CDFI FUND

US Department of the Treasury

NEW MARKETS TAX CREDIT PROGRAM:

SECOND ROUND (2003-2004) General Information

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND
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NEW MARKETS TAX CREDIT PROGRAM: SECOND ROUND (2003-2004) ALLOCATEES

The Community Development Financial Institutions Fund (Fund) selected 63 community development entities (CDEs) to receive allocations of New Markets Tax Credits (NMTCs) through a consolidated 2003-2004 round of the NMTC Program. These 63 CDEs are authorized to issue to their investors, in the aggregate, $3.5 billion in equity as to which NMTCs can be claimed. Throughout the life of the NMTC Program, the Fund is authorized to allocate to CDEs the authority to issue to their investors up to the aggregate amount of $15 billion in equity as to which NMTCs can be claimed. This is the second allocation round. In 2003, the Fund awarded $2.5 billion in tax credit authority to 66 CDEs.

How does the program work?

The $15 billion NMTC Program has the potential to stimulate economic and community development and job creation in the nation's low-income communities by attracting capital from the private sector.

The NMTC Program provides tax credits to investors who make "qualified equity investments" in privately managed investment vehicles called "community development entities," or "CDEs." CDEs are required to invest the proceeds of the qualified equity investments in low-income communities. Low-income communities are defined as those census tracts with poverty rates of greater than 20 percent and/or median family incomes that are less than or equal to 80 percent of the area median family income.

The credit provided to the investor totals 39 percent of the investment in a CDE and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is six percent annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

What was the distribution of allocations in the 2003-2004 round?

- 271 CDEs applied for allocations, requesting in the aggregate $30.4 billion in allocations.
- 63 CDEs (or 23% of the total applicant pool) received $3.5 billion of allocation authority.
- The average allocation award is approximately $56 million per allocatee.
- Allocation awards range in size from $2 million to $150 million. The median allocation award amount is $47 million.

What were some of the characteristics of the 63 allocatees?

- Twenty-three of the allocatees (or 37%) are non-profit organizations or subsidiaries of non-profit organizations. They received allocations totaling $1.3 billion.
- Twelve of the allocatees (or 19%) are certified CDFIs or subsidiaries of certified CDFIs. They received allocations totaling $508 million.
- Twelve of the allocatees (or 19%) are non-CDFI banks or bank holding companies, or subsidiaries of such institutions. They received allocations totaling $614 million.

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- Eight of the allocatees (or 13%) are governmentally controlled entities. They received allocations totaling $432 million.
- In all, 32 of the allocatees (or 52%) can be described as "mission-driven" organizations (i.e. CDFIs; non-profit organizations; or governmentally controlled entities) or subsidiaries of mission-driven organizations. They received allocations totaling $1.7 billion.

Where will the investments be made?

- The 63 allocatees are headquartered in 31 different states and the District of Columbia, but anticipate making investments in at least 44 different states, as well as D.C.
- Twenty-one (or 33 percent) of the allocation recipients will focus on local markets (e.g., a city-wide or countywide area).
- Fifteen (or 24 percent) of the allocation recipients will focus their investment activities within a statewide service area.
- Nine (or 14 percent) of the allocation recipients will invest in a multi-state service area.
- Eighteen (or 29 percent) of the allocation recipients will focus on a national service area.

What types of eligible investment activities do allocatees plan to make?

- The allocatees are required to invest the proceeds of the qualified equity investments they receive in low-income communities. NMTC proceeds may be used to finance a wide variety of activities, including:
  - <u>Loans to or equity investments in businesses</u>. **Twenty-four allocatees (or 38%) indicate that this will be their predominant financing activity**. Allocatees have proposed strategies ranging from microenterprise lending to multi-million dollar venture capital investments.
  - <u>Loans to or equity investments in real estate projects</u>. **Thirty-six allocatees (or 57%) indicate that this will be their predominant financing activity.** Most real estate projects—-with the general exception of residential rental housing—-are permissible under program regulations. Allocatees have indicated they intend to make investments in commercial, retail, industrial, mixed-use and homeownership housing projects, as well as in community facilities such as daycare centers, healthcare centers, and charter schools.
  - <u>Capitalization of other CDEs</u>. **Three allocatees indicate that this will be their predominant financing activity**. Allocatees may make direct loans to or investments in other CDEs to finance NMTC-eligible activities, or may purchase NMTC-eligible loans originated by other CDEs. This will help ensure continued availability of capital in low-income communities.
  - <u>Financial counseling and other services</u>. Allocatees are permitted to use NMTC proceeds to provide counseling in support of business activities.
- Most allocatees plan to engage in more than one NMTC-related activity. For example, many will offer financial counseling as part of their real estate or business investments.

Was geographic diversity a consideration in the evaluation process?

No. The statute establishing the NMTC Program does not provide Treasury with the authority to consider geographic diversity when making the allocation selection decisions. The most qualified applications were selected for allocations based on the evaluation process described below without regard to the geographic distribution of the allocation authority. As noted above, however, the CDEs that were selected for an allocation are geographically diverse.

Please explain the evaluation process.

The Fund is authorized over a seven-year period to allocate to CDEs the authority to issue up to $15 billion in equity for which NMTCs may be claimed. In this second round of allocations, the Fund was authorized to allocate to CDEs the authority to issue up to $3.5 billion in equity for which NMTCs may be claimed. The Fund received 271 applications that together totaled over $30.4 billion in NMTC requests.

The review process used to select NMTC allocation recipients in the second round of the NMTC Program is summarized below:

Step One:

- The 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 programs, and private sector members of the community development finance community. 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 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 they had disclosed all conflicts of interest to the Fund. Reviewers were further required to sign a confidentiality agreement stating that they would not reveal any information obtained from the Fund during the review process.
- Once selected, the reviewers underwent training to prepare them for the review process and were provided guidelines to assist them 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) 1-to-5 points for demonstrating a prior record of serving disadvantaged businesses or communities; and (ii) 5 points for committing to invest substantially all of the proceeds from their qualified equity investments into unrelated entities (i.e., entities that are generally not controlled or owned by the allocatee or its investors).
- In addition to evaluating and scoring each application, reviewers were required to recommend an allocation amount, based on 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 invest over three-year and five-year periods, respectively.

Step Two:

- An Allocation Recommendation Panel comprised of Fund staff reviewed the recommendations made by reviewers in Step One.
- The most qualified applications were deemed to be those applications with an aggregate base score (without including priority points) that was in the "good" range based on a scoring scale of weak, limited, average, good and excellent. In addition, each of the most qualified applications had to achieve an aggregate base score in the "good" range in each of the four application evaluation criterion. 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 advance to the panel phase of the review process.

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- A statistical review was conducted to identify inconsistent scores. In some cases where there was an inconsistent first phase reviewer score, the comments and recommendations of a fourth independent reviewer were used to determine whether the inconsistent score should be replaced.
- For each application, panelists reviewed the scores, comments and recommended allocation amounts provided by each of the first phase reviewers. Due to the large number of applications that were ranked highly by first phase reviewers, and given the Fund's desire to expedite the flow of capital into low-income communities, panelists were instructed to determine an allocation amount for each qualified applicant that reflected the applicant's needs over a 2-year period (a 2-year allocation amount), as opposed to a 3-year or 5-year allocation amount. This 2-year allocation amount was then used as the basis for the final award amount. The Fund determined that awarding allocations based upon the 2-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, and disbursement eligibility requirements; (ii) checks to determine whether prior-year allocatees successfully issued at least 50% of their Qualified Equity Investments on or before March 5, 2004; 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.
- As stated in the application materials, applicants that were recommended for an award amount that was lower than the minimum acceptable award amount specified by the applicant in Question 42 of the allocation application were not provided with a NMTC allocation.

Step Three:

- After the second stage of the review process, both the rank order list of applicants and the recommended 2-year allocation amounts were forwarded to the Selecting Official (NMTC Program Manager) for an allocation determination.
- In the event the Selecting Official's decision varied substantially from the panel's recommendation, the Reviewing Official (Deputy Director) reviewed the application file and made a final determination, helping to ensure a thorough set of checks and balances.

Step Four:

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

What are the next steps in the selection process and for the next allocation round?

- All applicants will be informed via e-mail of the Fund's decision. Shortly thereafter allocatees will enter into allocation agreements with the Fund.
- Applicants that were not selected for an allocation will be able to review specific reviewer comments pertaining to their application through a debriefing document that will be prepared by Fund staff. This document will be distributed in advance of the next allocation round.
- It is expected that the application for the third round of allocations will be available in the summer of 2004, will be due in the fall of 2004, and that allocation decisions will be made in the first quarter of 2005.
- For the next allocation round, the Fund will be able to issue up to $2 billion in NMTC allocation authority.

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