

**COMMUNITY
REINVESTMENT
FUND**



July 2, 2001

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SUBJECT: Comments on the Guidance issued by the Community Development Financial Institutions Fund on the New Markets Tax Credit

Dear Mr. Berg:

Thank you for the opportunity to comment on the Guidance issued by Community Development Financial Institutions Fund (CDFI Fund) on the New Markets Tax Credit.

The Community Reinvestment Fund (CRF) is a non-profit financial services corporation that was founded in 1988 for the purpose of bringing capital to community development loan funds throughout the country. CRF works with non-profit and governmental loan funds that provide loans in their communities for economic development, small businesses, affordable housing and community facilities. CRF purchases loans from these organizations, allowing them to recapitalize their funds on a continuous basis, and thereby to continue their lending activities. CRF then pools the loans its purchases and sells asset-backed securities backed by these pools to institutional investors, with CRF providing the levels of credit enhancement and servicing that are expected in the national capital markets.

Since 1989, CRF has raised over \$145 million in private capital to support continuing community development activity. Almost half of this activity has been in economic and small business loans to the type of businesses that will be served by the New Markets Tax Credit. As a result, CRF has extensive experience in underwriting and servicing loans to businesses in disadvantaged communities and in attracting sophisticated institutional investors to this market. Over a history of 13 separate debt security offerings, investors in CRF debt securities have never experienced non-payment or late payment on their investments.

It is with this perspective that CRF submits its comments on the proposed administration of the New Markets Tax Credit.

CRF is a founding member and a member of the Steering Committee of the New Markets Tax Credit Coalition (NMTCC). Members of the CRF staff have worked extensively with the NMTCC in preparing the comments NMTCC has submitted. CRF supports those comments. The comments contained in this letter will serve to highlight, elaborate or supplement comments submitted by the NMTCC.

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Section II. The New Markets Tax Credit Program: How the Credit Works

CRF strongly supports the NMTCC recommendation that the CDFI Fund be required to finalize Allocation Agreements within two months of a CDE being notified of an allocation award.

Section III. Applications

The Guidance should be clear that an entity may seek certification as a CDE regardless of whether it has an intention to seek an allocation of credits.

The Guidance states that "nonprofit entities and for-profit entities may be certified as CDEs by the Fund". This may be read to preclude government or quasi-government entities from applying to be a CDE. Based on more than 10 years of experience working with both non-profit and government community development loan funds, CRF strongly recommends that government and quasi-government entities (such as Redevelopment Authorities and Port Authorities) be allowed to apply to become CDEs as long as they meet the other requirements of the statute. In many communities, such entities are vital community development lenders. There is no prohibition in the statute against the inclusion of government and quasi-government entities as CDEs, and we do not believe the Guidance should include such a prohibition.

Section IV. Eligibility

CRF strongly supports the NMTCC recommendations with regard to eligibility. In addition, CRF makes the following recommendations:

- If an entity applying to be a CDE (or the sponsor, controlling entity, managing member or general partner of the CDE, collectively referred to herein as the "Sponsor") is a nonprofit entity which has been determined to be exempt from federal income tax under Section 501(c) or any other IRS code provision, and the exempt purpose of such entity involves serving distressed or declining areas, disadvantaged persons, neighborhood or community revitalization or similar activities benefiting such persons or low-income communities, then so long as the proposed activity is within the exempt purpose of such an entity and would not result in unrelated business tax, then such exemption from federal income taxation should be *de facto* evidence that the activities of such a CDE has a primary purpose of serving low-income communities. The reason for this assertion is that the penalty for activities outside the parameters of such exempt purpose would be either unrelated business tax and/or the forfeiture of the entity's tax-exempt status – both of which are a very severe penalties.
- Sections in the Guidance describing how the CDFI Fund intends to evaluate whether the *primary mission of the CDE is to serve or provide investment*

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capital to Low-Income Communities or Low-Income Persons are overbroad and go beyond the language of the statute. There are two particular concerns regarding the language on pages 11 and 12 of the Guidance:

- The phrase “directly serving” is used twice in the describing the activities of the CDE, while the word directly does not appear at all in the statute. As noted in the comments of the New Markers Tax Credit Coalition, the introduction of the “directly serving” concept is contrary to the statutory language and clearly contrary to the legislative intent since two of the qualified low-income community investment activities authorize a CDE to “indirectly” serve low-income communities through the purchase of loans from CDEs or investing in or lending to CDEs. This is particularly troublesome for an intermediary organization such as CRF which has served an invaluable role in its past efforts to create a secondary market for development loans and expects to serve a similar role by attracting new capital which will be employed in part by acquiring loans from or making loans to CDEs.
- The language includes an arbitrary standard that “60% of its activities are **dedicated to directly serving Low-Income Communities or Low-Income Persons**”. This phrase includes four troubling concepts:
 - 60% is an arbitrary percentage;
 - the concept of “dedicated” is highly subject to interpretation;
 - “directing serving” is more than problematic, it is contrary to the statute and legislative intent as described above; and
 - the use of the defined terms (which have geographic burdens), rather than more general terms like **disadvantaged communities**
- The accountability provisions are also in need of significant clarification and should recognize that the statute did not prescribe a formalistic requirement; rather, the statute was written to clearly suggest a substantive concept of “accountability” not a legalistic concept such as “control” or “voting rights.” Thus, we would suggest that the Fund consider other means toward achieving accountability such as representation of Low Income Communities or Low-Income Persons by any number of methods recognized in other areas of the Code. In CRF's case, such accountability is achieved through the means of requiring that a designated number (in CRF's case, over 50%) of its Board of Trustees be comprised of representatives of beneficiary organizations supported by

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CRF through the fulfillment of its Section 501(c)(3) exempt purpose. Under Section 509(a)(3) of the Internal Revenue Code, this concept is referred to as a "supporting organization", i.e. an organization which has a federal exempt purpose which supports a class of beneficiary organizations such as governmental and quasi-governmental economic development organizations. This is an accepted method of achieving accountability which, by the way, happens to include indirect representation in the case of a supporting organization. Since the legislative history of the statute also indicates accountability can be achieved through the use of advisory committees, the supporting organization concept should be more than adequate to achieve accountability.

- This section indicates that "a CDE certification will last for a period of 15 years **unless otherwise revoked or terminated by the Fund**" (emphasis added). CRF strongly recommends that the Fund set forth a definitive list of those items that will trigger a revocation or termination. Such a definitive list is critical because recapture can be triggered if "the CDE ceases to qualify as a CDE". In the interest avoiding possible recapture risk, investors will look to the CDE to represent that it will take all actions necessary to avoid revocation or termination of CDE status. Without a definitive list, such representation will be difficult if not impossible.

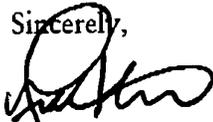
Additional Comments

Allocation of Credits to Entities within a CDE

The Guidance is premised upon a concept that the Credit will be allocated to a specific CDE entity that will actually utilize the Credits. This premise assumes that an allocation must be entirely utilized directly by the entity which applies for and receives the allocation. However, there may be multiple business reasons that an organization like CRF may want to form multiple entities to utilize the Credits (e.g. Geographic pools, single, large project pools, diversification of risk). The Guidance should provide for the award or allocation of Credits to a sponsoring or umbrella entity (herein, the "Applicant") which could then make subsequent sub-allocations to entities sponsored by or owned or controlled by the Applicant receiving the initial allocation, as long as the sub-allocation entities are described in the Comprehensive Investment Plan. This will permit the successful Applicants to form multiple investment vehicles such as special purpose entities required by financial institutions and credit rating agencies in order to reflect the custom and practice in the marketplace. It would also allow a successful Applicant to attract different investors to differing purposes as described above. To avoid the possibility of abuse, the CDE would need to identify its intent to do so in its Comprehensive Investment Plan and could be required to certify that

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sub-allocation entities met the standards set forth in its Comprehensive Investment Plan.

Sincerely,

Frank Altman
President