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

*Interpretive Letter #708
March 1996
12 U.S.C. 2901*

February 16, 1996

[]

Dear []:

This letter responds to your correspondence of November 15, 1995, concerning the [] Housing Fund [F] proposal. As your letter explains, [F] has asked [B] and several other community banks operating in [] County, [], to participate in a pilot project to provide funding to [F]. The banks would provide these funds either in the form of loans to [F] or investments in [F]. These funds would enable [F] to provide private mortgage insurance for affordable housing loans for low- and moderate-income persons in [] County.

You have asked whether [B] and the other participating banks would receive consideration under the Community Reinvestment Act (CRA) regulation only for the amount of their respective contributions to [F], or for the amount of mortgage loans that [F] is able to insure as a result of these contributions. I have conferred with my counterparts at the Federal Reserve Board, Federal Deposit Insurance Corporation and Office of Thrift Supervision and, for the reasons discussed below, we have concluded that the banks' contributions, if structured as investments in [F], would be "qualified investments" under CRA. If the banks' contributions are structured as loans to [F], they would qualify as community development loans under CRA. In either event, our examiners would take into account the overall impact these contributions have on affordable housing lending in [] County. The banks would not be entitled, however, to receive consideration under the regulation's lending or investment tests for the amount of mortgage loans insured by [F].

I. BACKGROUND

The [] (CDA), an agency within the State of []'s Department of Housing and Community Development, administers a single family home loan program. Periodically, the CDA issues revenue bonds that allow it to make or purchase mortgage loans to finance the purchase of single family residences in [] by eligible individuals and families.

To qualify for a CDA loan, an applicant must comply with applicable state and federal laws and regulations. In addition, an applicant must meet certain income and purchase price requirements. Individual applicants must have annual incomes under \$41,800, and family applicants must have annual incomes under \$49,800. In most areas of [], the purchase price of a home financed by a CDA loan may not exceed \$110,000.

A CDA loan may be made in an amount equal to the purchase price of the home plus settlement expenses. Therefore, many of the CDA loans have loan-to-value ratios that exceed 100%. In order for the CDA to obtain an investment rating on its bonds, all CDA loans must be insured by the Federal Housing Administration (FHA), guaranteed by the Department of Veterans Affairs (VA), or insured by [F] or an approved private mortgage insurer. Due to their high loan-to-value ratios, most CDA loans are insured by [F].¹ [F] insures the portion of a CDA loan that exceeds 75% of the value of the residence financed.

All CDA loans must also be insured under pool mortgage insurance covering the risk of default on the portion of each loan not covered by primary mortgage insurance. [F] has provided the pool mortgage insurance for all loans financed with the proceeds of all but one of the revenue bonds issued by the CDA.

In 1980, CDA and [F] entered into an Insurance Agreement that requires [F] to maintain a segregated reserve of money or securities available for payment of claims against [F]'s primary or pool mortgage insurance covering the CDA loans. The Insurance Agreement further requires that the ratio of the total amount of CDA loans insured by [F] to the reserve amount not exceed 40-to-1. Thus, [F] must maintain \$1 in its reserve account for every \$40 of CDA loan principal insured by [F].

The existing reserves maintained by [F] were derived from six issues of State general obligation bonds and an appropriation by the State General Assembly. The State last provided funding to [F] for its reserves in 1986 and is unlikely to provide any future funding. [F] expects that its remaining reserves will soon reach the maximum ratio provided by the Insurance Agreement. [F] would then have to stop insuring additional CDA loans.

[F] recently asked [B] and several other community banks to participate in a pilot project to provide additional reserve funding. These funds will be provided either in the form of loans to [F] or investments in [F]. The additional reserve funding provided by [B] and the other community banks pursuant to the proposed pilot project would allow [F] to support mortgage insurance for new CDA

¹ Typically, private mortgage insurers will not insure a mortgage loan with a loan-to-value ratio that exceeds 97%. The FHA will insure some loans with higher loan-to-value ratios, but the insurance is too costly for the majority of CDA loan applicants. Moreover, most CDA loan applicants are not veterans and, therefore, could not qualify for VA guarantees.

loans to low- and moderate-income persons in [] County. Due to the 40-to-1 reserve ratio established by the Insurance Agreement between [F] and CDA, each dollar of reserve funding provided by the participating banks would enable the CDA to extend \$40 of mortgage loans.

II. DISCUSSION

For purposes of CRA evaluations, [B] requests that the participating institutions receive consideration for the full amount of mortgage loans made possible by their contributions to [F]. The new CRA regulation provides a detailed framework for evaluating an institution's CRA performance. The new rule sets out a number of different evaluation methods for examiners to use, depending on the business strategy and size of the institution under examination.

Regardless of the evaluation methods used by examiners, however, any financial institution can receive positive consideration for making a "qualified investment" that benefits its assessment area or a broader statewide or regional area that includes the assessment area.² The new CRA regulation defines "qualified investment" as "a lawful investment, deposit, membership share or grant that has as its primary purpose community development." *See* 60 Fed. Reg. at 22,180, 22,191, 22,202, and 22,213 (to be codified at 12 CFR §§ 25.12(s), 228.12(s), 345.12(s), and 563e.12(r)). "Community development" is defined to include "[a]ffordable housing . . . for low- or moderate-income individuals." *See* 60 Fed. Reg. at 22,179, 22,191, 22,202, and 22,213 (to be codified at 12 CFR §§ 25.12(h)(2), 228.12(h)(2), 345.12(h)(2), and 563e.12(g)(2)).

A contribution to [F] has as its primary purpose community development because [F] enables the CDA to provide affordable housing loans to low- and moderate-income individuals. The funds provided by the banks will be used to insure loans in [] County, which includes the banks' CRA assessment areas. Therefore, assuming the banks' contributions to [F] are structured as investments, examiners would give positive consideration to the banks' contributions to [F] as qualified investments under any of the new performance tests and standards in the new CRA regulations.

² Examiners of large institutions, which are evaluated under the lending, investment and service tests, consider qualified investments under the investment test. *See* 60 Fed. Reg. at 22,181, 22,192, 22,204, and 22,215 (to be codified at 12 CFR §§ 25.23(a), 228.23(a), 345.23(a), and 563e.23(a)). In a small institution examination, examiners may adjust an institution's loan-to-deposit ratio, if appropriate, based on qualified investments. *See* 60 Fed. Reg. at 22,182, 22,193, 22,205, and 22,216 (to be codified at 12 CFR §§ 25.26(a)(1), 228.26(a)(1), 345.26(a)(1), and 563e.26(a)(1)). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. *See* 60 Fed. Reg. at 22,188, 22,200, 22,211, and 22,223 (to be codified at 12 CFR pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2)). The community development test, which is appropriate for wholesale and limited purpose institutions, evaluates, inter alia, the number and amount of qualified investments. *See* 60 Fed. Reg. at 22,182, 22,193, 22,204, and 22,215 (to be codified at 12 CFR §§ 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1)). And, finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, *investment*, and/or services, as appropriate. *See* 60 Fed. Reg. at 22,183, 22,194, 22,205, and 22,216 (to be codified at 12 CFR §§ 25.27(f)(1), 228.27(f)(1), and 563e.27(f)(1) (emphasis added)).

Similarly, if the banks' contributions to [F] are structured as loans, the loans would meet the definition of community development loans. *See* 60 Fed. Reg. at 22,179, 22,190, 22,202, and 22,213 (to be codified at 12 CFR §§ 25.12(I), 228.12(I), 345.12(I), and 563.12(h)). A large retail institution's record of helping to meet community credit needs through its lending activities is evaluated under the lending test. *See* 60 Fed. Reg. at 22,180, 22,192, 22,203, and 22,214 (to be codified at 12 CFR § 25.22, 248.22, 345.22, and 563e.22)). Under the lending test, examiners consider an institution's originations and purchases of loans, including community development loans. *See* 60 Fed. Reg. at 22,180-181, 22,192, 22,203, and 22,214 (to be codified at 12 CFR § 25.22(a)-(c), 228.22(a)-(c), 345.22(a)-(c), and 563e.22(a)-(c)). Community development loans may also be considered favorably in the evaluations of small institutions, wholesale and limited purpose institutions, and institutions evaluated based on a strategic plan. *See* 60 Fed. Reg. at 22,182-83, 22,193-94, 22,204-05, 22,215-17 (to be codified at 12 CFR §§ 25.25(c), 25.26(a)(1), 25.27(f)(1), g(3)(I), and pt. 25 app. A(d)(2); §§ 228.25(c), 228.26(a)(1), 228.27(f)(1), g(3)(i), and pt. 228 app. A(d)(2); §§ 345.25(c), 345.26(a)(1), 345.27(f)(1), g(3)(i), and pt. 345 app. A(d)(2); and §§ 563e.25(c), 563e.26(a)(1), 563e.27(f)(1), g(3)(i), and pt. 563e app. A(d)(2)). Thus, examiners will favorably consider as community development loans the banks' loans to [F] under the pilot project.

At a bank's option, examiners also consider under the lending test originations and purchases of community development loans by consortia in which the bank participates or by third parties in which the bank has invested. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,215 (to be codified at 12 CFR §§ 25.22(d), 228.22(d), 345.22(d), and 563e.22(d)). However, as you acknowledge in your letter, [F] is "not a consortium or third party which will originate or purchase loans." Therefore, this provision is inapplicable to the proposed pilot project, and the participating banks will not receive consideration under CRA for the dollar amount of the mortgage loans that [F] will insure.

It is important to note, however, that the dollar amount of a qualified investment or a community development loan is only one factor that examiners consider in evaluating an institution's CRA performance. Examiners also consider the innovativeness or complexity of qualified investments, their responsiveness to credit and community development needs, and the degree to which the qualified investments are not routinely provided by private investors. *See* 60 Fed. Reg. at 22,181, 22,193, 22,204, and 22,215 (to be codified at 12 CFR §§ 25.23(e), 228.23(e), 345.22(e), and 563e.23(e)). Examiners consider similar factors in evaluating a community development loan. *See* 60 Fed. Reg. at 22,181, 22,192, 22,203, and 22,214 (to be codified at 12 CFR §§ 25.22(b)(4), 228.22(b)(4), 345.22(b)(4), and 563e.22(b)(4)). These factors are included in the CRA investment and lending performance evaluations to recognize that the value of an investment or a loan is not necessarily tied to its dollar amount.

As you point out in your letter, the proposed pilot project is an innovative approach to addressing affordable housing credit needs in the [] area that are not being met currently by private investors. Accordingly, examiners will not limit their consideration of the banks' contributions to [F] to the actual

dollar amount of the investments or loans. The examiners will also consider the overall impact on affordable mortgage lending of the banks' contributions to [F].

I trust this has been responsive to your inquiry. You may also be interested to know that the staffs of the four financial supervisory agencies are presently developing a commentary that should provide additional guidance for resolving interpretive questions arising under the new CRA regulations. If you have any questions in the meantime, please feel free to contact me or Michele Meyer, an attorney on my staff, at (202) 874-5750.

Sincerely,

/s/

Matthew Roberts
Director
Community & Consumer Law Division
Office of the Comptroller of the Currency