April 19, 2016

Sent Via E-mail

Ms. Annie Donovan  
Director  
Community Development Financial Institutions Fund  
U.S. Department of the Treasury  
1801 L Street, N.W., 6th floor  
Washington, DC 20036

Re: Comments and Recommendations on Questions 42, 43 and 44 in the Compliance and Monitoring Frequently Asked Questions Document dated December 2015

Dear Ms. Donovan:

On behalf of the members of the New Markets Tax Credit (NMTC) Working Group, we submit the enclosed comments and recommendations related to questions 42, 43, and 44 in the New Markets Tax Credit Certification, Compliance Monitoring and Evaluation Frequently Asked Questions (FAQs) document dated December 2015. We believe your feedback to these comments and recommendations will help the industry better understand the language regarding when payments or reimbursements are made from qualified low-income community investment (QLICI) proceeds by a qualified active low-income community business (QALICB) to any debt or equity provider whose capital is used to fund the associated QEI.

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. The group includes 60 organizations that are allocates, nonprofit and for-profit community development entities (CDEs), consultants, investors, accountants and lawyers.

Please note that this letter is submitted with the support of the New Markets Tax Credit Coalition, an organization with more than 150 members consisting of CDEs, investors, consultants and other community development professionals.

While we certainly hope that these comments and recommendations are helpful in your analysis, we also look forward to meeting with you to continue our thoughtful discussion of these issues and the most effective way of providing clear and effective guidance in the future. We would be willing
to provide examples to help facilitate a discussion with you about the many various issues that may arise in applying the CDFI Fund’s guidance to possible NMTC transactions.

From our perspective as a group that has been active throughout most of the life of the NMTC program in helping to inform and guide the use and development of that program, we believe that investors, CDEs and low-income community businesses share the good-faith belief that the transactions in which they are involved are consistent with the purposes of the program. We would welcome the opportunity to discuss the analysis supporting particular transactions and ardently believe that any prospective guidance would benefit from such discussion.

We appreciate the continued commitment, dedication and outreach of the CDFI Fund, the Internal Revenue Service (IRS) and the Treasury’s Office of Tax Policy and Office of Small Business, Community Development & Housing Policy in implementing and managing the NMTC program. The CDFI Fund, IRS and Treasury, working together, have proven to be outstanding managers of the NMTC program, as evidenced by the tremendous success the NMTC program has achieved since its inception in 2000 by targeting billions of dollars of investments in low-income communities across the country. Since the program’s inception, the knowledge, understanding and experience among participants in the NMTC program have continuously risen, as has the demand and competition for the NMTC among investors, lenders, CDEs and qualified businesses. 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 greatly appreciate the opportunity to submit these comments and recommendations in an effort to further enhance the good being done by the NMTC program. We commend the CDFI Fund, Department of Treasury and IRS for their continuing efforts to improve and clarify guidance for the NMTC program to ensure its continuing success. 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 and Company LLP  
by Michael J. Novogradac

Enclosures

cc: Bob Ibanez, NMTC Program Manager, CDFI Fund
    David Meyer, Certification, Compliance Monitoring and Evaluation Program Manager, CDFI Fund
General Recommendations

The guidance in the New Markets Tax Credit Certification, Compliance Monitoring and Evaluation Frequently Asked Questions (FAQs) document dated December 2015 uses several terms that are similar, but different, than those used in the CY 2015 Notice of Allocation Authority (NOAA). The inconsistent use of terminology in different places creates confusion as to their meaning and the CDFI Fund’s intent. For example, when referring to which entity the restrictions on the use of QLICI proceeds used to repay or refinance will apply, the NOAA refers to "any debt or equity provider or a party related to any debt or equity provider." FAQ 42 refers to a "Project Sponsor (an entity that owns or Controls the QALICB)." FAQ 44 refers to "debt or equity provider" with no additional reference to any party related to that debt or equity provider.

In addition to the various terms used when referring to the entity that the QLICI proceeds will be used to repay or refinance, various terms are used when describing how an entity may be related to the QALICB. Among the sets of guidance, we have:

i) in the NOAA, the term "related," which is something of a tax term of art (though there's no indication that that's how it's intended here), as between any debt or equity provider and an entity related to it;

ii) in FAQ 42, the phrase "owns or Controls the QALICB," with "Control" appearing as a defined term (presumably as defined in the Allocation Agreement), but with no indication how much ownership might trigger the application of these restrictions;

iii) in FAQ 44, the phrase "owned or controlled" in relation to the assets, rather than as between entities, and with no apparent definition of either term (e.g., what does it mean to "control" an asset without owning it?); and

iv) also in FAQ 44, the term "Affiliate" as a defined term, presumably as defined in the Allocation Agreement (which turns on "Control", without reference to ownership).

This lack of consistency creates a lot of confusion, especially since QALICBs are often comprised of a number of equity owners, some of whom might also be involved (directly or indirectly) in providing leverage debt. Therefore, it is important to understand the definitions of each term used so that the Allocatee can make investments that it is comfortable will meet the requirements of these new restrictions.

We specifically recommend that the CDFI Fund add clarification in its guidance about what "related" means in the context it's included in the NOAA, which refers to "...a party related to any debt or equity provider...". We recommend that this clarification follow the guidance already included in FAQ 25 – How will the CDFI Fund monitor compliance with the unrelated entity requirement in Section 3.2(d) of the allocation agreement? FAQ 25 states:
An allocatee (awarded in and prior to the CY 2014 round) that has committed to invest in Unrelated Entities will be in compliance with its Allocation Agreement only if persons unrelated to the allocatee will hold a majority equity interest (as defined in IRC §45D(f)(2)(B)), and as determined subsequent to the receipt of a QEI, but prior to the allocatee using the proceeds of that QEI to make the initial QLICI. The allocatee must determine whether such persons are related to the allocatee (within the meaning of IRC §267(b) and §707(b)(1)) in consultation with its own tax advisors.

In addition to clarifying the definition of “related”, we recommend that the terms from the NOAA be used consistently throughout FAQs 42, 43, and 44. On page 4, we have provided a summary of the suggested edits to FAQs 42, 43, and 44 to incorporate these recommended changes.

FAQ 42

The final sentence of FAQ 42 is unclear as to whether it prohibits the reimbursement of costs outside of the 24 month window if costs within the 24 month window were reimbursed with QLICI proceeds that are used, directly or indirectly, to fund the associated QEI. We believe the intent of the new restrictions was to only apply to QLICI proceeds that are used directly or indirectly to fund a QEI. We believe the new restrictions in the NOAA do not apply if the CDE can provide documentation that traces the use of QLICI proceeds by the QALICB and show they do not directly or indirectly fund a QEI unless they meet the exceptions allowed in the NOAA and FAQ 42. We believe the concept of tracing is made clear in the guidance in FAQ 43 where CDEs are required to trace the use of QLICI proceeds. We recommend that this be clarified in the last paragraph of FAQ as highlighted below:

If the QALICB is using QLICI proceeds to reimburse or repay the Project Sponsor for documented, reasonable expenditures directly attributable to the qualified business of the QALICB that were incurred within the previous 24 months ($1,000,000), it may not use QLICI proceeds to repay or reimburse the Project Sponsor for any expenditures that occurred outside of 24 months to the extent that any such repayments or reimbursements are used, directly or indirectly, to fund the QEI.

FAQ 43

We request clarification about the requirement in FAQ 43 that the CDE be able to "trace the use of QLICI proceeds to use by the QALICB at the time of the initial QLICI is made and at least annually thereafter." This language suggests that the restrictions in the NOAA and in FAQ 42 and FAQ 44 are of an ongoing nature (even beyond the construction period). We are concerned that this ongoing requirement may be difficult to comply with since (i) FAQ44 applies to QLICI funds used "directly or indirectly" to fund a QEI, and (ii) money is fungible.

One investment structure that appears quite frequently is one in which there is a senior leverage lender not related to (or owned or Controlled by or an Affiliate of) a QALICB, and a junior leverage lender that is related to (or owned or Controlled by or an Affiliate of) a QALICB, and over the course of
the compliance period, the junior leverage lender makes additional advances to the investment fund (usually on a prescribed schedule) that are used to repay principal of the senior leverage loan.

It often happens in such transactions that the source of funds (or one source of funds) for the additional junior leverage loan advances are expected to be distributions by the QALICB to its equity owners. All or a portion of these distributions may, directly or indirectly, end up with the junior leverage lender. As long as the QALICB can show that the distributions come from project cash flow, and not QLICI proceeds, we believe they shouldn’t be subject to the new restrictions and guidance since the QLICI proceeds weren’t used, directly or indirectly, to fund the QEI. We recommend that additional guidance be provided that as long as the junior leverage loan advances are not readily traceable to QLICI proceeds, the amortization of the senior leverage loan advances would be consistent with the new guidance.

FAQ 44

At the end of FAQ 44 it states “Question 44 supplements and is not in conflict with the CY 2015 NOAA or Question 42 of this document.” We believe that FAQ 44, as currently worded, is meant to clarify the general restriction in the NOAA. FAQ 42, however, provides guidance on the two exceptions to the general restriction in the NOAA and, therefore, should supplement FAQ 44, instead of FAQ 44 supplementing FAQ 42. We believe the general restriction in FAQ 44 can apply even if the exceptions in FAQ 42 do not. However, we believe the exceptions in FAQ 42 can’t apply unless the general restriction in the NOAA and FAQ 44 also applies. For example, if a QALICB uses QLICI proceeds to reimburse an Affiliate of the QALICB and the QALICB Affiliate doesn’t use the proceeds to directly or indirectly fund the QEI, then the general restriction in FAQ 44 doesn’t apply because the QLICI proceeds aren’t used to directly or indirectly fund the QEI. Therefore, since the general restriction in the NOAA and FAQ 44 doesn’t apply, there is no need to determine if the reimbursement was for expenditures incurred more than 24 months prior to closing as described in FAQ 42. We recommend that this be clarified in the last sentence of FAQ 44 as highlighted below:

Under the CY 2015 round, a QALICB is not permitted to use QLICI proceeds to pay a debt or equity provider whose capital is used to monetize an asset owned or controlled by the QALICB or an Affiliate of a QALICB if that capital provider directly or indirectly funded a QEI. This provision does not apply to allocation awards made prior to the CY2015 round. Question 44 supplements and is not in conflict with the CY 2015 NOAA or Question 42 of this document. Questions 42 and 43 of this document supplement Question 44.
For your convenience, we have highlighted below our recommended changes to the FAQs from those suggested above.

**Compliance and Monitoring Frequently Asked Questions Document - December 2015**

42. What are the restrictions on the use of QLICI proceeds to repay directly or indirectly reimburse expenditures incurred by a QALICB or Project Sponsor (an entity that owns or Controls the QALICB) and to directly or indirectly any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI?

Beginning with the CY 2015 round, only documented reasonable expenditures that are directly attributable to the qualified business of the QALICB can be paid or reimbursed from QLICI proceeds to directly or indirectly fund a QEI, provided that these expenditures have either been (i) incurred no more than 24 months prior to the date on which the QLICI transaction closes, or (ii) represent no more than 5 percent of the total QLICIs made by the CDE into the QALICB.

Reasonable expenditures are expenditures for a legitimate business purpose that occur during the normal course of operation, and must be similar in amount and scope when compared to expenditures by a similar entity for a similar project under similar circumstances. Such expenditures may be made directly by the Project Sponsor any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI on behalf of the QALICB or be funded through a loan or equity investment made by the Project Sponsor to the QALICB made by any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI.

Of note, the IRS has not issued guidance on what costs are reimbursable under §45D. Until such guidance is made public, the CDFI Fund supports the use of the above parameters for transactions involving the reimbursement of incurred cost. The following examples are offered for additional clarity.

**Example 1: Project Expenditures within 24 Months**

Within 24 months prior to the closing of the QLICI transaction, a Project Sponsor uses funds it has raised from various sources to obtain development permits, begin construction, acquire or install equipment, or acquire other property related to the project; all of which represent reasonable expenditures and for which the Project Sponsor has retained documentation (i.e. invoices, receipts, proof of payment, etc.) totaling $1,000,000 and are directly attributable to the qualified business of the QALICB.

Out of $10,000,000 in total QLICIs, up to $1,000,000 of the QLICI proceeds can be used to reimburse the Project Sponsor for these documented expenditures and to directly or indirectly fund a leverage loan. The remaining QLICI proceeds ($9,000,000) could be used for operating needs, working capital needs, equipment, additional construction expenditures, or other needs related to the project or business of the QALICB.
Example 2: Project Expenditures up to 5% of QLICI Proceeds

Same facts as Example 1, except an additional $700,000 of documented, reasonable expenditures incurred by the Project Sponsor were incurred greater than 24 months prior to the closing of the QLICI transaction.

The QALICB may use no more than 5% of QLICI proceeds to reimburse documented, reasonable expenditures that are directly attributable to the qualified business of the QALICB regardless of when those expenditures were incurred. In this scenario, if the total QLICIs to the QALICB was $10 million, the QALICB could use up to $500,000 to reimburse expenditures that were incurred prior to the QLICI closing.

In summary, the QALICB may elect to either reimburse reasonable expenditures incurred within 24 months of the QLICI closing date as in the first example ($1,000,000) or reimburse reasonable expenditures that represent up to 5% of the QLICI proceeds incurred prior to the QLICI closing date ($500,000). It may not do both. If the QALICB is using QLICI proceeds to reimburse or repay the Project Sponsor, any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI for documented, reasonable expenditures directly attributable to the qualified business of the QALICB that were incurred within the previous 24 months ($1,000,000), it may not use QLICI proceeds to repay or reimburse any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI, the Project Sponsor for any expenditures that occurred outside of 24 months to the extent that any such repayments or reimbursements are used, directly or indirectly, to fund the QEI.

43. How will the CDFI Fund monitor the restriction on the use of QLICI proceeds to directly or indirectly reimburse expenditures incurred by a QALICB or Project Sponsor, any debt or equity provider, or a party related to any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI required under the CY 2015 NMTC Application?

CDEs must include such covenants in financing agreements with QALICBs as may be necessary to reflect this restriction. The agreements containing such covenants must be available for inspection by the CDFI Fund. Second, the CDE should collect information as may be necessary and maintain documentation to trace the use of QLICI proceeds to use by the QALICB at the time of the initial QLICI is made and at least annually thereafter. Where the QALICB will repay or refinance a any debt or equity provider, or a party related to a any debt or equity provider, whose capital was used, directly or indirectly, to fund the QEI under the 24-month or five percent exception rules, the CDE should maintain documentation supporting that the reimbursements can be directly traced to actual expenditures. This documentation must be available for inspection by the CDFI Fund. Documentation to support compliance with this restriction must be retained for the period of the QLICI in the QALICB plus three years or the seven-year compliance period plus three years, whichever is shorter.
44. Can a QALICB use QLICI proceeds to **repay** or **refinance** any a debt or equity provider, **or a party related to any debt or equity provider**, to monetize an asset owned or controlled by, or contributed, sold, or otherwise transferred to the QALICB, **or an Affiliates of a QALICB**, including but not limited to the accreted value of an asset?

Under the CY 2015 round, a QALICB is not permitted to use QLICI proceeds to **repay** or **refinance** any a debt or equity provider, **or a party related to any debt or equity provider**, on account of any equity investment or loan previously made by such provider in or to a QALICB, or on account of any contribution, sale, or other transfer of any assets by such provider to a QALICB, to the extent such provider's capital is used to **monetize an asset owned or controlled by the QALICB or an Affiliates of a QALICB if that capital provider directly or indirectly funded** a QEI. **There are two exceptions to this restriction that are explained in full detail in Question 42 of this document.** This provision does not apply to allocation awards made prior to the CY2015 round. Question 44 supplements and is not in conflict with the CY 2015 NOAA or Question 42 of this document. Questions 42 and 43 of this document supplement Question 44.