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October 16, 2001

Docket No. 01-16
Communications Division
Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Robert E. Feldman
Executive Secretary
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Docket No. R-1112
Ms. Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th St. & Constitutional Ave., NW
Washington, DC 20552

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20551
Attention Docket No. 2001-49

Dear Sirs and Madam:

It is a pleasure to submit comments on certain questions raised by your joint advance notice of proposed rulemaking, dated July 19, 2001, and to submit our request for guidance or regulations with respect to national bank participation in the New Markets tax credit program[1]. Because of the statutory goals and objectives of the New Markets program, we believe that guidance can be issued in the absence of Treasury regulations.

Both of us have had the privilege of working with national banks for the past 15 years in the low-income housing tax credit program[2] and in other aspects of community development activities. The banks' participation in the low-income housing tax credit program has materially contributed to that program's success, and has provided affordable housing to thousands of low-income tenants.

[1] Novogradac, Michael J. and Tracy, Thomas G., New Markets Tax Credit: A Program for Community Renewal Handbook, (2001, Novogradac & Company LLP).

[2] Novogradac & Company LLP, Low-Income Housing Tax Credit Handbook, (2001, Clark Boardman and Callaghan) and Tracy, Thomas G. and Stephens, Herbert, A Developer's Guide to the Low Income Housing Tax Credit, (1999, National Council of State Housing Agencies).

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General Comments

Several comments have been made pertaining to the lending and investment tests, and the relative importance of each. Others have suggested that these tests be abandoned for a "community development" test. Private investment has always been a necessary requirement for successful community revitalization. While revitalization seems to be both the reintegration of a neighborhood into the market and the improvement of economic conditions for existing residents, the latter generally follows private investment. Thus, to the extent that revitalization has occurred, it has been driven by increased private investment. In the past, Alan Greenspan has also stressed the importance of equity capital in community development. We believe that private investment serves as a catalyst for other aspects of revitalization to occur. Looking at the four factors that comprise community development under Part 25, a majority of them require private investment in one form or another.

The investment test has been instrumental in encouraging private investment by national banks. One indication of investment activity, according to data collected by the Comptroller of the Currency during the 1993 to 1998 time period, is that national banks invested in one type of community development investment (those permitted under Part 24 authority) seven times more in real dollars as they had in the previous 28 years[3]. If the investment test is not emphasized in future regulations, we are concerned that the level of private investment by national banks would substantially decrease. While the credit needs may still be served by future regulations, the level or community revitalization may diminish and the future of community revitalization programs, such as the low-income housing tax credit program and the New Markets tax credit program would be in doubt. We urge the OCC to retain the existing lending and investment tests.

New Markets Tax Credit Program

In December, Congress Passed the New Markets tax credit program as part of the Community Renewal and New Markets Act of 2000[4]. It is designed to generate $ 15 billion in new private sector investments in low- and moderate-income rural and urban communities. The purpose of the act is to broaden the incentives available for community revitalization.[5] Like the low-income housing tax credit program, New Markets tax credits

[3] Litan, Robert E., The Community Reinvestment Act after Financial Modernization: A Baseline Report, (April 2000, The United States Department of the Treasury), page EF-16.

[4] Community Renewal Tax Relief Act of 2000, Public Law 106-544, 106th Congress, 1st Session (December 21, 2000). Internal Revenue Code Section 45D contains the New Market Tax Credit provisions.

[5] In its Committee Reports, Congress recognized that tax incentives are available to taxpayers making investments and loans to small businesses in low-income communities, For example, the Report notes that tax incentives are available to taxpayers that invest in specialized small business investment companies

can be used to offset an investor's federal income tax. The federal tax credits are for qualified equity investments that are made through a qualified Community Development Entity.

In general, Community Development Entities, or CDEs must have a primary mission of serving or providing investment capital to low-income communities or low-income persons and maintain accountability to residents of the low-income communities. In general, a qualified low-income community investment is (1) any capital or equity investment in, or loan to, any qualified active business (including commercial rental real estate) in low-income communities. A qualified investment may also include the purchase from another CDE of any loan made by such entity which is a qualified investment, and certain financial counseling and other services (to be defined by IRS regulations) to businesses located in a low-income community or residents of a low-income community.

The New Markets tax credit is a 39 percent federal tax credit available to investors over a seven-year credit period, but since the credit is available on the first day of a credit period, the period in which investors receive the credit is shorter.

There are some differences between qualified investments under the New Markets tax credit program and community development test under Part 25, Community Reinvestment Act.

1. Geography does not appear to be defined in Part 25. A low-income community, for purposes of the New Markets tax credit program, is a census tract that either has a poverty rate of 20 percent, or if in a metropolitan area, the area median income does not exceed 80 percent of the metropolitan area median income, or otherwise does not exceed 80 percent of the statewide area median income.

2. Low-income thus encompasses both low- and moderate-income categories in Part 25.

3. The primary purpose of the Community Development Entity is serving, or providing investment capital for, low-income communities or low-income persons. This purpose should be considered community development under Part 25, which includes: (a) affordable housing (including multifamily rental housing for low- or moderate-income individuals, (b) community services targeted to low- or moderate-income individuals; (c) activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company

licensed by the SBA to make loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged. Most, if not all, of this area would fall under the Community Development Definition in Part 25, Section 25.12(h) which defines community development. Section 25.12(h)(3) deals with activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs or have gross annual revenues of $ 1 million or less. Therefore, the purpose of the New Markets legislation is to expand tax incentives to reach the broader aspects of community revitalization.

programs or have gross annual revenues of $ 1 million or less, or (d) activities that revitalize or stabilize low- or moderate-income geographies. While it is clear that the New Markets program is intended to promote community revitalization through private investment, the uncertainty of what constitutes revitalization for purposes of Part 25 creates a vacuum that could discourage national bank participation in many aspects of that program.

The success of the New Markets tax credit program will depend, in part, on national bank participation. To just allow participation in those activities which meet the more specific criteria of the community development test (i.e., community services targeted to low- and moderate-income individuals or small business loans) would be defeating the purpose of the New Markets legislation. This legislation expands incentives for community revitalization by encouraging private investment for all types of businesses that impact a community and providing for financial services to both low- and moderate-income individuals and to businesses. Because Congress has deemed these revitalization activities worthy of special tax treatment, and because the federal program will provide much needed private capital to low- and moderate-income communities, we urge that the OCC consider issuing guidance with respect to the following.

<u>I. Because of the importance of the New Markets tax credit program as a community revitalization program, and the impact that national bank investment would have on its success, it is absolutely essential that the OCC reduce uncertainty by providing guidance that the New Markets program is presumed to be eligible as community development.</u>

Revitalization, in the broad sense, is both the reintegration of a neighborhood into the market and the improvement of economic conditions for existing residents.[6] Reintegration involves traditional physical redevelopment and private investment. To the extent that revitalization has occurred, it has been normally driven by private investment, which is not limited to small business investment. Generally, it is thought that private investment precedes individual economic improvement.[7]

While the principal purpose of the Community Reinvestment Act is to encourage financial institutions to help meet the credit needs of the communities in which they operate, the focus of the Act, as it pertains to low-income housing tax credit or New Markets tax credit participation is on community development. The broader aspect of community development is apparent when national banks make investments, since these investments must have as their primary purpose community development, and when national banks participate in loan consortia or third party loans, since these loans must be community development loans. As explained later, national banks can participate in New Markets loans by investing in a Community Development Entity (CDE).

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[6] Sean Zielenbach, The Art of Revitalization, Contemporary Urban Affairs, Volume 12, Garland Publishing 2000, p. 263

[7] Ibid., p. 264

The Community Reinvestment Act has recognized that the broader aspect of community revitalization is a component of community development by including activities that revitalize or stabilize low- or moderate-income neighborhoods as part of the community development test. Thus, national banks should be encouraged to invest in community revitalization programs as well as affordable housing, social investing, or small business lending programs.

Tax credits have been an essential catalyst for private investment in community development activities. For example, without low-income housing tax credits, private developers could not afford to build housing that is affordable for low-income individuals, even though the demand is great, because it cannot be built for a price that fits within a low-income individual's budget. New Markets tax credits is another building block in the government's revitalization strategy, which encourages private investment in low- and moderate-income communities through business investments or loans and financial services to those businesses or residents in the low- or moderate-income communities. The New Markets program recognizes the broad nature of private investment and does not distinguish between the size of the business or its character.

The concept of community revitalization through private investment is very broad, involving not only investment in businesses both large and small, but also in commercial real estate such as retail centers and parking garages. The Internal Revenue Service has recognized this aspect of community revitalization when it upheld the tax-exempt status of an organization that was developing a parking garage and market rate apartments in a downtown district because the organization was involved in community revitalization. Other IRS rulings contribute to the multi-faceted nature of the community revitalization area.

Guidance was issued by the OCC after the initiation of the low-income housing tax credit program to make it clear that participation in that government program meet the community development test for qualified investments. We are requesting that the OCC issue guidance that the New Markets tax credit program is presumed to be eligible under Part 25 because it is a community revitalization program. Requiring national banks to get an individual determination on a facts and circumstances basis as to whether a proposed investment in the New Markets program meets the community development criteria or not is counter-productive and would discourage many types of New Markets investments, as well as general participation in the program.

<u>II. Clarification of a national bank's indirect participation, through a New Market tax credit investment, in loans originated by the Community Development Entity, in a manner similar to a loan consortia or investment in a third party loan.</u>

a. Section 25.22(a)(3) of Part 25, dealing with the lending test, provides that a bank may ask the OCC to consider loans originated or purchased by consortia in which the bank participates, or by third parties in which the bank has invested, only if the loans meet the definition of a Community Development Loan.

b. Section 25.22(d) defines lending by a consortia or a third party as community development loans originated or purchased by a consortium in which the bank participates, or by a third party in which the bank has invested. Section 25.22(d)(2) provides procedures by which CRA credit may be allocated among participants or investors, as they choose, provided that only one participant or investor may claim a loan origination or loan purchase and each participant or investor is limited to the percentage share with respect to loans claimed.

c. Example One. A group of banks, all of which are national banks as defined in Section 25.12 of Part 25, form a Community Development Entity (CDE) that receives an allocation of New Markets tax credits. The CDE's comprehensive investment plan (that is submitted to Treasury as part of the application for tax credits) is providing business mezzanine loans to qualified businesses in low-income communities. The loans will qualify as Community Development Loans under Part 25. The banks make a $ 5 million investment in the CDE and use a loan consortia structure to originate the business mezzanine loans.

d. The OCC should clarify that such investment by the national banks meets the lending test under Section 25.22(d) and that their method of claiming the loans and amounts that can be claimed is governed by Section 25.22(d)(2).

e. Example Two. ABC is a third party fund that is a CDE, and has received an allocation of New Markets tax credits. Its comprehensive investment plan is providing business mezzanine loans to qualified businesses in low-income communities. The loans will qualify as Community Development Loans under Part 25. A national bank makes an investment in ABC.

f. The OCC should clarify that such investment by the national bank meets the lending test under Section 25.22(d) and that its method of claiming the loans and amounts are governed by Section 25.22(d)(2).

III. Clarification of a national bank's indirect participation, through a New Markets tax credit investment, in a CDE, as a Qualified Investment for purposes of the investment test under Part 25.

a. Part 25 does not specifically address indirect participation by a national bank.

b. However, later guidance provides that the direct or indirect nature of the qualified investment does not affect whether an institution will receive consideration under the CRA regulations because the regulations do not distinguish between "direct" and "indirect" investments. Thus an institution's investment in an equity fund that, in turn, invests in projects that, for example, provide affordable housing to low- and moderate- income individuals would receive consideration as a qualified investment.

c. The purpose of the fund, however, was emphasized in other guidance. As long as the primary purpose of the investment is community development as defined in the CRA regulations, an institution's investment in a fund that in turn invests in a community development project is a qualified investment.

d. To qualify as a qualified Community Development Entity (CDE), the primary purpose must be serving or providing investment capital for low-income communities (which is low- and moderate-income areas under Part 25) or low-income persons (which is low- and moderate-income persons under Part 25).

e. Without definite guidance, discussed in (I) above, examiners may come to the conclusion that the primary purpose of the CDE is too broad to meet the community development test; and therefore, an investment in that fund would not receive consideration as a qualified investment. Therefore, the OCC should clarify that the statutory purpose required by New Markets legislation meets the community development test under revitalization; and therefore, investments in a CDE would receive consideration as a qualified investment.

Thank you in advance for allowing us to comment on the issues surrounding the review of the current regulations and to request guidance on how to apply the lending and investment tests to the New Markets tax credit program.

Yours truly,

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