National Housing
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October 2, 2009

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

Dear Mr. Josephs:

The New Markets Tax Credit Steering Committee of the National Housing and Rehabilitation Association (the "Committee") wishes to submit the following comments in response to the CDFI Funds August 3, 2009 request for comments concerning the New Markets Tax Credit (NMTC) Program—Allocation Application. We understand that the CDFI Fund may be unable to respond to all of the industry's concerns and comments so we respectfully would like to focus our comments on the questions pertaining to Related Party Equity Investments. We have discussed some of these concerns with you and your colleagues in the past and would like to reiterate these concerns in the context of our response to the following question:

Question 3. A CDE is entitled to earn five ''priority points'' for committing to invest substantially all of its QEI proceeds in businesses in which persons unrelated to the CDE hold the majority equity interest (within the meaning of I.R.C. section 267(b) or 707(b)(1)). With respect to the timing of this test, the CDFI Fund has determined that it is to be applied after the initial investment is made, and for the life of the seven-year compliance period (though an exception is permitted if events unforeseen at the time of the initial investment cause the CDE to have to subsequently take a controlling interest in the business). Is it appropriate that this test is applied after the investment is made, or should the
CDFI consider applying this test before the investment is made? If the test is to be applied before the investment is made, then how should the Fund treat circumstances whereby the receipt of the QEI and the investment in the business is essentially a simultaneous transaction, particularly when the CDE may not have any owners identified prior to the QEI closing?

We respectfully believe that it is most appropriate that the related party test discussed in this question be applied <u>before</u> the investment is made. The CDFI Fund is aware that its interpretation of the statute governing this test forces most allocatees to structure their investments as debt instead of equity in order to ensure that it does not have a 50% interest in either the capital or the profits of the qualified business after the transaction closes. We believe that most allocatees would prefer to structure NMTC transactions as either 100 percent debt or 100 percent equity. We believe that the current approach is contrary to the policy objectives of the statute, which we believe was intended, among other things, to encourage the investment of "patient capital" in low-income community businesses. Many low-income community businesses would benefit more from increased equity capital than they would from increased debt, especially when NMTCs are used to supplement and enhance other government priorities including but not limited to the Historic Rehabilitation Tax Credit and Energy Tax Credits. However, most low-income community businesses lack the substantial capital that would be necessary to exceed a substantial equity investment from a CDE, as would be required if the related party rule is applied after the investment is made. Without access to more equity, many low-income community businesses may not be able to obtain sufficient debt funding, even if the debt is subsidized by new markets tax credits.

There is no apparent policy reason for discouraging CDEs from making a majority equity investment in a QALICB, regardless of whether there is any other relationship between the CDE and the QALICB, while at the same time not placing similar restrictions on debt investments. The current approach forces CDEs to structure their investments as debt instead of equity. This often achieves a very similar infusion of money (e.g., the indebtedness will often represent far more than 50% of capital and profits of the business), yet as debt, it creates a greater burden on the QALICB.

This artificial bias for debt is particularly problematic in combined historic tax credit ("HTC") and NMTC transactions, which otherwise work extremely well together. Historic investors and their counsel are forced to resort to complex and convoluted tax structures to comply with the current interpretation of the related party rules.

Because Section §45D(f)(2) of the Code applies to applicants seeking an allocation of NMTC, we believe that the most likely policy intent behind the "related party" rules was a desire to discourage Allocatees, the entities that determine how allocation will be used, from investing in their own businesses. We do not believe that the policy intent was to discourage NMTC investors, who do not decide how the allocation is to be used, from investing in their own businesses, because the investor generally would not have an ownership interest in the applicant at the time of application, If this is a correct interpretation of the policy behind the "related party" rules, it would seem appropriate to test the relationship of the QALICB and the Allocatee CDE before an NMTC investor has made its QEI in the CDE. Under this interpretation, the relationship of the NMTC investor to the QALICB after the QEI is made would not be relevant.

It should also be noted that the related party rules set forth in Code Section 267(b) and 707(b)(i) test only whether the same parties have more than a 50% ownership interest (capital or profits interest in the case of a partnership) in two entities. In most QLICI equity investments, even if the CDE has more than a 50% capital or profits interest in the QALICB, the principals or owners of the QALICB prior to the transaction (the "QALICB Sponsor") retain day to day control of the management and operations of the QALICB. The CDE may have certain major decision rights to protect its investment, but the QALICB Sponsor remains in "control" of the business.

It is difficult to see a policy argument for prohibiting a QALICB from accessing more capital from a CDE investor not related to it prior to the investment, and who will maintain a passive interest that will allow the QALICB to manage the use of the capital for its own business goals.

It should also be noted that changing the timing of the related party test permits for less complicated NMTC transactional structures. This in turn would dramatically reduce transaction costs, including legal and accounting costs. This is especially true for transactions using multiple tax incentives like Historic Tax Credits and Energy Tax Credits.. The reduction in legal and accounting costs resulting from more streamlined transactions should result in a greater proportion of NMTC subsidy flowing to QLICBs.

NH&RA would also like to draw your attention to the following issues pertaining to questions 2 & 10 below.

Question 2: *Are the thresholds contained in Question 17 of the Application appropriate, given current economic conditions? If not, what should the criteria include? Should the Fund provide a range of flexible product commitments based on a discount of interest rates below market as defined by basis point reductions (or other product flexibilities) or continue to present commitment options in percentage terms?*

We would also urge you to revisit the thresholds contained in Question 17. Due to the low-interest rate environment, it is difficult to benchmark interest rates based on percent reductions. Instead of focusing on interest rates at a certain percentage below market, we suggest that it should be based on basis point reductions. Due to the today's difficulties obtaining credit, and the higher return requirements of investors in the market, it is imperative that CDEs are able to more precisely price their debt products and achieve a realistic spread. In addition to higher costs of capital, CDEs' underwriting criteria have become more stringent in an effort to mitigate risks. Given all of these market factors, a CDE may not be able to offer as wide a range of the flexible financing indicia, especially in the cases whereby the QEI investor is not the leverage lender.

*Question 10**:** Currently, the Fund uses economic distress factors from the most recent decennial census to qualify eligible census tracts and to verify, when applicable, that awardees are serving ''severely'' distressed communities. Are there other public sources of data on economic indicators (e.g., American Community Survey three- and five-year estimates for poverty rate, area median income, and unemployment rate) that are updated more frequently and readily available that the Fund should accept?*

NH&RA suggests that the CDFI Fund accept other public sources of data on economic indicators that are updated more frequently. The Federal Financial Institutions Examination Council's ("FFIEC) website offers a Geocoding System (http://www.ffiec.gov/Geocode/default.aspx) that is used for Community Reinvestment Act and/or Home Mortgage Disclosure Act data, and it includes demographic information based on the decennial census and the last three calendar years. Specific demographic information includes income, house, and population data. Because this data is updated annually, it provides a real-time assessment of the census tract and a more accurate reflection its demographics. The CDFI Fund should also consider demographic data derived from state or municipal government sources.

We would be happy to discuss this with you further at your convenience and appreciate your time and consideration.

Sincerely,

Thom Amdur
Executive Vice-President

cc: Rosa Martinez