This is still true even with the changes in the proposed regulations that allow distribution of the current taxable year's Operating Income and the prior taxable year's undistributed Operating Income.

For example, the books and records of a calendar year CDE may not be closed and adjusted until January 15th. Additionally, the tax returns will not be completed in most cases until some time in March. As a result, the only way a CDE can distribute its Operating Income before the end of the taxable year is if the CDE estimates its Operating Income for the given year. If the CDE miscalculates its estimate of Operating Income and distributes cash in excess of Operating Income, then investors in the CDE could potentially suffer recapture.

In order for the CDE to accurately determine Operating Income as defined in the Regulation, the CDE must wait until after year-end to calculate Operating Income. There are several examples throughout the Internal Revenue Code ("Code") that allow an entity to treat a distribution as having been made in a given taxable year if it makes the distribution within a certain amount of time after the end of a given taxable year. For example, Code Section 855 allows a regulated investment company to treat a distribution as having been made in a given taxable year if it declares the dividend prior to the due date for the filing of the tax return, including any extensions, and distributes the dividend within 12 months after the taxable year.⁵ Code Section 857(b)(9) allows a real estate investment trust to treat a distribution

⁴ For purposes of calculating operating income, Reg. 1.45D-1(e)(3)(iii) defines operating income as:

- (A) The CDE's taxable income as determined under section 703, except that—
 - (1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; and
 - (2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;
- (B) Tax-exempt income under section 103;
- (C) Deductions under section 165, but only to the extent the losses were realized from qualified low-income community investments under paragraph (d)(1) of this section;
- (D) Deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k), and any other depreciation and amortization deductions under the Code;
- (E) Start-up expenditures amortized under section 195; and
- (F) Organizational expenses amortized under section 709.

⁵ Code Section 855(a) provides the following rule for distributions after close of taxable year:

- (a) General rule.
For purposes of this chapter, if a regulated investment company—
 - (1) declares a dividend prior to the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and
 - (2) distributes the amount of such dividend to shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration,

Exhibit C

as having been made on December 31 of a given taxable year if the distribution is made by January 31 of the following taxable year.⁶

We recommend that the Regulation be clarified to allow CDEs, solely for purposes of determining if a recapture event has occurred, to treat distributions made by the due date (including extensions) of a CDE's federal income tax return to be treated as made in the prior taxable year. We have provided sample language for your consideration attached with this comment letter.

Distributions made for prior year(s)

In a given taxable year, a CDE may not want to or may not be able to distribute all of its Operating Income to its investors. The Regulation currently does not allow the CDE that is taxed as a partnership for federal tax purposes to carry this undistributed Operating Income forward to future years. The Proposed Regulation allows a CDE to distribute undistributed operating income from the prior taxable year only. If, however, the CDE is taxed as a corporation, it is permitted to make distributions out of accumulated earnings and profits. It seems inequitable that corporations may make distributions out of accumulated earnings and profits from all prior taxable years but entities taxed as partnerships are only permitted to make distributions out of current year Operating Income and undistributed Operating Income from the prior taxable year.

There are numerous examples of the inequities of this rule. For example, a CDE makes a 3 year loan that requires a balloon payment at the end of year 3 for the amount of principal and accrued interest. The CDE has accrued the interest income over the three years but has not received any current cash payments of interest. At the end of year three, the CDE receives cash for the repayment of the loan it made and corresponding accrued interest. However, because the taxable year in which the loan was repaid will only reflect the interest income for that year in its Operating Income calculation as the Regulation is currently interpreted, about two-thirds of the cash will be trapped at the CDE, unable to be distributed. With a carry-forward of undistributed Operating Income from prior years, the CDE would be able to distribute cash received when accrued interest is paid.

Another example relates to a CDE that decides to hold its interest income received in the earlier years of its NMTC investment period in a reserve account, to hedge against future potential loan losses or unanticipated operating expenses. As the CDE's operations stabilize, the CDE may be in a position to release some of these prior earnings and provide a return to its investors. However, under the current and

the amount so declared and distributed shall, to the extent the company elects in such return in accordance with regulations prescribed by the Secretary, be considered as having been paid during such taxable year, except as provided in subsections (b) , (c) and (d) .

⁶ Code Section 857(b)(9) allows dividends to be paid in the following year but deemed paid in the year they were declared:

(9) Time certain dividends taken into account.

For purposes of this title, any dividend declared by a real estate investment trust in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed—

- (A) to have been received by each shareholder on December 31 of such calendar year, and
- (B) to have been paid by such trust on December 31 of such calendar year (or, if earlier, as provided in section 858).

The preceding sentence shall apply only if such dividend is actually paid by the company during January of the following calendar year.

Exhibit C

proposed regulations, the CDE would be unable to pay distributions to its partners for its undistributed Operating Income, except for amounts related to the current and immediate prior year.

In an effort to create symmetry between the rules for corporations and partnerships as it relates to the Regulation, we ask that a CDE be allowed to make distributions from Operating Income in the same manner that a C corporation can make a distribution from earnings and profits. Code Section 316 defines a dividend as being a distribution out of accumulated earnings and profits or from current earnings and profits without regard to the accumulated earnings and profits at the time the distribution was made.⁷ We ask that entities taxed as partnerships be allowed to make distributions from Operating Income in the same manner. By creating this symmetry between corporations and partnerships, the burden on partnership CDEs to avoid redemption when distributing Operating Income without jeopardizing the NMTCs will be alleviated. We have provided sample language for your consideration.

If the proposed regulations are not changed to incorporate our previous comments regarding the inclusion of all prior taxable years' undistributed Operating Income and the timing of when distributions can be made, we recommend that the Regulations clarify the calculation of how distributions are applied to undistributed Operating Income. It is currently unclear as to which year's Operating Income would be deemed to be distributed first. For example, a CDE has \$100 of Operating Income for the current taxable year and \$100 of undistributed Operating Income for the prior taxable year for a total of \$200 that could be distributed based upon the safe harbor provision in the proposed regulations. If the CDE has \$120 of cash that it intends to distribute pro rata to its partners, would the \$120 distribution be applied first to the prior year's undistributed Operating Income of \$100 with the remaining \$20 applied to the current year's Operating Income, thereby leaving \$80 of undistributed current taxable year Operating Income (which would be available for distribution in the following taxable year)? Or, would the \$120 distribution first be applied to the entire current taxable year's Operating Income and next only \$20 attributable to the undistributed Operating Income from the prior taxable year (thus leaving \$80 of prior year Operating Income not available for distribution and no amount of current year Operating Income available for distribution in the following taxable year)? We believe that the CDE should be allowed to use the former approach using a first-in first-out (FIFO) methodology. Otherwise, \$80 of undistributed Operating Income will be unavailable to the CDE for distribution during the next taxable year.

Catch-up period for existing CDEs

We recommend that CDEs be allowed to apply these rules retroactively to allow them to “catch-up” their distributions. Without guidance on this issue, many CDEs chose not to make distributions due to the severe risk of recapture. If this guidance had existed, they would have made distributions in prior taxable years. If our recommendation to allow CDEs to distribute the cumulative amount of all prior taxable years' undistributed Operating Income is not incorporated into the final changes, we recommend that guidance be provided to allow CDE's with undistributed Operating Income from any prior taxable year to distribute their undistributed Operating Income. For all taxable years following the year in which the guidance is finalized, the CDE would only be able to distribute the sum of the current taxable year

⁷ Code Section 316(a) defines a dividend for purpose of distributions by a C corporation as follows:

(a) General rule.

For purposes of this subtitle, the term “dividend” means any distribution of property made by a corporation to its shareholders—

- (1) out of its earnings and profits accumulated after February 28, 1913, or
- (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Exhibit C

Operating Income and the undistributed Operating Income from the prior taxable year as provided in the Proposed Regulation. For example, a CDE began generating \$100 of Operating Income beginning taxable year 2006 and \$100 every year thereafter through 2009 for a total of \$400 of Operating Income. However, to date, the CDE hadn't distributed its Operating Income each year due to the lack of guidance in the Regulations. If the proposed regulations are finalized March 15, 2009, the CDE would then be able to "catch-up" its distributions by distributing the entire \$400 during 2009. In 2010 and each year thereafter, under the safe harbor provision, the CDE would be able to distribute the sum of its current taxable year's Operating Income and prior taxable year undistributed Operating Income.

Definition of Operating Income – capital gains

We commend Treasury for adopting our comments related to the inclusion of tax-exempt income and the CDE's allocable share of depreciation and amortization in the calculation of Operating Income. However, the inclusion of capital gains was not addressed in the proposed regulations. Some CDEs are making venture capital investments in qualified businesses. A goal of the NMTC program is for CDEs to provide equity capital (the most patient form of capital) to businesses located in distressed communities. If these investments are redeemed or otherwise sold, the CDE must reinvest the lesser of the proceeds received or the original cost basis. Amounts received in excess of the original cost basis do not need to be reinvested. However, the definition of Operating Income excludes capital gains. As such, while profits do not need to be reinvested by the CDE they cannot be distributed to investors without risking a recapture event. We recommend that capital gains be included in Operating Income.

Additional Comments Regarding the Proposed Redemption Regulations

Special exceptions

The amendment to the Regulations to allow distributions in a succeeding year of undistributed operating income from a prior year is useful given the difficulty of determining the actual operating income before year-end. The amendment does not address, however, the situations in which a CDE receives QLICI loan interest payments or equity distributions sufficient to make projected distributions which exceed the operating income safe harbor due to unanticipated losses incurred by the CDE or the QALICB.

Example #1: CDE makes loans to a QALICB. The QALICB defaults on its interest payments due to the CDE, and, as a result of this default, the CDE may incur additional expenses (or may be uncertain as to its ability to accrue the interest income). The CDE has a loan loss reserve set aside equal to 5% of the QEI, and uses the funds in the loan loss reserve to make distributions pro rata in accordance with the financial projections at closing. The distributions are in the amounts required for the Investment Fund (a) to pay interest due with respect to a Leverage Loan (or the economic return on an equity investment) made to the Investment Fund to fund a portion of the QEI and (b) to pay the Investment Fund's projected operating expenses.

Example #2: CDE makes a loan and an equity investment in a QALICB. The equity investment generates unanticipated losses which are not funded by the CDE. The unanticipated losses may be funded by project reserves, QALICB affiliate contributions or loans, or third party financing. The CDE receives the projected cash flow from the QLICI loan (or equity investment) and makes distributions pro rata to its members in accordance with the financial projections provided at closing. The distributions are in the amounts required for the Investment Fund (a) to pay interest due with respect to a Leverage Loan (or the economic return on an equity investment) made to the Investment

Exhibit C

Fund to fund a portion of the QEI and (b) to pay the Investment Fund's projected operating expenses.

The legislative history and the Final Treasury Regulations state that there is a recapture event if the investment is redeemed or "otherwise cashed out." The distributions described above in Examples #1 and #2 do not constitute a "cashing out" of the QEI since they are funded by loan loss reserve funds set aside for use in the event of defaults on QLICI loan payments or QLICI loan interest payments (or a return on an equity investment). The distributions are in amounts required to pay Leverage Loan debt service (or the economic return on an equity investment) and operating expenses of the Investment Fund.

The request is to modify the safe harbor (i) to define "operating income" to include QLICI loan interest payments without regard to whether the income should be accrued for federal income tax purposes up to the amount of the loan loss reserve held by the CDE and (ii) to add back the tax deductions incurred by the qualified active low-income community business or the CDE that do not reduce the CDE's operating cash flow. We have provided sample language for your consideration attached with this comment letter.

Allocation among multiple QEIs

In the event that multiple qualified low-income community investments ("QLICIs"), are made into the same qualified active low-income community business ("QALICB") (e.g. installments of historic tax credit equity or advances of a construction loan), there is uncertainty as to how payments of or for capital, equity or principal received by the CDE should be attributed to those QLICIs. Under Treasury Regulation Section 1.45D-1(e)(2)(ii) there is a recapture event with respect to a QEI if "the proceeds of the investment cease to be used in a manner that satisfies the substantially all requirement." It is not clear under this Regulation how the "proceeds of the investment" are defined. This is particularly relevant where (i) multiple QLICIs are made to a single borrower over a period of time, and (ii) these QLICIs are funded from multiple QEIs. In this situation, it is not clear whether the borrower would be deemed to have repaid the QLICI made with the first QEI, the last QEI or repaid QLICIs made proportionally from each QEI.

Similar uncertainty exists under Section 1.45D-1(e)(2)(iii) where multiple QEIs are made into one CDE over a period of time. In this case, there is uncertainty as to how distributions from the CDE which constitute a return of capital will be attributed among those QEIs for purposes of the redemption test for QEIs. For example, consider the case where multiple QEIs have funded a single QLICI. Cash is paid to the CDE by the borrower and that cash is distributed to the investor as a return of capital. Which QEI has been redeemed? This is particularly relevant where the first of a series of QEIs has reached its seventh anniversary but later QEIs have not.

We believe in both cases CDEs should be permitted to elect to use any reasonable method to treat proceeds from a repaid QLICI as applicable to the QEIs made into that CDE. Further, the Regulation should state that the use of a FIFO method, a LIFO method or a pro-rata allocation method should be allowed if consistently applied.

C Corporation filing consolidated return

If a CDE is taxed as a C corporation and is included in a consolidated return, then it will likely make cash payments to its parent, the qualified equity investment ("QEI") holder, to fund the CDE's portion of the consolidated group of corporations' income tax liability. Under Regulation 1.45D-1(e)(3)(i), a C corporation's distributions to its parent are limited to earnings and profits. Earnings and profits are reduced by federal income taxes. If a C corporation CDE distributed all its earnings and

Exhibit C

profits to its parent, and made a payment to its parent for its allocable share of income taxes, there is concern that the payment to the parent would be treated as a distribution in excess of earnings and profits. We have suggested language to clarify that this is not the result.

Reasonable Expectations

We believe the added language that is designed to protect CDEs who make QLICIs in other CDEs leaves uncertainty regarding whose reasonable expectation about the QALICB's status can be relied upon. The proposed revisions make it clear that, if a CDE (the "first CDE") makes a QLICI in another CDE (the "second CDE"), and then the second CDE makes a loan to a QALICB, the first CDE can rely on the reasonable expectation test. However, the wording of the revised regulation at least suggests that it is the first CDE that must have that reasonable expectation.

One of the advantages of enabling CDEs to invest in other CDEs is that it enables the first CDE to support and expand the activities and operations of the second CDE. Naturally, the second CDE will be operating in those markets and dealing with those QALICBs with which it is most familiar and will have the primary contact with prospective QALICBs. Accordingly, the second CDE will generally be responsible to the first CDE for determining that the QALICBs to whom the second CDE lends meet and are expected to meet the necessary qualifications.

However, if it is the first CDE that must have a reasonable expectation of continued QALICB status, then it seems that the first CDE would have to perform much of the qualification underwriting and analysis on QALICB status. This underwriting and analysis is probably more efficiently performed by the second CDE and would likely be done by the second CDE anyway as part of its efforts to screen eligible loans. This effectively requires both CDEs to do the same underwriting, which is unnecessarily duplicative, inefficient, and costly.

It should be clear that the first CDE can rely on the reasonable expectation test if either the first CDE or the second CDE has a reasonable expectation of ongoing QALICB status.

Proposed Effective Date

Because many of the proposed revisions to the regulations clarify policies that many industry participants have thought were already implicit in the Regulations, we believe it would be helpful if the proposed changes at the option of the taxpayer, could be relied on for periods prior to their effective date. Otherwise, CDE's will receive no additional comfort that transactions structured before the effective date will be allowed to rely on any of the clarifications and guidance provided in the proposed regulations.

Exhibit C

COMMENTS IN ADDITION TO THOSE RELATED TO THE PROPOSED REGULATIONS

Reinvestment Rules for Equity Investments

Many CDEs have made and many more would like to make QLICIs in the form of equity, as opposed to debt. However, the Regulation does not define when an amount received by a CDE from a QALICB with respect to an equity investment is payment of, or for, capital or equity. The Regulation does specify that if the amount is determined to be a return of capital rather than a return on capital, then it must be reinvested within 12 months from the date of receipt in order to be treated as continuously invested. Without guidance on determining whether a distribution received with respect to a QLICI must be reinvested in another QLICI, CDEs often choose not to receive any distributions with respect to their equity investments in QALICBs in order to avoid any possibility of failing the reinvestment and substantially all requirements. Since CDEs generally have operating expense funding needs, CDEs are forced to either fund cash reserves or split their QLICI into a debt portion, with current pay interest, and an equity portion. These solutions add administrative complexities and transaction costs that reduce the efficiency of the NMTC program.

We believe there should be symmetry between the rules for determining if a cash distribution received by a CDE from a QALICB on its equity investment in the QALICB must be reinvested with the rules for determining if a cash distribution received by an investor in a CDE is a redemption. We believe that symmetry is necessary since the issue in both cases is the return of a capital investment versus return on a capital investment. For redemption purposes, the determination of whether capital has been redeemed is made in order to determine if a recapture event has occurred. If one dollar of capital has been redeemed, recapture is deemed to have occurred. For QLICI reinvestment purposes, the determination between a return of capital versus a return on capital is made in order to determine whether the CDE is meeting the substantially all requirement. If capital has been received from an equity investment in a QALICB and not reinvested within twelve months, then the dollar amount treated as meeting the substantially all requirement is reduced by one. While the reason for making the determinations is different, we believe the underlying principles of return “on” investment versus return “of” investment are the same for both, and the method for determining which occurred should similarly be the same. We believe that this can be achieved by providing a cross reference in (d)(2)(i) to (e)(3). Just as distributions that are made by a CDE are not considered redemptions if they either don’t exceed accumulated earnings and profits or operating income, a QALICB would be allowed to make distributions in a similar manner without the distributions being deemed a return of capital for reinvestment determination purposes.

Example: CDE A makes an equity investment in a partnership. The investment is a qualified low-income community investment in a qualified active low-income community business. The qualified business makes a distribution to CDE A. The distribution will not be considered a return of capital for reinvestment consideration if either the distribution does not exceed the partnership’s operating income (as defined in the regulations pursuant to Reg. 1.45D-1(e)(3)) for the taxable year) or the distribution and all prior distributions do not exceed the partnership’s cumulative operating income for all years. (Note: This example assumes that the suggested language from our recommendations regarding the Redemption regulations will be incorporated.)

Exhibit C

Substantially All Safe Harbor Calculations

Under Treasury Regulation §1.45D-1(c)(5)(iv), a CDE has a 12-month period to invest QEIs it receives. The regulation specifically provides:

(iv) Time limit for making investments. The taxpayer's cash investment received by a CDE is treated as invested in a qualified low-income community investment as defined in paragraph (d)(1) of this section only to the extent that the cash is so invested within the 12-month period beginning on the date the cash is paid by the taxpayer (directly or through an underwriter) to the CDE.

Many believe that this provision implies that, so long as the cash is, in fact, invested within 12 months, it is deemed to have been invested from the date the applicable QEI was made. However, the wording of the regulation isn't entirely clear.

This creates uncertainty for investors regarding how a CDE would apply the safe harbor calculation using gross assets as defined in Treasury Regulation §1.45D-1(c)(5)(iii) in a situation in which it receives multiple QEIs at different times. For example, a CDE receives a \$1,000,000 QEI on January 2nd of a given year, 90% of which is invested in qualified investments within 12 months. On June 2nd of the same year, the CDE receives a second QEI of \$1,000,000 which it has not yet invested prior to the 12-month period applicable to the first QEI (but has invested within 12 months following the date of the second QEI). Unless the CDE can say that, when it invests the second QEI within the 12-month period applicable to that QEI, the second QEI is treated as having been invested as of the date it was made, the CDE will be unable to use the gross assets test in the safe harbor calculation. This problem may arise any time a CDE receives more than one QEI, even where there may be several years between QEIs -- uninvested QEIs may cause the CDE to fail the gross assets test even if the later QEIs are properly invested within the applicable 12-month period. In effect, the gross assets test could become largely useless for CDEs that receive multiple QEIs.

We recommend that Treasury Regulation §1.45D-1(c)(5)(iv) be revised to add:

(iv) Time limit for making investments. The taxpayer's cash investment received by a CDE is treated as invested in a qualified low-income community investment as defined in paragraph (d)(1) of this section only to the extent that the cash is so invested within the 12-month period beginning on the date the cash is paid by the taxpayer (directly or through an underwriter) to the CDE **and investments so made within such 12-month period shall be deemed to have been invested throughout such 12-month period for purposes of this paragraph (c)(5).**

We note that this is consistent with Treasury Regulation § 1.45D-1(d)(2)(i), under which qualified low-income community investment funds that are redeemed before the 7th year of the credit period and reinvested within 12 months are deemed continuously invested throughout the 12-month reinvestment period.

Exhibit C

Aggregation of QEIs

Treasury Regulation §1.45D-1(c)(6) provides, “A CDE may treat any qualified equity investments issued on the same day as one qualified equity investment. If a CDE aggregates equity investments under this paragraph (c)(6), the rules in this section shall be construed in a manner consistent with that treatment.” Under this provision, a CDE can receive multiple investments on the same day and treat them as a single QEI. However, if a CDE receives a single investment, it cannot elect to treat that single investment as more than one QEI.

It is not uncommon for a CDE to receive a QEI intended for a particular QLICI, but then for unexpected reasons, the CDE is unable to close the QLICI that the QEI was originally intended for. The CDE must then identify and close other QLICIs, the amounts of which may not correspond to the original QEI amount. This subjects the CDE and its investors to compliance risks associated with multiple QLICIs, the failure of any of which could result in recapture of NMTCs for the entire QEI.

We believe CDEs should be permitted to make an election to designate a single investment made on a particular date as one or more QEIs made on that date, so long as such election is made on or before the “substantially all” testing date selected for such QEIs (within the initial 12-month investment period). On the other hand, a CDE could accomplish exactly the same result if, instead of designating the initial investment as a single \$1,000,000 QEI, it received ten separate wire transfers of \$100,000 each and registered 10 QEIs on the same date.⁸ The only difference is that this latter approach represents a substantial reporting and administrative burden for the CDE and CDFI Fund. If the designation must be made within the limited period described above, this would give CDEs flexibility in getting their funds invested initially, without affecting compliance measurements over the long term.

In addition to the above, when for unexpected reasons the CDE is unable to close the QLICI that the QEI was originally intended for it is also not uncommon for an Allocatee to want to move a QEI from one sub-CDE to another sub-CDE. However, Allocatees are concerned that if the one sub-CDE seeks to transfer its QEI to the other sub-CDE with the same investor in each sub-CDE, the IRS would treat the transfer as a redemption triggering recapture of the tax credits associated with the QEI in the transferring sub-CDE.

For example, Sub-CDE 1 received a QEI of \$10,000,000. Sub-CDE 1 is a subsidiary of Allocatee ABC. Sub-CDE 1 was created to be used solely for debt QLICIs. Sub-CDE 2 is another subsidiary of Allocatee ABC and is used solely for equity QLICIs. For internal bookkeeping purposes, the Allocatee will not do both equity and debt QLICIs out of the same subsidiary CDE. The initial QEI in Sub-CDE 1 was for the purpose of funding a debt QLICI for a particular transaction. However, the transaction has failed to close and Allocatee ABC would like to use the proceeds of the QEI for equity QLICIs that are available to be funded through Sub-CDE 2. By moving the QEI from Sub-CDE 1 to Sub-CDE 2, Allocatee ABC is not seeking to re-start the 12-month substantially-all test. If Allocatee ABC cannot transfer the QEI from Sub-CDE 1 to Sub-CDE 2, then recapture may result if a replacement debt QLICI cannot be identified in time to satisfy the substantially-all requirement, and \$10,000,000 of NMTC-advantaged money will not reach low-income communities.

We believe CDEs should be permitted to transfer QEIs from one subsidiary CDE to another subsidiary CDE without triggering a redemption either to avoid a violation of the substantially-all requirement or for administrative purposes provided that the 12-month period for satisfying the substantially-all requirement does not expire as to the transferred QEI(s).

⁸ We note that some CDEs may even opt to segregate the QEI's into even smaller denominations, such as 100 QEIs at \$10,000 each, to further minimize recapture risk.

Exhibit C

Portions of the Business Requirements

The “portions of the business” provisions of the regulations (Treasury Regulation §1.45D-1(d)(4)(iii)) have become a very useful tool in structuring investments. In order to make use of these provisions, (i) a “complete and separate set of books and records” must be maintained with respect to the applicable portion of the business, and (ii) the proceeds of the CDE’s loan or investment are treated as a QLICI only to the extent that such proceeds are used in such portion of the business.

The regulations currently do not provide any definition of “complete and separate set of books and records”. Presumably, one of the intended benefits of making this test available is to encourage companies with varied and complex operations to locate businesses in low-income communities, without requiring that they set up and maintain separate legal entities. In addition to the costs of formation and organization that having to use separate entities would entail, companies are also often required to conform to complex, inter-company accounting rules that are both expensive and burdensome.

We believe that the purposes of the program and of the “portions of the business” regulations are met if the separate books and records are sufficient in content and detail to enable the company to demonstrate that the portion of the business would meet the tests constituting a QALICB if the business had been separately incorporated. We suggest that Treasury Regulation § 1.45D-1(d)(4)(iii)(A) be modified to add the following clarification:

For purposes of this paragraph (d)(4)(iii), the books and records required to be maintained with respect to a trade or business that is treated as a portion of a business hereunder will be deemed sufficiently complete and separate if they are sufficient to demonstrate that such trade or business would meet the requirements of subparagraphs (d)(4) and (d)(5) hereof if such trade or business had been separately incorporated.

To go a step farther than this and require that the books and records must be equivalent in all respects to that which the company would be required to maintain if the portion of the business had been separately incorporated, would defeat one of the main benefits of using this approach.

It is also not clear when the proceeds of a CDE’s loan or investment are deemed to be (or not to be) used in the trade or business that constitutes the portion of the business. In particular, (i) a company might advance funds for the benefit of such trade or business (e.g., the development of a new store in a low-income community) prior to the date when the CDE’s loan or investment closes, or (ii) a company might have an established, company-wide purchasing program under which it acquires goods or services, some of which are used for the benefit of the designated portion of the business.

If a CDE’s loan or investment is applied to reimburse the company for actual costs it has advanced for materials, supplies, goods, or services actually used in the designated portion of the business, then such proceeds should be deemed to have been used in the portions of the business. We suggest that Treasury Regulation § 1.45D-1(d)(4)(iii) be modified to state:

For purposes of this paragraph (d)(4)(iii), to the extent that the proceeds of a CDE’s loan or investment are applied to either pay or reimburse the costs of materials, supplies, goods, or services used in or for the portion of the business, they will be deemed used in the trade or business that constitutes the portion of the business.

Exhibit C

Partnership Allocations (Internal Revenue Code § 704(b))

It is currently unclear as to how a partnership allocates NMTCs among its partners. Internal Revenue Code (“IRC”) §45D and §704(b) provide no specific reference on how the NMTC should be allocated among partners in a partnership. The NMTC is a unique credit that doesn’t generate a readily identifiable expense similar to other credits like the low-income housing tax credit, which subsidizes construction costs that generate depreciation expense. In the absence of current specific guidelines, we believe that NMTCs should be allocated among the partners in a partnership in a manner that is most consistent with the existing §704(b) partnership allocation regulations. Therefore, the NMTC should be allocated in the same manner as the NMTC basis reduction which in turn should be allocated in the manner agreed to by the partners of the partnership and that is consistent with the partnership allocation safe harbor rules under existing Treasury Regulations. Guidance on this issue would be very helpful, particularly to Community Development Entities (CDEs) seeking to make venture capital investments.

Investments Prior to Receipt of Allocation Agreement

Under Treasury Regulation § 1.45D-1(c)(3), subject to specified conditions, an investor may make an equity investment in a CDE prior to the CDE’s receipt of its executed allocation agreement, and such investment is treated as a qualified equity investment as of the effective date of the allocation agreement. It is unclear, however, how this provision applies to subsidiary CDEs that must receive a sub-allocation in order for the investment to constitute a valid qualified equity investment.

Many (if not most) QEIs are made through subsidiary CDEs, and commonly, the parties to the allocation agreement will include, in addition to the CDE that received the allocation award, one or more subsidiary allocatees. Under CDFI Fund procedures, the fact that an allocation agreement has been executed by a subsidiary CDE is not, by itself, sufficient to effect a sub-allocation to such subsidiary CDE (the sub-allocation must be logged into the CDFI Fund’s system), and an investment cannot be a QEI unless and until the subsidiary CDE has received a valid sub-allocation.

We believe this can be addressed by a minor modification to Treasury Regulation § 1.45D-1(c)(3)(iv) so that it reads as follows:

(iv) Initial investment date. If an equity investment is designated as a qualified equity investment in accordance with paragraph (c)(3)(ii) of this section, the investment is treated as initially made **(A)** on the effective date of the allocation agreement between the CDE and the Secretary, **or (B) in the case of an investment in a CDE receiving a sub-allocation, the date (on or following the effective date of such allocation agreement) on which such sub-allocation is effective for purposes of such allocation agreement.**

In addition, we note that it would be appropriate for Treasury Regulation § 1.45D-1(c)(3) to make clear that the entity receiving the equity investment prior to the execution of the allocation agreement must be a CDE at the time the equity investment is received. Currently, Treasury Regulation § 1.45D-1(c)(3) does not explicitly provide that the entity receiving the equity investment must be a CDE when the equity investment is received.

Equity Investments in Other CDEs

Treasury Regulation §1.45D-1(c)(4)(i)(B) provides that the term qualified equity investment does not include “Any equity investment by a CDE in another CDE, if the CDE making the investment has

Exhibit C

received an allocation under section 45D(f)(2).” We believe this provision can inhibit investments in other CDEs in ways that were not intended by this provision.

Some allocatees obtain their allocations in their parent companies, though they will generally utilize their allocations by making sub-allocations to one or more subsidiary CDEs. At the same time, the parent company that received an allocation may have non-NMTC investment activities unrelated to those they undertake using their NMTC allocation.

We believe the intent of the above regulation is to preclude one investment from generating NMTCs twice (once when a QEI is made in the first CDE, and then a second time if the first CDE makes an equity investment in a second CDE with an allocation who designates that investment as a QEI). That concern, as well as our concern described above, can still be addressed if the above regulation is modified to read, “Any equity investment by a CDE **(the “primary CDE”)** in another CDE **(the “second CDE”)**, if the **primary** CDE making the investment has received an allocation under section 45D(f)(2) **and is using funds from any QEI to make the equity investment in the second CDE.**”

As an alternative, the regulation could be changed to exclude investments from a CDE with an allocation into another CDE only after the primary CDE has issued a QEI. That would allow a parent CDE who has sub-allocated all of its allocation to subsidiary CDEs to make equity investments since it won’t be issuing QEIs. This alternative can be enacted by modifying the above regulation to read, “Any equity investment by a CDE **(the “primary CDE”)** in another CDE **(the “second CDE”)**, if the **primary** CDE making the investment has received an allocation under section 45D(f)(2) **and has issued one or more QEIs for the full amount of its allocation.**”

Safe Harbor for Investments in Other CDEs

When a CDE makes a QLICI in the form of a loan or equity investment in a QALICB, it is permitted to claim the benefit of the “reasonable expectation” safe harbor with respect to the continued qualification of the recipient as a QALICB over the seven-year compliance period. However, when a CDE makes a QLICI in the form of a loan or equity investment in another CDE, there is no safe harbor with respect to CDE status, so as to protect that loan or investment as a QLICI should the recipient CDE cease to be a CDE during the compliance period.

Thus, the loss by the recipient CDE of its CDE status at any time during the compliance period would mean that the loan or investment would cease to constitute a QLICI. There are many scenarios in which there are no practical ways for this to be cured -- the proceeds of the loan or investment will have, in turn, been used to make loans or investments in QALICBs (as required by the regulations) and will not easily be recoverable from the non-qualifying intermediary CDE.

This has significantly impeded the use of NMTCs to invest in other CDEs. Generally, only the strongest and most sophisticated CDFIs have been able to raise capital under this program since only those institutions can provide enough comfort to investors that they will remain CDEs (or will be able to repay the investments should that status change) throughout the compliance period.

We believe that there should be a “reasonable expectation” safe harbor applicable to CDE status (presumably in Treasury Regulation § 1.45D-1(d)(1)(iv)) similar to that provided for QALICBs, which might read as follows:

For purposes of paragraph (d)(1)(iv) of this section, a CDE (the “second CDE”) receiving a loan or equity investment from a CDE (the “primary CDE”) is treated as a CDE for the duration of the primary CDE’s investment in the entity if the primary CDE reasonably expects, at the time the primary CDE makes the capital or equity investment

Exhibit C

in, or loan to, the second CDE, that the second CDE will satisfy the requirements to be a qualified community development entity throughout the entire period of the investment or loan.

Working Capital

Treasury Regulation § 1.45D-1(d)(4)(i)(E)(2) provides that working capital includes any proceeds that will be expended for construction of real property within 12 months after the date the investment or loan is made. While this provision takes into account the timing difference in which investment or loan proceeds are made to a construction project and then expended, it doesn't allow for a reasonable amount of time for the funds to be expended based upon the length of typical construction timelines. Historically, the construction period for NMTC projects is rarely 12 months or less. We believe that the regulation should be modified to 24 months to allow for a more reasonable construction period. We recommend that the regulation be amended with a provision such as the following to Treasury Regulation § 1.45D-1(d)(4)(i)(E)(2):

(2) Construction of real property. For purposes of paragraph (d)(4)(i)(E)(1)(i) of this section, the proceeds of a capital or equity investment or loan by a CDE that will be expended for construction of real property within **24** months after the date the investment or loan is made are treated as a reasonable amount of working capital.

Nonqualified Financial Property – Hedges

The NMTC program is designed to stimulate capital investment in low-income communities. The GAO Report to Congressional Committees regarding the New Markets Tax Credit Program dated January 30, 2004 stated that “[a]ccess to credit and investment capital is essential for creating and retaining jobs, developing affordable housing, revitalizing neighborhoods, and promoting the development of small businesses.”

Based on the purpose of the NMTC program to incentivize economic development in low-income communities, we believe that hedges entered into in the ordinary course of the QALICB's trade or business to manage risks of operations should not constitute nonqualified financial property. For example, an ethanol plant routinely enters into options, futures contracts and forward contracts in connection with the purchase of corn and natural gas required for the production of ethanol and in connection with the sale of ethanol. Another example is a food manufacturing facility which may use hedges to minimize the impact of price fluctuations of the core ingredients.

In order to address this concern, Treasury Regulation Section 1.45D-1(d)(4)(i)(E)(1) should be clarified by adding the following exclusion to the definition of nonqualified financial property: (iii) option contracts, futures contracts, forward contracts and similar property that a taxpayer acquires in the normal course of the taxpayer's trade or business primarily to manage risk of price changes with respect to ordinary property that is held or to be held by the taxpayer as the applicable terms are defined pursuant to Treasury Regulation Sections 1.1221-2(c) and (d).

Treasury Regulation Sections 1.122-2(c) and (d) provide definitions for “normal course”, “ordinary property” and “managing risk” in connection with defining hedging transactions that do not result in capital assets.

We believe this clarification will enhance the efficiency and the impact of the NMTC program by eliminating uncertainty regarding the proper treatment of such hedging transactions and allowing borrowers to use standard market practices in managing operational risks.

Exhibit C

Tenant Excluded Businesses

Treasury Regulation § 1.45D-1(d)(5)(ii) provides that “a CDE's investment in or loan to a business engaged in the rental of real property is not a qualified low-income community investment under paragraph (d)(1)(i) of this section to the extent a lessee of the real property is described in paragraph (d)(5)(iii)(B) of this section.” This provision takes the approach of disqualifying a CDE’s investment as a QLICI “to the extent a lessee . . . is” one of the prohibited businesses listed in paragraph (d)(5)(iii)(B).

First, this approach attempts to connect a specific quantity (a portion of the QLICI) to the existence of a business operation that is not in any way quantified. It is unclear whether a lessee must be engaged exclusively (or primarily) in a prohibited business, or whether the lessee’s engagement in any such business activity triggers this provision.

We recommend that the regulations clarify that, in order to disqualify a QLICI, the lessee must be “exclusively or primarily engaged in one of the prohibited businesses listed in paragraph (d)(5)(iii)(B)”. It would present a considerable burden on CDEs and investors if incidental activities by lessees could trigger disqualification.

An example of such incidental activities would be a hotel that includes a day spa that offers massage services and includes a sun tanning booth. The primary business of the hotel is to provide lodging and convention facilities as evidenced by the amount of square footage dedicated to these purposes and the income generated from these activities. The massage services and sun tanning booth generate an extremely small portion of the hotel’s overall income. It is not entirely clear if the massage services and sun tanning booth disqualify the hotel project from being able to receive a QLICI.

It is also unclear how to determine how much of the QLICI would be disqualified if, and to what extent, a lessee is engaged in any such business. This might be done based upon the proportion of square footage of the space of the “offending” lessee bears to the total rentable space in the property. Another approach could be based upon the proportion that the amount of the lessee’s space devoted to the prohibited activity bears to the total rentable space in the property. Or it might be done according to the proportion of the costs spent on the lessee’s space (or portion of that space devoted to the prohibited activity), relative to the total cost of the project. Or it could be done on the basis of the amount of income generated by the lessee’s space (or portion of that space devoted to the prohibited activity), relative to the total income generated by the project.

We recommend that the regulations provide guidance on how to quantify the lessee’s activity. We believe the square footage of the lessee’s space relative to other rentable space in the project would be the most reasonable approach. Square footage is readily determinable in real estate businesses and would not be subject to nearly as much uncertainty or manipulation as attempting to apportion costs or income between the lessee’s space or operations and the project as a whole. However, we also believe that a taxpayer should be able to select any other method that is reasonable.

Another concern about how the regulations are currently written is how the current approach bypasses the entire QALICB analysis, and in so doing, has the effect (presumably unintended) of by-passing the “reasonable expectation” safe harbor. As the regulations are written, the reasonable expectation safe harbor applies only to a CDE’s expectation about QALICB status. But a tenant’s engagement in a prohibited business impacts QLICI status directly, without reference to QALICB status. We recommend that the regulation be amended with a provision such as the following:

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For purposes of this paragraph (d)(5)(ii), a QLICI will not be disqualified if the CDE reasonably expects, at the time it makes the capital or equity investment or loan to a business engaged in the rental of real property, that lessees will not be engaged in the businesses described in paragraph (d)(5)(iii)(B) of this section.

Trade or Businesses Involving Intangibles

Treasury Regulation § 1.45D-1(d)(5)(iii)(A) provides that a “qualified business does not include any trade or business consisting predominantly of the development or holding of intangibles for sale or license.” We request Treasury provide clarification, possibly through the use of examples or by referencing a specific section elsewhere in the Internal Revenue Code, that clarifies the meaning of “developing or holding intangibles for sale or license.” Further clarification is needed to avoid any confusion about the type of intangibles referenced in this exclusion. Specifically, is there a difference between intangibles created as a result of the nature of the business?

We believe the key to the interpretation and application of this exclusion lies in the words “development or holding of intangibles for sale or license.” While the businesses of many companies involve intangibles, the above exclusion is intended to apply only to businesses that create the intangibles internally and then grant to their customers (though either sale or license) the right to use those intangibles. The exclusion should not apply where the intangibles arise out of contracts or transactions between the business and its customers.

We note that there are regulations under Section 367 of the Code, involving situations where a person is transferring or licensing an intangible to a foreign person, which draw a distinction between an “operating intangible” which is an integral part of a business, versus an intangible that is typically transferred for consideration and dependent on use by the transferee. A similar approach may be called for here.

In any case, we believe it would be helpful to clarify Treasury Regulation §1.45D-1(d)(5)(iii) through examples in the Regulations that illustrate the distinction made above. For example, assume a business enters into service contracts with its customers to provide cleaning services for commercial buildings, pursuant to which the customers agree to make fixed payments over the terms of the contracts. Although the service contracts may be intangible assets in the hands of the business, they are created by the transactions between the business and its customer that are integral to the nature of the business. It is not created by the business and then sold or licensed to others. We believe this would be a situation where the business would not be disqualified.

In contrast, assume instead that the business is primarily involved in developing a brand name, associated trademarks, and a set of operating procedures for “XYZ Commercial Cleaners”, which it then sells or licenses to third party operators of cleaning companies under agreements that entitle such operators to use the brand name, trademarks, and operating procedures so developed. The business receives fees for granting such rights, which might be based in whole or in part on the sales of the cleaning companies. We believe this may be a situation where the business would be disqualified, because the intangible assets (in the form of trade names, trademarks, and other intellectual property) are first created by the business and then transferred to others for consideration.

Without further clarification of the meaning within the regulation regarding intangibles, industry participants may be reluctant to invest in transactions involving businesses that have intangibles, regardless of the nature of the intangibles or how they are involved in the business.

Exhibit C

Control as Impacted by Enforcement

Treasury Regulation § 1.45D-1(d)(6) contain the “reasonable expectation” safe harbor for QALICB status and goes on to provide that this safe harbor is not available if and when the CDE obtains “control” of the qualified business. Treasury Regulation § 1.45D-1(d)(6)(ii)(C) provides an exception which protects a CDE’s ability to rely on the reasonable expectation safe harbor where the CDE obtains control due to financial difficulties of the QALICB.

One of the requirements for this exception is that the CDE must dispose of the entire amount of the investment or loan and reinvest the amount received in such disposition in a qualified low-income community investment within a 12-month period following acquisition of control. We believe that this does not provide CDEs with an adequate time period to deal with troubled investments.

For example, in the context of a real estate loan, it is common for lenders to acquire properties through foreclosure and hold them for a period of time prior to disposition. This enables the lender to recover as much of its loan as possible, by (i) avoiding the “distress sale” atmosphere of a foreclosure sale, (ii) enabling the lender to take steps to repair or improve the property prior to sale, and/or (iii) enabling the lender to sell the property at a time and manner of the lender’s choosing.

CDEs that face troubled loans need the flexibility to recover the most value for their investments. A CDE that forecloses on a real estate loan could acquire the property through an entity that it forms, and in which the CDE would own all, or nearly all, of the equity interests. Although the CDE’s equity interests could still constitute a QLICI, the CDE would “control” the entity because of its ownership. The requirement that the CDE *both* dispose of the property and re-invest the proceeds within 12 months is a severe constraint on the CDE’s ability to maximize its recovery. The regulations generally allow CDEs 12 months to reinvest, which recognizes the difficulty a CDE can face in finding, negotiating, and closing replacement QLICIs of the proper size and on acceptable terms.

However, under Treasury Regulation § 1.45D-1(d)(6)(ii)(C)(3)(ii), the CDE is penalized if it controls the property or the business for any significant period of time, because every day it continues to control the property or business reduces the time it has to dispose of it, if it wishes to continue to rely on the reasonable expectation safe harbor. We believe it should be sufficient if the CDE disposes of the investment within 12 months from when it acquires control. Once it does so, reinvestment would be governed by the general 12-month reinvestment period, during which there would be no question of “control” anyway because the CDE will be holding cash for re-investment in other QLICIs. We recommend that the regulation be amended with a provision such as the following to Treasury Regulation § 1.45D-1(d)(6)(ii)(C)(3)(ii):

The CDE sells or causes to be redeemed the entire amount of the investment or loan described in paragraph (d)(6)(ii)(C)(1) of this section **within a 12-month period** from the date on which it first acquired control and, by the end of the 12-month period applicable to reinvestment of the proceeds of such sale or redemption under paragraph (d)(2) of this section, reinvests the amount received in respect of the sale or redemption in a qualified low-income community investment under paragraph (d)(1) of this section . For this purpose, the amount treated as continuously invested in a qualified low-income community investments is determined under paragraphs (d)(2)(i) and (ii) of this section.

Exhibit D

Changes to the Allocation Agreement Section 9.13

Many NMTC transactions are now nearing the end of the 7-year NMTC compliance period (“Compliance Period”), and the Compliance Period for some transactions has already expired. As the industry has gained experience with the maturity of Qualified Low-Income Community Investment (“QLICI”) loans and the unwinding of NMTC transactions upon expiration of the Compliance Period, significant concerns have come to light about the proper interpretation of Section 9.13 of the Allocation Agreement. We present these comments to explain those concerns and to recommend solutions that will contribute to the efficiency of the NMTC program and reduce costs to the Qualified Active Low-Income Community Business (“QALICB”) Borrower, the intended beneficiary of the NMTC program.

Section 9.13 of the Allocation Agreement

Section 9.13 of the Allocation Agreement provides as follows:

9.13 Termination. Unless otherwise mutually agreed upon in writing by the parties hereto, this Allocation Agreement shall terminate at such time that:

- a. The CDFI Fund determines that the Allocatee has submitted to the CDFI Fund all reports required by this Allocation Agreement covering the 7-year credit period (as defined in 26 C.F.R. Part 1.45D-1(c)(5)(i)) after the Allocatee issues its last Qualified Equity Investment related to its NMTC Allocation; and
- b. The CDFI Fund determines that the NMTC Allocation has been used as permitted hereby or two years after the 7-year credit period (as defined in 26 C.F.R. Part 1.45D-1(c)(5)(i)) after the Allocatee issues its last Qualified Equity Investment related to its NMTC Allocation, whichever date is earlier. [Emphasis added].

Section 9.13 does not make clear whether the term “Allocatee,” as used in that Section, is intended also to apply to each Subsidiary Allocatee of an Allocatee (“Sub-Allocatee”).

Although probably not anticipated when the termination section of the Allocation Agreement was drafted, the vast majority of NMTC transactions involve a Sub-Allocatee that is a single purpose entity formed for the sole purpose of undertaking a single NMTC transaction. As a result, when that transaction reaches the end of its Compliance Period, QLICI made by the Sub-Allocatee generally matures and is repaid, with the proceeds distributed by the Sub-Allocatee to its investor. In the case of longer term QLICIs, the investor typically has the right under the NMTC transaction documents to require the redemption of its interest in the Sub-Allocatee after the end of the Compliance Period by distributing the QLICI loan documents to the Investor. There is typically a put-call arrangement between the investor and another transaction party (the “Put Party”), often an affiliate of the QALICB Borrower, which, if exercised, may result in the Put Party exercising the redemption right.

In any event, the result in most cases will likely be that, after the end of the Compliance Period, the Sub-Allocatee no longer has an interest in the QLICI loan, and probably will have no assets at all. Moreover, because the Sub-Allocatee typically is a single purpose entity whose sole purpose was to undertake the NMTC transaction, the Sub-Allocatee has no reason to continue its existence after it no longer holds its QLICI. Its parent Allocatee, however, may well continue to have an existence and activity through other Sub-Allocatees for many years. Under the Allocation Agreement, the CDFI Fund

Exhibit D

could continue to monitor and exercise remedies against the Allocatee even after some of its Sub-Allocatees have dissolved.

Practical Concerns

Section 9.13 of the Allocation Agreement creates several practical problems for a Sub-Allocatee that, after the end of its Compliance Period, no longer has any assets or any reason (or even any organizational authority) allowing it to continue its existence:

1. Section 9.13(a) provides no procedure for evidencing the CDFI Fund's determination that the Allocatee has submitted all reports required by the Allocation Agreement for the 7-year Compliance Period after the Allocatee issues its last Qualified Equity Investment (“QEI”). If this requirement also applies to each Sub-Allocatee, there is no clear way to determine when this requirement has been satisfied and the Sub-Allocatee will be required to maintain its existence for an indeterminate period.

2. Section 9.13(b) of the Allocation Agreement provides that the Allocation Agreement continues in effect until the earlier of (1) the date the CDFI Fund determines that the NMTC Allocation has been used as permitted by the Allocation Agreement, or (2) two years after the Allocatee issues its last QEI. Again, if this applies to each Sub-Allocatee, the Sub-Allocatee may be forced to continue its existence for up to two years after the end of the Compliance Period (assuming the CDFI Fund does not make the required determination earlier).⁹

3. If Section 9.13 applies to each Sub-Allocatee, and a Sub-Allocatee with no ongoing interest in a QLICI is required to maintain its existence for the additional two-year period, it is not clear what provisions of the Allocation Agreement would continue to apply to it during the two-year “tail”. For example, must it comply with Section 6.8 and maintain its existence as a CDE? Must it continue to maintain an Advisory Board and cause the Advisory Board to meet annually even though it no longer has an outstanding QLICI and no longer has any allocation authority? Must it continue to obtain audited financial statements even if it has no activity? Must it continue to submit Institution Level and Transaction Level Reports even if it has no activity? The CDFI Fund has issued guidance that states that these requirements continue for Allocatees and Sub-Allocatees until the Allocation Agreement terminates¹⁰. Would the Sub-Allocatee continue to be subject to all of the Events of Default under the Allocation Agreement, even though many of them relate to matters that are meaningful only during the Compliance Period? Compliance with these requirements seems to serve no purpose for a Sub-Allocatee whose Compliance Period has terminated. Moreover, continued compliance by Sub-Allocatees that have no further activity is an unnecessary and possible costly administrative burden.

4. Finally, if a single purpose Sub-Allocatee that no longer has any assets is required to maintain its existence for an additional two years after the end of the Compliance Period, and to comply with the terms of the Allocation Agreement, it will incur annual costs for tax returns, annual filing and state franchise tax fees, and the preparation of audited financial statements, among other costs. It is likely that these costs will be passed on to the QALICB Borrower under the terms of the NMTC transaction documents or as a condition to the unwind of the transaction, thus diminishing the benefit to the QALICB Borrower, the intended beneficiary of the NMTC transaction.

⁹ It should be noted that, since the Sub-Allocation to the Subsidiary Allocatee will have been “used” when the QEI is made at the beginning of the 7-year Compliance Period, it is not clear why it is necessary to wait until the end of Compliance Period to determine if it was used properly.

¹⁰ New Markets Tax Credit Compliance Monitoring and Frequently Asked Questions (May 2009) (the “May 2009 FAQ”)

Exhibit D

Recommendation

We suggest that most, if not all of these issues would be resolved if the conditions to termination of the Allocation Agreement set forth in Section 9.13 were interpreted to apply to the Allocatee but not to its Sub-Allocatees. Although the text on the signature page of the Allocation Agreement provides that each Sub-Allocatee agrees to all of the terms and conditions of the Allocation Agreement and agrees that all such terms and conditions apply to each Sub-Allocatee to the same extent as they apply to the Allocatee, the CDFI Fund has issued guidance to the effect that certain provisions of the Allocation Agreement apply only to the Allocatee. For example, the May 2009 FAQ provides that the CDFI Fund will monitor compliance with Section 3.2 of the Allocation Agreement on a consolidated basis for the total allocation amount and not separately for each Sub-Allocatee¹¹. The CDFI Fund has also provided that only Allocatees are required to submit audited financial statements to the CDFI Fund. However in lieu of collecting each Sub-Allocatee's audited financial statement, the CDFI Fund will require each Allocatee to simply certify that each Sub-Allocatee has obtained an "unqualified" opinion on its most recent financial statements¹².

We suggest that, to address the concerns set forth in this letter, the CDFI Fund issue guidance analogous to the above guidance, to the effect that the conditions to termination of the Allocation Agreement set forth in Section 9.13 will apply on a consolidated basis for the total amount allocated to each Allocatee and not separately for each Sub-Allocatee, and the Allocation Agreement will terminate as to a Sub-Allocatee upon expiration of the 7-year credit period after the Sub-Allocatee issues its last Qualified Equity Investment [or the earlier occurrence of an event of recapture], provided that the Sub-Allocatee has submitted to the CDFI Fund all reports required by the Allocation Agreement for such 7-year period.

Because the conditions on termination of Section 9.13 would stay in place with respect to Allocatees, the CDFI Fund would continue to have the ability to monitor performance of the Allocatee and its use of its Allocation, itself or through its Sub-Allocatees, and to exercise remedies against the Allocatee for Events of Default.

¹¹ Q&A 19, May 2009 FAQ

¹² Q&A 32, May 2009 FAQ