

Date: July 20, 1999.

Summary Conclusion: OTS will not take action against a federal savings association for violation of HOLA § 5(c)(3)(A) if the association invests in the development of a commercial industrial building, provided that certain conditions are met.

Subject: Home Owners' Loan Act/Savings Association Powers.



Office of Thrift Supervision
Department of the Treasury

P-99-6

Chief Counsel

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

July 20, 1999

[

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Re: Commercial Community Development Investment

Dear []:

This responds to your recent letter, submitted on behalf of [] (“Association”), requesting that the Office of Thrift Supervision (“OTS”) confirm that it will not take action against the Association for violation of § 5(c)(3)(A) of the Home Owners’ Loan Act (“HOLA”) ¹ if the Association invests in the development of a commercial industrial building.

In brief, we conclude that the OTS will not take action under HOLA § 5(c)(3)(A) if the Association makes the proposed investment, provided that certain conditions described herein are met.

I. Background

The Association’s two offices are located in [], [] (the “County” and the “State”). According to your letter, 28.6% of the County’s population is below the poverty level. The unemployment level in the County was the highest in the state of [] in January and February of 1999. Unemployment levels were more than three times the State average in both months. The Association has taken in the past, and wants to continue, steps to encourage community and economic development in the County.

¹ 12 U.S.C.A. § 1464(c)(3)(A) (West Supp. 1999).

The State's Commerce Department reports that 80% of the industrial prospects coming into the State are looking for an existing building. The Association therefore proposes to invest approximately \$500,000 in a commercial building that could be marketed to an industrial prospect. Upon sale of the building to the prospect, the Association's investment would be returned. You estimate that resale of the property will take approximately 24 to 48 months. You argue that this investment will help to bring jobs to the community and bring the poverty level to at least the state average, thus furthering the HOLA's community development goals.

The OTS's [] Regional Office has submitted material supporting your request and concurs in your belief that, although the Association's proposed investment does not appear to meet all the technical requirements of the community development investment authorization in HOLA § 5(c)(3)(A), it is consistent with the spirit and intent of that section. The Region has not identified any safety and soundness concerns with your proposed investment.

II. Discussion

Section 5(c)(3)(A) of the HOLA authorizes federal savings associations to invest up to 2% of their assets in equity investments in real estate located in "geographic area[s] or neighborhood[s] receiving concentrated development assistance . . . under title I of the Housing and Community Development Act of 1974."² The principal program administered by the Department of Housing and Urban Development ("HUD") under Title I is the Community Development Block Grant ("CDBG") program.

At the time HOLA § 5(c)(3)(A) was enacted, the CDBG program encouraged localities to target Neighborhood Strategy Areas ("NSA") to receive concentrated development assistance under Title I.³ Federal savings associations could thus easily determine what areas in their communities received "concentrated development assistance" and therefore qualified for § 5(c)(3)(A) investments by reviewing NSA designations.

² Title I of the Housing and Community Development Act of 1974 is codified at 42 U.S.C.A. §§ 5300, et seq. (West 1995). HOLA § 5(c)(3)(A) also authorizes certain loans in these areas. Combined loans and equity investments cannot exceed 5% of assets.

³ 24 C.F.R. §§ 570.201(e) and 570.301(c) (1978).

As we have previously noted,⁴ the CDBG program no longer contains an NSA component. Rather, under the current CDBG program, grants are given to hundreds of CDBG entitlement communities (mostly cities of 50,000 or more), to the States for expenditure in a manner consistent with HUD guidelines, and to some smaller cities and local jurisdictions. Localities are no longer required, or encouraged, to concentrate their Title I funding in particular neighborhoods. Instead, Title I funds can be expended to support any project that: (1) is located in an entitlement community, a nonentitlement area that is covered by a CDBG program administered by a State, or a jurisdiction that participates in the Small Cities program; and (2) meets CDBG project requirements for benefiting low and moderate-income persons or supporting certain other public welfare objectives.⁵

In an opinion issued May 10, 1995 (“May 10, 1995 Opinion”), OTS acknowledged that the HOLA § 5(c)(3)(B)⁶ reference to “concentrated development assistance” was obsolete. Rather than render the provision a nullity and frustrate the congressional purpose that lies behind the provision, OTS indicated it would take no-action positions for community development investments consistent with the spirit and intent of the statutory authority.

Given the nature of the inquiries OTS had received before issuing the May 10, 1995 Opinion, that opinion only set out the standards for community development investments in *residential* real estate. The May 10, 1995 Opinion specifically noted, however, that a thrift could seek case-by-case no action positions from OTS for “other investments” that a thrift believes are “consistent with Title I and the HOLA.”⁷ The Association seeks permission to invest in a commercial real estate development project.

Title I clearly encompasses commercial community development projects.⁸ Moreover, § 5(c)(3)(A) of the HOLA speaks in terms of “investments in real property

⁴ OTS Op. Chief Counsel, May 10, 1995 at 2-3.

⁵ See 24 C.F.R. Part 570 (1999).

⁶ In 1996, unrelated amendments to the HOLA affected the numbering of HOLA § 5(c)(3), so the community development real estate provisions formerly located at § 5(c)(3)(B) are now found at HOLA § 5(c)(3)(A).

⁷ May 10, 1995 Opinion at 4, n. 9

⁸ 42 U.S.C. §§ 5305(a)(14), (15) and (17) (West 1995); 24 C.F.R. § 570.203 (1999).

and obligations secured by liens on real property,” language that includes commercial as well as residential real estate development projects. The issue, then, is whether the particular commercial investment at issue is a bona fide community development investment, consistent with the spirit and intent of HOLA § 5(c)(3)(A) and Title I.

As noted, in the May 10, 1995 Opinion, OTS set out the standards that a residential community development project must meet in order to qualify as a community development investment under the HOLA. We will review the proposed investment by the Association under those standards, with a slight modification of the second standard to recognize that the investment in question is commercial real estate.

A. Location

The May 10, 1995 Opinion indicated that, at a minimum, the investment must be located in an area eligible for Title I assistance. Thus, we indicated that the investment must be located in either a CDBG entitlement community, in a nonentitlement community that has not been specifically excluded by the State in statewide submissions for CDBG funds, or in an area that participates in the Small Cities Program. Our opinion further noted that virtually all jurisdictions are covered by one of the foregoing designations.

So long as your proposed investment falls within such a community, as it appears to do, the location requirement would be met.

B. Substantial Public Benefit

Because the subject of the May 10, 1995 Opinion was a proposed residential investment, that letter required that the investment be made in a residential housing project that benefits low- and moderate-income people.⁹ Given the commercial nature of the investment proposal, the opinion’s specific requirement that the development be

⁹ An individual or family will be deemed to be low-income when they earn less than 50% of the area median income. 12 C.F.R. § 563e.12(m)(1) (1999); cf. 24 C.F.R. §§ 91.5 and 570.3 (1999). An individual or family will be deemed to have a moderate income when they earn less than 80% of the area median income. 12 C.F.R. § 563e.12(m)(2) (1999); cf. 24 C.F.R. §§ 91.5 and 570.3 (1999). As in the May 10, 1995 Opinion, we utilize OTS standards that closely approximate HUD Title I standards so as to minimize regulatory burden on thrifts. In each instance, the OTS standard is sufficiently similar to the HUD standard to serve the same policy purpose.

residential does not apply. Instead, we will consider whether the project is consistent with the type of commercial projects that are eligible for funding under Title I.

The Title I regulations delineating the eligibility requirements for CDBG funding for specific community development projects are extremely complex.¹⁰ Even before the technical requirements of HOLA § 5(c)(3)(A) became obsolete, the provision was never read to require that a project meet all the HUD requirements to be eligible for investment by a federal thrift. Instead, it was read to permit investment in any project located in an area receiving concentrated Title I funding. In effect, the concentration standard served as a proxy for ensuring that the projects thrifths selected for investment would generally further the statutory community development objectives.

Because we can no longer rely on the obsolete geographic concentration standard to screen potential investments, we instead believe it is appropriate to consider whether the project is of the same general type as would be eligible for funding under Title I. To go further and require a showing that the project meets all the precise details of the HUD regulations would cause § 5(c)(3)(A) to be much more cumbersome and restrictive than Congress apparently intended.

Under these circumstances, we are satisfied that your proposed investment will operate in a manner generally consistent with HUD's public-benefit standards under two categories: activities that benefit all residents in a particular area, where at least 51% of the residents are low and moderate income persons, and activities that generate jobs in a low- and moderate-income community. The OTS's recent Community Reinvestment Act Performance Evaluation of the Association found that, based upon information derived from the 1990 Census, 49.1% of the County's families met the standards for low or moderate income. Because the 1990 Census material is nearly a decade old, we used HUD's 2020 Community Planning Mapping Software, which HUD regularly updates, to compare information from the 1990 Median Family Income (Tract) with the 1997 Estimated Median Family Income (Tract) for the County. Of the [] tracts comprising the County, the comparison demonstrates that the [] tracts that fell in the lowest income category in 1990 remained in that category in 1997, while the other [] tracts each dropped into a lower income category. The trends shown by this comparison, along with the County's high level of unemployment, its percentage of population below the poverty

¹⁰ Based on our review of the HUD's CDBG regulations, it appears that commercial real estate development projects can receive Title I funding if, inter alia, they either: (a) create or retain at least one full-time equivalent job per \$35,000 of funds invested; or (b) provide goods and services to an area that has at least one low- or moderate-income person per \$350 of funds invested. 24 C.F.R. §570.209(b) (1999). Numerous other technical requirements are also imposed. 24 C.F.R. Part 570, Subpart C (1999).

level, and the other indicia cited in your letter, all indicate that the County is a low- and moderate income community. Not only should construction of the building help to provide jobs in the community, but it will attract industrial prospects to the County and make jobs available to low- and moderate income County residents. This should help to reduce poverty levels in the County and otherwise benefit a low- and moderate income community.

C. Safety and Soundness

The May 10, 1995 Opinion also required that the investment be, under all the facts and circumstances, safe and sound. Although OTS has reviewed the proposed transaction, ultimate responsibility for ensuring that the investment is safe and sound lies with the Association. An association that makes an investment that is unsafe and unsound will not be shielded from supervisory or enforcement action just because OTS reviewed the investment in advance.

D. Loan-to-One-Borrower Limitations

The May 10, 1995 Opinion also required, as a prudential matter, that the investment in a particular project or partnership not exceed an association's loans-to-one-borrower limit found in 12 C.F.R. § 560.93. So long as the applicable loans-to-one-borrower limit is not exceeded, the investment would not be objectionable on that basis. Your letter indicates that the proposed investment would fall within the Association's loans-to-one-borrower limit.

E. Other Applicable Provisions of Law

The May 10, 1995 Opinion also required that the investment comply with all other applicable provisions of law, such as the investment limits in HOLA § 5(c)(3)(A), the capital requirements, and the requirements of OTS regulations.¹¹ You should ensure that those requirements are satisfied.

Provided that the conditions described herein are met, OTS will not object to the proposed investment by the Association. The Association should maintain documentation showing how it will comply with the standards of this letter. OTS will review the documentation during periodic examinations.

In reaching the foregoing conclusions, we have relied upon the factual representations made in the material you submitted to us and in subsequent telephone conversations, as summarized herein. Our conclusions depend upon the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions. Moreover, this no action letter applies only to the specific transaction described herein. Because of the potential safety and soundness concerns presented by equity investments in commercial real estate, case-by-case OTS review will continue to be required for commercial investments under HOLA § 5(c)(3)(A), pending further notice.

If you have any further questions regarding this matter, please feel free to contact Deborah Dakin, Deputy Chief Counsel, Regulations and Legislation Division, at (202) 906-6445.

Very truly yours,

Carolyn J. Buck
Chief Counsel

cc: All Regional Directors

¹¹ Under OTS's capital regulation, the Association's investment may be placed in the 100% risk weight category if it would qualify as an equity investment permissible for a national bank. You should review 12 C.F.R. Part 24 (1999) to determine if your investment would qualify as a permissible community development or public welfare investment under the OCC's regulations. 12 C.F.R. § 567.6(a)(1)(iv)(T) (1999). If it would not, then the investment must be deducted in calculating your total capital. 12 C.F.R. § 567.5(a)(2) (1999).

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All Regional Counsel
All Regional Community Development Liaisons