Bank Regulators Clarify When HTC Investments Earn CRA Credit

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As the historic tax credit (HTC) industry digests and adjusts to the recent Internal Revenue Service (IRS) regulations on the proper accounting treatment of Section 50(d) income in a master tenant structure, there is offsetting good news from the nation’s bank regulators on when an HTC transaction can receive Community Reinvestment Act (CRA) consideration for a financial institution. The new Interagency Questions and Answers Regarding Community Reinvestment (Q&A) issued July 15 by the Office of the Comptroller of the Currency (OCC), Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC) has, for the first time, provided detailed criteria for when an HTC project meets the standards for CRA. There is reason to believe that this clarification from the bank regulators will increase HTC demand among banks and help mitigate the decrease in pricing expected in the post-50(d) market environment.

Background
The CRA requires regulated financial institutions to make loans to, invest equity in or provide services to low- and moderate-income (LMI) “assessment areas” within their retail footprints. CRA addresses the practice of redlining, where banks in the past have been accused of denying credit to minority and small business borrowers located in economically depressed neighborhoods regardless of their creditworthiness. In general, banks today are highly motivated to meet their CRA obligations, since failure to do so can bring adverse publicity and public challenges to bank merger plans.

Each bank develops its own plan to comply with the CRA. Investments in low-income housing tax credits (LIHTCs) and new markets tax credits (NMTCs) are popular because both target benefits to LMI areas or households and, under the regulations, automatically qualify as CRA investments. Since the HTC is not targeted to low-income communities or individuals by statute, regulators have been unable to provide a similar bright-line test for it.

In fall 2014, bank regulators requested public comments on a revised Q&A document. The Historic Tax Credit Coalition (HTCC), the National Trust Community Investment Corporation (NTCIC), the National Trust for Historic Preservation (NTHP), the National Park Service (NPS) and several members of
Congress all asked that regulators address when HTC investments can earn CRA consideration.

In response, three types of HTC transactions are highlighted in the preamble of the 2016 Q&A as being eligible for CRA consideration:

- HTC investments in space primarily leased to small businesses that provide measurable numbers of permanent jobs to low-income persons or jobs located in LMI communities or government designated areas for economic development.
- Transactions that provide direct benefits to LMI individuals—such as affordable housing or community development services (such as a community health center).
- HTC investments in projects that revitalize or stabilize LMI communities, federal disaster areas or distressed, underserved middle income rural geographies.

Commenting on the new CRA Q&A, OCC Deputy Comptroller for Community Affairs Barry Wides said, “For more than 35 years, the federal HTC program has been used to attract new private capital to the historic cores of cities and Main Streets across the nation. Many HTC projects can have a positive stabilizing impact on communities by creating jobs in low- and moderate-income geographies, designated disaster areas, designated distressed or underserved middle-income rural geographies, and government targeted areas for revitalization. The language in the preamble to the recently issued Q’s and A’s provides a clearer statement of when banks can receive CRA consideration for HTC community development investments in these areas.”

HTC transactions are small deals, earning less than $1 million in credits, and anecdotally we know that many of these Main Street-scale projects provide space for small businesses.

**Application to Mixed-Use Properties**

Lenders contacted for this article have asked how the new Q&A would apply for mixed-use projects. For instance, what if a transaction located in an LMI census tract and an economic development district has five floors with only the first floor providing space for small businesses? Wides said that banks should follow the existing 50 percent test. So for example, the above project would need to house small businesses in 50 percent or more of its leasable square footage to qualify for CRA.
How does the CRA Q&A relate to Part 24 Approval?

In conducting interviews, it became clear that banks want to know whether the new clarity on HTC CRA eligibility impacts their authority to make HTC equity investments as public welfare investments under Part 24 regulations. The simple answer is that these are two sets of regulations. Part 24 describes public welfare investments that are an exception to restrictions on “nonbanking” activities, such as equity investments in real estate. These guidelines found at 12 CFR 24.3 are distinct but similar to the criteria for CRA. The new CRA Q&A does not change the qualifications for Part 24 investments. Bank investors should note however, that Part 24 is interpreted differently by different bank regulators, so a check with examiners would be wise for institutions not regulated by the OCC.

Industry Reactions

History and the Hill interviewed leaders of tax credit investment groups at financial institutions that actively participate in the community development credit marketplace. Two institutions that have not traditionally invested in HTC transactions gave contrasting answers to the question of whether the clarified CRA guidance would impact their appetite for HTC investments.

Phyllis Reich of TD Bank was very upbeat about the guidance for a number of reasons. She said that the Q&A “opens the door for broader consideration of historic tax credit projects and gives financial institutions the ability to more confidently apply their own judgement within a clearer framework.” Reich said that she liked that the guidance was “broad and not too deep” allowing her and her community reinvestment officer to look at HTC investments on a deal-by-deal basis.
Kevin Goldsmith of JPMorgan Chase said that, while he believes the new guidance is a helpful clarification from the regulators, Chase’s interest in HTC investments was driven more by Part 24 than CRA eligibility. He said, however, that CRA eligibility was “a nice additional benefit” for these transactions. Thinking ahead, Goldsmith also said that if the higher returns on HTC investments ever fell to levels more like the NMTC and LIHTC, “CRA eligibility might be a factor that would keep us in the HTC business.”

Responses from other financial institutions have emphasized that the CRA Q&A is guidance only and that banks are free to interpret these broad guidelines and negotiate with their examiners whatever in their judgement meets the spirit and purpose of CRA. These investors say that every project has a unique story that may meet the test even if it doesn’t fall precisely within a set of general parameters.

Case Studies

Under the clarified guidance, HTC projects that would not previously be thought of as qualified may earn CRA credit for bank investors. For example, the Boilermaker Shops in Washington, D.C.’s Navy Yard was recently transformed from a 46,000-square-foot Navy ship boiler making facility into the Boilermaker Shops, a mix of convenience retail, restaurants and bars. It is located in a low-income census tract and the Capital Riverfront Business Improvement District. This $21 million project used $3.9 million in federal HTCs. Ninety-two full-time equivalent jobs were created, paying an average wage of $12 per hour. Ninety percent of the jobs were accessible to people without a college degree. Retail projects of this type in the past have generally not been viewed by banks as CRA-eligible, but we believe would now be included.

The Audubon Building, an office building on the edge of the French Quarter in New Orleans, has undergone a $17 million rehabilitation using $3 million in HTCs and reopened as the Saint Hotel. The building was flooded during Hurricane Katrina. It qualifies for CRA because of its location in a federal disaster area and a downtown development district, and its creation of new jobs. The hotel created 38 new jobs in hotel management, front office, maintenance and housekeeping, nearly all of which are accessible to individuals without college degrees. Jobs for low-income individuals, in LMI areas or in economic development district, all meet the definition economic development under the broader CRA regulations.

What’s Ahead?

The OCC has agreed to work with HTC advocates to publicize the Q&A as it relates to the eligibility of HTC transactions for CRA. Look for panel discussions at upcoming HTC conferences and additional articles in both banking and tax credit industry publications. Webinars for bank examiners, CRA officers and HTC practitioners are also under consideration.

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