Community Development Investments and the CRA Investment Test

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Agenda

- Public welfare investments vs. community development investments
- Primary types of investments
- Banker panel
- How much is enough?
- Regulator panel

Public Welfare Investments (PWI)

- “Qualified investment means a lawful investment, deposit, membership share, or grant that has as its primary purpose community development”
- Financial institutions need to make sure they have the LEGAL AUTHORITY to make a proposed community development investment
- Bottom line: check with your legal department to ensure authority

Public Welfare Investments

- OTS: thrift rules for investment authority are unique (see “Community Development Investment Authority” from the OTS)
- FDIC: refers to OCC rules for permissibility; cap of 2% of assets on housing investments; so specific public welfare cap

Public Welfare Investments

New Federal Reserve and OCC rules

- After-the-fact notification up to 5% of capital stock and surplus (under certain conditions)
- Prior approval up to 15% (used to be 10%)
- Under new definition, PWI must benefit LMI geographies or people

Public Welfare Investments

- The public welfare rules give banks the authority to make certain investments, but not all community development investments require the use of public welfare authority
- Typically DON'T need public welfare authority: MBS, bonds, SBIC, deposits, grants
- Typically DO need public welfare authority: LIHTC, NMTC, EQ2, CDVC

Community Development

- “Qualified investment means a lawful investment, deposit, membership share, or grant that has as its primary purpose community development”

1. Affordable housing for LMI individuals
2. Services for LMI individuals
3. Promote economic development by financing small biz/small farm
4. Revitalize and stabilize LMI geographies (or disaster areas or certain rural areas)

Types of investments

- Mortgage-backed securities (MBS)
- Low Income Housing Tax Credits (LIHTC)
- New Markets Tax Credits (NMTC)
- State/municipal bonds
- Small Business Investment Companies (SBIC)
- Loan funds/CDFIs
- Community development venture capital
- Equity-equivalent investments (EQ2s)
- Other investment funds
- Deposits
- Charitable contributions

Mortgage-backed securities (MBS)

- Pool of mortgages targeted to LMI borrowers
- Widely available
- Appetite for targeted MBS varies with interest rate environment
- Generally not considered high-impact or innovative, but can add volume

Low Income Housing Tax Credits (LIHTC)

- LIHTC is a credit against regular tax liability for investments in affordable housing projects; credit is available annually over a ten-year period
- Project must meet minimum set-aside requirements continuously for a full 15-year compliance period (longer in many places)
- Can be done directly or indirectly through a syndicator
- Intense competition has driven returns down
- High impact; direct investments can be complex

New Markets Tax Credits (NMTC)

- $15 billion in credits (plus $1 billion in hurricane relief); 39% credit over 7 years
- Treasury Dept. allocates credits to Community Development Entities (CDEs); CDEs invest in “low-income communities”
- Can be very complicated
- Competition for allocations has resulted in high-impact proposals
- Partner with allocatees or other NMTC investors

State/municipal bonds

- General term for any security issued by state, county, local government
- Can take a variety of forms (revenue bond, tax allocation bond) and for a variety of purposes (housing, infrastructure)
- Competitive market: lots of investors looking for action (impact of new insurance law?)
- Make sure the bond meets the definition of community development (use special caution with “affordable housing” bonds)

Small Business Investment Companies (SBICs)

- Privately-owned venture capital funds licensed by the SBA to invest in the long-term debt and equity securities of small businesses
- Automatically qualify as community development, but examiners will be looking at impact (RBICs also automatically qualify)
- Have separate investment authority

Loan Funds/CDFIs

- Provide capital for loan funds
- Equity investments in loan funds can take advantage of "double counting" rule
- High impact (leverage)
- Can be innovative and complex

Community development venture capital

- CDVC funds make “double bottom line” equity investments in small businesses
- Generally considered more innovative
- Can also be high-impact
- Not usually provided by private investors

Equity-equivalent investments (EQ2s)

- Long-term deeply subordinated loan with features that make it function like equity
- Use caution to ensure compliance with accounting guidance
- Extremely innovative, complex, and high-impact
- Not as popular as they once were

Other investment funds

- Indirect investments through funds like Access Capital or CRA FundAdvisors
- Funds invest in a variety of CRA-qualified instruments
- Outsource some of the technical skills, legwork, due diligence
- Can be fast, efficient

Deposits and Charitable Contributions

- Deposits: not a major part of Investment Test strategy, but can add some variety to your story
- Contributions: important to track these separately to see how you compare; have good documentation on why your contributions qualify

Banker Panel

How Much Is Enough?

- Volume (assets, Tier 1, deposits)
- Geographic coverage
- Innovative/complex/leadership
- Community impact
- Risk/return

Regulator Panel

Questions?

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