

COMMUNITY INVESTMENTS

A Community • Economic Development Publication

VOLUME THIRTEEN NUMBER 1



THE NEW MARKETS TAX CREDIT

Learn about one of the most promising federal community revitalization initiatives in decades and how you can take advantage of this new opportunity to facilitate investment in distressed communities

SHEDDING LIGHT ON SUNSHINE

Compliance with Sunshine became effective April 1—no fooling. This article provides a concise discussion of who must comply and what is required. Don't miss the handy flow chart that will assist you in determining whether you have a covered agreement

DISTRICT UPDATE

Featuring the profile of Leadership Council members from California, Oregon and Utah

THE BIG BANK WORLD OF CRA

A fascinating look at how CRA activities are structured and managed within "complex banking organizations" based on interviews with twelve of the largest domestic bank holding companies

CRA-QUALIFIED MUNI SECURITIES

Municipal securities offer a unique opportunity to invest in your community and earn CRA credit. Read about how they work, where to get them and what you should know before you invest

APRIL01

Community Investments

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Editor's **NOTEBOOK** by Joy Hoffmann

Are you reading this publication? We here at *Community Investments* are interested in finding out how you use this publication and we want to know how it could be more useful to you. If you simply use *Community Investments* to become better versed in specific issue areas, please let us know. If you've replicated ideas presented here, we would like to know that too.

Are we hitting the mark? Are the issues we cover relevant to your work? What is important in the community and economic field today that we aren't currently covering?

Any ideas for future issues? Please send recommendations for topics or specific programs we should consider covering.

Your responses will help us to measure:

1. Whether we still have an audience for *Community Investments*.
2. This publication's impact in the field.
3. Whether we should consider new directions/topics.
4. How we can continue to add value to your work in the community development field.

Please e-mail us at **sf.communityaffairs@sf.frb.org** attention Joy, or feel free to call or write me. Beginning with this issue, we will be supplying a postage-paid comment card that you can use at any time to send feedback or suggestions.

I appreciate how busy you all are and I thank you in advance for taking time to help us out. Thank you!

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The New Markets Tax Credit

A Promising New Tool for Community Revitalization

By Stockton Williams, The Enterprise Foundation



During their six years sharing power in Washington, one of the few things President Clinton and Republicans in Congress agreed on was the need to expand economic opportunity to distressed communities. In the final days of the 106th Congress last December, President Clinton and Congress reached consensus on a bipartisan bill designed to spur increased investment in urban and rural areas that have not fully benefited from the nation's recent historic economic expansion. The "Community Renewal Tax Relief Act of 2000" provides nearly \$26 billion in targeted tax incentives and regulatory relief that is expected to leverage several multiples of that amount in additional community development investment.

The key elements of the Community Renewal Act are:

- an increase and expansion of the Empowerment Zone program;
- a new initiative similar to Empowerment Zones called "Renewal Communities";
- dramatic increases in states' authority to allocate Low Income Housing Tax Credits for affordable apartment production and issue tax-exempt "private activity" bonds for housing, infrastructure and industrial development;
- a tax incentive, entitled the "New Markets Tax Credit,"

to encourage new investment in businesses, economic development and community facilities in low-income neighborhoods.

This article will look at the fourth element of this landmark legislation—the New Markets Tax Credit (NMTC). The NMTC is one of the most promising federal community revitalization initiatives in decades. The credit

enables lending institutions and community development groups to finance or assist a wider variety of projects and activities—from small businesses to retail centers, from manufacturing to high-tech, from charter schools to day care centers—where they are needed most. For lenders, the credit offers new opportunities to gain Community Reinvestment Act consideration, reduce their tax burden, tap new business markets and strengthen the communities in which they do business. For community developers, the credit provides a tool for raising desperately needed equity investment, stabilizing their capital base and attracting additional private investment to their neighborhoods.

While the NMTC is a new program, financial institutions and community groups should find it somewhat straightforward to work with, because it combines aspects of two familiar federal incentives for generating private investment in distressed neighborhoods: the Community Development Financial Institutions (CDFI) Fund and the Low Income

Housing Tax Credit (LIHTC). Like the CDFI Fund, the NMTC will be administered by the Department of Treasury and funneled through a variety of community development entities with expertise providing capital to distressed communities. Like the LIHTC, the New Markets Tax Credit will provide tax relief to individuals and institutions in exchange for their equity investment, provided those investments meet the strict, targeted requirements of the law.

In many important respects however, the NMTC is different from any incentive for community development ever created. Financial institutions and community groups interested in accessing the credit should read the law carefully. To do so go to: <http://thomas.loc.gov/home/c106query.html> and search for "Community Renewal Tax Relief Act." Please note that while the statute tells us much about how the credit will work, many questions, especially regarding when and how credits will be awarded, must await publication of the program's implementing regulations for answers. Those regulations are tentatively scheduled for release in mid-April. Treasury expects to allocate credits later this year.

The NMTC is intended to fill a glaring gap in the otherwise generally well functioning community development financing system—the need for equity capital for business and economic development investment. Because larger venture capital firms typically do business with established clients in established markets, smaller entities committed to investing in tougher areas cannot attract capital investments as readily. This inability handicaps their capacity to identify and cultivate potential projects, raise additional resources and build organizational strength.

This problem represents a real market failure, because, as readers of this

magazine well know, many urban and rural communities have a desperate need for businesses, jobs and services, *as well as the purchasing power and labor force to support them.* These communities in many ways are the most promising new markets for business investment in the country. According to the Boston Consulting Group and the Initiative for a Competitive Inner City, while inner-city consumers constitute \$100 billion in annual retail buying power, unmet demand exceeds 25 percent in many inner-city neighborhoods.

Despite this extraordinary, largely untapped market opportunity, inadequate information and higher risks—both real and imagined—have made many financial institutions, investors and businesses reluctant to commit capital in distressed communities. Those that do invest demand higher rates of return than most investments will yield. The New Markets Tax Credit is designed to bridge that gap. By increasing the after-tax return to investors that provide equity capital, the NMTC will lower risk for investors and businesses, while cutting the cost of capital for community development groups trying to bring business investment to their neighborhoods.

THE MECHANICS OF THE NEW MARKETS TAX CREDIT

The Treasury Department will allocate tax credits to certified "Community Development Entities" (CDEs). CDEs will be able to issue equity interests to investors for which investors may claim the credits, worth approximately 30 percent in present value terms. CDEs must place the tax credits within five years or the credits will be returned to Treasury for reallocation to other CDEs. This year, a total of \$1 billion of investment is eligible for NMTCs. That amount increases to \$1.5 billion in 2002 and 2003; \$2 billion in 2004 and 2005; and \$3.5 billion in 2006 and 2007.

Investors will be able to claim credits based on the amount of their equity investment in the CDE—rather than the cost of the CDE's project(s), as under the Low Income Housing Tax Credit, or the amount of the CDE or investors' investment in the project(s). The investor's equity investment in a CDE must be cash in exchange for stock (if the CDE is a corporation) or partnership interest (if the CDE is a partnership or limited liability company). The equity investment must be paid in cash, not as a bridge loan or commitment to pay. The equity investor's basis in the CDE is reduced by the amount of credit the investor claims, another difference with the LIHTC.

The tax credit is available over seven years—five percent for the first three years and six percent for the next four years, for a present value of approximately 30 percent. This is a relatively modest, although far from insignificant, subsidy. Thus, unlike the Low Income Housing Tax Credit, which generally provides a 70 percent to 91 percent tax credit, the NMTC alone will not be enough to attract investors. Projects financed with NMTC proceeds generally will have to generate economic benefits, such as cash flow, capital recovery and/or appreciation.

A CDE must be a corporation, partnership or limited liability company with a mission of serving or providing capital to low-income people or communities. It is also required to maintain accountability to the residents of those communities by providing for their representation on a governing or advisory board. A newly formed entity could meet the mission and community accountability requirements by referring to a parent organization. A CDE could be a for-profit subsidiary of a community development corporation (CDC) (including a bank CDC), for-profit community development financial institution (CDFI), community development venture capital fund, small business investment company

approved specialized SBICs automatically qualify as CDEs. In allocating credits, priority will be given to any CDE with a track record in community development, which could be the track record of a controlling organization, or to a CDE proposing to invest in businesses unrelated to the CDE itself.

A CDE must use “substantially all” (to be defined in regulations) of credit proceeds to provide financial assistance (grants, loans, equity, services) to “active low-income community businesses” in “low-income communities.”¹ Proceeds can assist virtually any business or enterprise, including other CDEs and nonprofit enterprises, with the following exceptions: golf courses, country clubs, liquor stores, massage parlors, hot tub and suntan facilities, racetracks and other gaming facilities and enterprises principally consisting of farming. Neighborhood retail centers, small businesses, manufacturing facilities, office space, childcare centers, charter schools, health care facilities and mixed-use projects that combine these uses are examples of projects that could be eligible for New Markets Tax Credit investment.

Also, housing generally is not intended as an eligible investment; the forthcoming regulations will provide more clarity on this. A CDE may provide investments to a business it owns in whole or in part. Qualified businesses must derive at least half their gross income from business in a low-income community. In addition, a “substantial portion” (to be defined in regulations) of their tangible property, as well as a substantial portion of services performed by their employees must be

¹ *Low-income communities are census tracts with a poverty rate of at least 20 percent or with median income not exceeding the greater of 80 percent of area median or statewide median income and, for a non-metro census tract, 80 percent of statewide median income.*

in a low-income community. A trade or business can be owned by or a branch of a larger corporation, provided that it is separately incorporated.

The credit may also be used in “targeted areas” within census tracts that do not meet the poverty or median income standards. Targeted areas must have pre-existing boundaries, such as established neighborhood, political or geographic boundaries, meet the poverty rate or median income standard as if they were census tracts and have an inadequate access to investment capital. A CDE may invest in one or more low-income communities or targeted areas. A CDE that falls out of compliance with requirements of the NMTC, such as by failing to maintain community accountability or invest substantially all of its credit proceeds in active low-income community businesses, risks recapture of its credits by the Treasury Department. Regulations will clarify how recapture will work and what flexibility a CDE will have to correct noncompliance before recapture occurs.

Any institution or organization committed to community revitalization should be enthusiastic about the New Markets Tax Credit, which has the potential to transform the financing of business and economic development in distressed areas. It is a particularly promising tool for encouraging profitable partnerships between lending institutions and community-based organizations. Lenders could invest in community group-established CDEs, provide financing to CDE projects and help CDEs raise additional resources. All such activities could benefit a lender’s bottom line, help it qualify for CRA credit and develop new customers, business lines and markets. Community groups and the neighborhoods they serve stand to benefit mightily from this increased private investment and economic opportunity.

CI



ABOUT THE AUTHOR

STOCKTON WILLIAMS is director of public policy for The Enterprise Foundation. Enterprise is a national nonprofit organization that invests in affordable housing, economic development, job training, childcare and crime prevention initiatives in distressed neighborhoods nationwide. Mr. Williams directs Enterprise’s Washington, D.C.-based public policy office, which advances Enterprise’s legislative and regulatory priorities with Congress, the Administration and other national organizations.

Prior to joining Enterprise, Mr. Williams was a senior legislative and policy associate at the National Council of State Housing Agencies. Before that he worked for nonprofit community development organizations in New York City; Baltimore, Maryland; and Charleston, South Carolina. Mr. Williams has a bachelor’s degree in religion from Princeton University and a master’s degree in real estate development from Columbia University.



Shedding Light on Sunshine

Effective April 1, 2001, each party to a Community Reinvestment Act (CRA)-related agreement must fully disclose the agreement and its terms to the public and the appropriate federal banking agency. Effective June 30, 2001, each party to a covered CRA-related agreement must submit an annual report to the appropriate federal banking agency concerning the use of CRA-related money and resources during the year ending December 31, 2000.

These disclosure and annual reporting requirements, known as “CRA Sunshine”, are part of the Gramm-Leach-Bliley Act of 1999. Agreements covered by this reporting requirement must satisfy **all** of the following five conditions:

1. The agreement must be in writing
2. The parties to the agreement are an insured depository institution (IDI) or any of its affiliates and a non-governmental entity or person (NGEP)
3. The agreement must involve funds or other resources of an IDI or af-

filiate with an aggregate value of more than \$10,000 in a year, or loans with an aggregate principal value of more than \$50,000 in a year

4. The agreement is made in fulfillment of the CRA
5. There has been communication between the parties of the agreement concerning the adequacy of the institution’s CRA performance

In addition to these five essential rules, enough other conditions and exceptions exist to warrant actually reading the regulation. Readers are strongly encouraged to visit our website (<http://www.frbsf.org/community/index.html>) to obtain a copy of the regulation. What follows is a brief summary of the regulation.

MUST BE IN WRITING

When assessing whether a CRA-related agreement is a “covered” agreement, the first question to ask is whether or not the agreement is in writing. The regulation states that a written agree-

ment includes contracts, arrangements or understandings—even if they are not legally binding—that are recorded on paper. This could be a document as formal as a contract and as informal as a press release.

IDIs AND NGEPS

The second question to ask is whether the agreement is between an IDI and an NGEP. The regulation’s definition of an IDI as an insured depository institution or any affiliate can cover a holding company all the way down to a non-bank subsidiary. NGEPS are defined as any organization that is not a federal, state, local or tribal government entity. Included in the category of NGEPS are such organizations as Freddie Mac, Fannie Mae and the Home Loan Bank System.

VALUE THRESHOLDS

The third question to ask is whether the loan, grant, payment or other consideration—such as services and in-kind contributions—exceeds the value thresholds set in the regulation. For loans, this value threshold is set at an

aggregate principal amount of \$50,000 over the course of a calendar year. The regulation provides reporting exemptions for individual loans secured by real estate (irrespective of the identity of the borrower or the loan terms) and agreements to make a single loan as long as it is not loaned substantially below market rates and is not used to relend. For grants, payments or other considerations, the value threshold is set at an aggregate amount of more than \$10,000 over the course of a calendar year.

For agreements covering multiple years with a specified payment schedule, the agreement would be covered for its entire term if a scheduled payment or loan exceeds the value threshold in any calendar year. For example, if an IDI made a three-year commitment to provide \$25,000 to an NGEF in increments of \$5,000 the first year, \$5,000 the second year and \$15,000 the third year, the agreement is covered and must be reported for all three years since the third year exceeds the value threshold. If the same commitment did not have a specified payment schedule, the entire value of the agreement would be credited to the first year and the \$25,000 commitment would be treated as if it were a one-year agreement.

FULFILLMENT OF THE CRA

The fourth question to ask is whether the agreement is in fulfillment of the CRA. This can be determined quite easily. If it involves the performance of any activity that is a factor in a CRA exam or in a decision to approve or deny an application, it counts. However, only those activities that are likely to receive favorable consideration from the banking agencies are covered. For example, although the CRA examination process looks at home mortgage lending to low-, moderate-, middle- and upper-income individuals, in most cases, only those loans originated to

low- and moderate-income individuals receive CRA consideration from the agencies.

“Discussing whether or not a certain product or service would receive favorable CRA consideration by the agencies is not considered to be a discussion regarding the adequacy of the institution’s CRA performance.”

CRA COMMUNICATION

The final question to ask is whether or not there was communication between authorized representatives of the IDI and NGEF concerning the adequacy of the institution’s CRA performance. Discussing whether or not a certain product or service would receive favorable CRA consideration by the agencies is not considered to be a discussion regarding the adequacy of the institution’s CRA performance. To be considered a CRA communication, the communication must have occurred prior to the agreement and within certain time frames as follows:

- Oral or written communication with a federal banking agency within three years prior to the agreement, or
- Oral or written communication with an IDI regarding testimony to a federal banking agency or comments in the public file within three years prior to the agreement

That time frame is reduced to one year for oral communication with the IDI regarding the adequacy of their CRA performance.

DISCLOSURE

Once a determination has been made regarding whether an agreement is covered, each party to the agreement must make a copy available to anyone upon request. NGEFs must also make a copy available to federal banking agencies upon request. Within 60 days of the end of each quarter, IDIs must submit either a complete copy of each agreement or a list of all agreements for that quarter to their relevant supervisory agency (RSA). Since the act was signed in November, 1999, this public disclosure requirement applies to covered agreements entered into after November 12, 1999. Public disclosure takes effect on April 1, 2001. The first IDI quarterly report is due to their RSA by June 30, 2001, for covered agreements entered into after November 12, 1999.

ANNUAL REPORT

NGEFs and IDIs are required to submit independent annual reports to their RSA six months after the end of the calendar or fiscal year. NGEFs have the option of submitting their annual report to an IDI, which is then required to submit the report to the RSA within 30 days. An NGEF must file an annual report if it received funds or used funds received under the agreement that year. The NGEF annual report must include the following:

- Name and address of the NGEF
- Information sufficient to identify the agreement (i.e. parties to the agreement and dates of the agreement)
- Amount of funds or resources received that year

(continued on page 11)



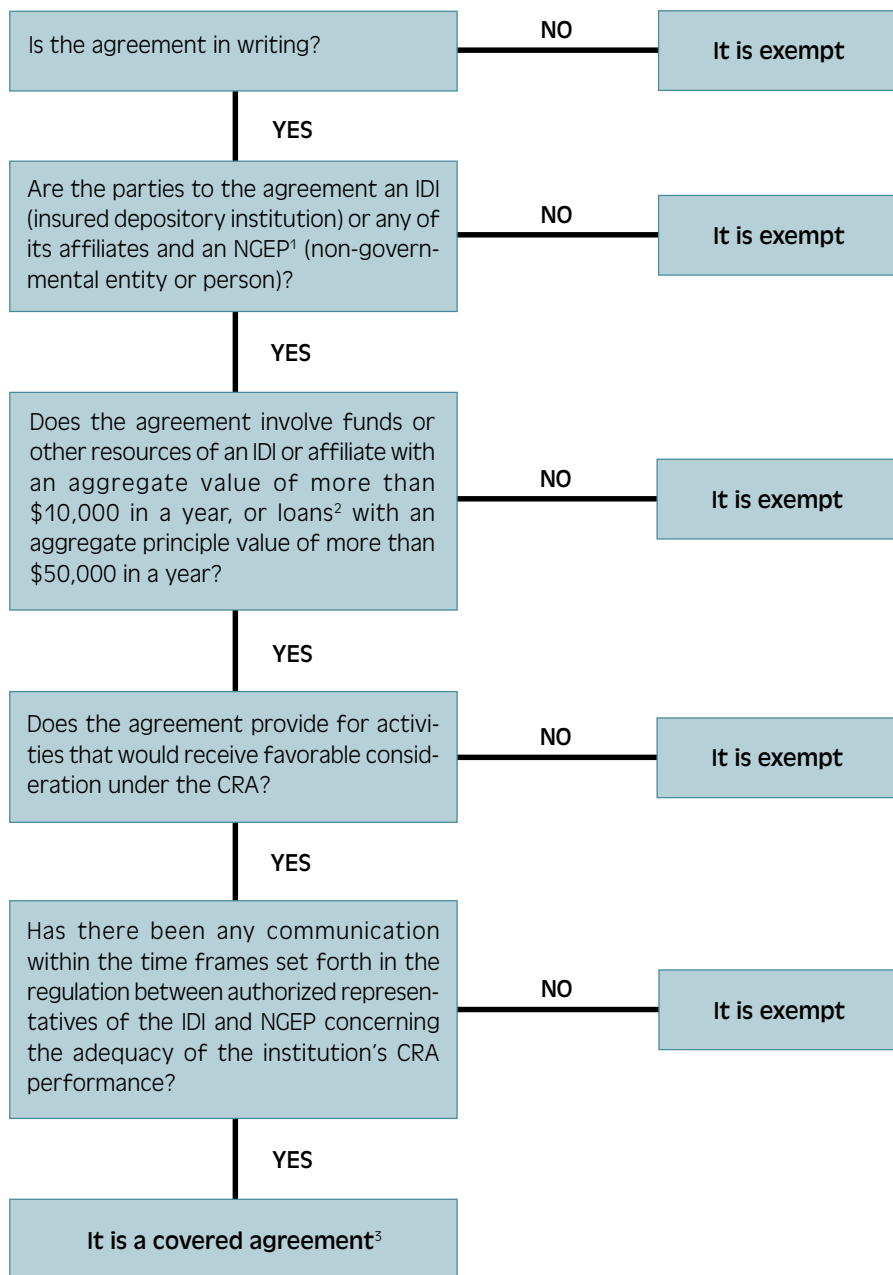
CRA Sunshine Flow Chart

This document serves as a summary of Section 711 of the Gramm-Leach-Bliley Act of 1999 and the final regulation governing the Disclosure and Reporting of CRA-Related Agreements ("CRA Sunshine") released through the Federal Register on January 10, 2001. This document is not comprehensive; please refer to the regulation for more guidance.

1 NGEPS are defined as any organization that is not a federal, state, local or tribal government entity. Included in this category are such organizations as Freddie Mac, Fannie Mae, and the Federal Home Loan Bank System.

2 The regulation provides for reporting exemptions for individual loans secured by real estate (irrespective of the identity of the borrower of the loan or the loan terms) and agreements to make a single loan as long as it is not loaned substantially below market rates and is not used to relend.

3 For additional reporting and disclosure guidance, please see the reporting requirements summary for IDIs and NGEPS on pages 9-10. A PowerPoint training resource and the Federal Register Rule are available to download from our website at: <http://www.frbsf.org/community/webresources/index.html>



NGEP Disclosure Requirements

- The obligation of an NGEP to disclose covered agreements to the public and to the federal regulatory banking agencies ends 12 months after the end of the term of the covered agreement.
- Disclosure requirements apply only to covered agreements entered into after November 12, 1999.

Disclosure of Covered Agreements by NGEPs to the Public

- The NGEP involved in a covered agreement must make a complete copy of the covered agreement available to any individual or entity upon request. At a minimum, the copy must include:
 - Names and addresses of the parties to the agreement
 - Amount of payments, fees, loans, etc.
 - How the funds will be used
 - The term of the agreement
 - Any other relevant information
 - The NGEP may withhold confidential or proprietary information as long as it is allowed under the Freedom of Information Act (FOIA)

Disclosure of Covered Agreement by NGEPs to the Agencies

- The NGEP involved in a covered agreement must make a complete copy of the covered agreement available within 30 days of receiving a request from a federal regulatory banking agency.
- If the publicly available version of the covered agreement differs in any way from the complete copy of the agreement, a copy of the public version of the agreement and an explanation justifying any FOIA exclusions must accompany the complete copy of the covered agreement.

NGEP Annual Reporting Requirements

- Annual reporting requirements apply only to covered agreements entered into on or after May 12, 2000.

NGEP Annual Report to the Agencies

- NGEPs that used funds or resources during the previous year that were associated with any covered agreement must file an annual report to the relevant supervisory agency (RSA) or an IDI within 6 months of the end of the year. At a minimum, the annual report must include:
 - The name and mailing address of the NGEP
 - Information sufficient to identify the agreement
 - Identify parties and date of the agreement
 - The amount of funds/resources received that year
 - Itemized list of how the funds/resources were used:
 - Compensation of officers, directors & employees
 - Administrative, travel, entertainment expenses
 - Payment of consulting & professional fees
 - Other expenses & uses
- A report prepared for any other purpose can be used so long as it contains all of the information required by the regulation. (For example, IRS Forms 990 or 990EZ)
- A single consolidated report covering all agreements may be filed if the NGEP is a party to 2 or more agreements.

IDI Disclosure Requirements

- The obligation of an IDI to disclose covered agreements to the public and to the federal regulatory banking agencies ends twelve months after the end of the term of the covered agreement.
- Disclosure requirements apply only to covered agreements entered into after November 12, 1999.

Disclosure of Covered Agreements by IDIs to the Public

- The IDI involved in a covered agreement must make a complete copy of the covered agreement available to any individual or entity upon request. At a minimum, the copy must include:
 - Names and addresses of the parties to the agreement
 - Amount of payments, fees, loans, etc.
 - How the funds will be used
 - The term of the agreement
 - Any other relevant information
- The IDI may withhold confidential or proprietary information as long as it is allowed under the Freedom of Information Act (FOIA)
- Copies may be placed in the CRA public file

Disclosure of Covered Agreement by IDIs to the Relevant Supervisory Agency (RSA)

Option #1

- The IDI involved in a covered agreement must submit to its RSA a complete copy of each agreement for that quarter within 60 days of the end of each quarter.
 - If the publicly available version of the covered agreement differs in any way from the complete copy of the agreement, a copy of the public version of the agreement and an explanation justifying any FOIA exclusions must accompany the complete copy of the covered agreement.

Option #2

- The IDI involved in a covered agreement must submit to its RSA a list of all agreements for that quarter. That list must contain:
 - Name and address of each IDI and NGEF involved in the agreement
 - The date the agreement was entered into
 - Estimated total value of payments, fees, loans, services, etc.
 - Date the agreement ends
- Complete copy and public copy of the agreement (if it differs in any way from the complete copy of the agreement) must be provided to the RSA within 7 days of an agency request.
- Disclosure obligation increases from 12 months to 36 months after the end of the term of the covered agreement

IDI Annual Reporting Requirements

- Annual reporting requirements apply only to covered agreements entered into on or after May 12, 2000.
- IDIs must file an annual report to its RSA within 6 months of the end of the year if it provided or received payments, fees or loans under a covered agreement that year or has data to report on loans, investments or services provided under a covered agreement that year. At a minimum, the annual report must include:
 - Name and principal place of business of the IDI
 - Information sufficient to identify the agreement
 - Identify parties and date of the agreement or provide a copy of the agreement
 - The aggregate amount of payments, fees and loans provided to or received by parties to the agreement
 - The aggregate amount of payments, fees and loans provided to an entity not party to the agreement
 - General description of terms and conditions
 - Can include references to past disclosures and annual reports if terms have already been reported
- A single consolidated report covering all agreements may be filed if the IDI is a party to 2 or more agreements.
- IDIs that receive annual reports from NGEFs have 30 days to forward it to the RSA.

- An itemized list of how the funds or resources were used, including:
 - compensation of officers, directors and employees
 - administrative, travel and entertainment expenses
 - payment of consulting or professional fees
 - other expenses and uses (NGEPs can use a report prepared for any other purpose as long as it contains all of the information required by the regulation)

An IDI must file an annual report if it, or any of its affiliates, provided or received payments, fees or loans under a covered agreement or it has any data to report on loans, investments or ser-

vices provided under a covered agreement that year. The IDI annual report must include the following:

- Name and principal place of business
- Information sufficient to identify the agreement
- Aggregate amounts of payments, fees and loans provided to or received by parties to the agreement or others that may not be a party to the agreement but are covered by the agreement
- A general description of the terms and conditions of the agreement

Both IDIs and NGEPs are permitted to submit a single consolidated report covering all agreements if they are a party to two or more agreements.

The first annual report is due on June 30, 2001, to each RSA or, for NGEPs, to an IDI that is party to the agreement. This annual report will cover agreements entered into between May 12, 2000 and December 31, 2000.

ENFORCEMENT

Willful failure by an NGEP to comply with these disclosure and reporting requirements within 90 days of receiving a written notice by a federal banking agency will result in having the agreements categorized as unenforceable and will allow IDIs to find successors to the agreements. For IDIs, a violation of the CRA Sunshine reporting requirement is a violation of the Federal Deposit Insurance Act and can result in all penalties associated with such a violation, including civil money penalties. *CI*

CRA Awards



Does your financial institution offer an innovative CRA program that you'd like to share with your colleagues and communities? Your chance is coming—the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco will once again be conducting a CRA Awards competition in conjunction with the 2002 Community Reinvestment Conference (for more information on the conference see pg. 23).

The awards competition is an effort to recognize and share innovative and outstanding examples of CRA-eligible products or services that have a significant impact in the community. Awards will be given in five categories (but will be limited to one per category per institution): lending, investment, service, community development and innovative use of the Federal Home Loan Bank's Affordable Housing Program (AHP).

Submissions will be reviewed by a panel of community development professionals and will be judged for their innovativeness and impact on the community.

Watch your mail in the coming weeks for the official announcement of the awards program, which will provide information on the submission requirements and procedures. In the meantime, you can see the submissions and winners from the 2000 CRA Awards program, at www.frbsf.org (click "Community Development," then "Publications and Reports").

CRA Leadership Councils were established to recognize and encourage community reinvestment roundtables, actively participate with the San Francisco Fed's Community Affairs staff to improve services. In this ongoing feature, we ask Council members to talk about their backgrounds and wisdom they would like to share. This time we are pleased to feature Marcia McAdams of Pacific Century Bank, N.A.



MARCIA A. McADAMS
VICE PRESIDENT, CRA & COMPLIANCE OFFICER
PACIFIC CENTURY BANK, N.A.; ENCINO, CALIFORNIA

The CRA and compliance hats were officially—albeit abruptly—handed to me in 1982. I didn't even have to apply. This was in addition to managing the special assets department. Competition was nonexistent; no one wanted any of the jobs that I was responsible for. Does that sound familiar? Once my initial terror subsided I decided that I enjoyed the CRA and compliance duties. I have been the CRA and Compliance Officer for Pacific Century Bank since 1992.

Pacific Century Bank, N.A. is an affiliate of Bank of Hawaii under the holding company, Pacific Century Financial Corporation. Pacific Century is a large bank by CRA standards serving the southern California market focusing on mid- and large-sized businesses. Our primary credit products are commercial, real estate construction, SBA, leasing and asset based lending, with departments for entertainment, private banking, international and investment. This has made the CRA enormously challenging for me. Recognizing the credit needs of small businesses, the bank implemented a small business credit product which has been highly successful.

Staffing is limited, so I have learned to be creative when developing community development service opportunities for staff participation. I try to keep the type of service small to limit the

time requirement and make it enjoyable. Operation Hope's *Banking on the Future* program fits this criteria well which has made it very successful. Another successful *small* activity is getting a staff member appointed to a credit review board for a CDC or CDFI. Because the staff member is able to review credits for the CDC or CDFI at their desk, this keeps out of office time to a minimum.

When I need to develop something from scratch I try to work smarter not harder, so I'll call on a CRA buddy from my networking database. Networking is the giant perk of conferences and organization meetings. I have long since learned that there is no benefit in keeping things to myself; I share whatever I can with the hope that I will get an assist from someone in return.

Much satisfaction is derived from my duties associated with community service. I have learned a great deal in the course of working with community organizations as these activities enable me to work on projects that expand my knowledge far beyond that of my everyday responsibilities. As a founding board member I recently assisted with the development of by-laws and a business plan for the Arizona Native American CDC, that, when formed, will serve the credit needs of Native Americans. I also serve on two

to three short-term special project task force committees at any one time. I am an appointed advisory committee member to the board of the Los Angeles Local Development Corporation. And what a thrill it was to qualify for the Fed's Leadership Council, which gives me the opportunity to work collaboratively with other CRA officers to benefit the community.

One of my greatest successes has been the CRA training I enlisted from my bank's regulatory agency, the OCC. Edward (Bert) Gregg, National Bank Examiner and Susan A. Howard, Community Affairs Specialist, conducted two incredibly informative three-hour seminars for a total of 140 Bank staff. Talk about a success story, I now receive the reports that I need, CRA information is included in a credit write up and two large community development loans were identified last year.

What does it take to be a CRA officer? In addition to the standard credentials, it takes fortitude, tenacity, flexibility, creativity, generosity with personal time, the ability to work independently and organization. My boss calls me a zealot and we laugh. I don't mind because it works and everyone benefits. The rewards are returned tenfold for the little that I contribute.

Update

ment efforts throughout the 12th District. The Councils, which are affiliated with the local CRA identify critical community and economic development needs, and to develop new products and how they became involved in CRA, their responsibilities, successes and any advice or words of Eric Century Bank, Ronald Mumford of Lewiston State Bank, and Brent Warren of KeyBank.



RONALD MUMFORD
VICE PRESIDENT & CRA OFFICER
LEWISTON STATE BANK; LEWISTON, UTAH

I had represented Lewiston State Bank on several legal matters for about eight years when they approached me about a full-time position. The position was typical of many in a small bank in that it encompassed many functions—in my case this included legal work, real estate loans and serving as the compliance officer. Later, the duties of CRA officer were added.

Lewiston State Bank is a three-branch/affiliate community bank with total assets of \$115 million. Lewiston State Bank has offices in Lewiston and North Logan, Utah. Our affiliate, Lewiston State Bank of Idaho is located in Preston, Idaho. Previously, we were known primarily as an agricultural bank, but in the past several years have expanded our products and services to serve non-ag small businesses. We also have added consumer products and services to better serve households in our community.

At Lewiston Bank, my plate is filled with responsibilities in CRA, compliance, legal duties, collections (including repossessions & foreclosures) and as many real estate loans as management can get me to do. I enjoy this diversity, but am always looking for ways to prioritize and simplify. In particular, I appreciate receiving time-saving web sites, forms, checklists and other resources. Two resources in particular that I have found valuable are:

HUD's web site to obtain updated median family income and the Kansas City Fed's 1st Source web site for rural CRA ideas.

I am proud of the work that our bank has done in rural communities helping to identify and fulfill their needs, particularly those of small businesses and farmers, whose needs are often distinct from those located in large urban communities. This has shown me that a significant CRA work can be accomplished through worthy small projects. A borrower who came to us for a loan to begin his small "adventure cameraman" business—getting shots of hunts, hikes and outdoor adventures—perfectly illustrates this point. The borrower had experience and talent, but few funds to begin and the equipment was expensive. We tapped into a business development fund and helped him secure an eligible co-signer in order to make the loan. He thanked us repeatedly, because he knew that we had "reached" for him. For the time this loan took, we probably could have done many other loans with a higher return. But in terms of personal satisfaction and good PR, this loan was a top producer.

My advice for CRA Officers, especially in a small bank, would be to include the entire bank in the work of CRA. If you need to, convince management that a "team approach"—with

everyone doing a little to support CRA—brings greater results than does the work of one person or even a department. CRA does not have to be difficult. What is needed is:

1. a "CRA attitude", which is a commitment to the principle that every bank has a responsibility to serve all the members of its community
2. a willingness to learn
3. a commitment to promptly implement CRA actions that are learned

It is also very important to get involved in committee work outside of the bank. The Fed's Leadership Council is an example. This provides an opportunity to hear opinions and to share in a variety of bank and customer perspectives with other CRA Officers. These perspectives can assist you in implementing CRA programs that will be most beneficial and appropriate to those you serve.



BRENT WARREN
CRA MANAGER
KEYBANK; PORTLAND, OREGON

I originally intended to be an elementary school teacher. After finishing graduate school and teaching for a year in California, I moved to Portland, Oregon and began substitute teaching. During a Christmas break, I signed up with a temp agency. My first assignment was to a large financial institution that was going through a merger. Nineteen years and nine mergers later I am *still* a banker. After stints in consumer and mortgage lending, loan servicing, training, loans under foreclosure/REO, credit administration and regulatory compliance, I became the CRA Manager for KeyBank in Oregon. In this capacity, I manage the office, coordinate the CRA grant process, and help identify lending and investment needs in the community.

KeyBank is an \$87 billion financial services corporation with branches in 14 states and lending operations in 49 states. In Oregon, KeyBank has assets of just over \$1 billion and 59 branches located mostly in the urban areas along the I-5 corridor. KeyBank's market share is about 4% of the state total—a distant 6th place among financial institutions. Although we are a full service commercial bank, our primary focus has been small business lending. This accounts for small business loan production that far exceeds our local market share. In 1999, KeyBank in Oregon was awarded the Minority Lender of the Year Award by the SBA. Last year

we received our first CRA rating from the OCC (having recently converted to a National Bank charter). We received an Outstanding rating in every state.

KeyBank is also a major player in affordable housing finance—both single family and multi-family. Our ever-evolving *Home Assist* home mortgage product for low/mod-income borrowers is one of the best in the country. It has very flexible underwriting, 3% down payment with no private mortgage insurance and no loan fees or points, and can be used for purchases or refinances. Additional funds can be borrowed for home improvement or repairs. The bank has also made community development lending a high priority. We market ourselves as a 'one-stop-shop' offering everything from acquisition/pre-development, construction and permanent loans to direct tax credit investments. We are also able to provide bond underwriting and placement for affordable housing.

In Oregon, I am located in the same office with the single-family mortgage specialists, multi-family community development lenders and tax credit investors, making it easy to talk about projects and cross-refer clients. Several of my counterparts at other banks tell me they are jealous of this unique structure and feel that it gives KeyBank a competitive advantage in the marketplace.

Some of the more interesting and innovative projects successfully undertaken by our community development team include:

- The Yards at Union Station: a large multi-phase, mixed-income tax credit project built on a "brown-field" site
- St. Anthony Village: a five acre village that includes independent senior housing, assisted living, Alzheimer's patient housing, a preschool and a church
- Villa de Suenos: a large housing project that contains a county-run medical clinic and daycare facility

I feel that being involved in the community is essential to my success because it helps to keep me on the pulse of development opportunities. In addition to being a member of the Fed's Leadership Council, I chair two committees: the Oregon Bankers Association Community Involvement Committee and the Consortium of Salem Area Lenders (CONSALL). I also serve on the loan committee for CONSALL and am the board president for Habitat for Humanity of Oregon. Because of the banking environment these days, in many ways this is still a "temp job", even after 19 years. Even so, being a CRA Manager is a great job!



The BIG

Bank World

of CRA

On November 12, 1999, President Clinton signed the Gramm-Leach-Bliley Act of 1999 into law, effectively repealing restrictions on bank affiliation with securities firms and insurance companies contained in the depression era Glass-Steagall Act. The Gramm-Leach-Bliley Act now permits banks, insurance companies, securities firms and other financial institutions to affiliate under common ownership and offer their customers a complete range of financial services. This Act places certain conditions on these new activities, one of which is that all of a holding company's insured depository institution subsidiaries have at least a satisfactory Community Reinvestment Act (CRA) rating.

The implementation of the Gramm-Leach-Bliley Act comes at a time when large complex banking organizations (LCBOs) are under pressure from shareholders to provide their products and services in a streamlined and cost-efficient manner in order to maintain strong earnings growth while at the same time satisfying community and

customer needs. To better understand how LCBO CRA activity is evolving in this environment, interviews were conducted with senior representatives from twelve LCBOs about how they manage their CRA activities from the holding company level down to their non-bank subsidiaries. This broad question encompasses many other questions such as how effective they have been at developing institution-wide CRA strategies and how they have balanced the needs of their communities with the need to streamline the delivery of their products and services.

This article will summarize the information gathered from those interviews with the goal of providing our readers with a snapshot of how complex institutions structure and manage their CRA activities to serve low- and moderate-income individuals and communities. The answers contained in this article may cause financial institution representatives to think differently about their CRA programs or at least see them in a larger context. For community-based organization representatives this information will offer insight into the opportunities, limitations and

*by Fred Mendez, Senior Community
Investment Specialist
Federal Reserve Bank of San Francisco*

conditions associated with bank partnerships.

The twelve LCBOs that provided information about how their CRA activities are managed include:

- Citigroup
- Chase
- First Union
- HSBC Bank USA
- Key Corporation
- National City Bank
- Sun Trust Bank
- Union Bank of California
- US Bank
- Wachovia
- Washington Mutual
- Wells Fargo

The information they provided focuses on four areas:

- **The LCBO:** the geographies they serve, their subsidiaries, and their primary lines of business
- **Subsidiaries:** those subsidiaries that contribute to the CRA-related goals and activities of the LCBO
- **CRA program:** overall CRA strategy; the decision makers in the areas of CRA-related lending, investment and service activities of the institution and any subsidiary; and how success is measured
- **Organization structure:** where the various CRA-related activities are housed or organized within the LCBO

THE LCBOs

The twelve LCBOs that participated in this study varied in scope and size from \$33 billion in assets serving three states to \$716 billion in assets and serving most of the country. All of these LCBOs concentrate their business activity in major metropolitan areas because these areas represent their biggest marketplaces and thus the largest concentration of opportunities.

Eleven of the twelve had centralized management systems where strategies

and decisions are developed at the holding company level. Eleven of the twelve considered their organization to be full service financial corporations striving to provide their customers with as wide an array of financial products as possible. After discussing the context under which their CRA activities are conducted, the representatives interviewed claimed that they could not be “all things to all people.” The bottom line is that these LCBOs have a core line of business they rely on during volatile times—be it small business, consumer or home financing products—and are quick to re-evaluate product lines that are not competitive or are less profitable. The one LCBO that had a decentralized structure allows each bank within the various states they are chartered to serve significant autonomy to run the way the local president deems best.

SUBSIDIARIES

Four of the LCBOs interviewed have subsidiaries that serve the entire nation with either mortgage or credit card products. One is actively engaged in check cashing to tap into the large population of unbanked individuals. Three of the LCBOs offer sub-prime lending products through finance company subsidiaries. Ten of the twelve LCBOs interviewed stated that their subsidiaries play virtually a non-existent role in the LCBO’s overall CRA strategy even though many of these serve low- and moderate-income individuals and communities. The primary reason given for why these subsidiaries do not play a more prominent role in the LCBO’s CRA program had to do primarily with the difficulty in managing and collecting the right data to report to their relevant supervisory agency. As such, almost all the CRA-related activities of these LCBOs that are evaluated under the CRA examination process continue to be performed at the insured depository institution level.

LCBO STRUCTURE & CRA PROGRAMS

All of the LCBOs interviewed said that the majority of their CRA-eligible business comes from metropolitan areas. This concentration of activity is due primarily to the concentration of population and, therefore, greater economies of scale in the development of products and services targeted to low- and moderate-income areas and individuals. The ability to develop products of sufficient scale and volume helps to ensure some measure of success and profitability. Other less obvious motivations exist in metropolitan area markets to encourage LCBO innovation in providing financial products to low- and moderate-income geographies. These motivations include:

- Partnerships opportunities with sophisticated community-based organizations that can provide guidance and support to LCBOs looking for ways to satisfy their obligations under the CRA
- Consumer advocacy organizations, the media and other advocates for low- and moderate-income individuals which can focus public scrutiny on the activities of these LCBOs and their impact on low- and moderate-income geographies

Given the benefits of concentrating CRA activities in major markets, rural areas are more of a challenge for LCBOs, making partnerships even more critical to leverage limited LCBO resources in these areas. All of the LCBO representatives interviewed defined the role of intermediaries for CRA-related lending, service and investment activities (CRA partners) as filling financial service gaps created for reasons that range from geography and human resources to lack of expertise.

When asked what qualities they look for in CRA partners, the LCBO representatives were unanimous in describing their “ideal” as:

- Having experienced management and talented staff
- Demonstrating a strong track record
- Having a clear and realistic business plan
- Serving a large geographic area or population base

CRA STRUCTURE AND DECISION MAKING

Irrespective of whether the LCBO interviewed had a centralized or decentralized management structure, the strategy for how CRA activities are conducted is similar. For LCBOs with a centralized structure, the most senior level executives overseeing the institution's CRA activity develop a strategy with the directors of the LCBO's business lines. Previous years' CRA-eligible activity by product line is used as a benchmark from which to develop this strategy, as is consideration of competitive and demographic information gathered by internal staff and through the CRA Public Evaluation of competing financial institutions. To ensure its alignment with the business strategy of the corporation as a whole, the new strategy is first communicated to the LCBO's executive committee. From there, the strategy is conveyed to the regional directors for each business line as well as to regional representatives who serve as "CRA experts." CRA experts specialize in CRA-related lending and investment projects by business line that, due to their complexity or unique nature, may not be easily managed by local branch or lending staff.

For the LCBO with a decentralized structure, a similar process takes place but at the regional level with the CRA and business line directors communicating their strategy to the president and executive committee of the local bank. The strategy of each local bank is then conveyed to the executive committee at the holding company level to

ensure consistency with the business strategy of the corporation as a whole.

The LCBO representatives interviewed all consider the major portion of their CRA-eligible activities (mostly in lending) to be conventional products that can be provided by any of the institutions' representatives. Community development service activities are also typically handled through conventional banking channels with local staff having broad authority. Twenty-five years of complying with the CRA has resulted in the standardization of many of the small business, consumer, home mortgage and charitable products that represent the bulk of CRA-eligible activities reviewed under the existing regulation. Those financial products and services that cannot be easily "standardized" are handled either through CRA partners (essentially outsourcing these activities) or through specialized teams of CRA experts who act as advisors to local lending or branch staff. In one fashion or another, all of the LCBOs interviewed use CRA experts to provide technical assistance to local institution staff or directly coordinate more complicated deals that are not "off-the-shelf."

Managing CRA-eligible qualified investments are a bit more complicated than CRA-related lending and service activities. Local representatives have fairly broad authority to grant funds to local organizations. Larger scale investments in organizations that do housing or small business lending will typically require the involvement of the regional CRA expert and sometimes may require approval from the senior executive overseeing CRA for the LCBO. In the case of the decentralized LCBO, approval from the executive overseeing CRA for the local institution may be necessary.

In all but the most complicated of cases, LCBOs typically have three layers of decision makers:

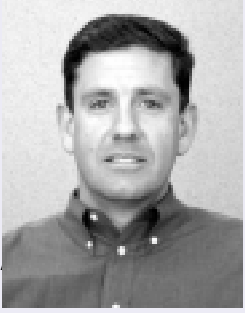
1. Branch and local staff
2. Regional CRA expert
3. Senior or executive vice president in charge of CRA

In the case of specialized and/or complicated initiatives, the decision-making structure can become complex. For example, a multi-bank initiative to create a community loan fund would require at a minimum the involvement of:

- a representative knowledgeable about community needs
- a representative to provide guidance concerning the CRA implications of the initiative (usually the regional CRA expert)
- a senior level CRA executive to authorize participation in the initiative
- a senior level treasury executive to approve the resources necessary for the institution to invest in the initiative

As LCBOs experiment in trying to find the ideal corporate structure, complex decision-making processes may be further complicated by reorganizations, which have become somewhat commonplace. Even when a local representative reports to in terms of CRA activity and business products may change from one period to the next. The senior level executives we spoke to at these LCBOs were quite honest in admitting that sometimes their staff isn't aware of who is next in line in the decision-making process.

The effects that these reorganizations and complex structures have on local markets ties in with the desire of these LCBOs to coordinate low maintenance partnerships. Local staff of LCBOs typically have responsibility over a large geographic area or population base



ABOUT THE AUTHOR

FRED MENDEZ is a senior community investment specialist for the Federal Reserve Bank of San Francisco. Since joining the Federal Reserve in April of 1993, Fred has acted as a liaison between financial institutions and their community to promote public/private partnerships for economic development. In this capacity he has advised community development lending organizations on regulatory matters surrounding consortia and community development lending; encouraged the evolution of the secondary market into the community development arena; researched legal and commercial issues to facilitate the flow of capital to Native American lands; and educated both the lending and non-profit community about community reinvestment requirements, community development lending, the secondary market, fair lending legislation and bank reform issues. Fred has published articles on the Community Reinvestment Act, community development lending, and Native American economic development, and has made numerous presentations at both national and regional banking conferences.

Prior to joining the Federal Reserve, Fred worked on the floors of both the Pacific Coast and New York Stock Exchanges, was a secondary market trade coordinator for Continental Savings of America and a financial industry specialist for Dow Jones/Telerate. He holds two degrees in economics with an emphasis in economic development and monetary policy.

and are limited in their abilities to serve on nonprofit boards or committees. Regional CRA experts serve even larger geographies and are therefore under even greater time and resource constraints. The most senior level executives overseeing an institution's CRA activity usually aren't even in the same state as many of the institution's partner organizations. This often means they must prioritize their involvement towards large and highly visible national organizations. Also as a result, the seniority level of bank representatives on nonprofit boards and committees has declined and the amount of time an institution's representative can dedicate to a particular organization is limited.

The ideal partner in this changing environment may be one that does not require the most senior level representative to actively participate on a board or committee. A few LCBO representatives went so far as to question their institution's requirement for a board or committee seat in return for financial support as long as the existing board or committee participants include senior representatives from small- or mid-sized financial institutions that can appropriately manage the use of funds.

CONCLUSION

While the information gathered through our interviews may not be new or groundbreaking, it underscores the systematic approach required to develop a successful CRA-strategy within large complex banking organizations. The aggregate of the responses reveals four areas of priority

common among all of the LCBOs as follows:

1. Concentrating resources on areas that have the greatest need and the greatest opportunity for success and profitability (i.e. major metropolitan areas)
2. Institutionalizing CRA products and services to reduce the need for costly, specialized programs and targeted products
3. Outsourcing financial products and services that cannot be provided efficiently or profitably by the LCBO to organizations that have experienced management, have a demonstrated track record, have a realistic business plan, serve a large geographic area or population base and do not ask for a lot in return
4. Creating a lean structure for dealing with specialized and complicated CRA projects

Looking ahead, LCBOs will continue to look for ways to serve the credit needs of low- and moderate-income individual and geographies, but will do so as organizations under pressure to provide these products and services in a streamlined and cost-efficient manner. Community development intermediaries that specialize in serving low- and moderate-income individuals and geographies will have the opportunity to play a larger role as LCBOs look for ways to outsource some of their CRA activities. **CI**

Investing in CRA-Qualified Municipal Securities

By Barbara Rose VanScoy, Principal, CRA Fund Advisors

BACKGROUND

The Community Reinvestment Act (CRA) requires regulated banks and thrifts to meet the credit needs of their communities. Large institutions—those with assets greater than \$250 million—are subject to three performance tests: lending, service and investment. Small institutions—those with total assets under \$250 million or an affiliate with total banking and thrift assets of less than \$1 billion at the end of the previous two years—can opt to have examiners review their performance under the investment test. For small institutions, investment test performance may be used to enhance a satisfactory rating, but may not be used to lower a rating.

While financial institutions are experienced with the lending and service aspects of the performance tests, some banks are still grappling with what constitutes a qualified investment. Under CRA, a qualified investment has as its primary purpose community development when it is designed for the express purpose of revitalizing or stabilizing low- or moderate-income areas, or providing affordable housing for or community services to low- to moderate-income persons. This allows banks and thrifts the latitude to invest in the communities that they serve through creative means rather than dic-

tated measures. Performance under the investment test is based on:

- the dollar amount of qualified investments
- the innovativeness or complexity of qualified investments
- the responsiveness of qualified investments to credit and community development need, and
- the degree to which qualified investments are not routinely provided by private investors

Finally, qualified investments must benefit the financial institution's assessment area(s) or a broader statewide or regional area that includes the assessment area(s).

The Interagency CRA Q&A¹ provides some examples of qualified investments. These include: state and municipal obligations, such as revenue bonds, that specifically support affordable housing or other community development; projects eligible for low-income housing tax credits; and organizations supporting the capacity of low- and moderate-income people or geographies to sustain economic development. The regulations also state that "as a general rule, mortgage-backed securities and municipal bonds are not qualified investments because they do not have as their primary pur-

pose community development, as defined in the CRA regulations." Thus, the key to investing in municipal securities is in determining the primary purpose of the bond issue.

HOUSING BONDS

In order to qualify as a community development investment, housing-related securities must primarily address affordable housing. Housing bond issues are generally either single-family or multi-family and can be local or statewide issues.

Single Family Issues: Single-family bond deals are usually targeted to geographic areas, such as cities and counties, or to a broader statewide area, and are often aimed at first-time borrowers. In analyzing single-family issues, financial institutions should look closely at the eligible participants for the bond program. Because housing authorities frequently define low- to moderate-income under a broader definition than the CRA regulations allow, the bank should research who ultimately benefits from the programs.

For example, the Idaho Housing and Finance Association permits participants in their residential lending program to have annual gross incomes up to certain limits, depending on which county the borrower lives in and the

¹ <http://www.ffiec.gov/cra/qnadoc.htm>

number of people in the household. In 1999, some targeted counties allowed borrowers to have incomes in excess of 140 percent of median family income. (To qualify as moderate-income under CRA, borrowers' incomes cannot exceed 80 percent of median family income.) Further research revealed that the average borrower in the Idaho Housing Program had an income of \$32,681 in 2000. The statewide median income for Idaho for fiscal year 2000 was \$43,700. Therefore, on average, the borrowers participating in the Idaho Housing and Finance Association residential lending program were moderate income.

Because of this confusion, some finance agencies have taken further steps to accommodate financial institution qualified investing. The Washington State Housing Finance Commission issues CRA Taxable Single-Family Program Bonds and imposes an annual income limitation of 80 percent or below of the Metropolitan Statistical Area's median income, which is in line with the regulators' definition. Programs such as these help facilitate community development investing by CRA-mandated institutions. Banks interested in investing in these types of issues should ensure that the housing authority's residential lending program guidelines coincide with those cited in the CRA regulations.

Multi-family Issues: Multi-family bond issues typically finance the construction and rehabilitation of apartment complexes. To be considered affordable, there must be a low- to moderate-income set-aside or some other income restriction. Not all multi-family housing deals address affordable housing. As with single-family issues, the bank should closely examine how the housing authority or issuer defines 'qualifying' or 'eligible tenants.'

HEALTHCARE ISSUES

Some bond proceeds are used to support healthcare facilities that serve a community development purpose. Community development includes health or social services targeted to low- or moderate-income persons. Hospitals, nursing homes, assisted living facilities and homes for the developmentally disadvantaged may qualify under CRA regulation if the patients at these facilities are low- to moderate-income. Usually these facilities serve a large share of Medicaid patients, whose incomes fall within the guidelines of CRA.

TAX ALLOCATION BONDS

Tax Allocation Bonds are bonds issued in conjunction with a specific redevelopment project—typically affordable housing. The taxes pledged to their repayment come from the increased assessed value over and above a pre-established base. The redevelopment creates this added value, known as the tax increment. Many states use tax increment financing (TIF), which provides for the financing of redevelopment projects through the use of tax increment revenues. Obviously, since not all community development activities occur in low- or moderate-income areas, it is important to explore beyond the project description and establish the income composition of the community.

ECONOMIC DEVELOPMENT

Many bond deals state their purpose as economic development. For regulatory purposes, there must be some determination of how the primary purpose is community development. Under CRA, an activity promotes economic development if it, "supports permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income; or supports perma-

nent job creation, retention, and/or improvement either in low- or moderate-income geographies or in areas targeted for redevelopment by federal, state, local or tribal governments." Ultimately, the community development purpose should be quantifiable in jobs created or retained, affordable housing units or other economic development activities.

ELIGIBLE INVESTMENTS

Aside from looking at the primary purpose of the issue, financial institutions must also analyze certain attributes associated with the bonds. Investment policies may restrict purchases of eligible investments because of rating or maturity constraints. Smaller deals may be non-rated or below investment grade because of the costs associated with insuring the bonds and thus ineligible investments for banks that can only invest in grade BBB or higher securities. Some investment policies limit the purchase of securities to maturities inside of ten years, although it is not uncommon for multi-family securities to have maturities of 30 to 40 years. Other banks are limited to taxable or bank qualified municipal securities (i.e. issues under \$10 million). Furthermore, bank qualified issues are generally limited to revenue bonds, which is only a fraction of the municipal market. This significantly reduces the universe of available opportunities. Taxable municipal securities offer a greater opportunity for investment than bank qualified issues, as issuance is considerably larger, both in the frequency of issues and the overall dollar volume generated.

PURCHASING QUALIFIED INVESTMENTS

Purchasing qualified investments usually requires a concerted effort by different divisions within the banking organization. Bank investment officers often have a negative perception of

qualified investments and choose to purchase only under duress from other areas of the financial institution. It is very important that the person responsible for monitoring CRA compliance establishes a strong working relationship with the person responsible for investing on the bank's behalf.

Unlike other investments, securities with a primary purpose of community development are not common in the market place. Because community development investments trade rapidly, especially in areas with a strong investor demand, financial institutions should be poised to respond quickly to qualified investment opportunities. This often requires establishing a network of investment professionals who are familiar with qualified investments. This network is a valuable resource for identifying projects currently trading in the market place, as well as sources for new origination. Given the limited expertise in CRA qualified investments, financial institutions should look for investment professionals with a proven track record, who are committed to researching and providing ample docu-

mentation to support the investment's community development purpose. While a bank or thrift should not depend solely on an outside source for supporting documentation, the financial institution should request verification of the qualified investment before undertaking any transaction.

CONCLUSION

Analyzing municipal securities as community development investments requires banks to explore the purpose, the structure and the credit risk of the issue. Financial institutions should establish a framework for examining qualified investments. A plan of action should also be developed so that community development and investment officers know what to look for and how much to invest. Examiners are often willing to suggest firms that specialize in qualified investment transactions if the institution is having difficulty finding or investing on their own. Ultimately, it is up to the financial institution to clearly understand the primary purpose of the issue and be able to relate that to their examiner. *CI*



ABOUT THE AUTHOR

BARBARA ROSE VANSCHOY is a principal at CRAFT Fund Advisors, the registered investment advisor for the CRA Qualified Investment Fund. Ms. VanSchoy is responsible for researching and documenting qualified investments on behalf of the CRA Qualified Investment Fund's shareholders. Prior to joining CRAFT Fund Advisors, Ms. VanSchoy was the director of research at SunCoast Capital Group. While there, she also headed SunCoast's Community Development Initiative, in which she assisted their depository clients with community development investing. Ms. VanSchoy was previously employed with Raymond James Tax Credit Funds as the director of debt placement, and as a vice president in fixed income research. She is a graduate of the University of Florida with a BSBA in finance, and a specialization in Latin American studies. She can be reached through CRAFT Fund Advisors at 877/272-1977 or directly at 800/519-7065.

A BANKER'S QUICK REFERENCE GUIDE TO COMMUNITY DEVELOPMENT MUNICIPAL BONDS

Definition: *Municipal bond* is a general term referring to securities issued by states, cities, towns, counties and special districts. A primary feature of these securities is that interest on them is generally exempt from federal income taxation and, in some cases, state income taxation. Because of this feature, the interest rates on municipal bonds are lower than interest rates on other types of bonds, but when taking into account one's income taxes, often provide a comparable, or better rate of return. Revenue bonds are municipal bonds secured and repaid only from a specified stream of non-tax revenues. Examples of revenues include tolls, utility charges, or charges and use fees from a facility being constructed with the proceeds of a bond issue, such as a sports facility or a housing project.

At one time, banks were permitted to deduct all the interest expense incurred to purchase or carry municipal securities. Tax legislation subsequently limited the deduction first to 85 percent of the interest expense and then to 80 percent. The 1986 tax law eliminated the deductibility of interest expense for bonds acquired after August 6, 1986. The exception to this non-deductibility of interest expense rule is for bank-qualified issues. An issue is bank-qualified if:

1. It is a tax-exempt issue (other than private activity bond) including any bonds issued by 501(c)(3) organizations, and
2. It is designated by the issuer as bank qualified and the issuer or its subordinate entities do not intend to issue more than \$10 million a year of such bonds

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Bulletin

— CONFERENCES AND SEMINARS —

2002 COMMUNITY REINVESTMENT CONFERENCE

The Federal Reserve Bank of San Francisco in partnership with the Federal Deposit Insurance Corporation, Office of Thrift Supervision and Office of the Comptroller of the Currency is pleased to announce the dates for the 2002 Community Reinvestment Conference. The conference is scheduled for January 30–February 1, 2002 in the ever popular City by the Bay: San Francisco. Registration materials are forthcoming. Please visit our website or call Bruce Ito at 415/974-2422 to have your name added to the mailing list. Most importantly, mark your calendar and plan to attend.

READY, WORK, GROW CONFERENCE

The Enterprise Foundation's 2nd annual workforce conference will take place May 14-15, 2001 at the Hilton New York. Attendees can choose from among 32 sessions organized among six tracks designed to achieve the conference theme of *helping people overcome barriers and build careers*. To obtain a registration brochure call the conference hotline at 410/772-2760.

— REFERENCES, RESOURCES & OTHERS —

HUD E-MAPS

A useful and user-friendly interactive community mapping resource is available at HUD's website: <http://www.hud.gov/emaps/>. The HUD e-map provides online information about HUD and Environmental Protection Agency (EPA) projects in communities throughout the nation. The maps can be customized with up to 15 layers, including census and MSA information, using on-screen tools. Map features can be selected to obtain specific information on the projects or businesses that they represent.

QUALIFIED INVESTMENTS GUIDE

A summary of qualified investments culled from 1999 CRA examinations performed by the four banking regulatory agencies in the Twelfth District has been compiled into a handy report. This blind report provides brief descriptions of the types of investments for which banks received CRA consideration. The institutions presented include large banks, small banks, wholesale/limited purpose institutions and banks operating under a strategic plan. The report also includes information on the institution's asset size, CRA rating, investment test rating and regulator. To obtain a copy call: Judith Vaughn at 415/974-2978 or download it from our website: <http://www.frbsf.org/community/index.html>.

CEDRIC

Consumer and Economic Development Research and Information Center (CEDRIC) is maintained by the Community Affairs unit of the Federal Reserve Bank of Chicago. One of the best features of this resource is the search engine for articles written on a range of subjects related to community reinvestment. A must add to your list of bookmarks. <http://www.chicagofed.org/cedric/index.cfm>

— INVESTMENT OPPORTUNITY —

NHDC LAUNCHES CALPOOL

The National Housing Development Corporation (NHDC) is a national nonprofit dedicated to the preservation of affordable multi-family housing, which is at risk of market conversion due to expiring federal subsidies or other market conditions. NHDC's business model is based upon a volume acquisition and "at-cost" disposition strategy that utilizes existing local non-profits to own and manage preserved properties in perpetuity. NHDC recently launched its first acquisition investment pool for the state of California. The offering, referred to as CalPool, seeks to raise a minimum of \$50 million from private investors such as banks, insurance companies and other corporations. The term of the investment is a maximum of 60 months (likely to be less), and pays an 8% preferred rate of return, plus any excess proceeds as may be generated from the sale of properties. CalPool's subscription deadline is June 30, 2001.

For more information on this CRA investment opportunity, please contact John Trauth at 415/332-4346 or Shawn Elliot Marshall at 415/389-8934.

COMMUNITY INVESTMENTS ARCHIVES

Would you like to read more about the topics covered in this edition? Copies of past articles from *Community Investments* are available on our website at www.frbsf.org/ or by request from Judith Vaughn at (415) 974-2978.

THE NEW MARKETS TAX CREDIT

SBICs: More Than An Equity Investment (Volume 9 #4, Fall 1997)

Low Income Housing Tax Credits and the New CRA Regulations (Volume 8 #1, Winter 1996)

New Markets Venture Capital Company application: <http://www.sba.gov/INV/venture.html>

CRA-QUALIFIED MUNI SECURITIES

Special Insert: More on CRA Investments . . . (Volume 11 #3, December 1999)

Free subscriptions and additional copies are available upon request from the Community Affairs Unit, Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, California 94105, or call (415) 974-2978.

Change-of-address and subscription cancellations should be sent directly to the Community Affairs Unit. Please include the current mailing label as well as any new information.

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