Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

Chief Counsel

November 22, 1996

[redacted]

Re: Commercial Community Development Investments

Dear [redacted]

This responds to your recent letter, submitted on behalf of [redacted] ("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)(B) of the Home Owners' Loan Act ("HOLA")[1] if the Association acquires an interest in a limited partnership that develops supermarkets in low-income areas.

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

I. Background

Currently, the Association's wholly-owned subsidiary, [redacted] ("Subsidiary"), holds a limited partnership interest in [redacted] ("Partnership"), a Delaware limited partnership. The Association proposes to cause the Subsidiary to transfer the Partnership interest to the Association as part of the Association's plan to wind up the affairs of the Subsidiary.

The managing general partner of the Partnership is [redacted] ("MGP"), a not-for-profit corporation, whose sole voting member is [redacted]

[1] 12 U.S.C.A. § 1464(c)(3)(B) (West Supp. 1996).

[redacted] ("SVM"), also a not-for-profit corporation. The Subsidiary holds a $[redacted] limited partnership interest in the Partnership. A number of other financial institutions also hold interests in the Partnership.

According to Article II of the Limited Partnership Agreement ("Partnership Agreement"), the Partnership's purpose is to acquire limited partnership interests ("Project Investments") in limited partnerships ("Project Partnerships") that "engage in the acquisition, rehabilitation. construction, expansion and/or leasing or other disposition of supermarkets or supermarket-related retail centers . . . in low income urban areas of the United States." Article II of The Partnership Agreement further states that Project Investments are chosen with the intent to "alleviate community deterioration and to further the revitalization of the surrounding community and the delivery of retail services to economically distressed areas under-served by such services."

Article II of the Partnership Agreement also provides that Project Investments are chosen with the intent to provide cash returns to the limited partners of the Partnership, and to preserve and protect the Partnership's capital. Article II of the Partnership Agreement further states that in the selection of Project Investments, the general managing partner, MGP, "shall only select projects in which a local nonprofit organization with tax-exempt status or its affiliate is a general partner of the Project Partnership." Project Partnerships may also have one or more other nonprofit or for-profit developers as co-general partners.

Your letter states that, although the Association's proposed investment in the Partnership does not appear to meet all the technical requirements of the community development investment authorization in HOLA § 5(c)(3)(B), you believe that the investment is consistent with the spirit and intent of § 5(c)(3)(B).

II. Discussion

Section 5(c)(3)(B) 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

[2] 42 U.S.C.A. §§ 5300, et seq. (West 1995). HOLA § 5(c)(3)(B) also authorizes certain loans in these areas. Combined loans and equity investments cannot exceed 5% of assets.

Urban Development ("HUD") under Title I is the Community Development Block Grant ("CDBG") program.

At the time HOLA § 5(c)(3)(B) 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 qualified for § 5(c)(3)(B) investments by reviewing NSA designations.

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) reference to "concentrated development assistance" was obsolete. Rather than render § 5(c)(3)(B) 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 § 5(c)(3)(B).

Given the nature of the inquiries OTS had received prior to issuance of 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 thrifts could seek case-by-case no action positions from OTS for "other investments" that a thrift believes are

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

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

[5] See 24 C.F.R. Part 570 (1996).

"consistent with Title I and the HOLA."[6] The Association seeks permission to invest in a commercial real estate development project.

Title I clearly encompasses commercial community development projects.[7] Moreover, § 5(c)(3)(B) of the HOLA speaks in terms of "investments in real property 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 that the Subsidiary proposes to transfer to the Association is a bona fide community development investment, consistent with the spirit and intent of HOLA § 5(c)(3)(B) 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 § 5(c)(3)(B). 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.

The Partnership Agreement lists 13 geographic areas in which at least $[redacted] million, in the aggregate, will be invested - Boston, Chicago, Detroit, Houston, Los Angeles, Newark, New York City, Philadelphia, Phoenix, San Francisco, Seattle, Washington, D.C. and the State of Connecticut. Given the heavily urban nature of these locations, the Association should be able to easily discern whether the locations for the proposed Project Investments fall within the entitlement communities eligible for funds under Title I by contacting the

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[6] May 10, 1995 Opinion at 4, n. 9

[7] 42 U.S.C. §§ 5305(a)(14), (15) and (17) (West 1995); 24 C.F.R. § 570.203 (1996).

appropriate regional HUD offices. So long as the Project Investments fall within such a community, the location requirement would be met.[8]

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 proposed to be transferred from the Subsidiary to the Association, the specific requirement that the development be residential is inapplicable. 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)(B) 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, § 5(c)(3)(B) was read to permit investment in <u>any</u> project located in an area receiving concentrated Title I funding. In effect, the concentration standard served as a proxy for ensuring that the projects thrifts selected for investment would generally further the community development objectives of § 5(c)(3)(B).

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[8] When federal savings associations invest in limited partnerships or corporations that make multiple equity investments in diverse locations, the OTS will not object if the limited partnership or corporation invests no more than a <u>de minimis</u> amount of its funds in projects that are located in areas not eligible for Title I funding. Investments will be deemed <u>de minimis</u> only if they do not exceed 10% of all investments made by the limited partnership or corporation. However, all investments of a limited partnership or corporation, even those covered by the <u>de minimis</u> rule, must meet each of the other standards set out herein.

[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) (1996); <u>cf</u>. 24 C.F.R. §§ 91.5 and 570.3 (1996). 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) (1996); <u>cf</u>. 24 C.F.R. §§ 91.5 and 570.3 (1996). 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.

[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, <u>inter alia</u>, 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. §§ 570.203 and 570.209(b) (1996). Numerous other technical requirements are also imposed. 24 C.F.R. Part 570, Subpart C (1996).

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)(B) to be much more cumbersome and restrictive than Congress apparently intended.

As noted above, the Association has indicated that the Partnership is managed by an affiliate of SVM, a nationally-known nonprofit community development corporation. Under the Partnership Agreement, the SVM affiliate is to select projects that are located in "low income urban areas" and will "alleviate community deterioration . . . and [deliver] retail services to economically distressed areas. . . ." Each project is required to have a local nonprofit general partner. Under these circumstances, we are satisfied that the Partnership will operate in a manner generally consistent with HUD's public-benefit standards by providing retail services in low- and moderate-income communities and generating or preserving jobs in those communities.

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 insuring 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.

In this regard, we note that [redacted]

We raised this issue with you during a telephone call on October 9, 1996. You indicated that the defect was subsequently cured. Our decision not to object to the proposed investment relies on that representation.

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. Your letter indicates that the Association is aware of this restriction. So long as the applicable loan-to-one-borrower limit is not exceeded, the investment would not be objectionable on that basis.[11]

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)(B), the capital requirements, and the requirements of OTS regulations.[12] Your letter indicates that the Association is aware of and will comply with these requirements.

Provided that the conditions described herein are met, OTS will not object to the proposed transfer of the Subsidiary's limited partnership interest in the Partnership to the Association. Prior to acquiring the interest, the Association should obtain from the Partnership a written acknowledgment of the standards in this letter and a statement that the Partnership will observe them. The Association should monitor the Partnership's compliance with these standards and maintain records documenting compliance. The documentation will be reviewed by OTS during periodic examinations.

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[11] For these purposes, investments by a savings association in more than one limited partnership or corporation organized by the same non-profit organization or promoter will not be aggregated solely because there is a common organizer or promoter. We would reach a different conclusion, however, if the organizer or promoter guaranteed the investment or if the separate partnerships or corporations invested in the same project or projects.

[12] OTS's former community development regulation, 12 C.F.R. § 545.41, has been eliminated and the statutory authority for community development investments is now found at 12 C.F.R. § 560.30. Under OTS's capital regulation, the Association's investment in the Partnership will be placed in the 100% risk weight category. 12 C.F.R. § 567.6(a)(1)(iv)(T) (1996). No deduction from capital will be required. 12 C.F.R. §§ 567.1(l) and 567.5(a)(2) (1996); 12 C.F.R. § 24.3 (61 Fed. Reg. 49654, 49660-61 (1996)). We also note that OTS recently proposed to promulgate a pass-through investment regulation. 61 Fed. Reg. 29976, 29991-92 (1996). If adopted in final form, that regulation will, inter alia, place limits on the pass-through investments of federal savings associations. The Association's proposed investment in the Partnership would constitute a pass-through investment within the meaning of the regulation.

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(B), pending further notice.

If you have any further questions regarding this matter, please feel free to contact Timothy P. Leary, Counsel (Banking and Finance), at (202) 906-7170.

Very truly yours,

Carolyn J. Buck
Chief Counsel

cc. All Regional Directors
All Regional Counsel
All Regional Community Affairs Liaisons