

THE BUZZ

Filling the LIHTC Investment Gap: Will CRA Help or Hinder?

By Buzz Roberts, Local Initiatives Support Corporation

With some major, traditional low-income housing tax credit (LIHTC) investors out of the market, finding new investors is a crucial challenge. There simply is not enough investment capital in the market today to fund all of the projects that have LIHTC allocations. One obvious source of new capital would be large local or regional banks that until now have not been significant investors.

The Community Reinvestment Act (CRA) has for 20 years been an important motivator for banks considering LIHTC investments. But in the context of today's investment climate, a proposed CRA policy—described in more detail below—is making it hard to attract these new bank investors.

At least one regulator seems to be applying the proposed policy even before it becomes final, and the results are becoming apparent: developments in most communities without experienced bank investors are having a hard time raising LIHTC investments on attractive terms, and some projects in some communities cannot attract on workable terms any investment at all. Rural areas are especially disadvantaged, but so are plenty of cities and suburbs. In some cases a bank may even shun an investment in one part of its community because it already has enough investments there to meet its CRA needs.

A regional or large local bank might find it attractive to begin making LIHTC investments by participating along with more experienced money center banks in a national or regional LIHTC fund. Novice investors generally lack the capacity to invest directly, and probably would not

invest enough to create a single-investor or "proprietary" fund. Multi-investor funds could offer new bank investors risk diversification, capacity and confidence by joining forces with more seasoned bank investors.

The Proposed Policy

In a joint 2007 proposal, the four federal banking regulators proposed a series of new CRA policies, which they have not yet finalized. These regulators are the Federal Reserve Board of Governors, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and the Office of Thrift Supervision.

One of the proposed policies addresses how a bank along with other investors or lenders is to receive CRA credit for making an investment or loan to a national or regional fund. The idea was to ensure that banks get credit only for investing in their own communities. Only one bank could claim CRA credit for any of the fund's project investments.

The regulators essentially offered two ways for LIHTC funds to accomplish this objective. In most cases in today's market neither alternative offers enough CRA recognition for most banks, unless a fund limits its investments geographically.

The first alternative would be for each investor to claim pro-rata credit for all of a fund's investment activities. But unless all of these activities are within a bank's CRA assessment area(s), the bank won't get full CRA recognition. A local or regional bank investing in a national fund would actually get the least recognition, since a relatively

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small share of the properties would probably be located within its assessment area(s).

The second alternative presents different problems. The sponsor of the fund would have to allocate each of its projects among the participating bank investors so that no two banks claim credit for the same project investment. This approach was workable when Fannie Mae and Freddie Mac comprised 30 percent to 40 percent of the LIHTC investment market and a substantial portion of a fund's total investment pool. If none of the banks wanted to claim a project for CRA purposes, the non-bank investors could take up the slack.

But this second approach does not work in today's market when CRA is needed most to keep the housing development process going. Fannie and Freddie are out of the market, and no one has stepped into their very large shoes. With banks comprising more of the investment in a fund, almost each project has to have a CRA-motivated investor. This poses an impossible dilemma: banks don't want to commit investments until they know what

projects will be in a fund, and a fund cannot commit to a project sponsor unless an investor is secured.

The biggest, most sophisticated bank investors have choices. They can make direct investments or invest through proprietary funds, where they can control where their investments will go and be assured of full CRA recognition. Some of these banks are increasingly adopting these strategies, and moving away from the multi-investor funds where their presence is most needed to comfort novice investors.

The regional or large local banks have fewer options. Multi-investor funds are getting smaller and money-center banks are participating less. To the extent a major bank investor does participate in a multi-investor fund, it will be first in line to claim CRA credit for a particular project that a smaller bank investor also needs for CRA. Because LIHTC investments are available only in projects that receive a state's allocation, there can be no assurance that a given fund will have a project located where a local or regional bank needs it for CRA purposes.

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In a market where LIHTC prices are falling, timing problems complicate matters further. Projects need to lock-in investment commitments to work, but a bank's decision to invest takes time.

None of this really makes sense from a CRA policy perspective. When CRA was enacted in 1977, the way to keep low-income neighborhoods from capital starvation was for banks to reinvest deposits in the communities that generated them. In today's world of capital mobility and successful reinvestment partnerships, the need is to make sure that capital gets to where it is needed on a safe and sound basis. Some communities have access to plenty of capital while others do not. It seems that policy makers have lost sight of the ball.

There is a way out of this. The regulators could give a bank full credit for making investments outside its assessment area(s), provided that the bank's lending and

service activities pass CRA muster. The communities served by money-center banks would still get investments but so would other, less fortunate communities. No bank would be required to invest outside its community, but it would get full CRA recognition for helping under-served areas. If the regulators won't make this adjustment, Congress should step in. Communities and families need the housing, and this part of the solution should be easy. ❖

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