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?