ADVANTAGE
CAPITAL

March 9, 2017

BY ELECTRONIC MAIL

Robert Ibanez
NMTC Program Manager
Community Development Financial Institutions Fund
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW, Washington, DC 20220

Re: Comments to Draft 2018 NMTC Allocation Application

Dear Bob:

Our firm, Advantage Capital Partners, has utilized the New Markets Tax Credit program to support small businesses throughout the United States as they generate jobs and community benefits for their Low income Communities. Our approach to the NMTC Program involves using the credits to raise pooled investment funds from third party lenders and equity investors that can be invested in a series of small business non-real estate QALICBs unrelated to either ACP or our investors. This model allows us to make smaller investments of shorter durations, appropriate for small operating businesses that need working capital and growth finance. Our CDE, Advantage Capital Community Development Partners (ACCDF), has been the recipient of New Markets Tax Credit allocations in 11 of the 13 allocation rounds to date, receiving allocations of $739 million through that process, including $80 million in the most recent round. With these allocations our CDEs have provided over $1.4 billion in QLICIs to low-income community small businesses.

The CDFI Fund has requested comments to its draft 2018 NMTC Application. We understand that the application is by necessity a complex exercise, one which tries to provide the Reader pool with a balanced look at widely divergent CDEs from across the community development and economic development landscape, in order to allow fair, objective scoring. Community development organizations that support community facilities, schools, low income services etc. have ample opportunity within the application to tell their story and score well. Our primary goal in the comments we submit below is to ensure similar opportunity for groups that support permanent job growth in these communities through business investing, a goal we know is supported by both the CDFI Fund and the original legislative intent. Said differently, we want to make sure the CDFI Fund does not inadvertently subvert its emphasis on small business/permanent job investing with an application that handicaps the CDEs that can best accomplish this goal.

We would be happy to discuss these comments or any other aspect of the application with CDFI Fund staff at any time.

1. **Question 18 Value Added and Innovative Investments:** We support the inclusion of Innovative Investments in the Application as a means of continuing to diversify the use of NMTCs in ways that meet the program's broad goals. We believe the question should revert to being a scored question in order to ensure all CDEs seriously consider this encouragement. We also have the following specific recommendations to improve Question 18's effectiveness:

   a. *New category: Unaffiliated/Non-Grant Leverage:* One of the key goals of the NMTC statute (and the CDFI Fund) is to drive more private capital into Low Income Communities, to overcome the biases and stereotypes that pervade traditional capital markets, paving the way for non-incentivized private investment in these communities. Currently, any explicit questions in the application regarding the source of leverage capital are reserved for section IV, Capitalization Strategy, a section that is not read or scored by the Reader pool. Yet the decision how to raise leverage capital is a critical component of a CDE's business strategy. To date, many CDEs rely overwhelmingly on either capital that is already affiliated with the QALICB, or government-sponsored grant-like capital as a source of leverage. While using these sources avoids the challenge for a CDE of finding arms-length commercial investors, they represent a policy trade-off: they do not advance the important goal of driving new investors and additional private capital into LICs. CDEs should be asked in the Business Strategy section whether and how much they intend to raise in private, unaffiliated capital for use as leverage debt. Readers should be instructed that this practice represents an Innovation that the CDFI Fund encourages.

   b. *Less Constraining Definition of Non-Real Estate (NRE) QLICIs:* The current definition of NRE investments that qualify under question 18 prohibits even $1 of any QLICIs made to a QALICB at one time from being used for real estate improvements. While this bright line rule might combat potential anticipated abuses, it has the unintended consequence of reducing a CDE's effectiveness, particularly one that invests in small business. Over years of LIC investing, we have found time and again that our small business QALICBs need a simplified financial source, a "one-stop shop" for their financial needs that can be used for equipment, working capital and facility improvements. Under the current rule, we might finance a rural manufacturer with $3MM to launch a new business line, whose uses include $1MM on equipment, $1MM on working capital (hiring), and $1MM on plant fit-up (qualifying as real estate). None of those dollars would count as NRE investing under the current rule, meaning we are being discouraged from making that investment despite the fact that $2MM squarely supports the NRE innovation. We request that the NRE rule be modified to adopt a look-through to the uses of any QLICI, such that that portion of a QLICI used for equipment or working capital be includable as NRE.

      To the extent the CDFI Fund is concerned that CDEs will meet this definition without fundamentally changing their traditional investment model, we suggest there may be a more targeted way of addressing this concern. For example, if the concern is that in any major real estate development roughly 5-10% of the project's costs go to finance equipment or operating reserves (clearly not an innovation under question 18), the NRE rule might eliminate any affiliated QLICIs in which the *majority* of proceeds are being used for real estate development. We would be happy to discuss other concerns and possible approaches if desired.

c. *Expanding Shorter-Term QLICIs to include True Equity:* Outside of ACCDF, the CDE community overwhelmingly makes QLICIs as loans with a minimum 7-year term, with lockout on prepayments during that period. While this kind of "patient" capital can be appropriate for certain LIC projects (especially real estate development), the CDFI Fund was right to recognize that this is inappropriate capital for many deserving QALICBs, especially small businesses. Seven-year capital has a strong likelihood of over-subsidizing a small business, which may only need NMTC capital to achieve a 2-4 year growth plan before graduating to traditional capital. It also limits those who can participate as leverage lenders, as most traditional investors expect the ability to turn capital more than once every 7 years. However, we believe the current implementation of this innovation unintentionally crowds out true equity investments, which are every bit as flexible and desirable for small business as shorter duration debt.

   True equity investments have no term and no lockout, and can be retired at any time, in line with any traditional investor's expectations. Most small business equity investments from outside investors are redeemed within 5 years. They too accomplish the broader goals established in question 18/shorter duration. However by encouraging only shorter duration debt, the Application is pressuring CDEs to choose this category over true equity. As illustration, an investor like ACCDF might encounter QALICBs that request 20% of its capital in true equity QLICIs in small and startup businesses, and 40% of its capital in the form of growth lending that is shorter than 5 years duration. If we guessed incorrectly and pledged 50% shorter duration debt in our application, we may be forced to ask some QALICBs to accept debt rather than equity, notwithstanding how much they prefer more flexible equity. We would prefer to see true equity investments, provided without any lockout terms, included in the category of shorter duration debt, to eliminate this contrary incentive.

d. *Definition of Small QLICIs:* As with shorter-duration innovation, the small QLICI innovation correctly recognizes that the large majority of CDEs use NMTCs to finance large-scale community and economic development projects, with a minimum project scale of $6-8 million. But many impactful LIC businesses and projects need smaller capital amounts, leading the CDFI Fund to challenge the industry to make QLICIs of $2 million or less. ACCDF agrees with this encouragement, having made over 100 initial QLICIs in this category to high-impact small businesses. The CDFI Fund's restrictive definition of a small QLICI however does not support its goal, and actually unintentionally disadvantages small business QALICBs by suppressing follow-on capital. Unlike a real estate development project that gets financed entirely at inception, a small business can run into disparate capital needs throughout its lifetime. Investors, particularly those who support equipment and inventory purchases and working capital, are routinely called on to provide additional capital over several years to support the business. Unplanned capital investments are without exception separate transactions, requiring new underwriting and additional risk.

   The CDFI Fund's rule that only new investments after 24 months can count as small QLICIs restricts CDEs' abilities in this regard: if we've counted a $2 million investment as a small QLICI, the rule effectively prohibits us from financing a later difficulty or opportunity for 24 months. When a business needs a new capital infusion, it cannot wait for an arbitrary timeframe to pass. Compounding this issue, when an existing investor refuses to provide capital, it sends a signal to the market that something is wrong with the business, suppressing outside investment as well. We would respectfully request that a new, unanticipated QLICI, 6 months or more removed from the initial QLICI, and unrelated to the initial QLICI in uses, should also count as a small QLICI in the event it is $2 million or less. Those qualifications would serve to prevent gamesmanship in CDEs who might arbitrarily stage a larger, single-purpose QLICI to get under the small QLICI cap.

2. **Question 25 Community Development Outcomes:** Currently the first three CDOs all concern job creation and the quality and accessibility of those jobs, which appropriately emphasizes the importance of increasing employment in LICs. Nevertheless, those questions do not distinguish direct/permanent jobs from indirect/construction jobs. We think these different job categories generate very different impacts in LICs, and should be described separately. Permanent jobs generated directly by the QALICB are not only indefinite in duration, generating years of benefits for residents and the LIC, but they give the CDE an opportunity to influence the quality of those positions directly through its investment in, and relationship to, the QALICB-employer. CDEs like ACCDF often influence QALICBs to hire locally, to offer training to unskilled employees, to provide wealth-building programs, etc., and can enforce those efforts through its QLICI agreements. Construction jobs on the other hand are impermanent, lasting at most 12-14 months and often far less. They are not the QALICB's employees, but those of its contractors and subs, and therefore less subject to the CDE's influence. Yet the current application lumps these job categories together, potentially confusing the Readers as to the respective value of each. We would recommend that CDOs (a), (b) and (c) all pertain to permanent/direct jobs. Construction/indirect jobs should be given their own CDO response, allowing those CDEs that specialize in real estate development to get credit for those jobs, but in a manner that does not confuse their impact with permanent/direct positions created and sustained by the QALICB itself.

3. **Question 26(b) and (c): Community Involvement in Investment Decisions:** Questions 26(b) and (c) take two different approaches to the same topic: whether a CDE's investment decisions were shaped or influenced by community voices beyond one's advisory board. These questions appear to have substantial overlap, and both play to the strengths of a CDE that focuses on community facilities, charter schools, or other community assets, which are almost by definition initiated by a community-based constituency. We respectfully suggest that these questions are, by their nature, more difficult to answer for a CDE that invests in small businesses in order to grow quality, accessible permanent jobs in LICs. Small businesses are typically struggling to survive, to grow, and to increase employment opportunities. They are not typically spending time on public relations designed to generate support from local community groups, whether government, not-for-profit or other institutions. And conversely, very few community organizations are inventorying and grading private small business in order to offer recommendations as to whose success will generate the greatest impact on its community. Indeed, governmental institutions are mostly prohibited from this kind of favoritism. This does not mean that a CDE small business investor can or should ignore its QALICBs' surrounding communities. Whether and how these QALICBs have reached out to or impacted their communities is critical to identifying the most impactful businesses. High impact businesses conduct outreach to hire locally; they focus on local suppliers to keep capital and jobs in the community; they provide benefits that go beyond the individual employee, like child care, continuing education, etc.; and they grow the local tax base to generate greater economics their communities can utilize.

We would request that question 26 contain alternative questions (b) and (c), where a CDE is permitted to answer one, or the other, or both. New question 26(b) would retain the community involvement and engagement aspects of what is today 26(b) and (c). New question 26(c) would ask a question more apropos of a CDE that invests in private small businesses, asking it to describe in what way the businesses in which it invests were targeted because of the intentional impact they have on their surrounding community.

4. **Question 30(e) Delinquent, Defaulted and Impaired Investments:** Within the asset management question 30, 30(d) covers delinquency rates, and 30(e) covers delinquent, defaulted or impaired loans or equity investments. 30(d) limits the time period for response to the past 3 years, however 30(e) has no such time limit. As a CDE with over $1.4 billion in QLICIs to date, this list has understandably become long: over the course of 300+ small business QALICBs we have experienced many ups and downs as would be expected making flexible capital available to businesses in overlooked communities. What should mater to the CDFI Fund is how we help QALICBs weather the rough patches, demonstrating patience and flexibility, often resulting in recovered health for the QALICB and a full recovery for the CDE. However, the current question without time limit requires that we use most of the allotted character count simply listing negative events rather than describing our efforts in response. As with 30(d), we believe a 3-year lookback in 30(e) would seem adequate to provide examples which can then be unpacked and explained, rather than a 12-year inventory of all such challenges.

5. **Question 43(a) Prior QEI and QLICI Description:** Question 43(a) requires the CDE to detail each QEI and QLICI from all past awards. As a CDE that has made nearly 200 QEIs and invested in over 300 QALICBs, we struggle to provide the information requested in the 2000 character count currently provided. We request that this response be afforded an additional 3000 character count to accommodate CDEs with long and growing track records using NMTCs.

Thank you for your consideration of these comments, and for the continued rigor with which you conduct this critical community and economic development program.

Sincerely,

Jonathan Goldstein
Managing Director

Michael Johnson
Managing Director