Comptroller of the Currency
Administrator of National Banks

Community Developments

Spring 2000 *Community Affairs OnLine News Articles*

Multifamily Rental Housing and CRA

Articles in the Spring 2000 issue of *Community Developments* (www.occ.treas.gov/cdd/Spring2000.pdf) describe various methods in which national banks have assisted in the preservation and development of affordable multifamily housing. This article illustrates the connection between the good business opportunities that we have identified and the benefit banks may earn under the Community Reinvestment Act (CRA).

The CRA was enacted in 1977 to prevent redlining and to encourage banks and thrifts to help meet the credit needs of all segments of their communities, including low- and moderate-income neighborhoods. It extends and clarifies the longstanding expectation that depositories will serve the convenience and needs of their local communities within the overall context of safe and sound banking practices. Regulators assess national bank' records of helping to meet their communities credit needs pursuant to the CRA, its implementing regulation and clarifying questions and answers (Qs and As).

Under the CRA regulation, large banks (independent banks that have total assets of $250 million, or more or banks affiliated with a holding company that has total bank and thrift assets of $1 billion or more) are evaluated under the lending, investment, and service tests.

The banks involved in the projects discussed in the articles in this issue of Community Developments are large banks; consequently, this article focuses on the lending, investment, and service tests. In addition, because the projects discussed in this issue of Community Developments only address issues with respect to lending and investment, this article only discusses issues raised under these two elements of CRA.

Definitions

Large banks receive favorable consideration under the CRA for "community development loans," and "qualified investments," among other things. For purposes of the CRA, a "community development loan" is a loan that:

- has, as its primary purpose, community development; and
- benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

(A bank's assessment area(s) generally includes geographies in which the bank has its main office, branches, deposit-taking ATMs, and surrounding area(s) in which the bank originates or purchases a substantial portion of its loans.)

A "qualified investment" is an investment, deposit, membership share, or grant "that has, as its primary purpose, community development." Under the investment test, OCC examiners assess the bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

Common to both of these definitions are the requirements that the loan, investment, or service:

- have, as its primary purpose, community development; and
- benefit the bank's assessment area, or a broader statewide or regional area that includes the bank's assessment area(s).

Activities, the Primary Purpose of which Is Community Development

When determining whether a particular loan or investment will receive CRA consideration, one must first determine if the activity has a primary purpose of community development. "Community development" includes, among other things, affordable housing (including multifamily rental housing) for low- or moderate-income individuals. Whether a multifamily rental housing project constitutes affordable housing for CRA purposes hinges on whether low- and moderate-income individuals benefit, or are likely to benefit, from the project. A multifamily rental housing project will not be considered affordable merely because rents are set according to a formula based upon the income levels in the area, if the project exclusively or predominately houses families that are not low- or moderate-income. For projects that do not yet have occupants, and for which the income of the potential occupants cannot be determined in advance, or in other projects where the income of the occupants cannot be verified, examiners will review factors such as demographic, economic, and market data to determine the likelihood that the housing will "primarily" accommodate low- and moderate-income individuals.

To determine whether a multifamily rental project is designed for an express community development purpose, the OCC first considers whether a majority of the dollars spent on the project fund housing for low- or moderate-income individuals or a majority of the beneficiaries of the project are low- and moderate-income individuals. However, some of the investment vehicles for affordable multifamily rental housing projects may not have the requisite majorities. If the measurable portion of any benefit bestowed or dollars applied to affordable housing is less than a majority of the entire project's benefits or dollar value, the activity may still be considered to possess the requisite primary purpose if:

- the express, bona fide intent of the project, as stated, for example, in a prospectus, loan proposal, or community action plan, is primarily affordable housing for low- and moderate-income individuals;

- the project is specifically structured (given any relevant market or legal constraints or performance context factors) to provide affordable housing for low- and moderate-income individuals; and
- the project provides, or is reasonably certain to provide, affordable housing for low- and moderate-income individuals.

Benefit to the Bank's Assessment Area, or a Broader Statewide or Regional Area that Includes the Bank's Assessment Area(s).

A second major consideration as to whether CRA consideration is given for a particular loan or investment is how it benefits the bank's assessment area. The CRA regulation generally requires community development loans and qualified investments to benefit the bank's assessment area, or a broader statewide or regional area that includes the bank's assessment area(s). The bank delineates its assessment area to consist of one or more metropolitan statistical areas or one or more contiguous political subdivisions and include the geographies in which the bank has its main office, it branches, deposit-taking automatic teller machines, and geographies in which the bank has originated or purchased a substantial portion of its loans.

A regional area may be as large as a multi-state area. For example, the mid-Atlantic states may comprise a regional area. Consequently, community development loans and qualified investments meet the geographic requirements of the CRA regulation if the project benefits an area that, though larger than bank's assessment area, includes the assessment area.

In evaluating the bank's performance under CRA, OCC examiners consider the bank's responsiveness to the needs of its assessment area. In most cases, the larger the regional area, the more diffuse the benefit to an institution's assessment area(s) will be and, thus, less responsive to the credit need of the assessment area(s). Examiners may view loans or investments with more direct benefits to the bank's assessment area(s) as more responsive to the credit needs of the area(s) than loans or investments for which the actual benefit to the assessment area(s) is uncertain or for which the benefit is diffused throughout a larger area that includes the assessment area(s).

Additional Considerations under the Lending and Investment Tests

The Lending Test

"Designing a Portfolio Permanent Loan Product" and "Saving America's Affordable Rental Housing Stock" in the Spring 2000 edition of *Community Developments* (www.occ.treas.gov/cdd/Spring2000.pdf) , discuss the roles that banks can play as lenders in the development of affordable multifamily rental housing. The CRA regulation provides examples of what types of activities would qualify as community development loans eligible for CRA consideration to include loans to, for example:

- Borrowers for affordable housing rehabilitation and construction, including construction and permanent financing of multifamily rental serving low- and moderate-income persons;
- Financial intermediaries including community development corporations (CDCs), and

community loan funds or pools that primarily lend or facilitate lending to promote community development; and
- Local, state, and tribal governments for community development activities.

The lending test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through its lending activities by considering, among other things, the bank's community development lending. The OCC considers loans that the bank purchases as well as those that it originates. A bank also may ask the OCC to consider loans originated or purchased by a consortium in which the bank participates, or a third party in which the bank has invested, if the loans meet the definition of a community development loan. These loans need not fund projects that are exclusively for the benefit of low- or moderate-income individuals. However, when evaluating the institution's record of community development lending, OCC examiners will give greater weight to the amount of the loan that is targeted to the intended community development purpose. For example, consider two $10 million projects (with a total of 100 units each) that have as their express primary purpose affordable housing and are located in the same community. One of these projects sets aside 40 percent of its units for low-income residents and the other project allocates 65 percent of its units for low-income residents. Although the bank would report both loans as $10 million community development loans, all other relevant considerations being equal, the examiner will take into account that the 65 percent set-aside project provides more affordable housing for more people per dollar expended.

"Affordable Rental Housing through the Eyes of a Community Developer" in the Spring 2000 edition of *Community Developments* (www.occ.treas.gov/cdd/Spring2000.pdf) describes multifamily transactions involving multiple subsidies that take much longer to structure because of the multiple funding sources. The performance criteria for the lending test also takes into account the complexity and innovativeness of the bank's community development lending. In evaluating the complexity and innovativeness of the bank's community development lending, OCC examiners will review the overall variety and specific terms and conditions of the bank's credit products. In addition, with regard to consideration of the innovation and complexity, OCC examiners will consider innovations that augment the success and effectiveness of its community development loan program. For example, in connection with a community development loan program, a bank may establish a technical assistance program under which the bank, directly or through third parties, provides affordable housing developers and other loan recipients with financial consulting services. The technical assistance may be favorably considered as an innovation that augments the success and effectiveness of the related community development loan program.

The Investment Test

Roles that a bank may play as an investor in affordable multifamily rental housing development also may result in positive evaluation under the investment test. A bank may purchase Low-Income Housing Tax Credits, as did Citibank (South Dakota) through its community development corporation, CitiHousing Inc., in the North Ridge project (*see* "A Divine Partnership"), or by investing in a low-income housing tax credit intermediary, as Park National did in the Ohio Capital Corporation for Housing equity funds (*see* "The Low-Income Housing Tax Credit Program: Community Bank Reaps More than Monetary Returns"). In addition, banks may invest in a REIT like LISC's Community Development Trust (*see* "The Community Development Trust: Investing in Affordable Multifamily Housing," certain types of mortgage-backed securities (*see* "Depositories Can Benefit from Fannie Mae's Special CRA-Targeted Multifamily MBS"), or municipal bonds that support affordable housing (*see* "Saving America's Affordable Rental Housing Stock"). All of these articles are in the Spring 2000 edition of ***Community Developments*** **(www.occ.treas.gov/cdd/Spring2000.pdf)**

The investment test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s). Examples of qualified investments include investments in or to:

- Projects eligible for low-income housing tax credits;
- Financial intermediaries (including community development corporations (CDCs)) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development;
- Organizations engaged in affordable housing rehabilitation and construction, including multifamily rental housing;
- State and municipal obligations, such as revenue bonds, that specifically support affordable housing or other community development; and
- Not-for-profit organizations serving low- and moderate-income housing or other community development needs, such as counseling for credit, home-ownership, home maintenance, and other financial services education.

When evaluating qualified investments that benefit an institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s), examiners will look at the following four performance criteria: the

(1) dollar amount of qualified investments;
(2) innovativeness or complexity of qualified investments;
(3) responsiveness of qualified investments to credit and community development needs; and
(4) degree to which the qualified investments are not routinely provided by private investors.

With respect to the first criterion, examiners will determine the dollar amount of qualified investments by relying on the figures recorded by the institution according to generally accepted accounting principles (GAAP). Although institutions may exercise a range of investment strategies--including short-term investments, long-term investments, investments that are immediately funded, and investments with a binding, up-front commitment that are funded over a period of time--institutions making the same dollar amount of investments over the same number of years, all other performance criteria being equal, would receive the same level of consideration. Examiners will include both new and outstanding investments in this determination. The dollar amount of qualified investments also will include the dollar amount of legally binding commitments recorded by the institution according to GAAP.

The extent to which qualified investments receive favorable consideration under the CRA regulation, however, depends on how examiners evaluate the investments under the remaining three performance criteria--innovativeness and complexity, responsiveness, and the degree to which the investment is not routinely provided by private investors. Examiners also will consider factors relevant to the institution's CRA performance context, such as the effect of outstanding long-term qualified investments, the pay-in schedule, and the amount of any cash call, on the capacity of the institution to make new investments.

Interaction Among the Tests

In some instances, the nature of an activity may make it eligible for consideration under more than one of the performance tests. For example, if the bank makes an investment in a CDC that is then used to make community development loans, the bank may receive consideration under the lending test for its pro-rata share of community development loans made by the CDC. Alternatively, the bank's investment may be considered under the investment test, assuming it is a qualified investment. In addition, a bank may elect to have part of its investment considered under the lending test, and the remainder considered under the investment test.

In addition, certain activities do not qualify for consideration under either the lending or investment test, but may qualify under the service test. For example, the agencies will not consider donated labor of employees or directors of a financial institution as a qualified investment, but will consider it under the service test, if the activity is a community development service.

Conclusion

Multifamily lenders and investors can determine how an activity may be treated under CRA by reviewing the CRA regulations and the Qs and As, which are available on the OCC's Internet web site (www.occ.treas.gov). National banks that have questions about how an activity might be treated for CRA purposes may wish to contact their OCC examiner.