



Comptroller of the Currency
Administrator of National Banks

Community Developments *Investments*

New Markets Tax Credits—Bridging Finance Gaps

Summer 2004

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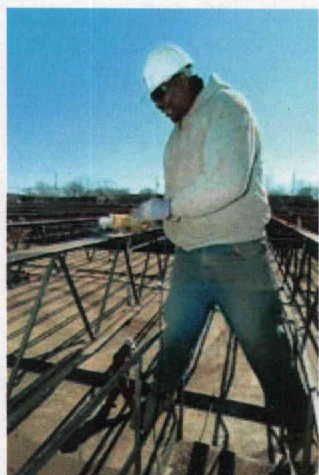
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OCC's Community Affairs Department

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New Markets Credits Turn “Un-doable” Deals into “Can-Do” Deals



Banks that want to increase their investment in economically distressed communities are turning to the four-year-old New Market Tax Credit (NMTC) Program, enacted as part of the Community Renewal Tax Relief Act of 2000.

In the first two rounds of NMTC awards, 31

depository institutions received \$1.2 billion in tax credit allocations. A third funding round of \$2 billion is expected later this year and then another \$7 billion is scheduled for allocation by 2007. NMTC's offer banks an opportunity to inject investment capital into economically distressed neighborhoods.

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This Just In...OCC's Districts Report on New Investment Opportunities for Banks

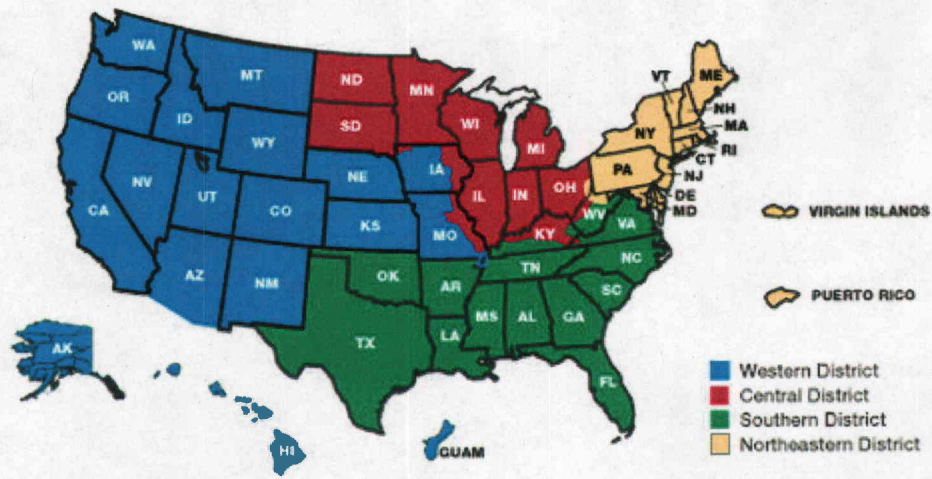
[Looking for new investment ideas?](#) In this article, OCC's District Community Affairs Officers (DCAOs) report on banking initiatives and partnership opportunities in each of OCC's four districts. In addition to being able to provide more information about these and other community development investment opportunities, DCAOs are available to consult with national banks in developing successful approaches to community developing lending and service delivery approaches.

Click on the map below for our DCAOs' contact information..

A look inside...

Welcome to the first on-line Investments edition of *Community Developments*. National banks are continuing to recognize CD investing as a way to remain financially and socially responsible to their customers and communities, and the OCC strongly supports these efforts. Banks find these investments add to their bottom line, expand their market reach, support the development of new products, and leverage matching funds from partnering sources. All in all, CD investing is an exciting opportunity.

This electronic magazine focuses on examples of national bank investments in community development activities. In particular, we will illustrate the investment opportunities available under OCC's national bank public welfare investment authority ([12 CFR 24](#) or "Part 24")...[Full Story](#)





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In addition to New Markets Tax Credits, national banks can make investments in historic and low-income housing tax credits using the Part 24 authority. Camden Commons, in Preble County, Ohio, is an old schoolhouse converted into older housing which received funding from the Ohio Capital Corporation through the syndication of tax credits to banks and other investors.

This electronic magazine focuses on examples of national bank investments in community development activities. In particular, we will illustrate the investment opportunities available under OCC's national bank public welfare investment authority (12 CFR 24 or "Part 24"). Each quarter we will bring you stories of diverse investments that help communities stabilize, revitalize, or grow. The articles will describe the investments and their value to the banks, and how each investment helped the community or neighborhood. In addition, each quarterly E-zine will contain resources that can help you:

- find CD investment opportunities in each OCC district;
- learn about CD investments made by other banks;
- find an OCC contact for guidance or assistance on CD investing;
- retrieve OCC regulations, forms, and guidance on CD investments;
- link to other federal Web pages that may have useful information.

Bank Participation in NMTC Program

Depository institutions have shown considerable interest in the NMTC program - 31 banks received \$1.2 billion of NMTCs in the first two rounds of funding. The CDFI Fund

In addition, we will provide you with a listing of Part 24 investments approved during the previous quarter of 2004 as well as access to precedent-setting opinion letters.

This edition also examines bank investments that have been made in conjunction with the New Markets Tax Credit (NMTC), a

will conduct a competition for \$2.0 billion in NMTCs later this year, and those interested in applying can visit the [CDFI Fund Web Site](#) now to begin the process of forming a CDE. Banks interested in investing in CDEs or funds created by NMTC awardees are encouraged to review the CDFI Fund's [list of awardees](#).

program designed to help spur growth in distressed communities. Last fall, the OCC revised Part 24 to explicitly identify NMTCs as an eligible investment. In addition, the OCC issued an [Interpretive Letter clarifying that NMTCs are an eligible CRA investment](#). In the past few months, the CDFI Fund has signed agreements with awardees of the first \$2.5 billion of the \$15 billion total to be made available over the next four years. In addition, the fund as

allocated \$3.5 billion of the second round of NMTCs. This edition describes transactions by two awardees: Key Bank Community Development Corporation and Oklahoma Metafund.

We hope this E-zine contains information about CD investing that can help your bank expand or target its investing efforts. I would like to hear your thoughts about this edition and any community development investment topics we might cover in future editions.

Barry Wides

**Acting Deputy Comptroller
Community Affairs**

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New Markets Credits Turn "Un-doable" Deals into "Can Do" Deals

Banks that want to increase their investment in economically distressed communities are turning to the four-year-old New Market Tax Credits (NMTC) Program, enacted as part of the Community Renewal Tax Relief Act of 2000.

In the first two rounds of NMTC awards, 31 depository institutions received \$1.2 billion in tax credit allocations. A third funding round of \$2 billion is expected later this year and then another \$7 billion is scheduled for allocation by 2007.

NMTC's offer banks an opportunity to inject investment capital into economically distressed neighborhoods.

The NMTC program is run by the [Community Development Financial Institutions \(CDFI\) Fund](#), which selects for-profit community development entities (CDEs) to market the tax credits to banks, venture capitalists, individuals, and corporations. Among the more than 1,300 registered CDEs are MetaFund and Key Corporation's subsidiary, Key CDC.

Although the two CDCs have taken different paths with their NMTCs, both roads have led to the same destination -- closings of deals that would not have worked without the incentive of tax credits.

Collaboration

Metafund's mission criteria include funding loans and investments that benefit low- to moderate-income distressed areas or residents of distressed areas, as well as financial viability, according to MetaFund Chairman and President A. Thomas Loy. Of Metafund's \$10 million capitalization, \$5 million came from six national banks under the Part 24 authority.

The banks are the eyes and ears of the fund in that they supply potential deals that Loy refers to as "but for" deals because they would not occur without the support of NMTC.

To date, this hybrid between a bank and a venture capital firm has funded over 20 businesses and projects in its home state, supplying \$4 million for single- and multi-family housing and commercial real estate projects. MetaFund received a \$50 million NMTC allocation in 2003. It plans to use the credits help companies in all stages of the business life cycle via loans, equity



This workman in repairing the remaining roof supports in preparation for the reconstruction of the dilapidated Longwood Plaza. This gut renovation was only "doable" because of the financial infusion from the sale of new markets tax credits.

"What we like to do is what I call a 'but for' transaction - 'but for' our involvement, the transaction wouldn't happen. We don't want to do a project a bank or investor would do anyway."

MetaFund Chairman and President A. Thomas Loy

and near-equity investments. An estimated 50 percent of its activities target urban areas, 35 percent target rural areas, and the remaining 15 percent will target suburban areas of Oklahoma.

To allow investors to target their funds to a particular project, MetaFund developed an LLC structure that uses preferred series stock to isolate an investor's project. A bank can invest in a single preferred series of MetaFund stock, which becomes the exclusive domain of investments from that bank investor. The bank then services the loan, with MetaFund providing a vehicle for flowing the tax credits back to the bank.

Saving Jobs

In its first NMTC deal, MetaFund partnered with Stillwater National Bank to put together a 'but for' loan that saved more than a dozen jobs in a small, central Oklahoma town. The loan funded the purchase of a defunct manufacturer that built a pipeline gas-flow measurement device. The purchasing company, which holds a patent on the measurement device, resurrected the business and retained the employees.

Stillwater Executive Vice President and Chief Lending Officer Jerry Lanier says the \$3.8 million NMTC deal benefited the bank and the borrower, which got a lower interest rate. "It's a small town that needed the industry and because [the plant was in] a rural county, the additional Oklahoma tax credits were greater than if they were in a metropolitan area, so that benefited the bank. We would certainly do it again," Lanier says.

NMTC Investments and Loans Eligible for CRA Consideration

Investments in community development entities (CDEs) can receive qualified investment consideration when the investment benefits the bank's assessment areas, provided the CDE's financial tools (loans or investments) promote economic development financing small businesses or farms and help to revitalize or stabilize low- and moderate-income areas.

Financial institution CDE loans to qualified active low-income community businesses (QALICB) or CDEs can receive community development loan consideration under CRA.

Loans less than \$1 million are reported as small business loans, and larger loans reported as community development loans (similar loans made by wholesale and limited purpose banks would all be considered community development loans).

See:

<http://www.occ.treas.gov/interp/feb04/int984.pdf>

An Existing Structure

Key Bank, NA looks at NMTCs as an opportunity to increase the reach and flexibility of its 15-year-old community development banking operation, which includes a community development lending and equity group and a home mortgage origination group focused on the low- and moderate-income segment. Community Development Banking's 105 staff members handle affordable housing, construction and permanent loans, equity investments, infill single-family construction loans, home mortgage loans, and economic development lending deals brought in by the group's community development loan officers spread across a 12-state footprint.

"The New Markets Tax Credit program has expanded our scope by giving us the flexibility of using the credits in our

There are many benefits to being both a NMTC investor and NMTC grantee, says Key Bank's Senior Vice President and National Manager of Community Development Lending John Kastellic. One is that loans are more affordable for community borrowers. On the equity side, rates of return are lifted on projects that might not otherwise offer enough cash flow or real estate tax benefit.

Going forward, Key hopes to use the NMTC as a partial guarantee -- primarily for small business lending -- for loans that would not be bankable because of their credit risk. Those loans would be

pricing on the loan side, making the financing more affordable."

John Kastelic, Key Bank senior vice president and national manager of Community Development Lending

closed its first NMTC loan in January 2004, a neighborhood shopping center deal in an economically fragile area of Cleveland. Raising all of the financing for the shopping center deal was tricky, says Russell Berusch, senior vice president of New Village Corp., the nonprofit developer of the project.

"Without the lower interest rate that Key provided by virtue of having the NMTC allocation, the project would not have gotten done. This project is fragile economically, because it's in an extremely poor neighborhood. The blended cost of funds had to be low, so the tenants could have rents that they could live with," says Berusch. "Without the NMTC program this project could not have been financed."

Today, the 39,000 sq. ft. center is in the midst of a \$6 million renovation including a new facade, brighter lighting, improved landscaping, increased security and a 19,000 sq. ft. Dave's Supermarket. Key Corp provided just over \$1 million of the project's funding, with the remainder coming from National City Community Development Corp., the City of Cleveland, federal grants and a \$25,000 equity contribution from New Village.

Alike More than Different

While Key and MetaFund have taken two very different approaches in the way they implement the NMTC program, they share a common goal: improving the lives of residents and businesses with programs that benefit all. And in the end, what's important is not so much how each CDC got where it was going, but rather that it was able to get deals going with NMTC that otherwise wouldn't fly.

priced conventionally with the NMTCs viewed as an additional loan loss reserve.

Key Community Development New Markets I LLC will use its \$150 million allocation primarily for shorter-term, construction-only loans and plans to recycle the returned funds as projects pay off.

Recent Project

Key





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This Just In...OCC's Districts Report on Investment Opportunities for Banks



Northeastern District

John Farrell (617) 482-1643

Denise Kirk-Murray (212) 790-4053

Investing in Sustainable Forestry

Rural banks in northern New England and upstate New York now have the opportunity to invest in a vital industry sustaining their communities: forestry. Under a new investment fund introduced by Coastal Enterprises, Inc., banks can receive tax credits for their participation in a program providing long term working capital for sustainable timber harvesting and forest management across the northern regions of Maine, New Hampshire, Vermont and New York. The project has received an allocation of New Markets Tax Credits, and investors purchasing these tax credits will be capitalizing a fund supporting forest-based businesses such as paper mills while helping to sustain jobs and maintain working forests and receiving a direct credit to federal taxes at the same time. Last year, Coastal Enterprises celebrated its 25th year of providing critical support to community development initiatives in Maine, and is now expanding its market to encompass all of the northern New England and upstate New York. For further information about this and other funds in these rural geographies, contact Coastal Enterprises, Inc, at (207) 882-7552.

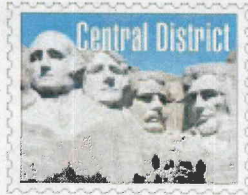
Connecticut Loan Fund Receives Grant

The Greater New Haven Community Loan Fund (GNHCLF)—a certified community development financial institution—received a \$175,000 financial assistance award from the Treasury's CDFI Fund. GNHCLF has been providing flexible, alternative financing in support of affordable housing and other community development projects in the New Haven area for fifteen years. The Financial Assistance award will be used as a credit enhancement for its loan programs, and will also support its efforts in providing homeownership counseling and financial literacy training for individuals and non-profit developers. The Fund lends to developers of affordable housing who incorporate sustained affordability into their projects, including community land trusts and limited equity cooperatives. The Fund is seeking investors, and offers flexible, negotiated rates of return on investments for periods ranging from one to 20 years. For further information on the Fund's projects or to learn how to make an investment, contact the Greater New Haven Community Loan Fund at (203) 789-8690.

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Central District

Paul Ginger (312) 360-8876



Norma Polanco (216) 447-8866

Equity Network in Rural Minnesota

Minnesota Investment Network Corporation (MINC) provides equity financing and business expertise to help small companies located primarily in rural Minnesota

grow and prosper, resulting in returns to investors, and jobs for communities. MINC also helps communities develop local capacity to make equity investments by organizing investors into RAIN® *funds* - a series of investment funds that pool the intellectual and financial resources of local investors to make equity investments in small businesses. Since 1998, MINCORP has raised more than \$15 million, made 25 investments and helped start seven RAIN® *funds* in Minnesota, Iowa and North Dakota, with three more in process. MINC is a certified community development financial institution that seeks competitive returns appropriate for the risks. Banks have referred companies needing equity to MINC, participated as senior lenders in financing companies in MINC's portfolio and have participated in organizing RAIN® *funds* with MINC. In addition banks have invested directly in MINC to provide equity investment capital to serve small businesses in the banks' market areas. For more information, contact Steve Mercil at 651-632-2140 or at smercil@mincorp.org. MINC's web site is <http://www.mincorp.org/>.

Cooperative Financing in the Upper Midwest

Northcountry Cooperative Development Fund (NCDF) is a for-profit, cooperatively owned loan fund that provides financing, training and expertise to small producer, consumer, affordable-housing, worker and land cooperatives in eleven states in the upper Midwest. NCDF today has more than \$8 million in assets, has made hundreds of loans to cooperatives since its founding in 1978 and has contained losses since 1978 to 0.27% of dollars loaned. Investors in NCDF include banks, cooperatives, religious orders, foundations and others. Certified by the Community Development Financial Institution (CDFI) Fund as a CDFI and as a community development entity, NCDF also has funding from the U.S. Department of Agriculture to help develop and finance rural housing cooperatives, and NCDF last year established a community development credit union that helps members of cooperatives finance their membership shares. Banks are involved with NCDF as co-lenders, as investors and on the board of directors. For more information, contact Margaret Lund at (612) 331-9103 or at margaret@ncdf.coop. NCDF's web site is <http://www.ncdf.org/>.

Kentucky Tax Credits for Small Business Investments

The Kentucky Investment Fund Act (KIFA) offers a 40% state tax credit to investors in funds that invest in small businesses in Kentucky. The purpose of KIFA is to encourage capital investment and small business development in Kentucky, to provide jobs to state residents, and to encourage the development of new products and technologies in Kentucky. After credits are allocated to a fund, the credits are proportionately granted to the fund's investors upon its completion of qualified investments. The Kentucky Economic Development Finance Authority and the Office of the New Economy allocate the credits to investment funds and administer the program. Nearly \$3 million in credits were awarded to three investment funds last year, and a new round of applications ended on March 15, 2004. Investment funds receiving tax credit allocations now are seeking investors. Banks can participate as investors in funds, can help to form new funds in subsequent rounds of the program, can finance businesses receiving investments from the funds and can refer businesses needing capital investments. For more information, contact Donna Dutton at 502-564-0531 or at Donna.Dutton@ky.gov. A complete description of

KIFA is available at http://www.one-ky.com/KIFA_TaxCredits.html .

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Southern District

Karol Klim (404) 588-4538

David Lewis (214) 720-7027

Banks Investing in Atlanta's Future

Investing in the Community Redevelopment Loan and Investment Fund, Inc. (CRLIF), a CDFI fund has proven to make a difference to metro Atlanta's most distressed neighborhoods. An affiliate of the Atlanta Neighborhood Development Partnership, Inc. (ANDP), CRLIF became a certified CDFI in 1999. Throughout its 13-year history, ANDP has been engaged in developing housing for people of moderate to low incomes. Their dedication to creating mixed-income neighborhoods has resulted in helping to build or renovate more than 7,800 housing units in the Atlanta metropolitan region. CRLIF assists ANDP with creating affordable housing by providing low interest loans to community development corporations and other nonprofit housing developers. Financial institutions and foundations can donate or invest from \$250,000 to \$5 million. One of the ways ANDP is able to rejuvenate distressed communities is through CRLIF, because it is able to underwrite risks that typically do not meet traditional lending criteria. CRLIF's CDFI fund totals \$12 million and also allows area banks to qualify for the Treasury Department's Bank Enterprise Award (BEA). For further information, please contact, CRLIF Director K.C. George, (404) 522-2637, or visit their website at www.andpi.org/housingfindept.

Promoting Business Expansion and Job Creation at Southeast Community Capital

Southeast Community Capital provides the growth capital businesses across Tennessee and the Southeast need for expansion and job creation. SCC was created in December 1999 as a statewide effort to increase access to capital for Tennessee's disadvantaged small businesses. SCC received its CDFI certification in May of 2001. With headquarters in Oak Ridge, SCC has added offices in Chattanooga, Memphis, and Nashville, TN. In each city, SCC has created a public-private partnership between the city and financial institutions. In each location, SCC manages a business opportunity fund, as well as its regional revolving loan fund that services all of Tennessee, northern Alabama, and northern Georgia. SCC's strategy is to grow each of its funds to more than \$5 million so that each fund will be self-sustaining and can meet local demand. Each fund focuses on disadvantaged areas and individuals for business growth and job creation in the local market. SCC is in the process of creating two funds, a regional loan fund for East Tennessee as part of the Nine Counties One Vision initiative and a city fund for Baton Rouge, LA. For information or to contact SCC about possible investment opportunities email gwin@sccapital.org or go to www.sccapital.org .

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Western District



Susan Howard (818) 240-5175

Dave Miller (720) 475-7670

Colorado Revolving Loan Fund Leverages Bank Investments

Bank investments in revolving loan funds like the Colorado Enterprise Fund can improve the future financial strength of entrepreneurs who may develop into future small business borrowers. The Colorado Enterprise Fund (CEF) is a non-profit community development financial institution providing financing for small businesses that may qualify for future bank loans but need time and experience to demonstrate that they are bankable. CEF provides up to \$150,000 to entrepreneurs who are unable to obtain financing from traditional sources. CEF also provides management assistance to their small business borrowers. CEF provides entrepreneurs access to *pro bono* professional services for legal, accounting, investment banking, and public relations questions. CEF loan programs include a specialized loan program designed to facilitate capital investment in childcare businesses. The expansion of childcare businesses provides a critical service to the employees of many companies as well as economic development. Investors in CEF include the U.S. Small Business Administration, the State of Colorado, US Bank and FirstBank. Contact: Colorado Enterprise Fund (303) 860-0242; <http://www.coloradoenterprisefund.org>

Nebraska Microenterprise Partnership Fund Provides Critical Funding for Microenterprise Loan Programs

Entrepreneurs build their livelihoods and their communities one job at a time primarily through small, family-operated businesses and farms. Microenterprises, businesses with five or fewer employees make up the majority of the small businesses in the United States. Microenterprise lenders are often in small rural communities and lack the resources to raise capital to fund their small business borrowers. The Nebraska Microenterprise Partnership Fund (NMPF), a community development financial institution, is a statewide financial intermediary providing funding for microenterprise loan programs. NMPF raises funds from national, state and private sources to fund grants and loans to microenterprise loan programs throughout the state of Nebraska. Access to funding and technical assistance through NMPF creates significant opportunities for new microenterprise lenders. NMPF has provided support for two microenterprise loan programs recently certified as community development financial institutions, the Self Employment Loan Fund of Lincoln Nebraska and Northeast Economic Development, Inc. in Norfolk, Nebraska. NMPF has received investments from financial institutions seeking to increase the level of microenterprise in the communities they serve. Investors include the state of Nebraska, the U.S. Small Business Administration, the U.S. Department of the Treasury Community Development Fund, US Bank, Wells Fargo Bank, and First National Bank of Omaha. For more information please contact: Nebraska Microenterprise Partnership Fund (402) 846-5757; <http://www.nebiz.org>

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Legal Authority for National Bank Investments in Subsidiary Community Development Entities and NMTCs

By Steven Key, Senior Attorney, Bank Activities and Structure Division, OCC

The OCC determined, in the 2003 revisions to 12 CFR 24 (Part 24), that a national bank investment in a new markets tax credit community development entity qualifies as a public welfare investment. Since then, several national banks have asked whether all investments in community development entities (CDE) must use the Part 24 investment authority and be subject to the capital and surplus requirements. The short answer is: No. Below are some questions and guidance to help you better determine when a bank can use another authority.

If a CDE limits its activities to making loans, can a national bank invest in a CDE pursuant to other legal authority?

Yes. A national bank may invest in a CDE either as an operating subsidiary or as a non-controlling equity investment if the requirements in [12 CFR 5.34](#) or [5.36](#), respectively, are satisfied. Such investments would not be subject to the limitations of Part 24.

What exactly is an operating subsidiary?

An operating subsidiary is a separate corporation, LLC, or similar entity, in which a national bank maintains more than a 50 percent voting or similar type of controlling interest, or otherwise controls the subsidiary and no other party controls more than 50 percent of the voting (or similar type of controlling) interest of the subsidiary. An operating subsidiary may engage in activities that are part of, or incidental to, the business of banking, including the making of loans or other extensions of credit. Operating subsidiaries are governed by 12 CFR 5.34.

Must a bank submit an application or notice to the OCC to establish an operating subsidiary?

Yes, a bank that intends to acquire or establish an operating subsidiary usually must submit an application or notice to the OCC. Well-capitalized and well-managed banks may file under the notice process for the acquisition or establishment of an operating subsidiary that will engage in only "eligible activities." The eligible activities, which are listed in 12 CFR 5.34(e)(5)(v), include making loans or other extensions of credit. If a bank is not well-capitalized and well-managed (or if the proposed activities are not eligible activities), the bank must follow the standard application process for all activities. See "Investment in Subsidiaries and Equities," *Comptroller's Licensing Manual*, for detailed guidance on the operating subsidiary filing procedures.

Pursuant to Part 5, may a national bank own, either directly or through an operating subsidiary, a non-controlling interest in a CDE that engages only in eligible activities?

Yes, the OCC permits national banks to own, either directly or through an operating subsidiary, a non-controlling interest in such a CDE. The CDE may be a corporation, limited partnership, LLC, or similar entity. Twelve CFR 5.36 provides a notice procedure for well-capitalized and well-managed banks to make certain types of non-

controlling investments, including non-controlling investments in entities engaged in the eligible activities listed in 12 CFR 5.34(e)(5)(v). For further details on the information that must be included in a non-controlling investment notice, see 12 CFR 5.36.



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 17, 2003

Interpretive Letter #984
February 2004
12 USC 2901

Subject: New Markets Tax Credits

Dear []:

This letter responds to your inquiry whether a financial institution's investment in connection with the New Markets Tax Credit (NMTC) Program in a "Community Development Entity" (CDE), or a loan by a financial institution CDE to a "Qualified Active Low-Income Community Business" (QALICBs) or another CDE, would receive consideration as a qualified investment or a community development loan, respectively, when the institution's Community Reinvestment Act (CRA) performance is evaluated. We conclude that such investments and loans would be favorably considered under the CRA.

New Markets Tax Credit Program

The NMTC Program (Program) was a part of the Community Renewal Tax Relief Act of 2000.¹ The Program was expected to stimulate investments that, in turn, would facilitate economic and community development in distressed communities.²

The Program created a tax credit for taxpayers' "Qualified Equity Investments" (QEIs) in CDEs.³ A CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in "Low-Income Communities" (LICs).⁴ CDEs must demonstrate that they (1) have a primary mission of serving, or providing investment capital for, LICs or low-income persons and (2) are accountable to residents of the LICs that they serve. CDEs are required to invest "substantially all" (generally 85 percent) of the proceeds of

¹ H.R. 5662, introduced on Dec. 14, 2000. Section 121(a) of Subtitle C of Title I of H.R. 5662 was enacted by section 1(a)(7) of the Consolidated Appropriations Act of 2001, Pub. L. 106-554 (Dec. 21, 2000).

² See, e.g., Guidance, New Markets Tax Credit Program, 66 Fed. Reg. 21,846 (May 1, 2001).

³ See 26 U.S.C. § 45D. Over a seven-year period, an investor may claim a tax credit of 39 percent (30 percent in present value terms) of the amount of its QEI.

⁴ LICs are census tracts with a poverty rate of at least 20 percent, or census tracts where the median family income is below 80 percent of the area median family income.

the QEIs into LICs, including loans or investments in QALICBs.⁵ In addition to investments in QALICBs, other “Qualified Low-Income Community Investments” (QLICIs) for CDEs are equity investments in, or to, another CDE; the purchase of a QLICI loan from another CDE; and financial counseling and other services to businesses located in, or residents of, LICs.

Community Development Financial Institutions and Specialized Small Business Investment Companies are automatically eligible to be designated as CDEs, but must complete an abbreviated application. Insured depository institutions with a primary mission of serving LICs or low-income persons, and with accountability to the LIC,⁶ also may be designated as CDEs.

Community Reinvestment Act

Community development loans and qualified investments are important considerations in financial institutions’ CRA performance evaluations. For larger banks, which are evaluated under the lending, investment and service tests, examiners routinely evaluate both community development loans and qualified investments. For smaller institutions, community development loans are routinely included when determining an institution’s loan-to-deposit ratio, while qualified investments that are lending-related are considered along with an institution’s loans. In addition, examiners will consider a small institution’s other qualified investments if a small institution wishes to be considered for an “Outstanding” rating. Along with community development services, community development loans and qualified investments comprise the basis for the CRA performance evaluation for wholesale and limited purpose institutions that are evaluated under the community development test. Finally, institutions that are evaluated under an approved strategic plan may include community development loans and qualified investments in their measurable goals.

A “community development loan”

- has a primary purpose of community development; and,
- except in the case of wholesale or limited purpose banks,

⁵ In order to qualify as a QALICB, and therefore be eligible to receive CDE investments, a business must meet the following criteria:

- At least 50 percent of the total gross income is from the active conduct of a qualified business in LICs;
- At least 40 percent of the use of the tangible property of the business is located in LICs;
- At least 40 percent of the services provided by the business’ employees are performed in LICs;
- Less than five percent of the average of the aggregate unadjusted bases of the property is attributable to collectibles (e.g., art and antiques), other than those held for sale in the ordinary course of business (i.e., inventory); and
- Less than five percent of the average of the aggregate unadjusted bases of the property is attributable to nonqualified financial property (e.g., debt instruments with a term in excess of 18 months).

(The gross income test is deemed to be met if either the tangible property or the services test is at 50 percent or higher.)

⁶ “Accountability” to the LIC may be demonstrated, for example, through representation by residents of the LIC on a governing board or advisory board of a corporate CDE.

- has not been reported or collected by the institution or an affiliate for consideration in the institution's assessment as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan; and
- benefits the institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s).⁷

A "qualified investment" is a "lawful investment, deposit, membership share, or grant that has as its primary purpose community development."⁸

"Community development" means:

1. Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
2. Community services targeted to low- or moderate-income individuals;
3. 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 (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or
4. Activities that revitalize or stabilize low- or moderate-income geographies.⁹

Discussion

Would a financial institution's investment in a CDE receive consideration as a qualified investment during the institution's CRA evaluation?

An institution's equity investment in a CDE would receive consideration as a qualified investment if the investment benefits the institution's assessment areas or a broader statewide or regional area that includes its assessment areas. Such investments may be considered to have a community development purpose under two prongs of the "community development" definition. First, to the extent that the CDE loans or invests in small businesses or farms, the qualified investment in the CDE promotes economic development by financing small businesses or farms. Second, because the primary mission of the CDE is to serve LICs, the loans and investments made by the CDE generally would help to revitalize or stabilize low- or moderate-income geographies.

Would a loan by a financial institution CDE to a QALICB or to another CDE receive consideration as a community development loan?

As long as a loan by a financial institution CDE to a QALICB or to another CDE has not been reported or collected by the institution or an affiliate for consideration in the institution's

⁷ 12 C.F.R. § 25.12(i).

⁸ 12 C.F.R. § 25.12(s).

⁹ 12 C.F.R. § 25.12(h). Low- or moderate-income individuals have income that is less than 80 percent of the area median income. Low- or moderate-income geographies have a median family income that is less than 80 percent of the area median income.

assessment area as a home mortgage, small business, small farm, or consumer loan (unless it is a multifamily dwelling loan), the loan would receive consideration as a community development loan.¹⁰ Loans under \$1 million to a QALICB or CDE by a retail institution would be reported as small business loans. However, larger loans would be considered community development loans because the loans have a primary purpose of community development, as discussed above.¹¹ For wholesale and limited purpose institutions, which are not evaluated on their small business lending, loans of any amount to a QALICB or CDE would be considered community development loans.

I trust this letter responds to your inquiry. I have shared this response with my colleagues at the other bank and thrift regulatory agencies, and they concur with this analysis. If you have further questions, please contact me at (202) 874-5750.

Sincerely,

-signed-

Michael S. Bylsma
Director
Community and Consumer Law Division

¹⁰ Of course, for retail institutions, the loan would also need to benefit the institution's assessment areas or a broader statewide or regional area that includes its assessment areas.

¹¹ The analysis whether a loan by any retail institution to a CDE would be a community development loan would be the same – if the loan is not reported or collected as a home mortgage, small business, small farm or consumer loan (unless it is a multifamily dwelling loan), it would receive consideration as a community development loan.