



## New Markets Tax Credit

# Compliance and Monitoring Frequently Asked Questions

May 2009

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*NOTE: This document is intended to serve as public guidance for the subject matter contained herein. The CDFI Fund reserves the right, however, to modify this guidance at any time upon public notice. The examples contained in this guidance are not exhaustive in nature and the CDFI Fund has the discretion to consider additional factors when determining matters of compliance.*

# NMTC COMPLIANCE & MONITORING FREQUENTLY ASKED QUESTIONS

## A. GENERAL COMPLIANCE QUESTIONS

### **1. Does the Fund impose an annual monitoring/compliance fee?**

At this time, the Community Development Financial Institutions Fund (the Fund) has elected not to collect the annual monitoring/compliance fee outlined in Section 7.1 of the allocation agreement. If the Fund elects to impose a monitoring/compliance fee, it will provide advance notification to all allocatees.

### **2. Will the Fund share data submitted by allocatees with the IRS or any other entity or agency?**

The Fund will, consistent with applicable law (including IRC § 6103), make allocatee reports available for public inspection after deleting any materials necessary to protect privacy or proprietary interests. The Internal Revenue Service (IRS) will be given access to the Fund's data to facilitate IRS's compliance program for IRC Section 45D.

### **3. When is compliance measured and for what period will the Fund measure compliance?**

In general, compliance for most items under section 3.2 of the allocation agreement is triggered by the earlier of two events: 1) a specific date found in allocation agreement subsections 3.2(a-k); or 2) when an allocatee has made 100 percent of its Qualified Low-Income Community Investments (QLICs).

Once compliance is triggered by either event noted above, the Fund will begin its annual compliance checks, and will continue such checks until QEIs are redeemed. Though the Fund will not complete formal compliance checks prior to the triggering event nor after QEI redemptions begin to occur, allocatees are expected at all times to comply with the requirements set forth in the allocation agreement, even for QLICs whose terms extend beyond the seven-year time period the Fund conducts its formal compliance tests. Allocatees that fail to do so could, at a minimum, be found in default of the allocation agreement.

Notwithstanding the above, the Fund recognizes that the IRS regulations allow allocatees up to one year to invest QEI proceeds into QLICs, and also allow allocatees to retain principal repayments of QLICs for a prescribed period before being required to reinvest these proceeds into other QLICs. The Fund will take these allowances under consideration when conducting its compliance checks, so that allocatees will not be penalized for an eligible retention of funds.



**Example 1:** An allocatee receives a \$100 million allocation, issues \$100 million in QEIs and closes \$95 million in QLICIs in fiscal year 2008. The allocatee retains \$5 million for administrative costs and did not close any additional QLICIs after December 31, 2008. The Fund would conduct its initial compliance check on the \$95 million in QLICIs and it will continue monitoring compliance for six years thereafter.

**Example 2:** An allocatee with a 9/30 fiscal year end receives a \$100 million allocation, issues a \$70 million QEI and closes a \$65 million QLICI in fiscal year 2008. The allocatee does not issue any additional QEIs prior to the 9/30/08 compliance trigger date. On September 30, 2008, the Fund would conduct its initial compliance check on the \$65 million QLICI and it will continue monitoring compliance for six years thereafter.

In year five, the allocatee receives an additional QEI of \$25 million and fully invests those proceeds in a new QLICI. The Fund would now conduct its compliance test on combined QLICIs of \$90 million for the next two years.

## **B. ALLOCATION TRACKING SYSTEM (ATS)/QEIS**

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

No. The IRS regulations specifically prohibit an allocatee that has received an allocation from directly providing a QEI to another allocatee. Additionally, an entity that invests in an allocatee and subsequently receives its own allocation cannot provide QEIs to other allocatees after the effective date of its allocation agreement.

For example, in June 2005, ABC Bank provided a QEI to Main Street CDE, a round 1 NMTC allocatee. Subsequently, ABC Bank applied for and was awarded a 2006 NMTC allocation. ABC Bank would not be allowed to provide additional QEIs to Main Street CDE or any other allocatee on or after the date of their award notification. This rule, however, would not preclude an affiliate of ABC Bank from providing QEIs to Main Street CDE, provided the affiliate has not received an allocation or sub-allocation of NMTCs.

### **5. How do I increase or decrease allocation amounts to a subsidiary that already has allocations transferred to it?**

Allocatees that have transferred allocations to a subsidiary can increase or decrease the transfer amount to a subsidiary by clicking on the “Transfers” link in ATS. Once open, click on the “Edit” button adjacent to the appropriate subsidiary and you will now be able to increase or decrease the amount of the transfer in the “Transfer Amount” field at the bottom of the screen.

Please note that you cannot enter an amount that is less than the finalized QEI amounts under the subsidiary, nor can you enter an amount that exceeds the allocation amount less any finalized QEI amounts. For example, an allocatee with a \$50 million allocation transferred \$30 million to its only subsidiary and the subsidiary finalized \$15 million in QEIs. At any time, the allocatee may transfer or return up to \$15 million in allocation to itself and subsequently reallocate the funds to another approved subsidiary.



Note: All allocation transfers must originate from the allocatee. ATS will not allow sub-allocatees to transfer any allocation amounts to other subsidiaries.

**6. Can an allocatee amend a finalized QEI in ATS?**

No. Only the Fund may amend a finalized QEI. All amendment requests must be submitted in writing from the Authorized Representative and include supporting documentation. QEI amendment requests should be forwarded to the CME unit at [cme@cdfi.treas.gov](mailto:cme@cdfi.treas.gov). The Fund will attempt to process QEI amendment requests in a timely manner, however, it cannot guarantee this. Thus, it is imperative that allocatees review all QEI entries for accuracy prior to finalizing them. Please refer to the Users Manual in ATS for additional details.

**7. I did not receive the QEI notification e-mail. How do I obtain a copy for our records?**

If you did not receive the QEI notification e-mail after finalizing a QEI, please submit a request to CME at [cme@cdfi.treas.gov](mailto:cme@cdfi.treas.gov). All e-mail notifications will be sent to the Authorized Representative indicated in the organization's myCDFIFund account. If the Authorized Representative has changed or his/her e-mail address has changed, please refer to the myCDFIFund Frequently Asked Questions document for guidance on how to update this information.

**8. My CDE is 100 percent owned by an S Corporation that has numerous shareholders. Will ATS require us to enter each of the shareholders and their respective information as NMTC claimants?**

If the individual shareholders claim the tax credit on their individual tax returns, each individual shareholder should be listed as a tax claimant in ATS and the required investor information (i.e. name, EIN and investor type) should be completed. This is necessary to assist the IRS in comparing ATS entries with IRS Form 8874 (New Markets Credit) that it receives from tax payers.

**9. I received an error message when attempting to finalize to a QEI in ATS. What could be causing this problem?**

The two most likely reasons an error message is displayed in ATS are: 1) you have been "timed out"; or 2) all fields are not complete. If there is no activity in ATS for 20 minutes, you will be logged out and an error message will be displayed. To correct this problem, simply log in and resume entering your QEI information. An error message may also be displayed if a field is left blank. For example, if you are using a tiered investment structure with no debt, you will still need to enter "0" in the "Debt Contribution" field. Please ensure that all fields are complete to avoid this problem.

**10. My CDE is employing a leveraged investment structure. What information is required in ATS regarding the debt provider?**

At this time, the Fund does not collect any information in ATS regarding the debt provider in a leveraged investment structure except the amount of debt it contributed to the tier 1 entity. If you indicated that the tier 1 investor is a pass through entity, you will be required to specify the amount of equity and debt that contributed to the tier 1 equity investment. Allocatees are advised to retain all pertinent information regarding debt providers and the QEI investment structure should the Fund or the IRS request such information.

**11. Will the Fund use the “Committed Funds” information in ATS when conducting compliance or eligibility checks?**

No. At this time, the “Committed Funds” field in ATS is for informational purposes only and will not be used when the Fund conducts any compliance or eligibility checks. “Committed Funds” are potential QEIs investments not captured by pending QEIs listed ATS.

## **C. ALLOCATION AGREEMENT**

*NOTE: The examples below describe the approach the Fund is taking with respect to monitoring compliance with Section 3.2 and 3.3 of the allocation agreement. The IRS may adopt a different approach with respect to monitoring compliance with IRC Section 45D.*

### Eligible Activities

**12. Which activities are permissible with respect to Financial Counseling and Other Services (FCOS)?**

FCOS is “advice” provided by the CDE relating to the organization or operation of a trade or business, including non-profit organizations. Possible FCOS activities include, but are not limited to, business plan development, assistance with business financials, assistance in securing financing, and assistance with general business operations. FCOS does not include “advice” provided to individuals, such as homeownership counseling or consumer counseling, that does not pertain to the operation of a trade or business.

The FCOS activity may be carried out by the CDE directly, or through third party agreements managed by the CDE. To the extent QEI proceeds are dedicated for FCOS, a portion of the monies must be spent, and counseling services provided, within one year of receipt of the QEI in order to qualify as a QLICI.

Any questions regarding the eligibility of FCOS activities should be addressed to the IRS at [new.markets.tax.credit@irs.gov](mailto:new.markets.tax.credit@irs.gov).

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

In general, loans or investments in businesses whose principal activities are the development or leasing of real property are considered “real estate QALICBs.” Transactions with businesses that are involved in all other types of business activities should be classified as non-real estate

business transactions regardless of: 1) how the business intends to use the proceeds of the transaction; or 2) whether the business intends to use any real estate as collateral for a loan. For example, if an allocatee provided a loan to a childcare provider that is a QALICB for the purpose of purchasing the property where the childcare center would be housed, the allocatee would categorize this loan as a “non-real estate QALICB” loan. However, if the allocatee provided a loan to a development company that is a QALICB for the purpose of building a space to lease to the childcare provider, this loan would be considered a “real estate QALICB” loan.

Notwithstanding the above, loans or investments made to special purpose entities that are principally owned by a non-real estate QALICB, and that were set up specifically to lease property back to the QALICB such that the QALICB is the principal user of the property, may be classified as either a “real estate QALICB” or a “non-real estate QALICB,” at the discretion of the CDE.

**14. My CDE has received principal repayments on a QLICI and will reinvest those proceeds in a new QLICI. Is the reinvestment QLICI subject to the same requirements found in Section 3.2 of the Allocation agreement (i.e. Types of QLICIs, Service Area, etc.)?**

Yes. To the extent a CDE re-invests repayments of principal as new QLICIs, the Fund will check compliance for all reported QLICIs against the requirements specified in the allocation agreement. For example, if an allocatee is required to invest 85 percent of its QLICIs in its approved service area, the Fund will measure compliance against all reported QLICIs that are currently outstanding, whether original investments or reinvestments, to ensure that 85 percent of its QLICIs are in the approved service area.

**15. If an allocatee is providing loans to or investments in other CDEs, how will the Fund monitor compliance with the provisions of Section 3.2? Will the Fund only consider the initial QLICI into the other CDEs, or will the Fund look through the CDEs to the ultimate QALICB recipients?**

The Fund will look through to the ultimate QALICB recipient for the purpose of monitoring compliance with specific provisions of Section 3.2 of the allocation agreement, including compliance with the service area requirement, the better rates and terms requirement, and the areas of higher distress requirement.

Allocatees are required to provide the Fund with transaction level data via the Fund’s Community Investment Impact System (CIIS), even if an allocatee uses multiple layers of CDEs to execute its QLICIs. For example, to determine compliance with the service area provision in Section 3.2 for an allocatee that invests in other CDEs, the allocatee will submit census tract information of the ultimate QALICB recipient that receives the QLICI proceeds to determine if the QALICB recipient was located in the service area as defined in Sec. 3.2. The location of the CDE (or CDEs) that received the initial loan or investment from the allocatee will not be considered.

**16. How does the Fund define “Affordable Housing” for the purpose of meeting Section 3.2(k) of the allocation agreement?**

1) A QLICI that finances rental housing units shall meet the requirements of Section 3.2(k) if it meets the following criteria:

- a) 20 percent or more of total rental units financed with QLICIs are both rent restricted, and occupied by individuals whose income is 80 percent or less than the area medium family income as determined and adjusted annually by HUD; **and**
- b) The same units noted in a) above must maintain their rent restrictions throughout the 7-year NMTC compliance period.

2) A QLICI that finances for-sale housing units shall meet the requirements of Section 3.2(k) if 20 percent or more of the total for-sale housing units financed with QLICIs are purchased and occupied by individuals with a 38 percent Debt-To-Income Ratio and are owner-occupied by individuals with incomes less than 80 percent of the area medium family income as determined and adjusted annually by HUD at the time the units are sold to the initial homebuyer.

**17. What is the “Substantial Rehabilitation” threshold for purposes of meeting Section 3.3(h) of the allocation agreement?**

In order to meet the substantial rehabilitation threshold, a CDE must show that the cost basis (as defined in 26 USC § 1012) of any improvements incurred during the 24-month period following the QLICI equals or exceeds 25 percent of the adjusted basis (as defined in 26 USC § 1011(a)) of the building upon which the improvements are located. This ratio will be assessed as of the first day of the 24-month period. In the case of a QLICI being used to provide “take-out” financing (as permitted under Section 3.3(h) of the allocation agreement), improvements equaling or exceeding 25 percent of the adjusted basis of the building upon which the improvements are located must have occurred within the 24 months prior to the QLICI being made.

[Service Area](#)

**18. My CDE is making several investments in a project over a period of three years. At the time of the initial investment, the project was deemed to be in an eligible NMTC census tract. Will future investments under the project qualify if the tract is later deemed to not be a qualified NMTC census tract?**

Yes. The Fund would consider an investment to be made within a qualifying census tract as long as the census tract qualified at the time of the initial QLICI disbursement related to the project. The allocatee must maintain relevant maps from the CDFI Fund Information and Mapping System (CIMS) to demonstrate eligibility at the time of the initial QLICI disbursement and relevant documents to demonstrate that follow-on investments can be directly tied to the original project.

[Subsidiary Allocatees \(Sub-Allocatees\)/Transfer of Allocation](#)

**19. If an allocatee elects to transfer allocations to a sub-allocatee (i.e. a subsidiary CDE listed in Section 3.2 of its allocation agreement), will the Fund monitor compliance with Section 3.2 separately by each subsidiary or on a consolidated basis for all sub-allocatees that are parties to the allocation agreement?**

The Fund will monitor compliance on a consolidated basis for the total allocation amount. For example, if ABC allocatee receives a \$1 million allocation and is required to invest 100 percent of its QEIs as QLICIs, and 80 percent of its QLICIs in areas of severe economic distress, then ABC allocatee must invest at least \$800,000 into areas of severe economic distress. If ABC allocatee sub-allocates \$500,000 of its allocation to each of two sub-allocatees, each sub-allocatee does not have to separately invest 80 percent of its \$500,000 sub-allocation amount (\$400,000) into areas of severe economic distress. It would be permissible, for example, for one subsidiary to invest \$500,000 into areas of severe economic distress and the other to only invest \$300,000 in such areas. Provided that the total dollar amount of QLICIs invested in such areas meets or exceeds \$800,000 on a consolidated basis, the allocatee and its sub-allocatees would be in compliance with the allocation agreement.

**20. How does the “joint and several liability” provision of the allocation agreement apply to allocatees that intend to sub-allocate tax credit authority to subsidiary CDEs?**

As stated in the allocation agreement, the allocatee and each of its sub-allocatees are jointly and severally liable for any event of default under Section 8.1 whether the allocatee or any of its sub-allocatees incurs the default. If such an event of default occurs, the Fund may impose remedies jointly or severally upon the allocatee and its sub-allocatees, except that the Fund will not terminate or reallocate any unused portion of the NMTC allocation with respect to any investment commitments related to a NMTC allocation made to a non-defaulting allocatee or sub-allocatee, as determined by the Fund.

### Unrelated Entities

**21. How will the Fund monitor compliance with the unrelated entity requirement in Section 3.2 of the allocation agreement?**

This sub-section of Section 3.2 requires certain allocatees to meet the IRS’s “substantially all” requirement by making investments in entities that are unrelated to the allocatee. Allocatees will be required to indicate in the transaction level report whether each QLICI made was to a related or unrelated entity. This test is measured on an aggregate QEI basis.

### Better Terms and Conditions/Flexible Products

**22. Section 3.2(f) of my CDE’s allocation agreement states that “All of the Allocatee’s QLICIs must (a) be equity or equity-equivalent financing, (b) have interest rates that are 50 percent lower than either the prevailing market rates for the particular product or lower than the Allocatee’s current offerings for the particular product, or (c) satisfy at least 5 of the indicia of flexible or non-traditional rates and terms, as listed in Section 3.2(f).” How can my CDE demonstrate that it is satisfying this requirement?**

The CDFI Fund generally monitors transactions on a loan-by-loan basis. Each loan must either have: (1) an interest rate that is at least 50 percent below a market comparable (or 50 percent

below the rate that would otherwise be offered by the CDE or its Affiliate); or (2) multiple concessionary rates or terms (e.g., higher loan to value ratio; reduced fees; non-traditional collateral; etc). It is permissible for a CDE to combine separate loan transactions for the purposes of meeting this requirement, provided that these transactions are part of a simultaneous closing and: 1) the blended interest rate is at least 50 percent below market (see example 1); OR 2) at least 50 percent of the dollar value of the combined transactions meets the concessionary rates and terms requirements (see example 2).

**Example 1:** A CDE finances a \$1 million transaction by combining a \$750,000 market-rate loan with a \$250,000 loan that is forgivable after seven years. If the blended interest rate on these combined products is 50 percent below the prevailing market rate, the CDE satisfies the requirements of Section 3.2(f) provided these transactions are part of a simultaneous closing.

**Example 2:** A CDE finances a \$1 million transaction by combining a \$500,000 market-rate loan with a \$500,000 below market rate loan. If \$500,000 (50 percent of the total transaction) has: a) an interest rate that is 25 percent below market; b) a loan to value ratio more favorable than market; c) origination fees that are lower than market; d) a debt service coverage that is lower than market; and e) interest-only payments for 7 years; then the CDE satisfies the requirements of Section 3.2(f).

**Example 3:** A CDE finances a \$1 million transaction by combining a \$750,000 market-rate loan with a \$250,000 loan that has an interest rate that is 50 percent below market. The CDE fails the requirements of Section 3.2(f) because less than 50 percent of the blended product offering meets the below-market interest rate requirement.

**Example 4:** A CDE finances a \$1 million transaction by combining a \$800,000 market rate loan with a \$200,000 equity investment. The combined transaction has concessionary features that include: a) interest rate that is 25 percent below market; b) loan to value ratio more favorable than market; c) origination fees lower than market; d) debt service coverage lower than market and e) interest-only payments for 7 years. The CDE meets the requirements of section 3.2(f).

<p><b>23. How does an Allocatee document “better rates and terms” for its QLICIs and how will the Fund determine compliance with the better rates and terms requirement of the allocation agreement?</b></p>
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If the Allocatee’s Controlling Entity, Affiliate(s) or QEI investor provides financial products similar to those offered by the Allocatee (or sub-Allocatee), the Allocatee may use the rates, terms and flexible features (LTV, DSC, etc) of the non-NMTC product (for a similar project and similar borrower) as a comparable for demonstrating that the QLICI meets the provisions of Section 3.2(f). Documentation may include the underwriting memorandum, or project assessment reviewed and approved by the Allocatee's investment committee. Such documentation should detail the rates, terms and flexible features of the QLICI and document how non-NMTC rates, terms and features were adjusted for the NMTC product, borrower and project.

If the Allocatee is basing its determination on market comparables, it should, to the best of its ability, retain all documentation that can demonstrate what the comparable market rate was at the time of closing the QLICI. For example, if the CDE benchmarks it returns to a specified market indicator (e.g., 200 points over the 7-year Treasury rate), then the Allocatee should retain

documentation demonstrating: 1) what the market indicator was on the day the transaction closed; and 2) that the interest rate offered by the Allocatee was sufficiently lower than the comparable market offering.

To document better rates and terms to a QALICB that would not otherwise obtain financing in the market, the Allocatee may use documents from other financial institutions that demonstrate that: the QALICB did not meet its financial underwriting criteria and the loan was not approved; or that the loan was approved with certain conditions, rates and terms that would result in the project being economically unfeasible or unsustainable.

The Fund will require a CDE to identify, in its Transaction Level Report, whether a transaction met the requirements for better rates and terms, as well as the applicable market comparables. The CDE should also maintain supporting documentation in its files, should the Fund request them. As stated above, documentation must reflect information relevant at the time the loan and/or investment was made.

### Areas of Higher Distress/Targeted Distressed Communities

**24. What supporting documentation does an Allocatee need to retain in order to demonstrate compliance with investing in areas of higher distress as reflected in Section 3.2(h) Targeted Distressed Communities of the Allocation Agreement? What resources are available to determine if a census tract is in an approved Area of Higher Distress?**

In addition to CIMS, which provides poverty rates, Median Family Income (MFI) percentages and unemployment rates, the Fund has provided several links on its website to assist allocatees. Please visit the “Compliance Monitoring and Evaluation” link for details.

Allocatees are advised to retain all relevant information in support of its decision to invest in such areas. Supporting documentation for the areas of higher distress requirement may include: statistical indices of economic distress such as poverty rates, median family income or unemployment rates at the census tract level based upon the most recent decennial census; materials from other government programs (e.g., HUD Renewal Communities; EPA Brownfields) demonstrating the area qualified for assistance under those programs; etc. Please visit the “Compliance Monitoring and Evaluation” section on the Fund’s website for links to the following sites:

- [Federally Designated Empowerment Zones, Enterprise Communities, or Renewal Communities](#)
- [Brownfield Sites](#)
- [SBA Designated HUB Zones](#)
- [Median Family Income and Poverty Rate Data](#)
- [Median Unemployment Rate Data](#)
- [Medically Underserved Areas \(Department of Health and Human Services\)](#)

**25. Is a “Housing Hot Zone” an eligible Area of Higher Distress criteria?**



Yes. Both Economic and Housing Hot Zones are considered eligible Areas of Higher Distress criteria under applicable allocation agreements (Round 1 through Round 4).

**26. Is there a single source to determine the unemployment rate for a census tract?**

Yes. The Fund utilizes the most recent decennial U.S Bureau of the Census data (currently the 2000 Census) when determining if a census tract's unemployment rate is 1.5 times greater than the national average. The unemployment rate for the 2000 Census is 5.8 percent, thus to qualify as an eligible Area of Higher Distress criteria, the unemployment rate of the subject census tract must be equal to or greater than 8.7 percent.

Allocatees may find a census tract's unemployment rate in Table DP-3 (Profiles of Selected Economic Characteristics) under the American FactFinder link on the U.S. Bureau of the Census' website ([www.census.gov](http://www.census.gov)). Allocatees may also use the Fund's mapping system to determine the ratio of census tract unemployment to the national average by utilizing the CDFI link instead of the NMTC link in CIMS.

**27. Does a SBA Designated HUB Zone qualify as an eligible area of higher distress criteria?**

Yes, however, for Round 3 and subsequent allocatees, the project must be located in a SBA designated HUB Zone **AND** the QLICIs must support businesses that obtain HUB Zone certification from the SBA. For allocatees prior to Round 3, the project must only be located in a SBA Designated HUB Zone to meet the area of higher distress criteria.

When completing the areas of higher distress section in CIIS, allocatees should respond to this criteria based on the language found in its allocation agreement. Thus, allocatees who received a Round 3 allocation should only respond "Yes" to a SBA HUB Zone if both requirements are met as detailed in the allocation agreement.

**28. How does the Fund define "other similar state/local programs targeted towards particularly economically distressed communities"?**

The program designation should be for a specific geographic area, as opposed to a population, preferably where the state or local government has designated it for redevelopment via legislation. Allocatees must maintain all relevant information regarding these designations in its files in the event the Fund requests such documentation. Some examples of local areas that qualify for the designation include:

- a local Tax Increment Financing (TIF) district
- an area affected by a major plant or facility closing resulting in permanent layoffs
- an area affected by Federal military base closings
- an area of unusually high commercial vacancy rates
- an area designated for the establishment of a regional technology/business center

[Qualified Equity Investment Usage](#)

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

(A) All allocatees must be able to demonstrate that they initially made QLICIs in the amount specified in their allocation agreements.

**Example:** If an allocatee received QEIs totaling \$1 million, and is required in its allocation agreement to invest 100 percent of its QEIs as QLICIs, then it must be able to demonstrate that \$1 million was initially invested as QLICIs.

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

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

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

**Example:** An allocatee received QEIs totaling \$1 million, and is required in its allocation agreement to invest 100 percent of its QEIs as QLICIs. It makes a loan of \$1 million to a QALICB. The QALICB repays the entirety of the loan after two years. The allocatee must reinvest the entire \$1 million into a QLICI within the timeframes required under IRS regulations in order to be compliant with Section 3.2(j).

Note: Consistent with IRS regulations regarding reinvestment, the CDFI Fund will not require allocatees to reinvest principal repayments that are received in year 7 of the compliance period.

## [Restrictions on Use of Allocation](#)

**30. Does Section 3.3(h) of my allocation agreement (prohibitions of real estate refinancing), allow for the “take-out” of both debt and equity**

Yes. Section 3.3(h), which is applicable to all allocatees that received allocations in the 2005 NMTC allocation round and in later rounds, generally prohibits allocatees from using QEI proceeds to re-finance loans that were made to businesses whose principal activity is the rental to others of real property. As provided for in Section 3.3(h), this general prohibition does not apply in the case of financing that is used to “take-out” debt or equity that was used to finance certain prior construction or acquisition activities.

[Material Events](#)

**31. Section 6.9 of the allocation agreement requires CDEs to report Material Events to the CDFI Fund within 20 days of the occurrence. How do I report a material event to the CDFI Fund?**

A Material Events form can be found on the CDFI Fund’s website at <http://www.cdfifund.gov/docs/certification/cdfi/Material%20Events%20Form.pdf>. You should use this form to identify the nature of the material event, so that the Fund can determine whether or not it will affect your CDE’s ability to remain certified as a CDE and/or to administer its allocation award.

## **D. REPORTING AND FINANCIAL STATEMENTS**

**32. Which organizations are required to submit audited financial statements to the Fund?**

Only allocatees are required to submit audited financial statements to the Fund. Submission of an audited financial statement will be required beginning with the first fiscal year in which the allocatee issues a QEI.

A sub-allocatee that has received a transfer of allocation (sub-allocatee) must have an audit performed for the fiscal year in which it issued a QEI and each year thereafter until the termination of the allocation agreement. It will not have to submit these audits to the Fund. In lieu of the Fund collecting the sub-allocatee’s audited financial statement, the Fund will require the allocatee to annually certify in CIIS that the sub-allocatee has obtained an “unqualified” opinion on its most recently completed audited financial statement.

**33. Is a Tax Basis financial statement acceptable in lieu of generally accepted accounting principles (GAAP) prepared financial statement?**

Yes. The Fund will accept financial statements prepared on a tax basis. However, allocatees are required to utilize the same basis of accounting from year to year. In the event an allocatee who prepares cash basis financial statements one year and then is required to use GAAP the next, the Fund will require that the prior years’ statements be adjusted to GAAP and the statements be

audited. Thus, while the Fund may accept tax basis financial statements for the first reporting period, it may require subsequent financial statements to be GAAP.

**34. How will the Fund treat an audit that has an opinion other than “unqualified”?**

The Fund would view such an occurrence as a Material Event under Section 6.9(b) of the Allocation agreement and it must be reported to the Fund. If the Fund determines that the underlying reasons are significant, it may elect to find the allocatee in default under Section 8.1 of the allocation agreement and may impose one or more of the remedies outlined in Section 8.3.

**35. Will the Fund accept the audit of an allocatee’s controlling entity, or parent company, if the allocatee is not separately audited?**

Yes. The Fund will accept the audit of a CDE’s controlling entity or parent company if the CDE’s activities are fully detailed in a schedule of assets, liabilities, income and expenses of the parent’s financial statements. If the audit does not provide these details, the Fund will require the allocatee to submit an audit that includes such information.

**36. How will an allocatee fulfill its reporting requirements as outlined in Section 6.5 of the allocation agreement?**

Allocatees will submit their Institution and Transaction Level Reports through CIIS and their QEI notices through the Allocation Tracking System (ATS). Both are Internet based systems hosted by the Fund and accessible to the allocatee via its myCDFIFund account. ATS, which is accessible on a real-time basis, will permit allocatees to report on QEI data as required under Section 6.5(a). Allocatees will submit Institution and Transaction Level Reports through CIIS. Allocatees can fax or mail the audited financial statement or send it as an attachment to its CIIS submission.

**37. Are allocatees that have yet to issue a QEI required to submit Institution and Transaction Level Reports?**

No. Submission of the Institution Level Report will be required beginning with the fiscal year in which the allocatee or sub-allocatee(s) issues its first QEI. If the first QEI is made by a sub-allocatee then both the sub-allocatee and the allocatee will need to submit the Institution Level Report for the fiscal year in which the QEI was made. These reports will be required for each fiscal year thereafter, until the allocation agreement is terminated.

Submission of the Transaction Level Report will be required beginning with the fiscal year in which the allocatee or sub-allocatee(s) makes its first QLICI. If the first QLICI is made by a sub-allocatee then both the sub-allocatee and the allocatee will need to submit reports for the fiscal year in which the QLICI was made. This report will be required for each fiscal year thereafter, until the allocation agreement is terminated.

**38. What if the allocatee and the sub-allocatee have differing fiscal year end dates?**

All reporting due dates are driven by the allocatee's fiscal year end date. CIIS reports due dates are always determined by the fiscal year of the allocatee regardless if any or all of the allocation has been transferred to a subsidiary-allocatee.

**39. Will there be any penalties for late reporting?**

Failure to submit required reports by the required deadline may result in default of the allocation agreement. Potential remedies include termination or reallocation of any unused allocations. A default finding would also make the allocatee ineligible to apply for any future CDFI Program and NMTC funding rounds. Section 8.3 of the allocation agreement lists the remedies available to the Fund when an allocatee defaults under the terms of the agreement.

## **E. CIMS (MAPPING)**

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

Both the Fund and the IRS will treat as eligible any otherwise qualifying QLICI that is made in a census tract identified under CIMS as being made in a NMTC eligible low-income community – provided that the census tract in question was identified as eligible in CIMS at the time the QLICI was closed. Closed shall be defined as an investment for which the allocatee has distributed cash proceeds from a qualified equity investment to the qualified low-income business or CDE.

CIMS utilizes U.S. Bureau of the Census data, however, slight variations may arise. While other data sources or mapping systems may produce differing results than CIMS, the Fund and the IRS will guarantee as being eligible only those qualifying areas identified in CIMS. The Fund will not pre-approve any tracts as eligible that are not already identified as eligible in CIMS. CDEs that wish to make investments in such census tracts do so at their own risk and are advised to maintain relevant reports and maps, as necessary, to demonstrate to the Fund and/or to the IRS that a census tract was in fact eligible at the time of investment.

CIMS data is subject to future changes. As stated above, allocatees can rely on current CIMS data to make investments. In the event that the data is updated or modified, allocatees should retain the CIMS geocoded data reports and maps demonstrating that the census tract met the NMTC low-income criteria at the time of investment.

**41. CIMS indicated that an address is not valid. How do I geocode an address that CIMS cannot validate?**

The Fund offers the following guidance for obtaining a FIPS code and/or maps for addresses that cannot be validated in CIMS:

- Log on to your myCDFIFund account.
- Click on the "Mapping" link.

- Open the “NMTC Low-Income Community” link.

If you know the FIPS code:

- Click on the “File” link
- Click “Import”
- Click “Enter Census Tract” and then enter the 11-digit FIPS code
- Depress the “Submit Tract Selection” button.

If you do not know the FIPS code:

- Click on “Tools”
- Click “Zoom To”
- Click either “County, MSA or State” and select the applicable county, MSA or state.
- Enable all “Labels” and “Layers” by checking all boxes under each link.
- Use the “Zoom In” or “Rectangular Zoom In” feature to locate targeted site.
- Once the targeted site is located, click the “i” button.
- Position pointer over designated census tract and left click.
- The FIPS Code will be displayed as the “Unit ID.” The 11-digit FIPS Code number is comprised of a 2-digit state number, a 3-digit county number and the 6-digit census tract number.
- Click on the “Reports” link.
- Open the “Low-Income Community Worksheet.”
- Print and retain this document for your files.

**42. As a result of operational upgrades made to CIMS in February of 2004, approximately 500 census tracts that had previously been identified as NMTC-eligible were deemed to be no longer eligible. Will the Fund be providing a transition period so that allocatees that made investments in those census tracts, or had intended to make investments in those census tracts, will be held harmless for these transactions?**

Yes. First and second round NMTC allocatees shall be permitted to make QLICIs in these census tracts, provided that the investment: 1) otherwise qualifies as a QLICI; and 2) is made by the allocatee on or before July 31, 2005, or is a follow-on investment to a QLICI that was made by the allocatee on or before July 31, 2005. In the case of a follow-on investment, it is incumbent upon the allocatee to maintain records (e.g., subscription agreements, loan documents, disbursement schedules) to demonstrate that the follow-on investment is directly tied to the initial QLICI. A list of the approximately 500 census tracts that qualify for this special dispensation can be found on the Fund’s website at [www.cdfifund.gov](http://www.cdfifund.gov).

## **F. CDE CERTIFICATION**

**43. Am I required to notify the Fund if a certified CDE has been dissolved?**

Yes. The Authorized Representative must contact the Grants Manager at:

[grantsmanagement@cdfi.treas.gov](mailto:grantsmanagement@cdfi.treas.gov) and provide the Name, Control Number and EIN of the dissolved CDE. The Fund would consider the dissolution of a certified CDE as a material event to the extent that it finalized a QEI.

**44. How will an allocatee maintain their CDE Certification status?**

An allocatee will be required to certify on an annual basis that they continue to meet the Fund's CDE certification requirements. The certification will be completed electronically via CIIS at the time the allocatee submits its reports. If the allocatee has transferred any portion of its allocation to a subsidiary, the allocatee will be required to certify on behalf of the subsidiary as well.

Should the allocatee (or any of its sub-allocatees) no longer meet the CDE certification requirements at any time, it must inform the Fund of such material event as required under Section 6.9 of the allocation agreement. If the Fund determines that an allocatee can no longer meet the CDE certification requirements, it will be found in default and an event of recapture declared.

**45. Does the CDE certification have an expiration date?**

In general, a CDE certification designation will not expire provided that the CDE continues to comply with the Fund's NMTC Program requirements. However, CDEs that obtained certification through self-certification as a CDFI or a Specialized Small Business Investment Company (SSBIC) may need to take additional steps to maintain their CDE certification status. Unlike CDE certification, CDFI certification is valid for only a defined time period. Therefore, an allocatee must either submit an application for re-certification as a CDFI or submit an application for CDE certification. The application must be submitted at the latest, 90 calendar days before the expiration date of the CDE's current CDFI certification. If the Fund receives a re-cert application from the allocatee prior to the expiration date of its CDFI certification, the allocatee will maintain its status as a certified CDE until such time as the Fund completes the certification review.

The Fund will periodically check the SBA's list of approved SSBICs. Should the allocatee no longer be a SSBIC, the Fund will notify the allocatee and allow the allocatee a set time period in which to submit a CDE certification application. This does not preclude the allocatee from informing the Fund, as required by the allocation agreement, of any loss of SSBIC designation prior to the Fund's review and notification.

**46. If a CDE loses its status as a CDE, will it be offered an opportunity for a cure period?**

Yes. The CDFI Fund will give the CDE an opportunity – not to exceed 90 days - to cure its non-compliance with its CDE certification requirements prior to removing its CDE designation and, if applicable, reporting this event to the IRS.

## **G. AMENDMENTS – SECTION 9.11**



#### **47. Can an allocatee amend its allocation agreement?**

Yes. Allocatees may amend their allocation agreements by submitting written requests to the Fund's Grants Manager. The request, at a minimum must: a) identify the name and control number of the allocatee; b) identify the portion(s) of the allocation agreement that need to be modified; c) state the reasons why the allocatee is making the request; and d) explain the extent to which the proposed modifications are consistent with what the allocatee had proposed in its initial application to the Fund, and will help to further the goals of the New Markets Tax Credit Program. The request can be submitted by mail to the Fund's Grants Manager, Community Development Financial Institutions Fund, 601 13th Street, NW, Suite 200 South, Washington, DC 20005 or by e-mail to [grantsmanagement@cdfi.treas.gov](mailto:grantsmanagement@cdfi.treas.gov) with subject line: NMTC: Allocation Agreement Amendment Request.

Justification for approving an amendment to an allocation agreement must be based upon a determination that the amendment is: a) consistent with the intent of the NMTC Program statute and regulations and furthers the goals of the NMTC Program; b) consistent with (or not a substantive departure from) the business strategy proposed in the initial application for an allocation; and c) sufficiently narrow in scope that it does not disadvantage other allocatees or other applicants from the same allocation round.

While an amendment request can be submitted at any time, it must be submitted no later than 90 calendar days before the allocatee's fiscal year end if a determination is desired prior to the end of the allocatee's fiscal year reporting period.

#### **48. How can allocatees add additional subsidiary CDEs to Section 3.2?**

Step 1: If the proposed subsidiary allocatees have not yet been certified as CDEs, the allocatee must first submit a CDE certification application on behalf of the non-certified subsidiary entities. Without certification, the Fund's databases will not link the subsidiaries to the allocatee, and the allocatee will NOT be able to add these subsidiaries to its allocation agreement.

Applicants should submit the forms as instructed in the CDE Certification Application, which include:

- CDE Form 1 – Applicant CDE Information Form (Allocatee);
- CDE Form 1a – Subsidiary Applicant Information Form (for each non-certified entity);
- CDE Form 1b – Subsidiary Applicant Primary Mission Certification (for each applicable non-certified entity);
- CDE Form 2 – Service Area and Accountability Form (for each non-certified entity);
- CDE Form 3 – Low Income Community Representative Form (for each LIC rep of each non-certified entity); and
- CDE Form 4 – Authorized Representative Certification Form (Allocatee).

Failure to provide all of the appropriate forms will delay certification and completion of the allocation agreement. The CDE certification application must be submitted to the Bureau of Public Debt (BPD), in accordance with the submission instructions provided in the CDE certification application.

Step 2: The allocatee must submit a written request to the Fund’s Awards Manager asking that the subsidiary entities be added to the allocation agreement. This request may be submitted as soon as the allocatee has received notification from BPD that the subsidiary entities have been assigned CDE certification control numbers. In the written request to the Awards Manager, include the name and award number of the allocatee and the names and CDE certification control numbers of the subsidiary CDEs to be added to the allocation agreement. The request can be submitted by mail to the Fund’s Grants Manager, Community Development Financial Institutions Fund, 601 13th Street, NW, Suite 200 South, Washington, DC 20005 or by e-mail to [cdfihelp@cdfi.treas.gov](mailto:cdfihelp@cdfi.treas.gov) or [grantsmanagement@cdfi.treas.gov](mailto:grantsmanagement@cdfi.treas.gov) with subject line: NMTC Allocation Agreement Amendment Request. Upon certification of these subsidiary CDEs, the Fund’s Legal office will work with the allocatee to obtain the appropriate documents required to amend the allocation agreement. The allocatee **MUST** be listed as the Applicant CDE in the CDE Certification Application; do not list the additional subsidiary entities as the applicant CDE.

NOTE: the above process does not apply to allocatees certified and established as a single entity under the Delaware Series Model. All activities within ATS and all data submitted within the institution and transaction level reports should be reported as if conducted by the Master series.

## **H. CONTROL OF SUBSIDIARY ALLOCATEES (SUB-ALLOCATEES) – SECTION 2.6**

### **49. Are New Markets Tax Credit Program (NMTC) allocation recipients (allocatees) permitted to transfer their tax credit authority to other entities?**

Yes. Allocatees may transfer all or a portion of their allocation authority to subsidiary entities (sub-allocatees), provided that each such subsidiary: a) has been certified as a qualified CDE by the CDFI Fund; b) is included as a party to an allocation agreement, either at the time of initial execution or through a subsequent amendment; and c) is “controlled” (as defined in the allocation agreement) by the allocatee at all times throughout the term of the allocation agreement.

### **50. How does the CDFI Fund define “Control,” for the purpose of demonstrating that an allocatee controls a subsidiary entity?**

The CDFI Fund defines “Control” as:

- (a) Ownership, control or power to vote more than 50 percent of the outstanding shares of any class of Voting Securities of any entity, directly or indirectly or acting through one or more other persons; or
- (b) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of any other entity; or
- (c) Power to exercise, directly or indirectly, a controlling influence over the management policies or investment decisions of another entity, as determined by the Fund.

An allocatee demonstrates Control of a subsidiary entity by meeting any one of these three criteria. An allocatee does not have to satisfy all three criteria in order to be deemed to Control a subsidiary entity.

Notwithstanding the above, beginning with the Round 3 allocatees, the CDFI Fund requires that in order for an allocatee to transfer its allocation authority to a subsidiary allocatee, the allocatee must demonstrate, at a minimum, that it exercises and will maintain a controlling influence over the investment decisions of the subsidiary allocatee.

**51. If an Allocatee included a Controlling Entity in its NMTC Allocation Application for the purpose of demonstrating a track record, is the Controlling Entity required to maintain control during the entire 7-year NMTC compliance period? If so, how does the Allocatee demonstrate control by its Controlling Entity?**

The entity that is designated as the *Controlling Entity* in an Allocatee's NMTC *Allocation Application* must continue in that capacity throughout the term of the *Allocation Agreement* with the Fund. To conform to the Fund's definition of a *Controlling Entity* as provided for in the application materials, it is required to continuously have a controlling influence over the management policies, and day-to-day management and operations (including investment decisions) of the Allocatee, as determined by the Fund.

**52. What does the CDFI Fund deem to be a "controlling influence over the management policies" of another entity?**

In order to demonstrate a controlling influence over the management policies of a sub-allocatee, the allocatee must be, at a minimum:

(a) Identified in all appropriate organizational documents as the managing entity of the sub-allocatee (e.g., the general partner, managing partner, managing member or similar managing entity of the sub-allocatee);

(b) At all times in principal control over the day-to-day operations of the sub-allocatee, and no other parties (including investors) may impose unreasonable limitations on the rights and privileges of the allocatee to carry out such general management functions or undermine the allocatee's control over the management of the sub-allocatee. The allocatee may enter into contracts with other entities to perform general management functions (e.g., underwriting transactions; compliance and monitoring), but the allocatee must retain the authority to remove the contracted parties with or without cause. Some indicia of management control include, but not limited, the authority to:

- (i) Make all material decisions affecting the business and affairs of the entity;
- (ii) Act for and bind the entity and to operate and administer the business;
- (iii) Make strategic, governance, and *contract decisions*;
- (iv) Establish all policies governing operations of the entity;
- (v) Acquire and dispose of interests in real or personal property;
- (vi) Establish and maintain bank accounts;
- (vii) Employ and terminate all officers, employees, consultants, and agents of the entity; and
- (viii) Exercise responsibility for business development, raising capital, underwriting, portfolio monitoring, reporting and compliance.

The existence of any one of these indicia, by itself, will not necessarily meet the management control test. Instead, when making a control determination the CDFI Fund will evaluate the totality of all of the facts and circumstances in each particular matter, including the existence of the factors listed above.

Please also note that certain factors which may amount to an unreasonable limitation on an allocatee's management control, include, but are not limited to:

- (i) The prohibition of the sale, disposition or transfer of any assets of the entity;
- (ii) The prohibition of entering into contracts valued above an unreasonably low threshold (e.g., \$5,000); and
- (iii) The hiring of agents or other entities controlled by investors in the allocatee or its subsidiary entities.

The existence of any one of these factors could result in a determination that the allocatee does not have management control over its subsidiary entity.

**53. What does the CDFI Fund deem to be a “controlling influence over the investment decisions” of another entity?**

In order to demonstrate a controlling influence over the investment decisions of a sub-allocatee, the allocatee must, at a minimum, have the authority to propose potential NMTC investments and the authority to approve all proposed transactions involving the use of NMTC proceeds. In other words, at no time can a QLICI be made without the authorization of the allocatee. This rule applies to initial NMTC investments as well as re-investments of NMTC proceeds that occur during the seven-year investment period. The allocatee's approval authority may be either explicit (e.g., the operating agreement clearly states the approval rights) or implicit (e.g., the final investment decision authority rests with an investment committee, the majority of whose members are appointed by the allocatee and are not affiliated with the investor).

An allocatee may share its control of the investment decisions of a subsidiary entity with an investor (e.g., both parties have the right to veto a proposed investment transaction), provided that the investor does not exercise undue influence over the decision-making authority of the allocatee. The CDFI Fund would likely determine that undue influence exists in situations where, for example: (a) the allocatee is required to decide on an investment proposed by the investor within an unreasonable amount of time (i.e., less than 30 days); or (b) the investor can stop the payment of management fees or other contractual payments to the allocatee if the allocatee does not approve an investment proposed by the investor.

**54. Will the CDFI Fund review operating agreements submitted by allocatees to determine whether they “control” subsidiary allocatees?**

The CDFI Fund no longer requires allocatees, as a matter of course, to submit such documentation in advance of executing or amending allocation agreements. The CDFI Fund reserves the right, however, to request such documentation from allocatees at any time, and will likely do so as part of its compliance and monitoring procedures. Allocatees may also be

required to submit certifications confirming their control of sub-allocates as part of annual reporting requirements. Allocates are therefore advised to follow the guidelines contained in this document to ensure that they maintain sufficient control over their sub-allocates.

The CDFI Fund will also require that allocates obtain legal opinions which confirm that they control their sub-allocates both at the time of initial closing of the allocation agreement and at the time of any subsequent amendments.

The CDFI Fund will not review operating agreements submitted voluntarily by allocates or investors that wish to obtain determinations concerning a control issue from the CDFI Fund.

**55. How does the CDFI Fund view investor rights to remove the allocatee as the managing entity of the subsidiary allocatee?**

The CDFI Fund is aware that many operating agreements for subsidiary entities may afford investors with the right to remove a managing entity for malfeasance or negligence. However, if such removal rights include: (a) the right to remove the managing entity without cause or (b) the right to remove the managing entity for violation of any provision of the operating agreement or any misconduct or breach of contractual obligations which does not have a material adverse effect on the business of the entity, the CDFI Fund could determine that the allocatee does not have management control over its subsidiary entity. In addition, if the investor decides to exercise its removal rights and, as a result, the allocatee no longer has any control over its subsidiary entity, the CDFI Fund may determine that such occurrence is an event of default under the terms of the allocation agreement and the CDFI Fund has the discretion to impose any or all of the remedies contained in the allocation agreement.

NOTE: The CDFI Fund has the right to approve all successors of the allocatee's interests as a party to the allocation agreement (see Section 9.4 of the allocation agreement).

*The CDFI Fund has the discretion to consider additional factors when determining the extent to which an allocatee demonstrates control over its subsidiary allocates.*