Overview of the 2002 NMTC Allocation Review Process

Please note that the attached overview only pertains to the 2002 round of the NMTC Program. The Fund reserves the right, in its sole discretion, to make changes to the allocation application review process and evaluation criteria for subsequent rounds of the NMTC Program.

Part I. Review Protocols

The CDFI Fund (Fund) is authorized to allocate to Community Development Entities (CDEs) the authority to issue up to $15 billion in equity for which New Market Tax Credits (NMTCs) may be claimed. In calendar year 2002, the Fund had the authority to allocate to CDEs the authority to issue up to $2.5 billion in equity for which NMTCs may be claimed. The Fund reviewed 345 applications requesting a total of nearly $26 billion in NMTC authority. A description of the 2002 allocation application review process as set forth in the Fund's allocation application evaluation policies and procedures is provided below:

<u>Phase I Review:</u>

- The Fund's review process required three reviewers to independently review and evaluate each application. The reviewers included Fund staff, other federal agency staff working in other community development finance programs, and private sector members of the community development finance community. The private sector reviewers were selected on factors such as their knowledge of community and economic development finance and experience in business or real estate finance, business counseling, secondary market transactions, or financing of community-based organizations. The Fund carefully screened each reviewer to identify any potential conflicts of interest with applicants. The Fund provided each reviewer with detailed descriptions of what constituted a conflict of interest, and each reviewer was required to sign a certification that he or she had disclosed all conflicts of interest to the Fund. Reviewers were also required to sign a confidentiality agreement stating that they would not reveal any information obtained from the Fund during the review process.

- The Fund provided reviewers with 1 and ½ days of focused training to prepare them for the review process. The Fund also provided reviewers with guidelines to assist them in scoring each application.

- In scoring each application, reviewers rated each of the four evaluation sections (Business Strategy, Capitalization Strategy, Management Capacity and Community Impact) as follows: Weak (0-5 points); Limited (6-10 points); Average (11-15 points); Good (16-20 points); and Excellent (21-25 points).

- In addition, reviewers rated applicants with respect to two statutory priorities: (i) up to 5 points for demonstrating a track record of serving disadvantaged businesses or communities; and (ii) 5 points for committing to invest substantially all of the proceeds from its qualified equity investments in unrelated entities.

- In addition to evaluating and scoring each application, reviewers were required to recommend an allocation amount based on the information provided in the application. Reviewers were instructed to recommend both three-year and five-year allocation amounts, based on the amount of capital the reviewer determined the applicant could reasonably raise and disburse over a three-year and five-year period, respectively.

<u>Panel-Phase Review:</u>

- In the second stage of the process, an Allocation Recommendation Panel comprised of Fund staff reviewed the first phase reviewers' comments and recommendations.

- In order to be considered for an allocation, an application had to achieve: 1) an aggregate base score (without including priority points) of at least 216 points, which approximates the middle of the "good" range based on a scoring scale of weak, limited, average, good and excellent; and 2) an aggregate base score of at least 48 points in <u>each</u> of the four-application evaluation criterion, which approximates the low end of the "good" range. Thus, an application with scores in the "good" range in three of the four criteria, but an "average" score in the fourth criterion, could not receive an allocation.

- A statistical review was conducted to identify anomalous scores. An *anomalous base score* was deemed to have occurred for an application whenever one of the three reviewers' base scores (total score minus priority points) varied significantly from the median of the three reviewers' base scores. An *anomalous section score* was deemed to have occurred for an application whenever one of the three reviewers' section scores, in one or more of the four sections, varied significantly from the median of the three reviewers' section scores. In cases where there was an anomalous first phase reviewer score that would have negatively impacted the ability of that applicant (or, in the case of a high score anomaly, any other applicant that scored below it) to receive an allocation, the comments and recommendations of a fourth independent reviewer were used to determine whether the anomalous score should be replaced.

- For each application, panelists reviewed the scores, comments and recommended 3-year allocation amounts provided by each of the first phase reviewers. Given the significant interest in the NMTC Program this year, the Fund determined that awarding allocations based upon the 3-year recommended allocation amounts would be the most effective way to ensure a fair distribution of allocations to as many of the most qualified candidates as possible.

- The panel also reviewed a variety of compliance, eligibility, due diligence and regulatory matters. Included in this review were (i) checks to determine whether any applicants that have been awarded funds through other Fund programs were compliant with the award requirements, (ii) verification that the applicants' investor letters were consistent with the capitalization information provided in their applications, and (iii) consultation with the IRS with respect to any applicant that proposed a business strategy that may not be permitted under the NMTC Program regulations.

<u>Selection of Allocatees:</u>

- After the panel phase of the review process was completed and all scoring anomalies resolved, the rank order list of applicants and the recommended 3-year allocation amounts were forwarded to the Selecting Official (NMTC Program Manager). The Selecting Official reviewed the rank order list and the recommendations, and decided whether to accept or modify the panel's recommendations.

- In the event the Selecting Official's decision reversed the panel's recommendation or varied considerably from the panel's recommended allocation, the Reviewing Official (Deputy Director) reviewed the application file and either accepted the recommendation or modified it.

- The Selecting Official/Reviewing Official reviewed each application, in rank order beginning with the application with the highest aggregate total score (inclusive of priority points), and made allocation determinations until there was no allocation authority remaining.

- The Fund's Awards Management unit checked the General Services Administration's list of debarred organizations to confirm that neither the allocatees nor their parent companies were debarred from participating in any federal programs.

- Per the Fund's allocation application evaluation policies and procedures, the Selecting Official's (and, as the case may be, the Reviewing Official's) allocation decisions are final.

II. Characteristics of an "Excellent" Application

As indicated above, for each of the four primary review criteria (Business Strategy, Capitalization Strategy, Management Capacity, Community Impact), applicants were scored by each of three first-phase reviewers as: weak (0-5 points); limited (6-10 points); average (11-15 points); good (16-20 points); or excellent (21-25 points). In order to be considered for an allocation of tax credits, an application had to: 1) receive an aggregate section score in at least the lower portion of the "good" range (48 points or above) under <u>each</u> of the four review criteria; and 2) receive an overall aggregate base score (the total score prior to the addition of any priority points) in at least the middle portion of the "good" range (216 points or above). Please note, however, that receipt of scores in the requisite "good" ranges as outlined above did not ensure that an applicant would receive an allocation. In calendar year 2002, the Fund only had the authority to issue up to $2.5 billion in equity for which NMTCs could be claimed and, since the number of applicants scoring in the requisite ranges for an allocation award exceeded the available allocation authority, many applicants scoring in the "good" range did not receive an allocation.

In order to receive a score in the "excellent" range in each of the four review criteria, applicants generally needed to demonstrate the following characteristics:

<u>Business Strategy:</u>

The Business Strategy should demonstrate that the applicant will deploy debt or investment capital, or offer products and services, which: 1) have been clearly designed to meet the articulated needs of underserved markets; 2) have features that offer flexible terms/conditions or offer non-traditional benefits; and 3) proactively target customers or partners that typically lack access to conventional sources of capital. The Business Strategy should propose the development of new products/services that offer a variety of features not currently provided; propose a significant increase in volume of existing products and/or services; or propose a strategy that meets the needs of LICs that have a significantly higher level of distress than LICs currently being served. Financial Counseling and Other Services should be offered. The Applicant (or its *Controlling Entity*) should demonstrate a consistently strong, successful track record during each of the past 5 years of providing products, services, or *Financial Counseling and Other Services.* This track record should indicate that it is highly likely that the applicant will be successful in deploying equity as projected. The Applicant should present an extremely strong case that demonstrates the value-added benefit of using the NMTC (per Q#26 of the application). The Applicant should present a well-designed strategy for locating qualifying activities based primarily on prior performance. Projected Annual Activity Levels (Tables B1-E1) should show that most of activity will occur by 2005, but majority occurs between 2002-2003 (i.e., 1st full year of allocation period); and assumptions (see Q31) should be provided to document demand such that pipeline deals are almost guaranteed to convert to closed deals.

<u>Capitalization Strategy:</u>

The applicant should demonstrate that it has raised (either through commitments or letters of interest/intent) 100 percent of the total amount of allocation requested [as specified in Tables G1 and G2, Q35 and Q36]. The applicant should be able to demonstrate that any letters of interest/intent identified will be available in less than one year from the date on which the CDE enters into an Allocation Agreement [Q36]. Investors should not have placed conditions (above and beyond those that were articulated in the business strategy) that could adversely impact applicant's ability to carry out its business strategy [Q37]. The applicant should have a strategy in place (including progress to date) to secure additional investments not specified in Tables G1 and G2 [Q38, Table G3]. The applicant should demonstrate that it is making excellent efforts to either attract investors that have not previously made community development related investments or increase the investments of those investors already investing in community development. The applicant should offer products/services, which are not offered by its investors [Q41]. The applicant should have a plan in place to use QEI proceeds in conjunction with other sources of financing for its proposed activities [Q44]. More than 95 percent of the QEI proceeds should be invested in QLICIs [Table H2]. The applicant and its subsidiaries should plan to issue at least 90 percent of QEIs by 2005, and this strategy should be supported by the narrative for transferring QEIs and business strategy [Q46, Q47, Q31].

<u>Management Capacity:</u>

There should be no vacancies in key personnel, and the organization's leadership and management structure shall have been in place for 2 years or more [Table J1, Q53]. In-house personnel should conduct all critical activities, unless industry standards dictate otherwise. If proposing to invest in or lend to real estate QALICBs, development team, consultants/advisors shall have worked together before and successfully completed more than one similar project [Q51]. There should be excellent skills in deploying capital, and relevant experience in locating underwriting, and approving QLICIs proposed in Tables B1-E1. Skills and experiences should be an excellent match to the individuals' roles and responsibilities. Experience should indicate a 5+year track record of underwriting QLICIs at a scale that is comparable to projected activity listed in Tables B1-E1. A successful track record of deploying investments in non-LIC communities should be shown as an excellent indicator that success could be transferred to delivery of investments to LIC. The board and management team should have appropriate role and task delineation given the business strategy and have five years of relevant experience in raising equity from profit-motivated investors and/or non-profit or governmental entities. The management team should demonstrate a track record of raising capital (with market or near-market repayment terms – Table G4) that equals at least 80 percent of the total equity it expects to raise with its NMTC allocation each year (Table I1). Key personnel should have experience using tax credits to attract capital investors. The applicant (not exclusively engaged in Financial Counseling or Other Services) should have experienced staff (minimum of five years of asset management experience) and established policies and procedures, MIS and other internal systems to effectively manage reporting requirements and compliance to both Fund and Investor. The applicant should demonstrate an excellent history of meeting compliance requirements of similar programs (Table K2). Policies and procedures, and infrastructure (e.g. information systems, legal staff, etc) should be in place to ensure compliance with CDE Certification and Allocation Agreement requirements.

Community Impact:

The applicant's strategy should be specifically linked to, and contribute to, the particular objectives of at least one other program/designation that targets particularly distressed and the hardest-to-serve communities – as described in narrative to Q66. The applicant's strategy should involve working with appropriate programs given its overall strategy in Q16. If the applicant is a CDFI/SSBIC/ NMVC, it should describe a clear strategy for using QEI proceeds to achieve the mission of these programs (Q68). The applicant's strategy should be targeted to particularly economically distressed communities, where the poverty characteristics exceed the LIC thresholds by the three factors listed in Q67. The applicant should articulate a clear strategy for targeting such areas. The answer provided by the applicant to Q67 should correlate to the answer provided in Q18 and, if applicable, Q22a and Q23. The applicant should have a structure in place to obtain feedback from LIC residents and local community organizations on its products/services and other elements of its investment strategy (e.g., conducting formal surveys/meetings; working through community partners to conduct outreach sessions; etc.). Feedback obtained should be actively used in support of the applicant's NMTC strategy. Feedback mechanisms should be seen as appropriate given the applicant's Management Capacity and the size of its service area (Q69-70). Low-Income Community representatives on the governing board or advisory board should play a proactive role either in designing, implementing, or monitoring the applicant's products and services; or identifying investments; charting new organizational directions for the applicant; etc. The applicant should have clear mechanisms in place to consult with Low-Income Community representatives, and mechanisms to allow for open dialogue between the applicant and its Low-Income Community representatives (Q71). Feedback obtained should be actively used in support of the applicant's NMTC strategy. The answer to Q71 should correlate to board experience described in Q54 and Q56, and board role described in Q55. The applicant's NMTC strategy should be part of or fit with a community/regional/other redevelopment plan already endorsed by a local planning entity or local government (e.g., narrative to Q72 should indicate that the strategy has been endorsed by local planning entity or local government). The applicant should be able to identify more than 3 impacts in Q73. The quality of these impacts should be robust and what would be expected given the applicant's overall strategy in Q16 (especially the description of the community's needs/ demand) and its products/services in Q17. The impacts should be well quantified in Q74, and the applicant should promote the sustainability of such impacts (e.g., even after investors sell, impacts/ activities will remain in community). Based on narrative to Q73, it should be demonstrated that the applicant would actually be able to achieve such impacts. The applicant should demonstrate that its NMTC products/services would help to either further past impacts the applicant has achieved or help it attain new ones. The new impacts should be unique to its NMTC strategy, and it should be demonstrated that the applicant would not be able to achieve these identified new impacts using other programs or funds. (Q73-74). The impact of the applicant's activities should be primarily for the benefit of the residents in the immediate or surrounding area. If economic benefits are expected for a wider community, it should be demonstrated that the activity would not negatively impact the immediate area (Q75). Attracting other capital (aside from the applicant's NMTC equity) to, and catalyzing further investment in, the service area should be an integral part of the applicant's strategy (Q76). The answer to Q76 should correlate with the applicant's intent to help borrowers secure additional capital in Q21, and to the applicant's ability to raise capital as described in Q57-58.