FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4 Interagency Interpretive Letter Clarifies How Investments in National Funds Are Treated Under the Investment Test

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Responding to concerns raised by the Local Initiatives Support Corporation (LISC) and its subsidiary, National Equity Fund (NEF), the OCC issued an interagency interpretive letter on September 11, 1997 which clarifies how investments in national funds, which are then invested in low-income housing tax credit transactions, will be treated under CRA's investment test.

The letter addressed three major areas of concern and responded to each as follows:

1. *Direct vs. Indirect Investments:* The agencies clarified that the CRA regulations do *not* differentiate between direct investments in specific projects vs. indirect investments made through regional or national funds — as long as the investments meet the definition of *qualified* community development investments. Both are considered legitimate investments.
2. *Geographic Distribution:* At the time limited partnerships are formed through national funds such as NEF, financial institutions are obliged to invest in "blind pools," since actual projects receiving committed funds haven't yet been identified. Given CRA's focus on an institution's assessment area, there was concern that tax credit investments made

through a national fund (such as NEF) would not receive the same level of consideration as investments in local or regional funds.

However, NEF has reported that financial institutions can *geographically target* their investment(s) to areas that correlate with their assessment area or a broader statewide/regional area. "NEF will provide investors a written statement that it intends to invest a specified dollar amount in a geographical region specified by the investor and based on the NEF regional structure. These targeting assurances from the NEF allow a retail institution to meet its geographic investment needs with an investment in NEF."

Furthermore, for limited purpose or wholsesale banks, qualified investments in a statewide or regional area which includes its assessment area will be favorably considered in the evaluation of an institution's CRA performance. If the wholesale/limited purpose bank has adequately addressed the needs of its assessment area(s), it may invest in a nationwide fund without targeting its funds.

3. *How Examiners Evaluate Investments in Equity Funds:* A financial institution may receive CRA consideration for its equity investment in low-income housing tax credits *at the time it makes a binding investment commitment to the partnership;* there is no need to wait until funds have been dispersed to specific projects. Once the partnership is formed, each investor records the promissory note on its books and amortizes the investment over the life of the tax credit benefit period. In each subsequent year after the initial investment, the CRA consideration that an institution would receive for the dollar amount outstanding would reflect the investor's accounting treatment in that year. Thus, examiners will consider both new and outstanding investments in their investment test determinations.

"The interpretive letter provides a needed comfort level for financial institutions considering investing in national funds. These funds have proven to be excellent tools for increasing investment in low-income housing."
-Ellen Lazar, Executive Director, National Association of Affordable Housing Lenders

For a complete understanding of the issues, CRA and investment officers are encouraged to read the full text of the interagency interpretive letter. For a copy, please contact June Yambao in Community Affairs at (415) 974-2978.