Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

Interpretive Letter #800
October 1997
12 U.S.C. 2901

September 11, 1997

Dear [ ]:

This letter responds to your letter (supplemented by additional written material, telephone conversations and meetings with OCC staff), in which you inquired about the applicability of the Community Reinvestment Act (CRA) regulations to a financial institution's investment in a pooled national community development fund, such as the [ ] (" "), that invests in low-income housing tax credit projects. Specifically, you asked:

(1) Whether the CRA regulations treat an institution's investment differently according to whether the institution invests directly in a project or indirectly, such as through a national fund;

(2) When and how examiners consider such an investment in a national fund by an institution; and

(3) How the CRA regulations define "region" for purposes of evaluating a wholesale or limited purpose institution's performance under the community development test.

Because the Agencies recently have received several inquiries regarding these general issues, we believe it is necessary to clarify how examiners will evaluate a financial institution's commitment to invest equity in community development funds.

The four federal financial institution supervisory agencies ("the Agencies") have promulgated substantively identical CRA regulations. Therefore, staff from all of the agencies have considered the issues you raised and they concur in the opinions expressed in this letter.

For the reasons discussed below, the Agencies conclude that:

(1) The CRA regulations do not differentiate between "direct" and "indirect" qualified investments;

(2) Examiners will consider the dollar amount of all qualified investments, including commitments to invest, that are recorded on an institution's books at the time of the examination and will evaluate these investments based on a variety of factors; and

(3) A "regional area" may be as small as a city or county or as large as a multistate area.[1] A wholesale or limited purpose institution that makes a qualified investment outside of the institution's assessment area(s) (or a broader statewide or regional area that includes the institution's assessment area(s)) will receive consideration for the investment, provided the institution has adequately addressed the community development needs of its assessment area(s).

I. BACKGROUND

According to the information you supplied, the [ ] is a non-profit affiliate of the [ ], a tax-exempt public charity under section 501(c)(3) of the Internal Revenue Code. Corporations, including financial institutions, enter limited partnership agreements with the [ ] to invest capital equity in affordable rental housing developments sponsored by low-income community-based development corporations not affiliated with banks ("upper-tier investment partnerships"). In return for their investments, the corporate investors receive federal low-income housing tax credits and related federal tax deductions when the housing projects are completed.

The [ ] operates under a two-tiered limited partnership structure -- (1) an "upper tier" with corporate investors as limited partners and the [ ] as a general partner, and (2) a "lower tier" with a community-based housing project sponsor as a general partner and the upper-tier investor partnership as the limited partner. The formation of an upper-tier investment partnership involves the execution of a partnership agreement and promissory note by each corporate investor. Some investors pay out their obligations immediately while other investors finance their obligations over time. You described an investor's obligations as "legally binding," "irrevocable" and "unconditional" because the delivery of an investor's note to the upper-tier partnership fully obligates the investor. Once the [ ] has received $5 million in investors' notes, it pledges the notes as security to obtain bridge loans.

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[1] Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment (hereinafter "Qs and As"), 61 Fed. Reg. 54,647, 54,651 (Oct. 21, 1996) (Q and A 6 addressing sections __.12(i) and __.563e(h)).

At the time an "upper-tier" partnership is formed, a financial institution commits to invest in the [ ] on a "blind pool" basis because the [ ] has not yet identified the actual projects to receive the committed funds. A financial institution can, however, target its investment to a particular geographical area that correlates with its assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s). You indicated that the [ ] will provide its investors a written statement that it intends to invest a specified dollar amount in a geographical region(s) specified by the investor and based on the [ ] regional structure.[2] According to your letter, the [ ] generally issues a report to investors when it has issued all the binding commitments necessary to invest all of the equity in project partnerships.

Investors may thus continually evaluate the performance of the [ ] to determine if the [ ] is actually meeting the investor's geographic and qualitative goals. These targeting assurances from the [ ] allow a retail institution to meet its geographic investment needs with an investment in the [ ]. A wholesale or limited purpose institution may target its investment in the same manner as other retail institutions or, if it has adequately addressed the needs of its assessment area(s), it may invest in a nationwide fund such as the [ ] without targeting its funds.[3]

According to your letter, once the upper-tier partnership is formed, each investor records the promissory note on its books as an "asset" and amortizes the investment over the life of the tax credit benefit period. The investor thus assumes all the benefits and burdens of the investment. Further, you state that this accounting treatment also applies to investors that finance their obligations over a number of years.

You stated that a financial institution should receive consideration under the CRA regulations for a qualified investment at the time the institution makes a binding commitment to the upper-tier partnership. At that time, "an investment for CRA purposes can legitimately be demonstrated" because all other indicia of ownership exist. You also stated that the method by which institutions should receive CRA consideration over the life of the investment should match the investor's accounting treatment of the asset -- i.e., in each subsequent year after the investment, the CRA consideration that an institution would receive for the dollar amount outstanding would decrease in an amount equal to the amortization taken in that year. In your view, such treatment would maximize CRA consideration in the early years when the risk is greatest and minimize CRA consideration in the later years when risk has diminished.

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[2] The [ ] regional structure consists of western, midwestern, southern and northeastern regions.

[3] *See* 12 C.F.R. §§ 25.25(e), 228.25(e), 345.25(e), and 563e.25(e).

II. DISCUSSION

A. The CRA Regulations Do Not Differentiate Between "Direct" and "Indirect" Investments

You inquired whether the CRA regulations treat a direct investment differently from an indirect investment. The regulations do not differentiate between direct and indirect investments.[4]

B. How Examiners Evaluate Investments in a Community Development Fund

Examiners evaluating an institution's qualified investments will look at the following four performance criteria:

(1) the dollar amount of qualified investments;

(2) the innovativeness or complexity of qualified investments;

(3) the responsiveness of qualified investments to credit and community development needs; and

(4) the degree to which the qualified investments are not routinely provided by private investors.[5]

These criteria reflect the Agencies' expectation, embodied in the CRA regulations, that examiners will consider not only the dollar amount of qualified investments, but also will exercise judgment on other factors affecting how such investments will be weighed as part of an overall CRA rating.

With respect to the first criterion, examiners will determine the dollar amount of qualified investments by relying on the figures recorded by the institution according to generally accepted accounting principles (GAAP). Examiners will include both new and outstanding investments in this determination. The dollar amount of qualified investments also will include the dollar amount of legally binding commitments recorded by the institution according to GAAP.

As a general matter, institutions may exercise a range of investment strategies, including short-term investments, long-term investments, investments that are immediately funded, and

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[4] The Agencies answered this question in a recent interagency letter. *See* Interagency Staff CRA Opinion Letter from Michael Bylsma (June 10, 1997) (designated as OCC Interpretive Letter No. 787) (copy enclosed).

[5] 12 C.F.R. §§ 25.23(e); 228.23(e), 345.23(e), and 563e.23(e).

investments with a binding up front commitment that are funded over a period of time. Under any of these investment strategies, institutions making the same dollar amount of investments over the same number of years, all else being equal, would receive the same level of consideration.

However, a variety of considerations *beyond the dollar amount of the investment* will affect the level of favorable consideration that examiners will accord any qualified investments in any given examination. The extent to which qualified investments receive favorable consideration also depends on how examiners evaluate the investments under the remaining three performance criteria -- innovativeness and complexity, responsiveness, and degree to which the investment is not routinely provided by private investors.

Examiners also will consider factors relevant to the institution's CRA performance context, such as the effect of outstanding long-term qualified investments, the pay-in schedule and the amount of any cash call, on the capacity of the institution to make new investments.

C. Consideration of Qualified Investments By Wholesale or Limited Purpose Institutions

You inquired how CRA examiners interpret the term "regional area" for purposes of measuring the performance of a limited purpose or wholesale financial institution under the community development test. As explained in the Qs and As issued on October 21, 1996, a "regional area" may be as large as a multistate area, such as the mid-Atlantic states.[6]

In evaluating a qualified investment by a wholesale or limited purpose institution, examiners would first consider whether the institution has adequately addressed the needs of its assessment area(s). Although a wholesale or limited purpose institution is not required to help meet the credit needs of a broader statewide or regional area, qualified investments in a broader statewide or regional area that includes the institution's assessment area are favorably considered in the evaluation of an institution's performance in its assessment area(s). Examiners that find a wholesale or limited purpose institution has adequately addressed the needs of its assessment area(s) will give favorable consideration to qualified investments, community development loans, and community development services by that institution nationwide.[7] Finally, as you requested, we confirm that the criteria applicable to qualified investments described earlier in this letter would be considered by examiners in evaluating qualified investments made inside and outside of an institution's assessment area(s).

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[6] *See id.* (Q and A 6 addressing sections __.12(i) and __.563e(h) (meaning of "regional area")).

[7] *See* Interagency Staff CRA Opinion Letter from Michael Bylsma, at II.B. (Dec. 23, 1996) (designated as OCC Interpretive Letter No. 764) (copy enclosed).

III. CONCLUSION

You asked whether the Agencies' examination staff follow the guidance provided in interagency interpretive letters, such as this one. The Agencies consult with one another on each interagency CRA letter to ensure that we provide consistent guidance. The Agencies also work to ensure that examiners apply these rules consistently by, for example, conducting joint training, reviewing public evaluations on an interagency basis, and providing additional examiner guidance, as needed.

I trust this letter has been responsive to your inquiry. If you have any additional questions, please feel free to contact me or Julie Yang, an attorney on my staff, at (202) 874-5750.

Sincerely,

/s/

Michael Bylsma
Director
Community and Consumer Law Division
Office of the Comptroller of the Currency

Enclosures