



**Comptroller of the Currency
Administrator of National Banks**

Washington, DC 20219

March 26, 1999

**Corporate Decision #99-07
April 1999**

Ms. Beth Whitehead
Associate General Counsel
National Bank of Commerce
One Commerce Square
Memphis, TN 38150

Re: Operating Subsidiary Application by National Bank of Commerce, Memphis, Tennessee
Application Control Number: 1999-SE-08-0002

Dear Ms. Whitehead:

This responds to the application filed by the National Bank of Commerce, Memphis, Tennessee (“Bank”), to establish Saddlery Lofts, LLC, as an operating subsidiary (“Operating Subsidiary”). For the reasons set forth below, I find that the proposed activities would be permissible for a national bank and its subsidiaries. Accordingly, the Bank’s operating subsidiary application is approved.

I. Background

One of the Bank’s customers, THOB, LLC (“THOB”), owns a leasehold interest in several connecting vacant warehouses (“the Property”) located in an historic district of downtown Memphis. The individual structures on the Property are “certified historic structures.” This certification permits the party controlling the Property to receive a rehabilitation tax credit for 20 percent of the total qualified rehabilitation expenditures under 26 U.S.C. § 47 (“IRC § 47 Credits”).

THOB wishes to rehabilitate the Property, converting the warehouses into residential apartment units. The Bank desires to provide financing for the rehabilitation. Because it is not able to make use of the IRC § 47 Credits which would arise with the rehabilitation, THOB proposes a structure which would permit the Bank to take advantage of the IRC § 47 Credits while reducing THOB’s cost of financing the rehabilitation. The Bank and THOB will establish the Operating Subsidiary.¹ The Operating Subsidiary will sublease the Property, on a long-term basis, from THOB. The Bank will provide

¹ The Bank will have a ninety-nine percent member interest in the Operating Subsidiary, and THOB will have a one percent member interest.

construction financing, taking advantage of the IRC § 47 Credits to reduce the origination fee and interest rate charged while receiving an appropriate yield.²

In order to avoid recapture of the IRC § 47 Credits the Bank must hold its interest in the Operating Subsidiary for at least five years. See 26 U.S.C. § 50. Promptly after the expiration of the statutory holding period, the Bank would sell its interest in the Operating Subsidiary to THOB, LLC.

II. Discussion

A national bank may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(d)(1) (1998). A loan or extension of credit is a “bank’s direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds or repayable from specific property pledged by or on behalf of the borrower.” 12 C.F.R. § 32.2(j) (1998). The financing transaction proposed by the Bank fits this definition and therefore is permissible.

It is established OCC precedent that a national bank or its operating subsidiary may hold legal title to property, as a technical matter, when doing so is an integral part of a secured financing arrangement with its customer. See, e.g., No-Objection Letter No. 86-2 (February 25, 1986), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. ¶ 84,008 (permitting national bank to hold legal title to real property incidental to making of a loan).

Most of the precedents in fact have involved financings where the bank was taking advantage of Internal Revenue Code tax credits to reduce the customer’s cost of borrowing. For example, on October 24, 1994, an OCC letter confirmed that, where the financing arrangement is merely a preliminary step in furtherance of the bank’s extension of credit, the arrangement is not contrary to 12 U.S.C. § 29. There, the bank jointly established a trust with a creditworthy marketer of hydrocarbon products. The marketer made a commitment to purchase the hydrocarbon producer’s output, and the trust, with funds borrowed from the bank, purchased corresponding production payments from the producers. The letter concluded that the trust’s purchase of the production payments was permissible under Section 29 as a preliminary step to further a secured financing transaction. Letter from Robert J. Herrmann, Deputy Comptroller (October 4, 1994) (unpublished).

Similarly, a November 4, 1994, letter confirmed a national bank may acquire an interest in real estate as an integral part of a secured lending arrangement. The bank extended credit to owners of natural gas reserves through a trust arrangement in which the funds advanced by the bank were repaid through the sale of gas produced from reserves in which the trust acquired a working interest. As a participant in the trust, the bank received a fixed, after-tax return on the funds advanced to the trust and an equity interest in the residual earnings of the trust following repayment of the amount advanced. The letter

² Upon completion of the project, the construction loans made to the Operating Subsidiary would be converted to permanent loans to be repaid from the project’s operating income.

further noted that the trust arrangement added nothing to the transaction because a national bank could not invest in a trust that engaged in an otherwise impermissible bank activity. Letter from Horace G. Sneed, Senior Attorney (November 4, 1994) (unpublished).

Most recently, on March 23, 1998, the OCC confirmed that a national bank may acquire legal title as a preliminary and integral step undertaken to further a secured financing transaction. The bank had extended credit to a company that owned and operated oil and gas leases. The bank's operating subsidiary purchased, from the borrower, interests in several natural gas leases. The subsidiary's ownership of these interests allowed the bank to take advantage of tax credits for the production and sale of natural gas and, in return, reduce the borrower's financing costs. The letter opined that while it might appear that the bank was acquiring an interest in real estate in violation of 12 U.S.C. § 29 such a narrow view of the statute would elevate form over substance. Because acquiring legal title was merely a preliminary step, undertaken to further the permissible financing transaction, the subsidiary's purchase of the lease interests was permissible. Letter from Steven J. Weiss, Deputy Comptroller, Bank Organization and Structure (March 23, 1998); cf. Interpretive Letter No. 603 (Aug. 3, 1992), reprinted in [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,437 (permitting national bank to acquire options to purchase real estate in connection with its activities in a community development project).

Each of these letters confirms that the key element in the 12 U.S.C. § 29 determination is that the property interest is being acquired in furtherance of a permissible banking activity. In the case of the proposal here, the Bank would acquire an interest in the Operating Subsidiary only in furtherance of its provision of financing for rehabilitation of the Property. The substance of the transaction remains that the Bank is providing construction financing, which will be converted to permanent loans and repaid from the rehabilitated Property's operating income. By taking advantage of the tax credits, the Bank would be able to facilitate this financing by reducing the cost of borrowing while receiving an appropriate yield. For these reasons, it is proper to treat the transaction as an extension of credit that is permissible for national banks.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may establish the Operating Subsidiary.

If you have any questions, please contact Steven Key, Attorney, Bank Activities & Structure Division, at 202/874-5300.

Sincerely,

/s/

Steven J. Weiss

Deputy Comptroller
Bank Organization and Structure