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Regulatory Relief Poses Inadvertent Consequences

By Richard B. Hutchins, CPA

Some bank investments in workforce housing in disaster or rural areas and in new markets tax credit projects have been stymied because the language in a bill passed in October 2006 changed the geographic and population criteria, disqualifying some investments that had qualified under previous law.

No longer are banks able to make investments primarily to promote the public welfare in general, including investment in low- and moderate-income communities or families, the requirement now is that the primary benefit of the banks' investments must be housing, services or jobs for these communities and families. This seemingly simple change in language had several consequences that many in the industry believe "may not have been fully appreciated" when the Regulatory Relief Act was passed late last year. And steps are now under way to try and correct what is generally viewed as the well-intentioned passage of S. 2856, but, which in effect, swept the underpinnings from many banks' efforts to invest in the direct public welfare.

The Back Story

S. 2856, passed October 13, 2006, restricted the public welfare authority of national and state banks by limiting their investments strictly to those that benefit primarily low- and moderate-income (LMI) communities and families. Removed from previous law were the banks' abilities to revitalize or stabilize designated disaster areas that do not serve communities that were LMI prior to the disaster. It also made ineligible those investments that do not primarily benefit LMI populations that are located in rural middle-income underserved or distressed communities. S 2856 also disqualifies banks from using new markets tax credits (NMTC) in middle-income census tracts with greater than 20 percent poverty rates and does not allow for investment in mixed-income affordable housing in government areas targeted for revitalization if those areas are not LMI areas or serving LMI populations. Many industry observers also note that it is "counterproductive that banks may obtain CRA consideration for these investments but are prohibited from making them under the current public welfare language."

The Proposed Solution

On February 5, 2006, Rep. Barney Frank, D-Mass., with the support of banks, the affordable housing and NMTC industries, and other associations, introduced H.R. 1066. This bill would authorize banks and other federal saving associations to restore the preexisting, longstanding authority of national and state banks to make investments that included but did not primarily target the welfare of low- and moderate-income communities or families through the provision of housing, services and jobs. The bill was passed by the House of Representatives by voice vote on February 27 and referred to the Senate Committee on Banking, Housing and Urban Affairs.

H.R. 1066 would permit investments to be made directly or by purchase of interests in an entity primarily engaged in making a public welfare investment. A major new addition to the proposed legislation is that it would authorize thrifts to make investments to the same extent as those made by banks. It is estimated this could add as much as $15 billion in investments to promote the public welfare. The bill would prohibit a federal savings association from making an investment that would subject it to unlimited liability to any person. It would also instruct the director of the Office of Thrift supervision to establish: 1) the amount of any savings association may invest in any one project; and 2) the aggregate amount of investment of any savings association. Further, the bill would restrict the aggregate amount of investment an savings association, subject to specified determinations made by the director and prohibit the maximum aggregate amount of investments of any saving association from exceeding 15 percent of its capital stock actually paid in and unimpaired and 15 percent of its unimpaired surplus.

Opening Doors to New Possibilities

Under the proposal, NMTC investments would be permitted. Banks could make investments in communities in the GO Zone that were not low- and moderate income (LMI) before the disaster, as well as be eligible for Community Reinvestment Act

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(CRA) consideration because they revitalize and stabilize a designated disaster area consistent with a government revitalization plan. For example, St. Bernard Parish in New Orleans was a middle-income neighborhood before Hurricane Katrina. Now, few live there giving it the appearance of a ghost town. The fact that it was middle income in 2005 now disqualifies it under S. 2856, but under the new proposal public welfare investment would be possible.

Likewise, workforce housing, inclusionary zoning and other types of mixed-income multifamily rental housing programs that are increasingly being used by state and local governments to promote affordable housing can under the proposal qualify for banks' investments if less than 50 percent of the multifamily rental units are affordable housing or the project is not in an LMI community.

In underserved or distressed rural middle-income communities, public welfare investments are necessary to attract new or retain existing businesses and residents, consistent with a government revitalization plan. But an historic tax credit project on a town square in a middle-income rural community and targeted for revitalization that is ineligible under present welfare law would under the new proposal once again qualify. It would also be eligible for CRA considerations.

Industry Reaction

A letter from banks, affordable housing and community organizations, and trade associations is being circulated, seeking the support of Sens. Christopher J. Dodd, D-Conn., chairman of the Committee on Banking, Housing and Urban Affairs, and Richard C. Shelby, R-Ala., ranking member of the committee, for H.R. 1066, the Depository Institution Community Development Investments Enhancement Act.

The signing entities note that communities will be the ultimate beneficiary of the revised language because "banks will be able to work with their community partners on projects to help build affordable housing and make other direct investments that they are currently prohibited from making."

Conclusion

From 1992 to 2006, the standard permitted national bank and community development investments in every state totaling more than $16 billion, according to a source testifying before a Senate subcommittee. With the unintended change in language resulting from the 2006 Regulatory Relief Act, many of those dollars will be invested elsewhere. Restoring the previously qualifying categories of investments can generate billions of dollars of investment by national banks, state banks and thrifts, which will help revitalize local communities across the nation without the use of taxpayer funds. Public welfare investments are publicized by federal regulators and are subject to key regulatory controls designed to protect against risks to the safety and soundness of the bank and to the deposit insurance fund. Therefore, we urge support of H.R. 1066 to allow financial institutions to continue investing in our communities. ❖