



# **Community Investing: Understanding CRA and Community Development**

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# Reviewing Community Development Activities

- Understanding the definition of “Community Development”
  - What is the primary purpose
  - Who are the target group
  - What geographic area receives benefits
  - Responsive to community needs
  - May be innovative and complex

# What is Community Development?

- Affordable Housing
- Activities that Promote Economic Development
  - Financing Small Businesses and Farms
- Activities that Revitalize and Stabilize LMI geographies
- Activities that revitalize and stabilize –expanded to include:
  - Designated Disaster Areas
  - Distressed non-met. middle income geographies
  - Underserved non-met. middle income geographies

# Expanded Definition of Community Development

- Includes loans, investments, and services
  - For projects or activities that meet “eligible uses” criteria and relate to approved NSP plans
  - Must be In designated target areas
  - May be outside AA as long as needs of AA are adequately addressed
- Key change – loans, investments, and services related to NSP may benefit middle-income borrowers or geographies

# NSP – Eligible Uses

- Financing mechanisms for foreclosed properties
- Purchase & rehab abandoned or foreclosed homes & residential properties
- Land banks for foreclosed properties
- Demolition of blighted structures
- Redevelopment of demolished or vacant properties

# ISB Community Development Test

- The number and amount of community development loans
- The number and amount of qualified investments
- Provision of community development services
- Responsiveness to these activities

# Some Community Development Investment Programs & Products

- Low Income Housing Tax Credit – (LIHTC)
- Small Business Investment Companies – (SBIC)
- CRA Targeted Mortgage Backed Securities
- New Markets Tax Credits – (NMTC)
- Community Development Financial Institutions (CDFI)
- Community Development Corporations – (CDC)
- Minority or Women-Owned Financial Institutions and Low Income Credit Unions
- Grants to qualified CBO and programs, e.g. IDAs

# Regulators' Presumption during CRA Exam

- Any loans to or investments in the following:
- Low Income Housing Tax Credits
- Small Business Development Company
- Small Business Investment Company
- Rural Business Investment Company
- New Markets Tax Credits
- Community Development Entity
- Promote economic development

# Low Income Housing Tax Credits

- To Leverage private funds for construction and rehabilitation of rental units for low and moderate income households
- LIHTC Investors receive dollar-for-dollar credits on their federal taxes
- Credits are claimed annually for 10 years
- Rental properties must reserve a specific number of units for LMI tenants during the compliance period
- Properties receiving tax credits are required to stay eligible for 30 years. (Used to be 15 years)
- Institutions can purchase tax credits directly or through syndicators – Multibank (CDCs)

# Example

- VA LIHTC – based on population e.g. 10 Million.
- \$1.75 tax credit per capita.
- 10 Million x \$1.75 - \$17.5 Million
  
- \$100,000 tax credit translates to \$10,000/yr.
- Sold on the market e.g. at 90 cents on the \$
- Translates to \$9,000 tax credit/yr for 10 years
- Apartment project raises \$90,000 equity for development costs

# What is an SBIC?

- A Small Business investment Company is.....
  - A Private Investment Fund
  - With Private Management
  - And Private Investors
- *Formed specifically to invest in small businesses, generally where equity participation is a significant component of the financial return*

# How Does the SBIC Program Work?

The program is administered and managed by the SBA

- Organization
- Licensing
- Funding Leverage
- Investment Parameters
- Oversight

# Small Business Investment Companies (SBICs)

- By statute, investments in SBICs are considered economic development investments for CRA purposes
- Types of returns – SBICs do not necessarily produce current income
- Appreciation – SBIC returns on investment are long term and lumpy
- With SBICs, it is essential that banks understand the investment philosophies of the fund managers and their track record
- SBICs are examined and monitored by SBA examiners periodically.

# Examples of SBIC funded Entities

- Federal Express
- Apple Computers
- Amgen
- Outback Steakhouse
- Compaq
- Staples
- Costco Wholesale
- Palm Computing
- Sun Microsystems
- Intel

# SBIC Investment Restrictions

- Prohibited Investment categories
  - Project Financing
  - Real Estate and Farm Land
  - Passive Businesses
  - Financial institutions
  - Businesses with majority of assets or employees outside the US

# CRA Targeted Mortgage-Backed Securities

- The CRA-MBS are targeted to specific geographic assessment areas
- The issuer or seller matches the requested borrower profile and income specification (LMI)
- Securities are liquid and typically have no resale restrictions
- Issuer provides bank with pertinent loan data on the mortgages backing the securities

# CRA Targeted Mortgage-Backed Securities

- Compared to other CRA Qualified Investments (Some Munis, LIHTCs, Low Yield Deposits, CRA Mutual Funds, Grants)
  - **CRA Qualified Investments**
  - **Credit Risk/Guarantee** (Agency – Fannie/Freddie have timely payment of interest and principal; Agency long term unsecured debt is AAA and the MBS are further backed by the mortgaged properties)
  - **Attractive Yields** (Normally higher than Treasuries and Corporate bonds of comparable maturity and credit quality)
  - **Excellent Liquidity**
  - **Low Transaction Costs** – No Management Fees
  - **Saves Bank Personnel Resources** (No Loan File Reviews, etc.)

# Community Development Financial Institutions (CDFI) Fund

- The mission of the CDFI Fund is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States.
- CDFIs – Eligible Entities include thrifts, banks and Credit Unions, Depository HC

# CDFI Fund

The CDFI Fund achieves its mission by directly investing in and supporting **Community Development Financial Institutions (CDFIs), Community Development Entities (CDEs), and other financial institutions** through the following programs and initiatives:

- **Certification Programs (CDFI and CDE) {CDCI}**
- **CDFI Program Financial Assistance (FA) & Technical Assistance (TA)**
- **Bank Enterprise Award (BEA) Program**
- **New Markets Tax Credit (NMTC) Program**
- **Native Initiatives**
- **Financial Education and Counseling Program**

# New Markets Tax Credits

- Program is administered by the CDFI Fund
- Designed to help underserved communities by offering tax benefits to equity investors
- Allocate tax credits to support equity investments in rural and LMI areas
- The 2011 allocation was \$3.5 billion
- Community Development Entity designation is for applied through the CDFI Fund
- Tax credits are awarded to Community Development Entities on competitive basis

# New Markets Tax Credits

- Tax credits are taken at 5% annually over the initial three years and 6% annually over the remaining four years – Total of 39% over 7 years
- Investments – Qualified Low Income Community Development Investments (QLICIs)
- A CDE has 5 years to sell the credits for cash
- The CDE has 12 months to invest “substantially all” the proceeds from the QEI into QLICIs

# Other Key CD Investments

- Investments in Minority and Women-owned Financial Inst. and Low-Income Credit Unions
- Various investments undertaken by banks with MDI, women-owned financial institutions or low-income credit unions
- Activity must meet the credit needs and benefit the Assessment Area for the bank to get full CRA credit
- New Q&A – clarifies that the geographic restriction does not apply to CAPITAL INVESTMENTS undertaken by banks in cooperation with MDI, Women-owned financial institutions and low income credit unions.

# Community Development Services

- Service must have CD as its Primary Purpose
- Typically related to the provision of financial services
- Examples:
  - Providing financial services through branches and other facilities located in LMI areas
  - Financial services to help revitalize and stabilize LMI geographies
  - Technical Assistance – Non profit and Tribal entities serving LMI or economic revitalization needs
  - Providing financial education to LMI or entities serving them



Questions?