



F R I E D M A N B I L L I N G S R A M S E Y ®

CAPITAL FOR YOUR CONQUEST

OVERVIEW OF COMMUNITY DEVELOPMENT
INVESTMENT INSTRUMENTS:

**PRUDENT INVESTMENT
OPPORTUNITIES**

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Fixed Income

2006
MARCH



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GENERAL COMMENTS

Opportunities discussed in this presentation may or may not be actually offered in the marketplace at this time. No recommendation to pursue such investment opportunities or any securities is being made.





CRA INVESTMENT OPPORTUNITIES

- WHAT IS NEW ON THE HORIZON?
 - Innovative?
 - Not routinely available from private investors?
 - Complex?
 - Address community needs?
 - Can they generate significant amounts of CD investment?
 - Afford bank the opportunity to take a leadership role?



What Is Bank Owned Life Insurance (BOLI)?

- BOLI is life insurance purchased and owned by a bank on the lives of executives and directors, who consent to being insured.
- Unlike our personal life insurance policies, for which we pay monthly or annual premiums, BOLI premiums are paid upfront, creating a sizeable investment account (cash value).
- Cash Value of the life insurance grows tax-deferred.



WHAT IS CRA BOLI?

- If the Insurance Company policy offers a Separate Account that Invests the BOLI cash value in CRA-eligible investments, then banks can get “CRA Credit” for their BOLI Investment.



CRA BOLI IS CRA QUALIFIED

- **OCC -Interpretive Letter #1008** (July 19, 2004)

“The OCC has concluded, and the other agencies are in agreement.... that a bank’s investment in the BOLI-CRA separate account would be a qualified investment.”



CRA BOLI FUND

- Invest in geographically specific debt securities
- Generate a tax-advantaged, competitive return
- Predominantly invest in Agency, AAA, and AA credit quality, debt securities targeted to support community development activities
 - Single Family Affordable Housing
 - Multi-Family Affordable Housing
 - Small Business Lending
 - Job Creation
- Generate CRA Investment Test credit
- Could invest in loans, which might garner CRA Lending Test credit



Community Impact

- More than **\$60 Billion*** in current BOLI cash values are available to be invested to support CRA by just the 50 top banks alone!
- Additional BOLI investments are continually being made

* Source: FDIC



Huge Community Impact

- BOLI funds can be channeled to support:
 - Single Family Affordable Housing
 - Multi-Family Affordable Housing
 - Small Business Lending
 - Job Creation





CRA BOLI PROCESS

- Bank purchases (or already owns) BOLI
- Bank requests that a specific portion of its BOLI be dedicated to CRA and invested in a suitable vehicle
- Insurer identifies suitable investment that can also address geographic requirements
- Bank receives detailed report of target region investments, documentation to support CRA examinations



CRA Compliance Benefits

- Bank can indicate that it wants BOLI separate account investments tailored to provide the type of CRA “credit” that it desires
- Community Development Investment
- Lending Test
- Both





BOLI FINANCIAL BENEFITS

- Since it is life insurance, BOLI enjoys **tax-deferred** cash value growth and **tax-free** death benefit proceeds.





BOLI ECONOMICS 101

Common Features of Insurance Dedicated Bond Fund

- Tax-advantaged, market-rate investment
 - *Benchmarked to custom MBS/Treasury/Muni Index*
- High credit quality / low Risk Based Capital weight (20%)
- Stable value wrap reduces volatility of returns
- Diversified returns of a commingled vehicle



Why Make CRA Investments inside of BOLI?

		CRA Qualified Investments			
		Existing Product	Existing Product	Existing Product	Proposed Product
		CRA Mutual Fund	LIHTC Equity Investment	CRA-Targeted MBS Investment	BOLI based CRA-MBS Fund
Expected Gross Return ^{1,2}		5.70%	7.00%	5.70%	5.70%
less Mgt fee & expenses		<u>0.75%</u>	<u>N/A</u>	<u>N/A</u>	<u>0.40%</u>
Net return		4.95%	7.00%	5.70%	5.30%
less Taxes Due @		1.73%	0.00%	2.00%	0.00%
	35%				
less Insurance Expenses ³		<u>0</u>	<u>0</u>	<u>0</u>	<u>1.00%</u>
Net After-Tax Return on Investment		3.22%	7.00%	3.71%	4.30%
Fully Taxable Equivalent Yield (FTEY)		4.95%	10.77%	5.70%	6.62%
Financial Ratios:					
Cost of Funds		4.00%			
After-tax COF		2.60%			
Return on Assets (ROA)		0.62%	4.40%	1.11%	1.70%
Return on Equity (assuming 8% Capital)		7.72% 4	55.00% 1	13.81% 3	21.25% 2
Risk Weight		20%	100%	20%	20%
Return on Risk-Weighted Assets (RWA)		3.09% 4	4.40% 3	5.53% 2	8.50% 1

Assumptions:

- CRA-MBS are typically priced at a premium ranging from 3/8ths to 1 full point over TBA prices for regular MBS; this model assumes a premium of 5/8 which would reduce the expected yield by roughly 15bps.
- CRA or "Targeted" MBS may prepay slower than regular MBS which extends duration and adds positive convexity. This fact has been widely studied and reported; but, this phenomenon is not reflected in this simple model.
- Insurance costs are expressed over the life of the contract and the model assumes that the policies are held until death. (Total costs include premium tax, DAC tax, mortality, stable value wrap, distribution and M&E for a single premium MEC contract)

Source: FBR & Co., Inc

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SMALL BUSINESS HELPS COMMUNITY DEVELOPMENT

- 46% of small business owners in America are women or minorities.
- 80% of small business owners use their credit cards to finance expansion since they do not have access to traditional forms of business credit
- 54% of small business workers have a high school degree or less
- 12 jobs are retained or created with each SBA loan financed business

Source: SBA



SBA LOAN FUND

- Fund would purchase the federally guaranteed portion of SBA loans. These loans qualify for CRA under the lending test and investments in the SBA Loan Fund should qualify for CRA credit under the investment test.
- Like other CRA loan funds, the Fund would allocate investor's CRA benefit by geography of the loans, while investor's return is diversified in that it is based on the performance of the entire SBA Loan Fund.



SBA 7(a) Loan Program

- Loans guaranteed up to 85% by the US Government.
- Loan max. is \$2 Million.
- Average loan size is approx. \$500,000 with a weighted average life of 4 years.
- Typical loan is either a monthly or quarterly adjustable that is tied to the Prime Rate. SBA loans typically carry interest rates between 175-275 bps. over the Prime Rate, which is currently 7.5%.
- Fully amortizing, between 7 and 25 years. Loans can be prepaid. However, loans with a maturity 15+ years have a prepayment penalty of 5% during first year, 3% during second year, and 1% during third year.
- Many originators of SBA loans sell the federally guaranteed portion of the loans they originate, which carry the full faith and credit of the US Government. Their rates adjust as the Prime Rate changes.



SBA LOAN FUND ECONOMIC BENEFITS

- Since the federally guaranteed portion of SBA loan securities carries a 0% risk based capital charge, investments in the SBA Loan Fund would carry a 20% risk-based capital charge.
- Minimal interest rate risk



SBA LOAN FUND CD BENEFITS

- Would promote permanent job creation/retention and improvement in LMI areas and/or for LMI persons
- Would increase financial liquidity and may lower cost of capital within the Small Business Administration (SBA) Section 7(a) loan secondary market



SBA LOAN FUND

CRA Benefits:

- *Positive Consideration under the Investment and/or Lending Test* - Investor is investing in a partnership that buys Community Development Loans, where the business is located within LMI areas. Since these loans are owned in loan form (not securitized) an investment in this fund can be recorded under the investment or lending test of CRA.
- *Geographically Targeted CRA Benefits* -
- *“Safe and Sound”* - Primary asset of the Fund is federally guaranteed.
- *Innovative CRA Investment:* SBA loans are a unique way to do community investing



SBA LOAN FUND

- **Investment Benefits:**

- *Limited Interest Rate Risk* - Return is based on adjustable assets, so as interest rates increase so will coupons on loans in the fund.
- *Limited Credit Risk* - Primary asset is US Government Guaranteed SBA loan securities. SBA loan securities carry a 0% risk based capital charge, similar to US Treasuries.



SBA LOAN FUND

- The SBA 7(a) loans purchased would be adjustable rate (tied to the Prime Rate), so as interest rates increase or decrease, the coupon to the SBA Loan Fund's would remain constant as a spread over LIBOR.
- Due to the variable nature of the yields on the SBA loans, which change as market interest rates change, the value of the underlying loans should not fluctuate significantly.



For More Information. . .

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