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Sent Via Mail and Fax

Mr. Jeff Berg
Community Development Financial Institutions Fund
601 13th Street, NW
Suite 200 South
Washington, DC 2005

Dear Jeff:

Thanks for the opportunity to submit comments on the New Markets Tax Credit. We appreciate your previously taking the time out of your busy schedule to meet with us, and look forward to discussing these comments with you in person. The two of us have over 30 years of experience structuring and managing tax credit investment vehicles that are designed to serve low-income families and communities. Our goal is to make the New Markets Tax Credit an investment vehicle as successful as the Low-Income Housing Tax Credit..[1]

We are re-submitting our original comments as well as providing additional comments. For this letter, we blended our prior comments into the structure outlined in your Guidance.

1. IRC section 45D(f)(2) requires that in making allocations of NMTCs, priority be given to: (a) any applicant that has a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities or (b) any applicant which intends to satisfy the Substantially All Test by making Qualified

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1 See www.taxcredithousing.com for additional information about the Low-Income Housing Tax Credit.

Low-Income Community Investments in one or more businesses in which persons unrelated to the CDE hold a majority equity interest.

(a) How should the Fund implement this policy? For instance, should the Fund incorporate preference points into the scoring? Should the Fund make awards to organizations that are deemed competitive and meet one or both of these criteria before providing an allocation to any other applicant?

Before answering this question, it is important to fully understand the two priorities and how they fit within the total allocation system. It is also important to note that while the point system is a necessary way to rank the various applicants, it is important to structure an allocation system that prevents applicants from so aggressively "chasing points" that "point chasing" applications defeat applications that are considerably more feasible, financable, and realistic.

1. **Experience.** Experience is important only to the extent that it relates to the capacity of the applicant to carry out its comprehensive investment plan. In this respect, it is more of a threshold item in that the Fund may not want to award an allocation of tax credits to a CDE that cannot demonstrate adequate experience.

   a. **Who must be Experienced?** A basic problem with this priority is that it focuses on specific entities. The Committee Report speaks of experience of the CDE or any affiliates. The Guidance speaks of the controlling member in the case of a limited liability company. Neither of these entities may be the management team whose experience is most important to the success of the comprehensive investment plan. Therefore, emphasis must be given to the track record of the CDE's proposed management team, whether or not the management team is associated with the CDE or an affiliate.

   b. **Experience must be Relevant to Proposed Investment Strategy.** Generally, experience should not count towards meeting this "priority" unless it has direct relevance to some aspect of investment under the New Markets Program, and in particular, has direct relevance to the proposed investment strategies. For example, if a CDE has some experience in providing technical assistance to community organizations, but does not propose to use funds from sale of New Markets Tax Credits for providing some form of technical assistance, then the experience should not count. However, if it is relevant to some aspect of the New Markets investing, it should count. For example, experience in structuring tax credits from related programs should count because groups with that experience will be better suited to structure New Markets Tax Credits than groups with no tax credit experience. Also, experience in raising capital from investors that buy tax credits (such as raising capital for the LIHTC program) should count as experience because the general manner in which the investments are structured and marketed to investors under the LIHTC program will be similar to the way in which investments will be structured and marketed to investors under the New Markets program. Experience in raising venture capital from investors should count as experience to the extent that the applicant's proposed investment strategy involves raising funds from venture capital investors.

c. **Areas in which Experience should be Counted.**
   i. Experience with respect to the nature of the investment itself (i.e., commercial real estate experience, or venture capital or leveraged buy-out experience). Where the CDE is a "fund of funds," we believe that the experience of the various fund managers involved with the fund of funds should be counted. These managers will be responsible for implementing the comprehensive investment strategy. Thus, experience should not be limited to the controlling general partner or member of the CDE, but should be expanded to include all members of the management team. Submission of proposed contracts at application stage is one way to identify the management team.
   ii. Experience with respect to structuring federal and state tax credits and partnership tax law (necessary for successfully marketing the New Markets Tax Credits). One of the difficulties with the Community Development Corporations Tax Credit Pilot Program was the fact that partnerships were not formed that were attractive to investors, and participants did not obtain clear, timely direction from the IRS in order to precisely quantify the tax advantages of investing in community development. Thus, this program lacked the expertise that the investment banking components of the private market can provide.
   iii. Experience with respect to raising capital under a program using federal tax credits or other tax benefits as the primary benefit to investors, and experience raising capital for the intended types of investments (i.e., commercial real estate, venture capital or leveraged buy-outs).

d. **How Should Experience be Quantified, and What should it be Used For?** We believe that the experience factor should really be a threshold item in that the Fund would be more comfortable allocating tax credits to sponsors with track records as opposed to those that did not. There is less probability that tax credits would be returned to the government from experienced sponsors. Therefore, we propose that points be assigned to each area where experience should be counted to determine whether a sponsor meets the threshold. The amount of points necessary to meet this threshold is subjective and should be determined by the Fund. Once a threshold is attained (or not attained) the sponsor will be evaluated for the other criteria focusing on the comprehensive investment plan. These criteria should be the nature of the proposed investments and their impact on community revitalization, and whether the proposed plan intends to attract new capital as opposed to merely attracting existing LIHTC investors and Community Reinvestment Act investors. During this evaluation process, points scored for experience will not be considered. If the sponsors meeting the "experience" threshold are deemed competitive by the Fund (i.e., they score a sufficient amount of points with respect to their investment strategies) they will be awarded tax credits before awards are made to sponsors without the experience. The rationale behind this procedure is the fact that if a group of sponsors are competitive with respect to their investment strategies (i.e., all things being relatively equal), the sponsors with experience should be given priority over those without experience. However, if a sponsor is not competitive with respect to its investment strategy, then it should be given a lower priority than a sponsor that is competitive but has no experience.

2. **QLICI Investments in One or More Businesses in which Persons Unrelated to the CDE hold a Majority Equity Interest.** This statutory priority appears to be more of an anti-self serving provision than a threshold item like the Experience Priority. Therefore, we propose that it serve as a negative point situation with respect to points awarded for the nature of the investment and its impact on community revitalization. The rationale behind this position is the fact that related party transactions, generally, are more susceptible to being structured more for the benefit of the related parties rather than others. Therefore, in the New Markets context, the investment may positively impact community revitalization, but the private benefit in related party transactions may be substantially greater than the private benefit in nonrelated party transactions. This increase in private benefits generally comes at the cost of reduced public benefit. Another problem with related party transactions is that they do not normally have the benefit of arm's length transactions or market scrutiny. Therefore, it is difficult to determine the reasonableness of the transaction or its pricing. Depending on the amount of negative points assigned to a related party transaction, the result could make the applicant not competitive. In such a case, the sponsor would not be considered for an allocation until the competitive sponsors receive an allocation. This result would occur even if the related party sponsor met the experience threshold.

3. **Conclusion.** In developing the allocation system, it is important to avoid focusing on points rather than in presenting the best investment strategies for New Markets investing. We believe the selection should be first, last and always based on the best management team, the strongest CDE, and the most effective investment and operational strategies. Therefore, while points should be awarded for the experience priority (and negative points for the related party transaction), the experience points should count only toward a preferential group of competitive sponsors, and not toward the ultimate selection of successful applicants.

(b) What specific factors should the Fund consider when evaluating whether an applicant meets the requirements for priority treatment?

Structured investments similar to those proposed in the comprehensive investment plan:

Over $ 50 million	10 points
> $40 million < $ 50 million	8 points
> $30 million < $ 40 million	6 points
> $10 million < $30 million	4 points
< $10 million	2 points
Structured no investments	0 points

1. Experience with Respect to Structuring Federal Tax Credits and Partnership Tax Law

Part I Structured more than 10 Offerings	**5 points**
Structured less than 10 Offerings	3 points
Structured no Offerings	0 points

2. Experience with Respect to Raising Capital (programs using Federal Tax Credits or Investments similar to those proposed in Comprehensive Investment Strategy)

Part II Over $1 billion dollars	**10 points**
>$500 million < $1 billion	8 points
> $100 million < $500 million	6 points
> $50 million < $100 million	4 points
> $10 million < $50 million	2 points

Success in raising funds for "blind pool" investments would be eligible for an additional 2 points.

(c) Should more weight be given to one priority category over the other and should an applicant be allowed to receive preference points under both priority categories?

Under our proposal, one priority serves as a threshold that gives an applicant a priority over applicants that did not meet the experience threshold. However, the applicant still must be "competitive" as described in our response above. The other priority is really a negative factor rather than a priority, since related party transactions serve the private interest more than the public interest. If the transaction is not related party (i.e., the actual priority), it is neutral. No positive points should be awarded. Once an applicant meets the experience threshold, whatever points were assigned to the priority are eliminated and the applicant is in a general priority status if it is "competitive." At that point, tax credits will be awarded beginning with the application with the highest points (not including the experience points) and ending with the applicant with the lowest amount of points within the successful group.

2. Should there be limits as to the amount of a NMTC allocation that may be awarded to an applicant in a calendar year?

An aggregate limit of 10% of the available NMTC allocation should be instituted. To ensure an equitable distribution of the credit authority, at least ten applicants should win awards. This limit will ensure that result. In determining the 10 percent limitation, the CDE (or *controlling* general partner or member when the CDE is a partnership or limited liability company) and its affiliates will be aggregated.

We oppose any preferences or set-asides for a particular organizational structure of the management of the CDE (not-for-profit, for-profit, CDFI, SBIC, etc.). The CDE that receives a portion of the national limitation should be a CDE that submits a proposal that would achieve the greatest amount of community revitalization good and most effectively enhance an area's economic and social vibrancy.

3. During the evaluation process of NMTC applications, the Fund will request that applicants provide information on their track records for providing capital or technical assistance to Low-Income Communities and disadvantaged businesses and the effect that such investment/technical assistance has had on such Low-Income Communities or businesses. Applicants may also be required to describe the social underwriting criteria that they will use when deciding which companies to invest in. If an applicant receives a NMTC allocation, it will be required to report to the Fund on the ways in which the Qualified Equity Investments are used to benefit Low-Income Communities.

(a) What indicators should the Fund assess when evaluating the community development impact of an applicant's prior activities or the social underwriting criteria of its loan policies?

In determining the impact of an applicant's prior activities, the extent of its prior activities must also be evaluated. The extent of prior activities, or experience, thus is considered in two areas. First, it is considered in order to determine whether the applicant meets the experience threshold (see discussion under Question 1, dealing with priorities). In that respect, the prior activities are a threshold requirement that get you to the point of being eligible for priority consideration for an allocation. But once these activities demonstrate success, the focus turns to how the allocation would be used. This focus is the second area of consideration of prior activities. In this area, prior activities are only a part of the overall consideration of an applicant's comprehensive investment plan. An important part of this consideration is evaluation of the applicant's management team. Here, two factors will be considered. First, the nature of their prior activities will be considered. And second, the impact of their prior investments will be considered.

Nature of Prior Activities

Dollars invested
Track record of Blind Pool Investing
  Dollars Raised
  Investments Made
Warehousing Capabilities
 Number of investments managed
 Strength of accounting, tax and investor relations personnel

Impact of Prior Investments

Number of successful investments in the past
Number of businesses funded
Total cost of asset built
Number of properties built
Gross income of businesses funded
Percentage growth of business funded
Number of employees employed
Number of persons positively impacted by investments (and a description of the impact).
Other redevelopment in nearby neighborhoods that may have been started by the business development

In comparing and contrasting the quantitative measures, qualitative judgment will need to be exercised.

The social underwriting criteria of the proposed investment strategy is also a critical component. In assessing the social underwriting, great emphasis should be given to the following:

1. The degree to which new capital is being provided,
2. The risk level of the investment being made,
3. The likelihood that the investment would be made without the New Markets Tax Credit incentive.

The greatest net social good will be created by a thriving and successful investment that would not have otherwise have been made. We believe that a set-aside or minimum allocation of 25% should be available for applicants committing to make venture capital investments. Further qualifying definitions of venture capital investments should be developed.

The quality of the investment strategy is of critical importance. This strategy, in the early allocation cycles, will most certainly include many unidentified investments. This is why we believe emphasis should be given to the strategy for identifying future investments, and the track record shown in successfully identifying and managing investments is critical.

Eligible business plans should include both plans specific to a particular geographic area as well as plans that are not specific to any particular geographic area. Plans that are not geographic area specific should be judged with a greater emphasis on the quality of their investment strategy.

(b) On what basis should the Fund judge how "successfully" capital or technical assistance has been provided?

In providing capital, dollars raised is one way to demonstrate success. The ability to continue to raise capital demonstrates that both investors and investees view your efforts as successful. Investors are choosing to continue to invest and investees are continuing to use the raised capital. Guidelines exist for disclosure of track records in Offering Memorandums. The information disclosed includes total number of investment funds, amount of dollars raised per fund, success or failure of each program, and so forth. Similar standards for disclosure could be adopted here.

Furthermore, any group with a track record of raising capital will have a track record of dealing with difficult investments. How they have dealt with difficult investments will be an additional indicator.

(c) What information should the Fund request from allocation recipients as indicators for evaluating the effectiveness of the NMTC Program (e.g., number of jobs created or retained, increases in revenues of businesses receiving Qualified Low-Income Community Investments, rates of return to investors from Qualified Equity Investments, or number of clients served at facilities that are developed)?

In conclusion, we wish to re-emphasize that the goals of the New Markets Tax Credit program is economic investment in low-income communities. For the most part, these goals do not include other aspects of community revitalization, such as eradication or blight or improvement of the living conditions of residents in the immediate neighborhoods, although these goals may be indirectly met through economic investment. Two factors are material to success of the program. First, it is our belief that a true partnership with the private equities market must be accomplished in order to have a system that can adequately invest the billions of dollars of available authority. This places strong emphasis on institutional sponsors, with strong track records of raising large amounts of capital, to be the centerpiece of the program. Second, the primary goal of the program is to attract the venture capital that has otherwise not been available to the low-income communities. We have had numerous discussions with fund managers of some of the largest venture capital groups in the United States, and the reception to the New Markets program is very positive. There is truly an opportunity to combine the expertise and discipline of the venture capital community with the social objectives of this program. This aspect of investing should be emphasized in the allocation process because it represents an extremely efficient form of economic investing. We believe that true venture capital investing should be provided with a set-aside, or at the very least, a priority.

We believe that the New Markets Tax Credit should create an incentive for private capital, in a fashion that may help eliminate the need for further incentives. This initial risk capital is the hardest to obtain and should be used to help attract and leverage capital that is more risk averse.

To this end we note that proposals that are based on venture capital should be evaluated on their ability to successfully identify, select and manage their investments. We believe that few, if any, applicants will be in a position in the early rounds of this program to submit proposals with truly fully identified and committed investments.

Given the above objectives, the greatest measure should be the degree to which such capital is not otherwise available. A secondary measure is the degree to which an investment creates, retains or expands a business for long period of time. Creating a long-term beachhead of stable economic success will do more for revitalization than a creating a short-term unbelievable success that then fails.

Additional measures of effectiveness would include:

1. Companies are successful if they become profitable…. So increases in revenues would be one way of measuring the effectiveness
2. Companies are successful if they grow or expand… so increases in employees, or increases in capital expenditures or plant and equipment would be another way of measuring the effectiveness
3. Risk based capital is needed to start this revitalization process. So another measure would be the ability of the venture capital manager to take calculated risks, not only with the nature of the business itself, but also because of where it is to be located, and the approach taken to ensure that the business has the best chance possible to succeed. These factors are identified in the due diligence process, selecting management, improving on business plan, and follow-up after investments are made through board participation, etc.

4. In following the through process on 3 above, actual success is a measure of effectiveness, but another measure should be the profile of the companies selected for investment. Does the general profile allow for potential success in revitalizing the community or not? It makes a difference if the investment is made to a company that has a good business plan, has good management, and has every opportunity to grow and be successful, as opposed to investments made to businesses that are not growing and will never grow.

Other Comments

We note that in structuring such CDEs, some private capital markets investors may not be able to use the tax credits. Rather, with the assistance of the tax credits to lower the economic investment cost, they may be desirous of investing in the community. To open new markets to such investors, the New Markets Tax Credit program should be flexible enough to allow the tax credits to be bifurcated from the underlying economic investment. We believe that this is allowable within the existing structure of the Internal Revenue Code.

We also believe that accessing the private capital equity markets should have a substantive preference over using the tax credit to subsidize existing low-income community investment commitments and obligations.

After a CDE receives an allocation of the national limitation, an ongoing monitoring program will need to be in place. This monitoring program may appropriately be under the control of your group, or may be more appropriately a direct responsibility of the Internal Revenue Service. The monitoring program needs to monitor compliance by a CDE with its proposed business plan and monitor its compliance with the operational rules of Section 45D. We have detailed comments in this area that we will make when the appropriate monitoring body is identified.

Thanks again for providing us the opportunity to comment on the New Markets Tax Credit program, we look forward to working with you. Thomas Tracy can be reached at (760) 804-6026 and Michael Novogradac can be reached at (415) 356-8000. Our e-mail addresses are thomas_tracy@keybank.com and michael.novogradac@novoco.com.

Yours very truly,

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cc: Mr. Sean Zielenbach