

THE BUZZ

CRA Changes Remove Two Obstacles to Bank LIHTC Investment, Other Problems Remain

By Buzz Roberts, Local Initiatives Support Corporation

The four federal banking regulators—the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC) and Office of Thrift Supervision (OTS)—recently revised proposals that would have further complicated bank investing based on low-income housing tax credits (LIHTCs). Unfortunately, the agencies did not address other obstacles to attracting the regional and large local banks that could help fill the LIHTC investment gap.

This policy is important because most active LIHTC investors are banks motivated by the Community Reinvestment Act (CRA). The money-center banks have the size and capacity to navigate the CRA policies adequately, such as by investing directly or through proprietary funds. But current guidelines make it much harder for regional and large local banks to receive full CRA recognition for investing in nationwide and regional funds, which can provide them risk diversification, deal structuring, execution and asset management support and efficiency. Many of these banks do not face the same financial stress as some of the money-center banks, so they have the tax capacity to use LIHTCs if CRA offered a substantial and predictable incentive to invest.

The FRB, OCC, FDIC and OTS set CRA implementation policy jointly to ensure consistent treatment of the various banks and thrifts they oversee. They make most of the CRA policy guidance in the form of formal Questions and Answers (Q&A) documents.

The latest round of this Q&A policymaking began in 2007 and as proposed would have complicated CRA recogni-

tion for LIHTC investments in two respects. On January 6 of this year, however, the regulators revised the proposals for the better.

First, the agencies had proposed to deny CRA credit for legally binding investment commitments recognized under generally accepted accounting principles (GAAP) until actual investments are made. This would have reversed long-standing policy and disrupted the well-established practice of investors funding LIHTC commitments in stages, effectively delaying CRA recognition. Fortunately, the agencies withdrew the proposal, leaving the current policy in place.

Moreover, the agencies had proposed how each bank participating in a nationwide community development fund should show that the bank's funds are benefiting its local assessment area (AA). In most cases, the result would have been an unworkably complex tracing scheme and tight targeting to each bank's AA. The revised guidance affirms the value of nationwide funds and makes key improvements. It allows CRA recognition if the fund's "purpose, mandate or function includes serving" a bank's AA or a broader statewide or regional area that includes an AA.

There are two important concepts here. First, the fund's intent to serve the bank's geography is sufficient to meet the requirement. The fund's organizational documents or alternative documentation, such as a best-efforts letter, will be acceptable evidence. Second, the benefit can be to the region that includes the bank's AA and not limited to the AA itself, a much more workable standard consistent

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with long-standing CRA policy.

This is progress, but it leaves open how much CRA recognition a bank will get from participating in a nationwide or multiregional fund. If we think of a nationwide or multiregional fund as an aggregation of regional funds, then the issue comes down to how participation in regional funds is treated. Unfortunately, the new Q&A does not address three existing problems.

- ♦ First, in order for a bank to get recognition for a regional investment, it must already be adequately addressing the needs of its AAs. This is a good concept but the agencies are applying it too rigidly. For example, the agencies have encouraged investments in the Gulf Opportunity Zone (GO) even from banks located outside the area. But examiners told one bank it would not get CRA recognition for an LIHTC investment to redevelop public housing in New Orleans because it had not made enough investments in one of the bank's AAs where LIHTC investment opportunities are limited and capital remains plentiful. A more workable and

more predictable threshold is warranted.

- ♦ Second, current policy guidance permits examiners to discount recognition for investments if the regional area is large relative to the AA, on the basis that the benefit to the AA may be diffuse. This policy has led some examiners to deeply discount the CRA recognition at the time of a bank's examination, which may be a year or two after the investment decision is made. We have heard reports that even investments in statewide and metropolitan area funds have received reduced CRA recognition on this basis. Clearly, these discounts undermine the CRA motivation for bank participation in regional funds, and the uncertainty compounds the problem. A bank needs to know up-front that it will receive full recognition for such activities.
- ♦ Third, banks are confused about how large a region can be. A 1997 policy interpretation appeared to validate regions as large as a quadrant of the country, a workable standard for nationwide funds. But the Q&A guidance here is vague, offering the smaller "mid-Atlantic states" as an example. Some banks have lost confidence that the quadrant ap-

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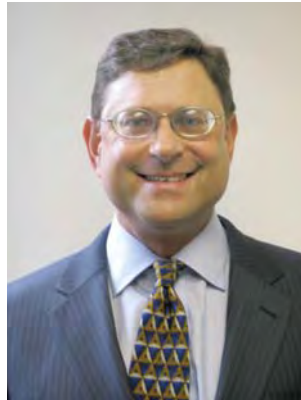


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proach is acceptable to examiners. The agencies should reaffirm that it is.

More workable CRA policies are not the entire solution to the current short fall of LIHTC investment. Some banks may face other issues in LIHTC investing, including their capacity to use tax credits and capital constraints. Moreover, it will be important to seek investments from sectors other than banking. But banks motivated by CRA remain the primary type of investor still active in the LIHTC market today, and many more regional and large local banks could start investing if they could get full and unambiguous CRA recognition for investing through regional and nationwide funds. The banking regulators deserve credit for revising proposals that would have made matters worse. Now they should remove the remaining obstacles. ❖



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