April 8, 2013

Lisa M. Jones
Manager, CDFI Bond Guarantee Program
CDFI Fund
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Ms. Jones,

Local Initiatives Support Corporation (LISC) is pleased to provide comments on the CDFI Fund's interim rulemaking relating to the administration of the CDFI Bond Guarantee Program.

Established in 1979, LISC is a national non-profit CDFI that is dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity — good places to work, do business and raise children. LISC mobilizes corporate, government and philanthropic support to provide local community development organizations with loans, grants and equity investments; local, statewide and national policy support; and technical and management assistance.

LISC has local programs in 31 cities, and partners with 58 different organizations serving rural communities throughout the country. LISC focuses its activities across five strategic community development goals:

- Expanding Investment in Housing and Other Real Estate
- Increasing Family Income and Wealth
- Stimulating Economic Development
- Improving Access to Quality Education
- Supporting Healthy Environments and Lifestyles

We applaud the CDFI Fund for releasing the regulations on the CDFI Bond Guarantee (BG) Program. We believe that this program can transform the community development industry by providing a source of inexpensive, long term capital that is simply not available in the current marketplace.

Like all CDFIs, LISC is limited in it product offerings by the duration of the capital it can obtain from its investors. As a result, LISC currently offers loan products that generally do not exceed

five to seven years. This loan capital is suitable primarily for pre-development loans, construction loans, and mini-permanent financing. With the potential of 30-year money through the BG Program, LISC will be able to offer permanent financing in support of critical community development projects, including charter schools, health care facilities, and multifamily housing – allowing these borrowers to significantly lower their debt service while providing them with the certainty of long-term, fixed mortgages at a time when interest rates are likely to start climbing higher.

We appreciate the flexibility provided in the regulations that would allow CDFIs to use the capital in support of a wide variety of community development activities, including refinancing its own debt and that of its current borrowers. We appreciate as well that the CDFI Fund is providing a reasonable interval of time to secure commitments and draw down funding from the Federal Finance Bank (FFB). This will better enable LISC and other CDFIs to adequately source and underwrite their potential investments. Finally, we appreciate that LISC will be able to offer loans of multiple tenors through a single bond issuance (which we believe was communicated verbally in a CDFI Fund sponsored BG Program Information Session, but please see Comment No. 7 below).

While there are many positive elements to the rules, there are unfortunately a number of attributes that could negatively impact successful implementation of the program, making it challenging to achieve the desired impact. Of most concern:

1. ***Recourse; Collateralization Structure and Requirements.*** We understand that the Bond Loan will be full recourse to the borrowing CDFI, giving the bondholder access to the CDFI's balance sheet. That does not pose a problem for LISC. The challenge for LISC, and we suspect for many other CDFIs, is the requirement that in addition to the Bond Loan being a full recourse obligation, all Secondary Loans made with the Bond Loan proceeds have to be pledged as security and held by the Trustee.

   Most lenders to LISC provide their loans on a full recourse, unsecured basis. An essential aspect of that structure is that LISC's covenants include a 'negative pledge' – LISC promises its lenders that LISC will not pledge its assets to another creditor.

   The requirements imposed through the BG Program regulations would cause LISC to be in violation of this covenant, and would be likely to cause great concern among LISC's lenders since they would no longer have a parity interest in LISC's assets. This might well endanger LISC's ability to obtain loans from banks and other financial institutions, something we will need to continue to do to fulfill our community development mission since even a generous allocation of Bond Loans to LISC would not meet all of our lending needs.

   We suggest a different approach. We propose that the Bond Loan be secured by a blanket pledge of all of LISC's loan receivables – not just the Secondary Loans made with Bond Loan proceeds. LISC would give a similar pledge to LISC's other lenders, which would be of equal priority to the pledge securing the repayment of Bond Loans to LISC. We believe that providing Treasury with a security interest in all of LISC's loan receivables, coupled

with financial covenants, should provide Treasury with the same comfort, and positive experience, that lenders to LISC have enjoyed without any lender ever experiencing a loss.

Under this approach LISC would still be required to identify the Secondary Loans funded with Bond Loan proceeds, and all payments under such loans would be forwarded to the Relending Account or used to pay or prepay the Bond Loans.

We believe this approach would be satisfactory to LISC's lenders, because in the highly unlikely event of liquidation of LISC's assets, all parties would stand on an equal footing.

The exception to the parity interest would be the Risk Share Pool of 3%, which would be specifically assigned to the CDFI Fund; no other lender would have an interest in such funds.

2. ***Substitution of Collateral.*** Under the proposed Regulations, it would appear that Treasury can (at its discretion) require the CDFI to "replace" non performing loans assigned to the BG portfolio with other loans held by the CDFI. This is a problem for two reasons. The first is that the CDFI might not have another loan with the exact characteristics of the loan that it is to take the place of – interest rate, maturity, LTV, etc. The second problem is related to the issue described above – other lenders to a CDFI will be concerned if the highest quality loans in the portfolio are constantly taken out of the basket of collateral for the other lenders and instead pledged to Treasury. We believe the solution we outlined above addresses this concern. However, if you do not adopt our proposed solution, we recommend that the final regulations, or program operating guidelines, include significant flexibility about what would constitute an acceptable substitute loan – our suggestion is that the main criterion be that the substitute loan have a maturity date no later than the loan for which it is being substituted. The proposed regulations use the vague phrase "Equal Quality" – we propose that this be considered in the broadest possible way. In addition, we propose that the borrowing CDFI be able to, on its own initiative, substitute loans if it chooses to do so (subject to credit approval by the Qualified Issuer).

3. ***Loan Modification.*** CDFIs need flexibility to modify loans to their borrowers, reflecting the varying circumstances that affect the timing of completion of projects. Such modifications could range from an extension of the term of the loan to changing the interest rate. We believe it will be very difficult, administratively, to modify Secondary Loans under the structure in the proposed Regulations. As we understand the structure, every Secondary Loan modification would require the consent of the Qualified Issuer and might require paperwork to be signed by the Trustee. Not having the ability to nimbly modify a Secondary Loan that reached its maturity and simply needed a bit more time to repay could add to a CDFI's delinquency rate, unnecessarily hurting its standing with its credit providers and impeding the flow of capital to the organization.

   Under the blanket lien structure we propose above, processing amendments would not be a challenge. However even if the CDFI Fund does not agree to that structure we recommend that neither Trustee nor Qualified Issuer consent be necessary for ordinary amendments such as a simple maturity date extension.

4. ***Subordinate Collateral.*** By its very nature, the funding of community development projects often requires different levels of collateral. By requiring that Secondary Loans always be secured by a first lien interest on the underlying collateral, CDFIs will not be able to use these funds to fill the important role of providing subordinate debt, and thus greatly minimize the degree to which CDFIs could use Bond Loan proceeds to leverage additional sources of private capital. Removing this requirement from the regulations could facilitate several billion more dollars of private capital investments into low income communities. Rather than allowing only collateral that is in a first lien position, we instead propose that the underwriting guidelines for Secondary Loans issued by the CDFI Fund allow appropriate second liens as collateral.

5. ***Ability to make Secondary Loans on a Non-Recourse Basis.*** While this issue is not explicitly addressed in the proposed Regulations, we wanted to point out that it is important that CDFIs have the flexibility to provide the Secondary Loans on a non-recourse basis, if appropriate given the type of transaction. For example, in Low Income Housing Tax Credit transactions, first mortgage financing needs to be provided on a non-recourse basis.

6. ***Events of Default under Secondary Loans.*** The proposed Regulations delineate what Events of Default must be included in the terms of Secondary Loans. We propose that the CDFI making the Secondary Loan be able to include standard notice and cure periods with respect to non-bankruptcy related Events of Default under Secondary Loans.

   Moreover, the Events of Default for Secondary Loans detailed in the Proposed Regulations vary from those usually included by CDFIs in their standard loan documentation – for example, the Event of Default in the proposed Regulations that refers to any monetary judgment against a Secondary Borrower that remains unvacated for 60 days does not include an exception for deminimus events (a minor fine (for example, $50), a failure to shovel snow from a sidewalk, etc.) that a borrower accidentally overlooks that may even lead to a judgment. In standard CDFI loan documents, immaterial matters of this kind would not normally constitute Events of Default.

   We believe that in such matters the CDFI Fund should defer to the judgment and expertise of CDFIs in determining these kinds of terms for their own Secondary Loans. If the CDFI Fund believes it needs further comfort on the details of the legal documentation for the Secondary Loans, we believe it would more appropriate if the Regulations provided that the Qualified Issuer shall review and approve the loan forms used to make Secondary Loans instead of specifying in the Regulations details such as Secondary Loan Events of Default.

7. ***Confirmation Needed Regarding Bond Loan Drawdowns.*** We wish to confirm that drawdowns in different tranches under Bond Loans can have different repayment terms. For example, if a CDFI is approved for an aggregate of $40 Million in Bond Loans, and draws them down in four $10 Million increments, must all of those drawdowns have the same term?

LISC's view is that for these funds to be most useful, the borrower of the Bond Loan should be able to specify, on a drawdown by drawdown basis, whether it wishes the drawdown to have a 5 year term, 10 year term, 20 year term, etc. and then specify the same, or different, terms for the subsequent drawdowns. This will enable the borrowing CDFI to issue a variety of financial instruments meeting the varying needs of community development projects that are in its pipeline and expected to be financed. Of course we understand that the final maturity of all Bond Loans cannot extend past the maturity date of the underlying Bond, but within that parameter we urge the CDFI fund to allow maximum flexibility.

8. ***Cost of the Program.*** The program structure may create unnecessarily high costs for borrowers. While the bond issuance rate will theoretically be priced close to the prevailing Treasury rate, the FFB will attach an undetermined liquidity premium on top of this. The CDFI will then charge a spread on top of the all-in rate provided by the FFB, a spread which will also need to take into account fees that the CDFI must pay to the Qualified Issuer, to the Master Servicer, and to the Treasury Department. By the time the loan gets to the Secondary Borrower, it may be priced so high that there is little demand for the product.

   While we recognize that some of the costs associated with this program are inevitable, we believe that others are purely an artifact of the regulations. Most notably, the requirement that the Qualified Issuer cannot make a Bond Loan to an affiliated entity means that many CDFIs that would otherwise be quite capable of managing Bond Loan issuances and monitoring will instead have to pay a third party to serve in this role. We recommend that Treasury remove this restriction.

   The regulations also indicate that the Treasury Department will identify a single Master Servicer that all Qualified Issuers will have to use. It seems that the burden should not be on the Qualified Issuers to pay for these services, but rather could be borne by the Treasury Department through a contractual arrangement, using the funds that were appropriated to the CDFI Fund in 2010 for the purpose of administering the BG Program and/or the fees that Treasury is permitted to collect for ongoing program administration.

9. ***The relending pool restrictions are severely limiting.*** By statute, CDFIs may keep no more than 10% of the bond proceeds in a relending pool. This is a relatively small cushion to avoid what could be program noncompliance and prepayment penalties. We suggest that the 3% Risk Share Pool not be deducted from this already small amount.

   The regulations allow for a six month window before redemption is triggered. We recommend a one year period, especially in cases where the CDFI experienced a prepayment of a particularly large secondary loan, and/or allowing the CDFI to "replace" loans in the BG portfolio with other loans issued by the CDFI (provided these loans would otherwise meet all the requirements of Secondary Loans).

10. ***Base Rate Subject To A Collar.*** The rate on CDFI Secondary Loans is based on a spread over the Bond Loan rate. The spread is subject to a collar. The maturities of a Bond Loan and a Secondary Loan may be different. We believe that it is more appropriate to base the

interest rate and the allowable spread on the maturity of the Secondary Loan as opposed to the maturity of the Bond Loan. The Secondary Loan Borrower will want to have a rate based on the Secondary Loan maturity, rather than on the maturity of the funding source for the Secondary Loan. The CDFI will be able to manage the interest rate risk between its cost of funds and the lending rate.

In addition, it is important that when the CDFI Fund reviews a CDFI's proposed collar, it bear in mind that for many CDFIs the spread on their lending is a crucial source of revenue to fund all of their costs related to providing loans; if the CDFI Fund rejects a proposed collar as being too great a spread over cost of funds, it may deprive a CDFI of crucial revenue without which it would have to constrain its lending activities.

11. **Breakage Fees; Prepayment Penalty.** It is not clear to us whether there will be prepayment penalties in addition to a breakage fee. We believe that while breakage fees are completely appropriate, there should not be additional prepayment penalties.

We believe that these are the most critical issues that Treasury needs to address to enhance the likelihood of successful implementation of the program. In addition, we believe there are other considerations Treasury should undertake as it launches the program, including:

- ***Treasury should limit, as best it can, the influence it exerts over qualified CDFI lending decisions.*** We believe that the regulations are unclear as to the degree to which Treasury will be specifying or approving underwriting criteria of CDFIs, underwriting Secondary Loan transactions, or interfering with the CDFI's ability to restructure troubled loans. Further rulemaking or guidance should address what (if any) role Treasury will take in these regards.

- ***Transparency in pricing.*** Treasury should provide, as part of the application materials, a matrix of potential pricing ranges (inclusive of the FFB's liquidity premium) that correspond to various maturities. The applicants need to have at least a rough idea of where the pricing will end up before they go through what is likely to be a rigorous application process.

- ***Expedited release of supporting bond documents and underwriting guidelines; feedback opportunity.*** We would encourage Treasury to release, simultaneously with the BG application materials, templates of all relevant closing documents (i.e., the Agreement to Guarantee, the Bond Trust Indenture, and the Bond Documents), as well as the underwriting parameters for Secondary Loans. CDFIs, qualified issuers and other program participants need to have a complete understanding of their ongoing commitments and obligations should they receive the guarantee authority, so that they may make informed decisions prior to submitting their applications. In addition, it is essential that there be some time, and opportunity, to provide feedback on all of this material.

- ***Providing guidance for applications submitted on behalf of multiple CDFIs.*** Now that Congress has limited Treasury's bond guarantee authority to $500 million in FY 2013, we are concerned that Treasury may be less willing to provide $100 million or more to a single organization through a single application. If that's the case, then the CDFI Fund should

advise applicants of this risk prior in the application instructions, and also provide a path for CDFIs to more readily partner together in an application submitted on their behalf by a single Qualified Issuer.

Bond Guaranty Authority:

Finally, while we are greatly relieved that Congress has provided the necessary appropriations language to enable the Treasury Department to issue $500 million of bond guarantee authority in 2013, it is disappointing that this figure is just half of the $1 billion that was authorized for 2013, and more disappointing yet that a total of $2.5 billion of bond guarantee authority has lapsed and cannot currently be recovered.

We therefore recommend seeking a legislative fix that would enable the Treasury Department to carryover unused bond guarantee authority from prior years into future years, as is currently permitted under the New Markets Tax Credit Program. On top of the obvious benefit of leveraging at least $2.5 billion more of investment into low income communities without any cost to the Federal government (since this is a zero-subsidy program), a carryover provision would provide more breathing room for Federal officials to review the merits of each bond guarantee application -- since they will no longer be pressured to reach decisions before the rapidly approaching deadline of September 30th.

Thank you for consideration of our comments.

Sincerely,

Matthew Josephs
Senior Vice President for Policy