Focus on Affordable Multifamily Housing
—by Jerry Hawke, Comptroller of the Currency

Our country has benefited from 10 years of economic prosperity. However, not all Americans have shared in these benefits. Today, families earning the minimum wage cannot afford the rent on a modest two-bedroom apartment in any of the major metropolitan housing markets of the country. In addition, the country is losing approximately 2,000 units of affordable rental housing every month.

Affordable multifamily housing can and is being produced in communities throughout the country. The financing of and investment in affordable multifamily housing has grown to be a profitable business opportunity for financial institutions. Moreover, it is being done through partnerships between financial institutions, community organizations, and government. This edition of the OCC’s Community Developments newsletter focuses on the issue of affordable multifamily housing and identifies some of the ways in which banks can provide debt and equity financing for this much needed type of housing.

In this edition, we describe the programs and projects of national financial intermediaries, banks, and community organizations working in partnership to develop and preserve affordable multifamily housing. You will learn about successful multifamily financing and investment programs, and some of the more recent innovations in investment opportunities that preserve and build units for low-income renters, including federal low-income housing tax credits (LIHTCs). Recent changes to the OCC’s Part 24 community development investment program are discussed as well as how all of these opportunities might be eligible for CRA credit.

From a successful nonprofit developer’s point of view, you will hear a call for greater sensitivity on the part of banks to match appropriate rates and fees with the goal of creating and preserving affordable housing. Also included is an article describing Fannie Mae’s programs for affordable financing.

All in all, this edition of Community Developments showcases the many opportunities available to banks to earn a profit while developing and preserving this important housing resource. Now that Financial Modernization is behind us, or more correctly – ahead of us, it is a call for rededication of our efforts to provide banking leadership in the financing of affordable multifamily housing.
The Low-Income Housing Tax Credit Program:
Community Bank Reaps More than Monetary Returns

—by Hal Keller, President, Ohio Capital Corporation for Housing

Created by Congress in 1986, the Low-Income Housing Tax Credit program has been a premier program for encouraging big-name, national corporations, including national banks, to invest in the development of affordable housing. Benefits such as a solid return on investment, the dollar-for-dollar federal tax credit, and Community Reinvestment Act credit have made the housing tax credit a popular investment program. Since the program began, more than $4 billion in tax credits have been awarded to corporate investors.

The success of the program can be attributed to a “win-win” situation for the public sector investment and recipient. The corporate investor receives tax credits and related deductions. The community development partner is able to secure equity financing, resulting in the development of new and/or improved affordable housing stock in the community.

But when you are community-based bank investing in a local fund, you reap the benefits of both sides of the equation. Park National Bank, a $1.2 billion asset community bank, located in Newark, Ohio, has invested in the Ohio Capital Corporation for Housing’s (OCCH) equity funds since the first fund was created in 1989. “We first invested in Ohio Capital because we were impressed with the people who started the company and the board of directors,” said John Kozak, chief financial officer for Park National Bank. “We also wanted to invest in affordable housing and liked the diversification and quality of underwriting Ohio Capital’s equity fund provided.” Since 1996, under its public welfare investment program (“Part 24”), the Office of the Comptroller of the Currency (“the OCC”) has approved national bank investments in approximately 50 state and regional tax credit funds similar to OCCH’s equity funds in Ohio.

As Ohio’s leading syndicator of federal low-income housing tax credits, OCCH has raised more than $230 million in private capital and has assisted in the production of over 5,400 housing units. The approximately 100 developments in the fund are located in both urban and rural areas throughout the state of Ohio. Since Park National Bank’s initial $500,000 investment in Ohio Equity Fund I, its shareholders have been able to experience, first-hand, the community benefits of helping in the development of quality, affordable housing. Park National Bank is one of seven affiliates of the Park National Corporation. The affiliates are primarily located in rural and small city areas throughout central and eastern Ohio. Through the Ohio equity funds, about 800 housing units have been developed in these approximately 12 non-metro counties with a Park National-affiliate presence.

Park National Bank’s investments in housing credits has increased steadily throughout its relationship with OCCH, culminating in a recent Ohio Equity Fund IX investment of $4 million, making Park National Bank’s total investment in the program $16.5 million. “We continue to get the returns as promised, we receive CRA credit, and we get to see the money come back into our own communities,” Kozak said. “We narrowly focus on Ohio Capital because we consistently see projects developed in our areas. Other investors may look at national or out-of-state equity funds, but that doesn’t make sense to us.”

Ohio Capital Corporation for Housing also sees a benefit to the Park National relationship. “When we work with Park National, we are working with the key decision makers that run the company, and that means a lot to us,” said Hal Keller, president of OCCH. “They are very concerned with how these investments and projects affect their community, which blends well with our corporate mission, ‘to cause the production, rehabilitation and preservation of affordable housing in Ohio.’”

It should also be noted that the OCC recently revised its Part 24 investment regulation, which eliminates any geographic restrictions on tax credit investment benefits. Keller applauds this Part 24 revision by the OCC since it may attract more bank investment in the tax credit funds initiated by OCCH. (See accompanying article on “Changes to the OCC’s Part 24 . . .” appearing on page 4.)

“We want to invest in affordable housing opportunities in our communities, and we continued on page 3
TAX CREDIT PROGRAM
continued from page 2
couldn’t get the same results on our own,” Kozak said. “The low-income housing tax credit program, and OCCH’s equity funds, maximize the returns
to us and to the community.”

For additional information, contact Hal Keller, President, Ohio Capital Corporation for Housing
at (614) 224-8446, or hkeller@occh.org.

“Tax Credits 101”
The Low Income Housing Tax Credit Program (LIHTC) is now the single largest federal ini-
tiative to stimulate the production of affordable rental housing. Investments in LIHTCs will
provide dollar-for-dollar offsets to the bank’s federal income tax liability. Moreover, invest-
ments in LIHTCs are a qualified investment for banks under the OCC’s Part 24 regulation.
Listed below is an example of a sources and uses of funds pro forma and equity calculation for a
typical tax credit investment.

<table>
<thead>
<tr>
<th>Sources of Funds</th>
<th>Uses of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction/Permanent Mortgage</td>
<td>Construction costs</td>
</tr>
<tr>
<td>Municipal Soft Second Mortgage</td>
<td>5,300,000</td>
</tr>
<tr>
<td>State Soft Second Mortgage</td>
<td>Professional Fees</td>
</tr>
<tr>
<td><strong>Equity - Sale of LIHTCs</strong></td>
<td>300,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Carrying Costs</strong></td>
</tr>
<tr>
<td></td>
<td>900,000</td>
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<tr>
<td></td>
<td><strong>Other Expenses</strong></td>
</tr>
<tr>
<td></td>
<td>500,000</td>
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<tr>
<td></td>
<td><strong>Developer Fee</strong></td>
</tr>
<tr>
<td></td>
<td>400,000</td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
</tr>
<tr>
<td></td>
<td>7,000,000</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Tax Credits Awarded</td>
</tr>
<tr>
<td>Ten Year Benefits</td>
</tr>
<tr>
<td>Total Value of Tax Credits</td>
</tr>
<tr>
<td>Bank is 99% Limited Partner</td>
</tr>
<tr>
<td>Value of Credits to Bank</td>
</tr>
<tr>
<td>Bank Purchases Credits at $.7575</td>
</tr>
<tr>
<td><strong>Equity Invested in Project</strong></td>
</tr>
</tbody>
</table>

In this example, the $3.7 million of equity invested (found in the sources of funds column)
resulted from the developer’s sale of tax credits to the bank. These credits were received by
the developer from the state allocating agency. The equity calculation column illustrates how
this $3.7 million equity figure is derived. The annual tax credit allocation of $493,400 is avail-
able to the bank for 10 years, which results in a total value for the credits of $4,934,000.
However, the bank is a 99 percent limited partner in the project, so its stream of tax credits
equals $4,884,660 (.99 x $4,934,000). The bank then purchases the tax credits at a discounted
value of 75.75 percent resulting in equity to the project of $3,700,000. (It should be noted that
the discounted value of the tax credits at 75.75 percent cited in this example would vary in
the marketplace based on supply and demand). In addition to the 10-year stream of tax cred-
its, most properties will also sustain losses from operations, which are passed through to the
limited partner investor. These losses will further reduce the investor’s taxable income and
increase the internal rate of return.
Changes to the OCC’s “Part 24” Public Welfare Investment Program Helps Banks to Invest in Affordable Multifamily Housing

—by Jacki Allen, Community Development Division

We recently revised our “Part 24” public welfare investment regulation in order to make it easier for national banks to self-certify community development investments. Part 24 is the formal regulation known as the Community Development Corporations, Community Development Projects, and Other Public Welfare Investments regulation, 12 CFR 24 (“the regulation” or “Part 24”). The regulation permits national banks to make equity and debt investments that are designed to promote the public welfare, including investments in affordable multifamily housing and other community development activities. In the past 15 years, more than 700 national banks have made equity investments in excess of $3 billion in affordable housing through investments under Part 24, including investments in low income housing tax credits (LIHTC).

The reasons for the changes to the regulation include: (1) encouraging continued national bank investments in community development projects and to expand investment options; (2) reducing the regulatory burden; (3) streamlining the self-certification process for national banks; and (4) increasing consistencies between the regulatory agencies on community development investments.

The OCC made technical changes to Part 24, expanding the self-certification process and providing more options for national banks to use in making community development investments by:

- Expanding the scope of public welfare investments activities that national banks may self-certify;
- Recategorizing the list of investments eligible for self-certification as examples of qualifying public welfare investments;
- Removing the geographic benefit information requirement in self-certification letters and investment proposals;
- Removing the geographic restrictions for self-certified investments so that national banks can use the self-certification process to make eligible public welfare investments in any area;
- Adding the receipt of federal low-income housing tax credits by the project in which the investment is made as an additional item on the regulation’s list of ways that a national bank may demonstrate community support or participation for its public welfare;
- Eliminating the requirement that a bank demonstrate that it is not reasonably practicable to obtain other private market financing in order to qualify as a public welfare investment;
- Revising the former list of investments eligible for self-certification, which now provides examples of permissible public welfare investments, to: (1) provide that projects receiving low-income housing tax credits need not include non-profit participation, and (2) include investments in community development financial institutions, as defined in 12 USC 4702(5); and,
- Clarifying that if a national bank wants to make loans or investments designed to promote the public welfare that are authorized under provisions of the banking laws other than paragraph 11 of section 24, it may do so without regard to the provisions of 12 USC 24 (Eleventh) Part 24.

How does this help a bank that wants to increase its involvement in multifamily housing?

Most public welfare investments by eligible banks can be self-certified by submitting a letter to the OCC which contains information about the investment. Unlike in the past, public welfare development investments, such as those described in the articles by Joe Hagan, Joy Aruguete and Mike Bodaken in this newsletter, can now be self-certified regardless of the location of the project. Banks can also self-certify any qualified investment without reviewing it against any local

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Permanent Financing Options for Multifamily Construction Loans

—by Joseph S. Hagan, Managing Director, Banc One Capital Funding Corporation

A ffordable housing lenders live in a world of very tight ratios. A typical Low Income Housing Tax Credit ("LIHTC") deal has debt service coverage ratios of 1:10 to 1:15. These tight ratios make for very interesting loan committee meetings. One way to make the approval process easier is to have a permanent loan takeout. The requirement by the construction lender to have a permanent loan takeout is made easier because the vast majority of the equity providers require, not only a takeout, but also a fixed-rate product. Fannie Mae’s Targeted Affordable Forwards program provides an interest rate lock that meets the equity provider’s requirements and provides a level of comfort to the construction loan lender. This Fannie Mae program is very popular, with over $650 million committed in 1999 for some 75,000 units. At Banc One Capital Funding Corporation (BOCFC), we have been involved in a number of these transactions. In recognition, BOCFC has been named Fannie’s Mae Targeted Affordable Housing lender for three of the past four years.

Developing the Targeted Affordable Forwards program, which provides a forward rate lock, created a number of obstacles for Fannie Mae. After a series of pilot products, it recognized the best way to lock into an interest rate was to secure the funds within the first 12 months of the construction period. This was problematic for Fannie Mae because its charter prohibits it from construction lending. So it is important to understand that although the program provides the construction lender with a permanent loan interest rate, it does not eliminate lease-up risk. Fannie Mae will not close the permanent loan until the project has leased-up successfully.

This program requires close coordination between the construction and permanent lender as well as the equity provider. At Banc One, the smoothest execution is when we provide all of the financing pieces. We like to call ourselves a “one-stop” shop.

So, here’s how it works. Under the forward commitment arrangements, Fannie Mae will lock in the interest rate prior to the commencement of construction. The Fannie Mae program will permit a construction and lease-up period of up to 24 months with one 6-month option. Fannie Mae has us underwrite and size the permanent loan at the same time as the construction loan. The underwriting process includes an appraisal and all of the third party reports. There is a 90 percent maximum loan-to-value requirement for the size of the permanent loan that is based on the as-completed value. With additional subordinated debt, maximum loan-to-values can go up to 95 percent and 100 percent depending on whether the debt requires mandatory repayment (applicable to 95 percent) or is paid only out of available cash flow (applicable to 100 percent). The Fannie Mae program also permits a debt service coverage down to a minimum of 110 percent on 9 percent LIHTC transactions in which all of the units are reserved for low-income renters. In all other LIHTC transactions the debt service coverage is 115 percent.

The Targeted Affordable Forward program has two draw options. The first is the single draw option. Under the single draw option, funds are advanced to the construction lender within 30 days of the borrower electing to lock the interest rate. However, the rate must be locked prior to the construction loan closing. The second option is the floating rate option where four preset draws are made over a 12-month period. The interest rate for each draw is set separately at the time of the draw. The interest rate for the permanent loan is not set until the final draw and will be the blended rate of the four draws. At Banc One, we prefer the single draw option because the interest rate for the permanent loan is set at the construction loan closing.

When pricing the construction loan, the lender must be aware that the Fannie Mae funds are provided to the lender at a rate close to the permanent loan interest rate. Typically, the construction lender will price the construction loan at a spread above the Fannie Mae rate. Construction loan interest rates under this program are generally higher than a typical loan, because the Fannie Mae cost of funds are higher than a bank’s cost of funds. In addition, since the permanent loan

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PERMANENT FINANCING

Funds are drawn in one lump sum or in four draws, the bank will invest the funds until drawn by the borrower.

In order to overcome Fannie Mae’s construction loan prohibition, the construction lender is required to provide a letter of credit or some other form of security in the amount of the permanent loan. The construction lender must be at least an “A” rated institution in order to qualify for the Fannie Mae program. The security will be in place until permanent loan closing.

The permanent loan must close within 24 months of the closing of the construction loan and after the project has achieved 90 percent occupancy for 90 days. Once the project has met the Fannie Mae occupancy requirement, the permanent lender will do a final underwriting based on actual revenues and expenses for the property. The Fannie Mae lender will complete an inspection to verify occupancy and calculate the loan based upon the stabilized net operating income and the loan will close.

Banc One Capital Funding Corporation has been the top lender in Fannie Mae’s Targeted Affordable Forwards program three of the last four years. This program has been effective in providing sound community development construction loans, thus meeting the needs of affordable housing developers. An example of a transaction using the program is illustrated below.

For more information about this program, contact Ken Bowen at Banc One Capital Funding Corporation at 800-837-5100.

Joseph S. Hagan, Managing Director at Banc One Capital Funding Corporation, was the author of this article.

Forward Commitment Permanent Financing - Example

Treymore at McKinney is a 192-unit new construction, mixed income, multifamily apartment project located in McKinney, Texas. It consists of 24 two-story buildings with 48 attached garages and a community building on approximately 17 acres. Thirty units are restricted to families earning incomes at 50 percent of area median income (AMI), and 114 units are restricted to persons earning incomes at 60 percent of AMI; 40 percent of the project’s units are both rent-restricted and occupied by persons earning incomes at or below 60 percent of the area median income.

Banc One entities provided all aspects of the financing, including the construction loan, forward commitment permanent financing and Section 42 tax credit equity. The permanent loan is non-recourse and fully amortizes over 30 years. The rate was locked at 7.458 percent. The project was developed by a minority-owned firm based in Texas.

SOURCES OF FUNDS
$ 7,182,000 Construction/Permanent Financing (Banc One Capital Funding, Fannie Mae DUS Lender)
 5,081,386 Section 42 Tax Credit Equity Proceeds (Banc One Tax Credit Fund V)
 1,566,375 Deferred Developer Fee and Cash Flow from Operations
$13,829,761

USES OF FUNDS
$ 2,069,500 Land & Site Work
10,554,082 Construction Costs
 1,206,179 Construction Interest & Financing Fees (Construction & Permanent)
$13,829,761
A recent study of multifamily housing developments showed 26 percent had 200 or more units, while 43 percent had 51-199 units. This leaves 31 percent with 5 to 50 units. The Banc One Community Development Corporation (CDC) is one of the largest direct multifamily equity players in the market. The CDC has focused on the smaller projects (less than 60 units). One of the most difficult pieces of financing for the smaller deals has been permanent financing.

While it is true Fannie Mae offers a small-loan program, the issue is, and always will be, the size of the permanent loan. It takes the same amount of effort to underwrite a $600,000 permanent loan as it does a $6,000,000 loan. Naturally, loan originators will focus on the larger loan. From a practical standpoint any loan less than $2,500,000 will not get much attention by a permanent loan originator. In addition, many of the smaller projects are done by less-experienced multifamily developers requiring more of a hands-on approach, which further exacerbates the situation.

In response to this problem, the Banc One CDC developed a portfolio product, which provides permanent financing to these small deals. Since the CDC was already active in the small-deal market, it was accustomed to working with the less-experienced developer and providing more hands-on support. The most difficult issue, then, was the interest rate risk as well as the term of the loan. To be competitive, the CDC had to provide a fixed-rate product for a period of at least 18 years.

In 1997, the CDC created its small-deal permanent loan product. The product focused on small deals needing permanent loans of $500,000 to $2.5 million. Working with Banc One’s Fannie Mae DUS lending group, Banc One Capital Funding Corporation, the CDC designed its program to be like Fannie Mae’s by designing documents and underwriting procedures similar to those used in a typical Fannie Mae loan. Because the CDC modeled its program after Fannie Mae’s, it now has the ability to sell the loans in the secondary market.

There are some notable differences between the two programs. One is in the way the interest rate and the forward rate are calculated on a deal. Internally, the CDC decided not to match-fund its loans because it expected to sell the loan to Fannie Mae in the near term. Consequently it decided to keep a check on the interest rate. The CDC did this by instituting a floor of 8 ¼ percent. The actual rate is calculated by adding 2 3/8 percent to the 10-year treasury rate for loans under $1 million and 2 ¼ percent for loans over one million. The CDC does offer a forward rate lock at a cost of 2.5 basis points per month of the forward request.

The program has been very effective with commitments of over $30 million for 30 transactions.

For more information contact John Hart, Senior Vice President, Banc One Community Development Corporation at 614-248-5346.

Joseph S. Hagan, Managing Director of Banc One Capital Funding Corporation and Board Member of the Banc One Community Development Corporation was the author of this article.
A way to meet investment tests under the Community Reinvestment Act (CRA), small and mid-sized depository institutions may purchase qualifying geographically targeted multifamily mortgage-backed securities (MBS) directly from Fannie Mae’s Investor Trading Desk. Fannie Mae has been providing this targeted approach for buyers of single-family MBS for several years. Since late 1996, Fannie Mae has sold more than $1.2 billion in targeted securities backed by single-family loans to over 60 lenders. Today, the Fannie Mae Trading Desk offers a similar targeted approach to investors in multifamily securities, with some important differences between single-family and multifamily MBS.

Single-family CRA-targeted MBS are primarily backed by loans to borrowers with incomes less than 80 percent Area Median. CRA-targeted multifamily MBS use different eligibility criteria. For example, because CRA was enacted to increase investment in housing for low- to moderate-income households, multifamily MBS backed by Low-Income Housing Tax Credit (LIHTC) equity investments are generally eligible for CRA credit. In other cases, however, the geographic location (assessment area) may provide sufficient information to inform a potential buyer whether the investment is eligible.

Most Fannie Mae multifamily MBS are issued under the Delegated Underwriting and Servicing (DUS) product line. Fannie Mae specifically identified

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Small Loan Financing - Example

Casa de Roman is a 48-unit apartment complex located in Somerton, Arizona. One-hundred percent of the units will provide affordable housing; 5 units will be targeted at individuals/families earning below 30 percent of area median income; 5 units will be at 40 percent AMI; 15 units will be at 50 percent AMI; and 23 units will be at 60 percent AMI. Construction financing was provided by Banc One, Arizona, NA; tax credits were purchased by Banc One Tax Credit Fund; and the permanent financing was provided by Banc One Community Development Corporation through their small loan program. The developer is the largest nonprofit developer, manager, and provider of various social services in Arizona. The 18-year loan amortizes over 30 years and is fixed at 2.375 percent over the 10-year Treasury Bond.

**SOURCES OF FUNDS**

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<td>$676,500</td>
<td>Construction Financing (Banc One, Arizona, NA)</td>
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<tr>
<td>2,562,646</td>
<td>Section 42 Tax Credit Equity Proceeds (Banc One Fund IV)</td>
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<tr>
<td>305,413</td>
<td>Deferred Developer Fee &amp; Developer Equity</td>
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</tbody>
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**USES OF FUNDS**

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<tr>
<th>Amount</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>$265,614</td>
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<td>174,302</td>
<td>Construction Interest &amp; Financing Fees (Construction &amp; Permanent)</td>
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<td><strong>$3,544,559</strong></td>
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A Divine Partnership...

—by Annette LePique, Community and Reinvestment Development Specialist, Midwestern District

As in many communities throughout the country, Sioux Falls, South Dakota was in need of affordable rental housing. In 1995 Citibank (South Dakota), N.A., initiated a dialog with various players in the Sioux Falls real estate community to develop much-needed affordable rental units for low-income families in the city. Citibank staff took the lead by contacting Costello Property Management, a proven leader in the management of affordable housing units in five states. Costello, in turn, contacted the Presentation Sisters, an order of Catholic nuns, who had successfully developed nursing homes and hospitals serving low-income residents of South Dakota. Originally, the thought was that the Order could serve as the general partner to develop a multifamily, low-income housing tax credit project.

The Presentation Sisters were interested in creating housing opportunities for low-income families and individuals, but did not think they had the expertise to serve as the general partner. This brought the project to the attention of the Bishop of the Diocese of Sioux Falls, The Most Reverend Robert J. Carlson. After much discussion, St. Joseph Catholic Housing, Inc. was created to serve as the general partner to work with Citibank in developing a multifamily housing project in Sioux Falls. Sister Josita Schwab with the Presentation Sisters would assume a role in the project that has made this partnership a success story.

Under the structure developed, the project involves 60 units, all of which received federal low-income housing tax credits allocated by the South Dakota Housing Development Authority. Construction and permanent financing was provided by Citibank.

As general partner, St. Joseph Catholic Housing, Inc. owns a 1 percent interest in the property and CitiHousing, Inc. (a Community Development Corporation approved under OCC’s Part 24 program – see article on page 4), purchased a 99 percent interest as a limited partner for $1,974,000. See flow chart below.

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A DIVINE PARTNERSHIP
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Today, the North Ridge project provides 60 families with affordable housing in a wooded area located in the southwest part of Sioux Falls. Situated on nine acres, it is near the freeway, a shopping mall, and an elementary school. A narrow creek runs behind the buildings near the city’s bike trail. The units are larger than the standard apartment size, and include 28 three-bedroom townhouses and 2 four-bedroom townhouses, each with its own washer and dryer. Presently 76 children live at the complex. Average rent payments are 30 percent below market rate.

The occupancy rate has remained steady at near 100 percent in the four years since the initial rent-up. Valerie Kuhl, Community Development Lender for Citibank (South Dakota), N.A. declares North Ridge a “wonderful place to live.” Two words describe the reason for this “Sister Josita.”

Sister Josita Schwab, a Presentation nun, represents the order’s unique contribution to this project. When they first opted-out as general partner, they affirmed a commitment to the project after it was developed. It came in the form of Sister Josita, the on-site social service worker. Daniel J. Costello, Costello Property Management, describes Sister Josita’s involvement as “extremely low-keyed, she brings a wonderful element that is not about any particular religion, just service to the residents.” Sister Josita’s services include advocacy for the resident families and activities and programs for the children after school and on weekends. She has started a Girl Scout and a Boy Scout troop for the children and serves as the leader of each. While her first year’s salary was donated by the order, she is now on the payroll of Costello Property Management and “worth every dime” according to staff there.

Along with her duties at North Ridge, Sister Josita is also working at West Creek Woods, another Citibank-led project designed for low-income elderly residents. There she serves approximately 45 elderly residents as a companion and advocate in obtaining needed services. In her job at West Creek Woods, just as at North Ridge, Sister Josita is paid from the cash flow of the project.

The impact of this unique partnership is simple, more partnerships, more projects and more affordable housing units created. South Ridge, a new project of the partnership in the southeast part of Sioux Falls, is a mirror of North Ridge, serving low-income residents with 60 new units.

St. Joseph Catholic Housing, Inc. has expanded its participation in affordable housing to approximately 400 units in seven new projects, six of those utilize low-income housing tax credits and are financed by Citibank. Costello Management is involved with all seven new projects. Citibank continues developing other opportunities to partner, including Lutheran Social Services, Inc. as they continue to create and provide decent housing for limited income South Dakotans. This past summer two of the Citibank projects have expanded to include the rehabilitation of existing buildings for a total of 144 new affordable units. The bank’s commitment included mortgages of $1.5 and $1.7 million. St. Joseph Catholic Housing, Inc. decided to go it alone on one small project. At the request of a local community, the nonprofit converted a vacant Catholic grade school to 14 units of much-needed conventional housing in Salem, South Dakota.

There is a larger lesson to be learned from this project – one that can have applications to other banks in other communities. In order for a project like this to be successful, a partnership must exist. The bank can play a key role in creating the dialogue and getting the people talking. It is not surprising to find the community partners referring to their banking partners as Bishop Carlson did:

“" It is no exaggeration to state that “but for” Citibank’s involvement and generosity in the North Ridge housing project, St. Joseph Catholic Housing, Inc. would not have been created and the Catholic Diocese of Sioux Falls would not have become involved in low-income housing.”

For additional information, contact Valerie Kuhl, Citibank, at (605) 331-7325.
Affordable Rental Housing Finance
Through the Eyes of a Community Developer

—by Joy Aruguete, Executive Director, Bickerdike Redevelopment Corp., Chicago, Illinois

Despite the current general economic prosperity in the U.S. Department of Housing and Urban Development (HUD) Secretary Andrew Cuomo recently cited a lack of affordable housing in the U.S., with more than 5.3 million American families in need of affordable housing. While homeownership is a coveted goal, multifamily housing will continue to be significantly needed in an overall housing strategy. Available financing tools, especially for multifamily housing, are a challenge to access, and only skim the surface of meeting this need.

Affordable multifamily housing finance is complicated, difficult to access, involves a layered financing strategy, requires creativity, and is often not well understood by private lenders. Yet, it is essential to building healthy, economically viable communities. Given the available financing tools, private lenders play a vital role in helping meet the affordable housing need in this country.

The single greatest government financing tool available for affordable multifamily rental development in the U.S. is the Low Income Housing Tax Credit Program. The Tax Credit program is a vehicle to bring corporate investment into affordable housing development.

With the use of tax credits, a typical multifamily development looks like this: owner/investor equity (through tax credit syndication); housing block grant funding (through HOME program); possible state and/or local affordable housing dollars; possible Federal Home Loan Bank Affordable Housing Program dollars; possible private donations; and finally, a private lender – usually a bank. While tax credits are frequently used, it is not out of the question that an affordable multifamily development be done without tax credits.

The good news for the private lender is that it has the safest position of all in this financing strategy, not to mention receiving CRA benefit. The private lender usually holds first position, and typically lends a small portion of the overall portion of financing of the total development cost. Tax credits and HOME dollars are typically administered by the state, and there are opportunities for private lenders to play a role in these multifamily developments, both as first lender and in predevelopment financing.

In some areas community developers are challenged to find private lenders interested in this type of development, and in other areas there is considerable interest by lenders. In most scenarios, the real challenge lies in obtaining reasonable and sensible terms from the private lender.

OK, you’re a private lender and interested. First, remember you are in first position and lending a relatively small portion of the debt. Second, you’re a lender and you are going to make money from your loan, but don’t get too greedy – this is an affordable housing development and every dollar counts, especially over the years of project operation.

During the pre-loan commitment phase, lenders can get unreasonable with fees. Community developers understand you incur costs in the process of lending money, however, there are times when fees clearly are excessive and unwarranted. Lenders should keep their fees in check, because increased fees drive the total development cost up and makes affordability more challenging. Additionally, when the developer is a not-for-profit community developer, there is certainly a nonmonetary CRA value in this lending and this should be a consideration when assessing both fees and terms.

Sometimes, lenders want to charge excessive fees.

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AFFORDABLE RENTAL HOUSING FINANCE

continued from page 11

interest rates, they don’t want to offer fixed rates for the life of the loan (or at all). A reasonable interest rate and length of time for the rate lock-in period are essential. Financing for these developments takes much longer to put together because there are multiple sources, each with their own set of requirements. These projects are typically tightly budgeted and need predictability over time. Again, affordable housing is the operative consideration here.

Sometimes lenders schedule a balloon payment on the loan. I’m not saying that this is never warranted, for instance a scheduled condominium conversion after a set number of years, etc. However, this can place the project in complete turmoil in seeking refinancing, and is not helpful or advisable for a healthy project. The maturation of tax credits (before an investor can exit) is 15 years, most government financing is 30 or 40 years, and is non-amortizing or partially amortizing — usually with some interest-only. The private loan should be for 30 years in most cases and certainly no less than 15 years (tax-credit life) without a specific request and plan by the owner, illustrating financial feasibility for project operations.

Some lenders automatically assume that this type of development is inherently high-risk and should, therefore, assess terms accordingly. However, developers of affordable housing and especially not-for-profit community developers are a diverse group. Some of us have significant experience with this type of development and have a successful track record of developing well-performing projects. Yet, typically lenders treat not-for-profit developers specially, with financing for these developments being handled as higher risk, and typically with more hoops to jump through. Neighborhood lending programs, while important, are often famous for this and some of us with more experience and well-performing portfolios prefer to avoid these programs for this reason.

Additionally, for affordable housing developments with several lending sources, the private lender typically will not take advantage of the already rigorous requirements the community developer must fulfill for the other (usually govern-

ment) lender. Rather, the community developer is often forced to duplicate compliance with requirements at additional cost to the community developer. For example, regarding the construction inspection: on a typical project the city, state, syndicator, and the community developer’s own architect inspect the completed work on a regular basis. However, the private lender typically requires its own inspecting architect be used, and the cost is passed on directly to the community developer as part of fees in the loan. The private lender could easily agree to utilize the reports of the other inspecting bodies (who do not charge the community developer for their inspectors) since all are financing the same project. This drives costs up and duplicates work being performed by other lenders.

In general, quality affordable housing is a significant need in this country. There are many opportunities for private lenders to play a role in financing this type of housing development. A primary consideration and guiding objective in this type of development is affordability and lending terms have a significant impact. The partnerships between community developers guided by community residents, government, investors, and lenders can make a positive contribution to ensuring healthy, stable communities.

Bickerdike Redevelopment Corp. is a 32-year-old not-for-profit community-driven development corporation in Chicago, Illinois. It has developed 827 units of affordable housing, including 128 single-family homes and flats. Its rental housing portfolio encompasses 10 projects and they perform property management on all of its properties. The corporation has three developments in the pipeline encompassing an additional 79 units. For additional information, contact Joy Aruguete, Executive Director, Bickerdike Redevelopment Corporation, at (773) 278-5669.

The Bickerdike Redevelopment Corporation (BRC) was founded in 1966 on Chicago’s near northwest side to provide affordable housing to working class residents — primarily European ethnics and Latinos — in an old neighborhood where many homes were built before 1900. BRC is a “spinoff” of the Northwest Community Organization (NCO), a group founded in 1962 by neighborhood organizer Saul Alinsky and Roman Catholic Cardinal Meyer. From its earliest days, NCO fought against slum housing, urban renewal, and redlining; BRC was created as a grassroots solution to address these problems.

BRC’s early executive directors include George Knight, Executive Director of Neighborhood Reinvestment Corporation, and Bruce Gottschall, Executive Director of the Neighborhood Housing Services of Chicago. BRC recently received the “Pablo Eisenberg Neighborhood Leadership Award” from the National Neighborhood Coalition in recognition of its work on behalf of low- and moderate-income neighborhoods.

-by Bud Kanitz
Recent changes in 12 CFR 24, the Part 24 Public Welfare Investment Program, make it much easier for national banks to make investments that promote the public welfare. A number of financial intermediaries have been formed to invest in community development and public welfare projects on a national basis. The new regulation should ease the flow of capital to these national intermediaries.

One such vehicle is the Community Development Trust (CDT), the country’s first real estate investment trust created solely to provide capital for community development projects. The Local Initiatives Support Corporation, (LISC), the country’s largest nonprofit financial intermediary for community development finance, created CDT as a for-profit real estate investment trust (REIT) in August 1998. LISC invested $1,500,000 in seed capital and supported the start-up of the REIT. In June 1999, CDT completed its initial offering, a $31,750,000 private placement of common stock with many of the country’s leading financial institutions. CDT’s bylaws restrict its activity to debt and equity investments that meet the requirements of the Community Reinvestment Act (CRA). CDT maintains a board of directors that includes representatives of the financial institutions who invested equity capital, and leading figures from the community development field.

CDT’s primary objective is providing capital for affordable rental housing for low- or moderate-income individuals and families. CDT will also invest in facilities that provide community services to low- or moderate-income individuals including, commercial and retail facilities, assisted living, charter schools, and other community development projects.

CDT’s business plan works as follows. CDT purchases CRA-eligible long-term fixed-rate loans from community development banks and other financial institutions and creates participation interests in the loans for sale to institutional investors through the REIT. Generally, CDT retains a subordinate interest in the loan and sells the senior participation to an institutional investor interested in long-term fixed-rate assets. The originating bank generally will continue to service the loan after the sale. CDT purchases loans as small as $250,000 or as large as $5,000,000, thus providing liquidity to a market that is underserved by traditional mortgage originators.

Mellon Bank, N.A., was the founding investor in CDT’s initial private placement. Under the regulation in effect at the time, Mellon submitted an investment proposal to the OCC for approval of its proposed equity investment in CDT pursuant to Part 24. Based on CDT’s mission to invest primarily in community development projects and a review of the Private Placement Memorandum and other documents, the OCC concluded that Mellon’s equity investment in CDT was consistent with the statute and the regulation, and approved the investment in 1999. Other national banks have piggybacked on Mellon’s original approval and have invested in CDT’s initial private placement. These banks include BancOne, Fleet, Wachovia, Wells Fargo, Citicorp, and First Union.

The elimination of the geographic restriction in the regulation was most important to CDT and other national community development investors. Under the old regulation, Mellon could not invest in CDT if more than 25 percent of its investment would be made outside its investment area. This requirement placed certain constraints on Mellon’s investment in that at least 75 percent of Mellon’s funds needed to be invested in the region in which Mellon maintains its main offices or branches. The result of this requirement was that investments made by CDT were not made based on need and opportunity, but primarily on the location of its investor base.

CDT expects to raise additional equity capital early next year. The recent changes to the regulation will greatly simplify national bank participation in future equity placements. For additional information, contact Judd Levy, President and CEO, The Community Development Trust, (212) 271-5099.
Saving America’s Affordable Rental Housing Stock: The Crisis, and the Appropriate Financial Services Role

—by Michael Bodaken, President, NHT/Enterprise Preservation Corporation

Losing Ground: Why We Need to Preserve Affordable Housing

The United States is experiencing an unprecedented prosperous period. Homeownership hit a record high level last year. Unemployment is at its lowest rate in almost 30 years. Rapid technological innovation has increased productivity and created longer-sustainable economic growth. Demand has grown in all sectors.

However, some of America’s citizens are being left behind. Our nation is experiencing a crisis in affordable multifamily rental housing inventory. Ironically, rising real estate markets often translate into an increased potential for the loss of affordable housing rental opportunities.

Rental housing opportunities are also shrinking because the subsidies and contracts on much of this nation’s regulated housing supply are about to expire: Consider the following:

• Many owners of HUD-assisted affordable housing are actively choosing to exit government-sponsored programs, whether they are motivated by personal lifestyle choice, HUD’s increased scrutiny of their actions, or tax considerations. According to data gathered by the National Housing Trust, private owners have already “taken to market” over 100,000 HUD-assisted or insured apartments, and 2,000 more such apartments are losing affordability monthly. The average rent hike associated with conversion from “regulated affordable” to market rate is 45 percent.

• According to HUD, some 1.5 million privately owned, federally insured apartments using Section 8 will have their government contracts expire over the next five years alone. The unpaid principal balance on the loans on these properties is well over $50 billion!

• Other potential affordable housing with expiring subsidies include housing subsidized by the Rural Housing Service and Low Income Housing Tax Credits.

The struggle for affordable housing is geographically widespread and includes the working poor. According to Harvard’s Joint Center on Housing Studies, in no housing market in the nation — not Baltimore, not Iowa, not Texas, nowhere — can a household earning today’s minimum wage reasonably afford a modest two-bedroom rental. While the rest of our nation is well sheltered, the poor and very poor are living in overcrowded or dilapidated housing, or are spending a very large percentage of their discretionary income on shelter, placing rent in competition with other essentials, like food.

In short, structural changes that affect the availability of affordable housing are affecting the lives of those who need it profoundly. Perhaps the National Low Income Housing Coalition gave the most vivid picture of the life these low-income families lead: “Like a high stakes game of musical chairs, the number of poor renters remains the same and they must compete for a diminishing number of affordable places to live.”

Nonprofit Housing Acquisition: an Opportunity Emerges

Within the potential loss of affordable housing lies an opportunity for nonprofit, mission-driven ownership. Toward this end, the National Housing Trust and the Enterprise Foundation have created the NHT/Enterprise Preservation Corporation (“NHT/Enterprise”), a 501(c)(3) acquisition entity with the sole purpose of preserving affordable multifamily housing that serves very-low-income households. Initially, NHT/Enterprise will focus on government-subsidized apartments. We welcome opportunities to handle a portfolio, especially when no local organization has the capacity to work on a large scale. NHT/Enterprise also plans to purchase tax credit supported homes and unsubsidized apartments.

NHT/Enterprise is unique in several ways:

1 According to the Joint Center for Housing Studies at Harvard, in 1995, almost 3.9 million unsubsidized households spent more than 50 percent of their incomes on housing costs and the wages former welfare households earn — at least initially — are inadequate to cover the cost of a modest two-bedroom rental. State of the Nation’s Housing, 1999.

2 “Out of Reach: The Gap Between Housing Costs and Incomes of Poor People in the United States” (National Low Income Housing Coalition, September 1999).
The National Housing Trust and Enterprise have provided $1.3 million seed capital to the effort. An additional $1.7 million has been invested by the MacArthur Foundation, Fannie Mae Foundation and Freddie Mac.

NHT/Enterprise builds on the Trust and Enterprise’s experience in acquisition and rehabilitation. The Trust has helped preserve more than 5,000 government-assisted apartments during the past six years. Enterprise Social Investment Corporation (ESIC) has raised more than $2.5 billion in equity from more than 180 different financial institutions to help create approximately 6,000 homes.

The response to NHT/Enterprise has been overwhelming. Owners of more than 40 properties in nine states have already asked our organization to consider purchasing their properties, which average 80+ units with an unpaid principal balance of approximately $15,000 per apartment and rehabilitation costs of less than $5,000 per unit.

The Financial Services Role

Lenders can play a crucial role in this process. The new banking modernization laws permit banks and investment bankers to work under one roof. The efficiencies gained could be used to support nonprofit purchases of existing, multifamily housing. Mortgage lenders and investment bankers who now work for the same financial services company can help us achieve our social and economic goals. Consider the following products:

- Bridge Financing: NHT/Enterprise and other nonprofits often want to tie down properties through a credit facility. This facility, typically six months to three years in duration, can be paid at market interest rate. The default “take-out” strategy for this type of financing is through a 501(c)(3) tax exempt bond. For example, NHT/Enterprise Preservation Corp. recently purchased a very-well-maintained 208-unit community located in Kissimmee, Florida. There, the bridge financing of approximately $8 million, provided by Bank of America at below prime, will be taken out by a Standard and Poor’s or Moody’s senior/subordinate bond debt structure. The rehab costs will come out of the bond (see attached sidebar).

- Permanent Financing: Lenders with investment banking capacity can provide 501(c)(3) “take-out” financing for the bridge loan. Since the property has been underwritten by the same financial services institution, the investment banker and original underwriter should be able to better manage interest rate risk, and bring lower-cost financing to the ultimate consumer—in this case, the nonprofit purchaser. To the extent these efficiencies are realized in the marketplace, lower-cost financing should translate into a more affordable multifamily housing product in the form of lower rents. In the Kissimmee example, the bridge loan made by Bank of America, will be taken out by a senior/subordinate bond. The senior bond, rated by Moody’s will be publicly traded. The subordinate, unrated bond, will be privately placed with institutional investors.

- Letters of Credit: Some lenders are already providing standby letters of credit to help enhance the credit rating of 501(c)(3) bonds. This is particularly useful when used with so-called “Lower Floater” type bonds. The letter of credit can help reduce the interest rate, ultimately reducing the cost of permanent financing and making the transaction more economically feasible. LaSalle Bank, N.A., in Chicago, provided a Letter of Credit to credit-enhance variable rate bonds used for the preservation and improvement of the 268-unit, Barbara Jean Wright Courts located on the revitalizing near West Side of Chicago.

- Direct Purchase of 501(c)(3) tax exempt Bonds: Some financial institutions will privately purchase the 501(c)(3) bonds for their own portfolios, lowering transaction costs. Tax-exempt rates (exempt from federal income tax and state tax) for 30-year 501(c)(3) bonds are currently 6.5 percent. Today’s tax-exempt rate on the unrated subordinate bond is approximately 8.6 percent. For example, Fannie Mae directly purchased 501(c)(3) bonds.

- Purchase of Tax Credits: Low Income Housing Tax Credits increasingly are being used to help purchase and renovate existing multifamily housing. The same firm that provides the bridge and the take-out financing can purchase the property’s tax credits. NHT/Enterprise is currently evaluating properties in Houston, Texas, and Washington, D.C., with anticipated funding from private activity bonds and low-income housing tax credits. A financial institution could purchase the tax credits and extend the loans in these situations.
NHT/Enterprise Revolving Acquisition Fund

NHT/Enterprise Preservation Corporation intends to develop its own bridge product: a "Revolving Acquisition Fund" to make loans or equity investments in properties purchased by NHT/Enterprise or one of its local nonprofit partners. The concept is to "take-down" the asset with the Fund, then "take-out" the fund within three years at the prevailing market interest rate. Take-outs will be facilitated with either 501(c)(3) bond financing or through a combination of private activity bonds and 4 percent tax credits. Financial services firms who can manage interest rate risk and who realize the synergies of both bridge and permanent financing will invest in the NHT/Enterprise Acquisition Fund.

Conclusion

Now that the Financial Modernization Act has been signed into law, lenders need to consider how the law can be used to strengthen community development efforts. No more important social issue exists than the sheltering of very-low-income families and seniors. Intelligent investment in bridge and take-out financing, and bond or tax credit equity purchase, can earn a lender the prevailing market rate and harness efficiencies that ultimately benefit low-income renters. Never has the opportunity to harness market forces to do social good been greater. The resources exist. The choice is America's.

For additional information, contact Michael Bodaken, President, National Housing Trust, (202) 333-8931.

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<th>Bridge Loan</th>
<th>Permanent Financing</th>
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<td>Bank of America</td>
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<td>Term</td>
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<td>DCR</td>
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<td>Loan to Value</td>
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<td>Transaction Costs</td>
<td>$7.80 million</td>
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<td>Payoff Bridge</td>
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<td>Capital Improvements</td>
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<td>Debt Service Reserves</td>
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<td>Other Transaction Costs</td>
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DEPOSITORIES BENEFIT

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fies those MBS/DUS that are backed by mortgages, which are secured by affordable housing properties. These are properties with low-income occupancy restrictions that may use various public subsidies to keep rents affordable. Most Fannie Mae MBS/DUS are sold shortly after the loans backing the MBS are closed, which is usually four to six weeks prior to the issuance of the MBS.

Another important difference is that single-family MBS may be readily available in a given geographical area. However, a multifamily MBS may be better suited to the investor’s needs, because of its term or prepayment provisions. Multifamily loans typically incorporate a yield maintenance formula that is passed through on a pro rata basis to the investor. Most multifamily affordable MBS/DUS have a minimum 18-year term and many have up to a 15-year yield mainte-
Articles in this issue of Community Developments describe various methods in which national banks have assisted in the preservation and development of affordable multifamily housing. This article illustrates the connection between the good business opportunities that we have identified and the benefit banks may earn under the Community Reinvestment Act (CRA).

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

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

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

Definitions

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

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

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

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

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

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

Activities, the Primary Purpose of which Is Community Development

When determining whether a particular loan or investment will receive CRA consideration, one must first determine if the activity has a primary purpose of community development.

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

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

- the express, bona fide intent of the project, as stated, for example, in a prospectus, loan proposal, or community action plan, is primarily affordable housing for low- and moderate-income individuals;
- the project is specifically structured (given any relevant market or legal constraints or performance context factors) to provide affordable housing for low- and moderate-income individuals; and
- the project provides, or is reasonably certain to provide, affordable housing for low- and moderate-income individuals.

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

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

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

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

**Additional Considerations under the Lending and Investment Tests**

**The Lending Test**

“Designing a Portfolio Permanent Loan Product” on p. 7 and “Saving America’s Affordable Rental Housing Stock” on p. 14, discuss the roles that banks can play as lenders in the development of affordable multifamily rental housing. The CRA regulation provides examples of what types of activities would qualify as community development loans eligible for CRA consideration to include loans to, for example:

- Borrowers for affordable housing rehabilitation and construction, including construction and permanent financing of multifamily rental serving low- and moderate-income persons;
- Financial intermediaries including community development corporations (CDCs), and community loan funds or pools that primarily lend or facilitate lending to promote community development; and
- Local, state, and tribal governments for community development activities.

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

“Affordable Rental Housing through the Eyes of a Community Developer” on p.11 describes multifamily transactions involving multiple subsidies that take much longer to structure because of the multiple funding sources. The performance criteria for the lending test also takes into account the complexity and innovativeness of the bank’s community development lending. In evaluating the complexity and innovativeness of the bank’s community development lending, OCC examiners will review the overall variety and specific terms and conditions of the bank’s credit products. In addition, with regard to consideration of the innovation and complexity, OCC examiners will consider innovations that augment the success and effectiveness of its community development loan program. For example, in connection with a community development loan program, a bank may establish a technical assistance program under which the bank, directly or through third parties, provides affordable housing developers and other loan recipients with financial consulting services. The technical assistance may be favorably considered as an innovation that augments the success and effectiveness of the related community development loan program.

The Investment Test

Roles that a bank may play as an investor in affordable multifamily rental housing development also may result in positive evaluation under the investment test. A bank may purchase Low-Income Housing Tax Credits, as did Citibank (South Dakota) through its community development corporation, CitiHousing Inc., in the North Ridge project (see “A Divine Partnership” on p. 9), or by investing in a low-income housing tax credit intermediary, as Park National did in the Ohio Capital Corporation for Housing equity funds (see “The Low-Income Housing Tax Credit Program: Community Bank Reaps More than Monetary Returns on p. 2). In addition, banks may invest in a REIT like LISC’s Community Development Trust (see The Community Development Trust on p. 13), certain types of mortgage-backed securities (see “Depositories Benefit from Liquidity and Flexibility in Fannie Mae’s Multifamily Financing Alternatives” on p. 8), or municipal bonds that support affordable housing (see “Saving America’s Affordable Rental Housing Stock” on p. 14).

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

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

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

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

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

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

Interaction Among the Tests

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

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

Conclusion

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

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**Hot Topics**

**Effective Practices in Community Development Finance**

In March, the OCC published *Effective Practices in Community Development Finance*, a report based on strategies that have helped selected national banks engage in community development finance. To better understand this growing commercial bank activity, the OCC conducted a study of national bank strategies in support of affordable mortgage lending, affordable multifamily housing finance, and direct small-business lending. Financial institutions embarking on broad-scale CD lending and investment programs will learn about effective strategies in those areas as well as major government and secondary market programs and other resources they may use to help respond to the credit needs of their communities. Accompanying the study is the *Community Development Resource Guide*, an annotated compendium of approximately 145 resources that we hope will assist bankers in obtaining information about CD programs and tools.

The *Effective Practices* publication and accompanying *CD Resource Guide* are available for downloading from the OCC’s Internet site at http://www.occ.treas.gov. Additional copies are available as a set for $15. To obtain additional copies of the publications, please contact the Communications Division at (202) 874-4960.

**Housing Tax Credit/Bond Cap Increases**

Increases to the low-income housing tax credit (LIHTC) and private activity bond cap were part of the package to increase the minimum wage that was recently passed by the House of Representatives. The tax credit has not been increased since its inception in 1986. It is estimated to have lost 40 percent of its value since that time. The measure would increase each state allocation of tax credits from $1.25 per person to $1.75 per person over a period of several years.