LISC
LOCAL INITIATIVES
SUPPORT CORPORATION

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RE: Notice and Request for Public Comments on New Markets Tax Credit Application
OMB Control Number 1559-0016

The Local Initiatives Support Corporation (LISC) is pleased to provide comments to the CDFI Fund regarding the contents of the New Markets Tax Credit (NMTC) application, as well as the NMTC application review process.

BACKGROUND

LISC is a non-profit housing and community development organization and certified Community Development Financial Institution (CDFI) with offices in 38 cities throughout the country, and a rural network encompassing 130 partners serving 49 different states and Puerto Rico. LISC's work supports a wide range of activities, including affordable housing, economic development, building family wealth and incomes, education, community safety, and community health. In 2023, LISC and affiliates invested $2.4 billion in grants, loan and equity capital to support distressed urban and rural communities across the U.S.

LISC is also a certified Community Development Entity (CDE) that has received $1.22 billion of NMTC allocations since the inception of the program. To date, LISC – through our subsidiary Broadstreet Impact Services (formerly the New Markets Support Company) -- has placed $1.2 billion in NMTC equity investments in 186 different projects in low income communities throughout the country, supporting $4.2 billion in total development costs. To date, LISC's NMTC investments have supported:

- More than 29,000 construction and permanent jobs
- 14.3 million square feet of commercial and community space
- Healthcare facilities serving more than 350,000 patients
- Educational facilities serving more than 40,000 students
- Nearly 700 housing units

In short, we have a long record of partnership with the CDFI Fund in applying for and effectively deploying NMTC allocations. Below we provide a number of recommendations with respect to applicant eligibility, the NMTC application and the application review process. We are also members of the NMTC Coalition and the Novogradac NMTC Working Group and are supportive of the comments submitted by those entities as well.

ELIGIBLITY

CDE Certification. The Application Instructions have been modified to require that an entity *be certified* as a CDE as of the date the Notice of Allocation Authority (NOAA) is published in the Federal Register, as opposed to having *submitted* the application for certification in accordance with a date provided in the NOAA. We urge two points of caution here:

1. Requiring that the CDFI Fund actually certify the applicant CDE as of the date of the NOAA isn't transparent to potential applicants, since applicants generally don't know when NOAAs are released and certainly don't know how much time in advance of the NOAA to submit a CDE certification application in order to get pre-approval by the CDFI Fund. This is in contrast to the much more transparent approach currently employed, where the applicant need only submit the application by a date certain provided in the NOAA. If the CDFI Fund is to incorporate this new approach, it should provide as much notification as possible to potential CDEs so that they have a sense of when to submit their certification applications; and it is incumbent upon the CDFI Fund to complete these certification reviews in a timely fashion. Otherwise, this change in approach will unfairly penalize new applicants seeking NMTC allocations.

2. The CDFI Fund is in a period of transition with respect to the certification of CDFIs. All certified CDFIs have to submit recertification applications by December of 2024 and demonstrate compliance with a new set of certification protocols. We anticipate that it may take the CDFI Fund several months to complete reviews of these applications, and we are also hopeful that the CDFI Fund will be granting transition periods as need to accommodate CDFIs that may need to make organizational changes in order to be compliant under the new guidance. The CDFI Fund should be very clear in the NOAA as to the eligibility status of CDEs that are certified based upon their status as a certified CDFI, in cases where their recertification determinations are pending.

QEI Issuance Requirements. The CDFI Fund requires prior-year allocatees to meet certain thresholds for issuing their QEIs in order to be eligible for additional allocations, including a minimum issuance of 20% of their prior year's award. <u>We think the CDFI Fund should NOT include allocations from the immediate prior year's award round in the QEI issuance review</u>. The rush to get 20% out the door, often within six months of signing an award agreement, drives CDEs towards the deals that can close quickly, rather than those with the highest impact. It also puts an artificial strain on all parties involved in closing transactions (e.g., CDEs, investors, lawyers, accountants, etc.), further driving up transaction costs and also disadvantaging smaller and newer CDEs that may not be viewed as "high priority" clients.

APPLICATION COMMENTS

Part I. Business Strategy

Question 19: Innovative Investments. We would encourage the CDFI Fund to revisit its determinations of what qualifies as underserved states. While we applaud the CDFI Fund for attempting to spread around allocations to all states, the inclusion of large states such as California and Texas – which have certainly seen their fair share of allocations over the years – suggests that perhaps the CDFI Fund needs to adjust its metrics so that smaller, historically underserved states continue to be the focus of this activity. Alternatively, the CDFI Fund should attempt to focus on underserved communities in those larger states.

Part II. Community Outcomes

Question 25b: We strongly caution against the approach contemplated under a revised Question 25b, which requires applicants to identify a specific percentage of their allocations to be invested in areas of "deep distress", in Native Areas or US territories. This would put smaller CDEs with limited service areas that may not include those markets at a distinct competitive disadvantage. It could also lead to higher risks of noncompliance, given that these communities comprise only a very small portion of the country, and the amount of investable deals – even with the NMTC subsidy available – are likely limited. CDEs may make good faith estimates based on deals in its pipeline at the time of application but find themselves losing out on projects if there is a rush from other CDEs to close a limited set of deals.

A better approach, we believe, would be to include these three items under Question 19 "Innovative Investments". It is notable that Q. 19 already includes Native Communities, as well as U.S. territories, which have historically been included as underserved states. So the CDFI Fund would need only create a new category for "deep distress" under Q.19. In this manner, CDEs that are targeting these markets will presumably be able to score better in the review process, while not necessarily disadvantaging CDEs that do not cover those communities as part of their natural service area or creating market distortions. It also eliminates the redundancy between Q.19 and Q.25b

Short of eliminating Question 25b, we would encourage the CDFI Fund to provide more clarity as to how this question impacts the overall score. For example, does the applicant's commitment have to be in-line with its track record? Are there certain thresholds of commitments that will result in a higher score? What are the points at stake/bonus points available for making this commitment? It's critical that an applicant understand the stakes of the response to this question.

Question 26. Community Development Outcomes. We recommend that the CDFI Fund publish a comprehensive list of acceptable metrics for each of the community outcomes, to allow CDEs to be more confident that the metrics they put forward are what the Fund is looking for. If a CDE wants to use its own metrics that are not on the list, it could have to follow a CDFI-fund defined "quality metrics" criteria.

The CDFI Fund may also want to reconsider its current policy that an applicant is not required to select more than one of the categories. While we generally agree with the concept that an applicant should not feel it has to check all the boxes in order to get the highest score, only requiring an applicant to check at least one box likely means that the applicant is checking the single box where it has the most compelling narrative, so as not to risk lowering its score by checking additional boxes. Given that there are a wide range of impacts to choose from, perhaps the CDFI Fund should require every applicant to select a minimum of two of the categories.

Part III. Management Capacity

Questions 29-31. The CDFI Fund collects a significant amount of narrative information from applicants discussing their management capabilities. We are concerned that the significant expenditure of an applicant's time on these questions may not be warranted or necessary, given that: (1) these questions are not being factored into the numerical scoring; (2) Tables C1 and C2 provide an excellent snapshot of the skills and abilities of senior management team; and (3) the vast majority of applicants now have a significant track record of QLICI deployment, and are already required to discuss that in Part 5.

While we understand there may be a need to do a more extensive staffing and systems analysis of organizations that are new to the NMTC space, for experienced NMTC applicants, we would encourage you to only require narrative responses in which prior year allocatees indicate that they have had issues with prior year allocations (e.g., trouble deploying; significant delinquencies or defaults; etc.). In other words, for prior NMTC allocatees, we would encourage the CDFI Fund to model its approach to Qs29-31 to the approach taken in Q.33 – which makes a series of inquiries to identify potential red flags, but only requires applicants to provide substantive responses in instances where red flags emerge.

Question 34/Table D2. We applaud the CDFI Fund for attempting to capture all of the fees that will be collected by an applicant, including those that will be passed through to third party entities that have been contracted to support certain aspects of their strategy (e.g., application preparation, project selection and underwriting, compliance management, etc.). However, we are concerned that all of the fees and benefits are not necessarily being captured here. Notably, we believe that banks that are providing allocations and serving as the equity investors are able to report less fees because they are getting profits through their QEI investments. The CDFI Fund should consider adding a new question to ascertain whether the allocatee will be obtaining the investment from a related entity, and if so, the anticipated returns on the QEI portion of the investment.

We also recommend that the CDFI Fund consider moving this question, along with the corresponding table, into the Business Strategy section of the application. In this manner, the responses to this question will factor into the application scoring, and not just the phase II review. Relatedly, we think it would be useful to include in the scored part of the application a question about the extent to which the applicant is relying on third party entities to support the bulk of their NMTC related deployment activities, and if it is significant, how the staff of the CDE or its Controlling Entity will actively engage in project selection, underwriting, etc.

Lastly, we recommend that the CDFI Fund augment its analysis of this question by reviewing, for prior-year allocatees, the fee data that is now being collected in the annual Transaction Level Reports; as these data points have been recently modified and are now capturing a great deal of useful information about prior transactions.

Part IV. Capitalization Strategy

Questions 35-37. Similar to the approach we are recommending in the Management Capacity section, we would encourage the CDFI Fund to streamline (or remove entirely) these questions with respect to CDEs that have a demonstrated track record of raising and deploying capital. Since this section does not factor into the scoring of the application, the CDFI Fund should consider carefully how much narrative is truly needed to be collected here – particularly when the most relevant information is captured in the corresponding Tables or can otherwise be ascertained from an applicant's QEI issuance report. The CDFI Fund, instead of capturing narrative about capitalization strategy from prior awardees, could simply add a question to Part V asking an applicant to provide an explanation, if applicable, for why it has yet to issue QEIs that have been allocated more than three years prior.

Similarly, the CDFI Fund should consider doing away entirely with collecting investor letters of interest or intent. Unlike the early years of the program, the NMTC investment market is well established now, such that the CDFI Fund should be reasonably confident that any CDE that receives an allocation will be able to raise QEIs and deploy them within the requirements set by statute and in award agreements. Requiring investor letters is no longer necessary at this stage in the program's evolution and creates an unnecessary burden on applicants as well as investors.

Part V: Information Regarding Previous Awards

We believe that the information collected in Part V should be part of the scored application. Most applicants have now been recipients of multiple years of awards, and this would present an opportunity for application readers to compare the relative impacts of an applicant's prior activities with those of other applicants – including projects, impacts, fees, etc.

REVIEW PROCESS

Overview:

The NMTC application scores have become increasingly compressed at the highest end of the scoring range, with an application's likelihood of success now more likely to be a reflection of which applications were "well written" and/or which reviewers were assigned to read the application, rather than the relative merits of the application. The CDFI Fund should consider a range of changes to the application review process to ensure that outcomes better reflect the relative capabilities of the organizations applying for allocations, rather than the skills of the application writers or the variances of the application reviewers.

Background:

In the initial rounds of the NMTC Program, each application was reviewed by three different reviewers, each of whom could provide an application with a score of up to 110 points (inclusive of 5 bonus points each for the two statutory priorities). Each application could therefore receive a total score of 330 points, and there were minimum overall scores and scores within each section needed in order for an application to be considered minimally qualified to receive an award. Applications that met the minimum thresholds were advanced to an internal CDFI Fund application review panel, which reviewed applications in descending order of score and provided each with award amounts until the allocations were exhausted.

The CDFI Fund has generally maintained this same approach in ensuing years, with two significant changes along the way. First, it determined that applications would only be scored on the Business Strategy and Community Impact sections; and that the bonus points would be cut in half. This change lowered the highest possible score from 330 points to 165 points. Then it subsequently determined to reduce the initial reader review number from three reviewers to two reviewers, thus lowering the highest possible score from 165 points to 110 points. These two changes effectively meant that applications which were once scored on a range of 330 points are now beings scored within a range of 110 points, leaving much less room for reviewer discretion.

At the same time, the applications submitted have gotten significantly stronger. This can likely be attributable to three factors: (i) greater transparency within the application guidance and in the debriefing guidance; (ii) an increasing reliance on outside consultants to write applications; and (iii) an increasing number of organizations that have received multiple allocation awards, and thus can provide better responses to many of the questions.

All of these dynamics have collectively resulted in an unsustainable clustering of applications at the very highest end of the scoring range. In the 2023 application round, 130 of the 197 scored between 106-110 (top 96%), and only 103 of those could be awarded. This meant that 27 different organizations failed to get awards likely by a point or two, and many more were left out that may have been just three or four points below this cut off. There is likely not a substantive distinction between any these "runner up" applications from the winners, such that it is quite likely that a different set of reviewers would have led to a different outcome. With so much at stake for each individual application, reviewer variance or how well an application is "written to the test" should not be the primary determinant of which applicants receive awards.

Recommendations on Scoring:

1. **Broaden the range of scoring outcomes --** The CDFI Fund should consider increasing the base application score to 100 points, or 50 points for each of the Business Strategy and Community Impact sections. Expanding the scoring range will allow for reviewers to better differentiate which applications are excellent vs very good vs merely good, and hopefully diminish the likelihood of so many applications clustering towards the highest end of the scoring range.

2. **Update application questions and reviewer guidance to tease out more nuance in the application strategies.** Clearly the application reviewers are reviewing the applications in such a way that it is leading them to deem an overwhelming portion of the application pool as extremely highly qualified. While there are quantitative elements to the application questions, many are qualitative – and that is where reviewers should be instructed to better separate out the ones that are truly performing at a higher level than others. Ideally, the final range of scores should be closer to a bell curve than the extreme positive skewing we are currently seeing.

3. **Return to using three reviewers**. In addition to providing a greater range of scoring outcomes (e.g., 165 points vs 110 points under the current scoring model), this will also better enable the CDFI Fund to identify anomalous scores on a given application. With two reviewers that have divergent scores, it is not readily discernable which reviewer is likely anomalous. A third reviewer provides a median score, allowing the CDFI Fund to better identify when a fourth application review may be necessary to remove an anomalous score.

4. **Assess which reviewers may be outliers in real time**. If the CDFI Fund maintains its use of only two reviewers, it should consider trying to determine whether any application pool is being disadvantaged because the two reviewers happen to both be harsh graders. The CDFI Fund could do this by assigning the same application to every single review team, and seeing where each reviewer grades this application. The reviewers would not be made aware of which application is this "test" application. If it is learned that two readers which provide much lower scores than the mean have been assigned to the same application pool, that entire pool could be reassigned.

5. **Allow NMTC application consultants to serve as reviewers**. There are dozens of consultants that provide services to CDEs as application writers/reviewers. In the initial years of the program, these consultants were allowed to serve as CDFI Fund application reviewers provided that they didn't have a financial interest (e.g., a success fee, compliance fees, etc.) in the outcome of any single application within the pool. The reader was conflicted out of reviewing any application which they helped prepare but would otherwise be allowed to serve as a reader provided there were no other financial conflict of interests identified. When the CDFI Fund determined to ban all consultants as readers, they lost perhaps the best source of quality application reviewers. The CDFI Fund should revisit this decision.

<u>Other Recommendations:</u>

1. **The CDFI Fund should provide debriefings to all applicants.** The CDFI Fund has moved away from providing specific reviewers comments as part of the debriefing, which we believe was a disservice to that applicants and one that merits revisiting. But to the extent that the Fund continues to provide more or less automated debriefings, there is no reason that all applicants should not receive a debriefing.

2. **The CDFI Fund should clarify what causes successful applicants to receive reductions in their award amounts**. The range of award amounts over the past several years would seem

to indicate a “tiering” of applicants that we suspect is not based on the score an application received, but rather on other factors that are not transparent to the applicants. Applicants should be made aware of whatever “formula” the CDFI Fund is applying to arrive at the final award amounts for a given application pool; or if it’s more of a qualitative determination, the factors that are being taken into consideration when adjusting award amounts.

Thank you for consideration of our comments.

Sincerely,

Matt Josephs
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