PRACTICAL APPLICATION OF
CRA TO LIHTC INVESTING
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1. **Introduction – CRA and LIHTC Investing**

The Community Reinvestment Act (CRA) is the leading driver for corporate investment in affordable housing projects utilizing the Low Income Housing Tax Credit (LIHTC). The purpose of CRA is to encourage banks to help meet the credit needs of communities in which they operate, including low and moderate income neighborhoods, consistent with safe and sound banking operations (12 U.S.C. Section 2901-2908). LIHTC projects qualify as public welfare investments by providing housing to low and moderate income tenants and therefore have a presumption of qualifying as a CRA investment.

While investors choose to participate in LIHTC projects for varying reasons, CRA consideration has driven banks to be the largest segment of LIHTC investors. CRA considerations are consistently the highest driving factor in investment in and pricing of LIHTC projects.

This section of the materials will walk through how CRA functionally operates in the LIHTC investment space.

2. **CRA as a Motivating Factor for LIHTC Investors**

Generally, investors in LIHTC fall into one of two investor buckets.

- **Economic Investors**
- **CRA Investors**

a. **Economic Investors.** Those that are economically driven are evaluating a project or a fund with multiple projects based on the economic return the investment is projected to produce for.

- Economic investors are generally less concerned with the location of the project since they are not using the investment to fulfill CRA requirements relating to any specific location need.
- The concerns regarding location for an economic investor are based in the real estate market for underwriting purposes rather than based in choosing a location drive by fulfilling CRA requirements.
- Economic investors are very price sensitive and their participation in LIHTC investment ebbs and flows as market forces push pricing up or down.
b. **CRA Investors.** CRA driven investors make their LIHTC investment decisions based on the footprint of their CRA needs. The Assessment Area is driven primarily by:

- Location of financial institution offices
- Location of branches and ATM’s
- Where the institution is originating substantive numbers of loans.

(i) Those investors driven by CRA considerations:

- tend to be less sensitive to pricing than purely economic investors
- though prices in these markets still fluctuate based on market forces, pricing is not the primary factor they are taking into account
- they do not exit the LIHTC market based solely on less favorable economics.
- it is important that they are participating in the LIHTC market in a meaningful way in the locations that match their Assessment Area. CRA investors have an investing goal to positively impact the institution’s CRA rating.

3. **Direct Investing v. Syndicator Investing**

a. **Direct Investing.** CRA motivations and the impact these motivations have on choosing transactions affects both investors that are engaging in direct investments and those investing through a syndicator.

- Direct investors are those that seek their own investment opportunities and enter a transaction directly at the project level rather than working with a syndicator of LIHTC transactions.
- Generally, those investors that engage in direct investing tend to be larger institutions that have significant staff and infrastructure to be able to evaluate transactions on their own, move through the underwriting and closing process and have asset management staff to monitor performance and compliance of the transactions after they invest.
- Additionally, the majority of investors that invest directly also do investing through syndicators. It is not typical for a financial institution to engage only in direct investments in LIHTC.

b. **Syndicator Investing.** LIHTC investing through a syndicator entails the investor choosing the syndicators with which to do business.

- The syndicators act as the intermediary for assisting LIHTC investors in finding transactions meeting their stated requirements, handling much of the transaction underwriting on behalf of the investor, taking the transaction through to closing and providing continued asset management services on behalf of the investor.
- The LIHTC investor is investing through a fund set up by the syndicator. That investment fund becomes the investor into the LIHTC project entity.
- According to a February 16, 2017 report by the U.S. Government Accountability Office on the role of syndicators in LIHTC, it identified 36 active syndicators as of October 2015 (GAO-17-285R LIHTC Syndication, Page 2).
• In the syndicator/investor relationship, the parties work very closely with the goal of fulfilling each investor's CRA obligations.
• Sometimes in the market you find economic investors that take CRA location into account.
  • Certain segments of the market call for economic investors to work through syndicators seeking product that they can re-syndicate further up the chain
  • Often additional protections are added to the transactions.
  • These investors are generally not of an industry type that would seem to fall within CRA consideration investors but because they are making their investment decisions based on the ability to syndicate to their client base, CRA becomes a main driver in their investment decision making.

4. How CRA fits into the two Types of Fund Investing: Proprietary and Multi-Investor Funds

As noted above, investors that participate in the LIHTC market through a syndicator are generally investing through an investment fund that is managed by a syndicator. There are two types of funds syndicators offer as investment vehicles; proprietary funds and multi-investor funds. Both of these investment vehicle types allow institutional investors to receive allocation of CRA benefits for the properties in which the funds invest.

a. Proprietary Funds. Investment vehicles set up by a syndicator in which only one investor participates.
  • The fund invests in multiple LIHTC projects with the tax benefits flowing to the investor from the fund entity.
  • The fund is generally either a limited partnership or a limited liability company which is taxed as a partnership.
  • Tax benefits flow to the investor according to its ownership percentage in the fund.
  • Proprietary investments allow investors to have a substantial amount of input and control over the investments chosen for the fund and how the fund is operated.
• **Process of setting choosing deals for CRA Purposes.** The example LIHTC projects shown here for this proprietary fund would be selected and approved by the fund investor based on the investor’s CRA Assessment Area.
  - Syndicator and investor then pursue those particular LIHTC projects through a bidding process.
  - The price the investor is willing to pay for each such investment is partially driven by its CRA need where each project is located.

• **Investor Flexibility and Control.** The process that takes place between investors and syndicators participating in proprietary funds is one that is tailored to the particular investor and allows significant flexibility for meeting a particular investor’s CRA needs.
  - Proprietary investor share their CRA Assessment Area with their syndicator partners and work together to source deals in the proper area to satisfy CRA.
  - The CRA Assessment Area is the main driver in determining what transactions they bid on.
  - Bidders in the marketplace are completing against each other to win a particular LIHTC transaction.
  - This creates high competition and increased pricing for LIHTC transactions located in CRA markets that have a large number of banking institutions.
b. **Multi-investor funds.** Includes multiple investors in a single fund.
   - A syndicator establishes and manages the fund.
   - The fund makes investments in multiple projects.
   - Multiple investors hold ownership interests, allowing the tax benefits to flow to the investors based on their ownership percentage in the fund.
   - Multi-investor funds can range from fairly small investment funds with only a few investors (often referred to as a “club fund”) to very large funds with investment amounts in the several hundred millions of dollars and a significant number of investors in a single fund.

**Typical Multi-Investor Fund Structure**

This sample of a typical multi-investor fund chart depicts what would be a fairly small fund of this type. As the chart indicates, there can be many investors and many projects in a single fund that need to be properly paired together for CRA purposes.

- **Complexity of CRA for Multi-Investor Funds.** Multi-investor funds are much more complex than proprietary funds in terms of CRA.
  - All of the various institutions investing in the fund are receiving tax benefits from the same LIHTC projects in which the fund invests.
  - The tax benefits from each project partnership flow to each investor based on the individual investor’s ownership percentage in the fund.
    - For example, in the chart above, the Fund Investor labeled with 22% as its ownership interest will generally receive 22% of the tax credits and other tax attributes that flow from each of the 10 listed LIHTC projects.
    - The same is true of each of the other investors based on their percentage ownership noted.
  - However, CRA does not “flow” in that same way.
• **Process of Multi-Investor CRA.** Investors coming into a multi-fund investment scenario do not have the luxury of working with the syndicator in determining exactly what projects in which the fund will invest and precisely where those projects will be located. Generally, a multi-investor fund is marketed as a group of properties that have been selected and additional “slots” for investments in the fund that will target a certain CRA area for potential investors. Investors are usually not as actively engaged with the syndicator in selecting and pursing the specific projects. The puzzle of determining what CRA eligibility matches are available for each investor in the fund can be challenging. As it relates to these types of community development related investments, multiple institutions cannot claim CRA in the same investment dollars. Therefore, the appropriate mix of projects matching the CRA needs of a significant group of investors, without any overlap in those CRA allocations, needs to be carefully crafted.

• **Demonstrating CRA Allocation Methodology through a Hypothetical Multi-Investor Fund**

  The methodology in allocating CRA in a multi-investor fund is best illustrated by way of example. In the coming pages, we will explore an example of a hypothetical multi-investor fund with five investors and fifteen projects in which the fund is investing. The example also includes hypothetical cities in which the projects are located as well as the total dollar amount being invested by each of the five investors. The total amount invested in this hypothetical fund is $100 Million with the total amount of fund equity associated with all of the total projects equaling $100 Million. This example represents a simplified version of what a typical multi-investor fund would look like.

  Each investor wishes to have CRA allocated to it equaling 100% of the dollars they invest in the overall fund. However, for each investor, that allocation needs to be in locations that are within the institution’s CRA Assessment Area without any overlap with other investors. This becomes difficult in very high population markets such as major city centers because many institutions are looking for their investment dollars to be allocated to projects in these same areas.

• **Examples**

  Please see next page
Multi-Investor Fund – CRA Distribution Example

**Fund Investors**

- **Investor 1**
  - National Footprint
  - Investing $20 Million

- **Investor 2**
  - Footprint is National but Major Markets Only
  - Investing $19 Million

- **Investor 3**
  - National Footprint
  - Investing $16 Million

- **Investor 4**
  - South Eastern Footprint
  - Investing $20 Million

- **Investor 5**
  - Non-Financial Institution
  - No CRA Requirements (Economic Investor)
  - Investing $25 Million

**LIHTC Investments in the Fund**

- LIHTC Property 1 - Miami, FL
  - Investment Size: $8,700,000

- LIHTC Property 2 - Ft. Lauderdale, FL
  - Investment Size: $7,700,000

- LIHTC Property 3 - St. Paul, MN
  - Investment Size: $4,600,000

- LIHTC Property 4 - Helena, MT
  - Investment Size: $5,700,000

- LIHTC Property 5 - Blue Summit, MO
  - Investment Size: $5,200,000

- LIHTC Property 6 - Denver, CO
  - Investment Size: $10,400,000

- LIHTC Property 7 - Spokane, WA
  - Investment Size: $10,200,000

- LIHTC Property 8 - Newark, NJ
  - Investment Size: $4,300,000

- LIHTC Property 9 - Nashville, TN
  - Investment Size: $7,500,000

- LIHTC Property 10 - Holbrook, AZ
  - Investment Size: $6,850,000

- LIHTC Property 11 - Oroville, CA
  - Investment Size: $4,700,000

- LIHTC Property 12 - Fort Stockton, TX
  - Investment Size: $6,400,000

- LIHTC Property 13 - Greensboro, NC
  - Investment Size: $4,750,000

- LIHTC Property 14 - Seattle, WA
  - Investment Size: $6,700,000

- LIHTC Property 15 - Fayettville, NC
  - Investment Size: $6,300,000
From a tax benefit perspective, each investor in this example will receive its share of tax benefits and attributes from each property in the fund proportionate to its ownership.

- For example, Investor 1 holds a 20% stake and will receive 20% of the tax attributes from each of the fifteen listed properties.
- However, the allocation for CRA purposes needs to match each investor’s specific needs based on that institution’s footprint.
- The following chart shows an example of how the CRA associated with each of these projects could be allocated among the five investors to meet each investor’s specific CRA needs.

**Example CRA Allocations per Investor**

- **Investor 1 National $20 Million**
  - Property 3: St. Paul, MN $3,600,000
  - Property 6: Denver, CO $8,600,000
  - Property 7: Spokane, WA $3,400,000
  - Property 11: Oroville, CA $1,000,000
  - Property 14: Seattle, WA $3,400,000
  - **TOTAL $20 Million**

- **Investor 2 Major Market National $19 Million**
  - Property 1: Miami, FL $5,500,000
  - Property 2: Ft. Lauderdale $1,500,000
  - Property 8: Newark, NJ $3,800,000
  - Property 9: Nashville, TN $6,250,000
  - Property 11: Oroville, CA $1,950,000
  - **TOTAL $19 Million**

- **Investor 3 National $16 Million**
  - Property 1: Miami, FL $191,348
  - Property 2: Ft. Lauderdale $76,345
  - Property 3: St. Paul, MN $1,000,000
  - Property 6: Denver, CO $1,800,000
  - Property 7: Spokane, WA $3,576,000
  - Property 8: Newark, NJ $500,000
  - **TOTAL $16 Million**

- **Investor 4 Southeastern U.S. $20 Million**
  - Property 1: Miami, FL $3,000,000
  - Property 2: Ft. Lauderdale $6,100,000
  - Property 13: Greensboro, NC $4,750,000
  - Property 15: Fayetteville, NC $6,150,000
  - **TOTAL $20 Million**

- **Investor 5 No CRA $25 Million**
  - **TOTAL $0**

- Each investor is allocated a portion of the deals that fit with the respective investor’s Assessment Area.
- The CRA allocations are specific to each property and each investor rather than tracking an investor’s ownership in the overall fund.
- To illustrate this, look to LIHTC Property 2 located in Fort Lauderdale, Florida. The CRA allocation for this property has been allocated such that Investor 3 is receiving a CRA allocation of $76,345 for investment in LIHTC Property 2 (which represents only 1% of the amount the fund is investing in LIHTC Property 2) despite the fact that Investor 3 holds a 16% ownership stake in the fund.
- Investor 4 is receiving a CRA allocation of $6,100,000 in LIHTC Property 2 (representing 79% of amount the fund is investing in LIHTC Property 2) though Investor 4 holds a 20% ownership stake in the fund. In determining which project, or portion of a project, gets allocated to a specific investor for CRA purposes, each investor’s footprint is the controlling factor.
- The investors in the hypothetical fund that have a national footprint have the most flexibility for allocating CRA.
- Conversely, an investor similar to Investor 4 that has a footprint limited to the Southeastern portion of the United States will have a more limited investment profile for the fund.
- Investor 4 will want its investment dollars to go to a fund where the mix of projects includes transactions in its Southeastern footprint. CRA allocation outside of that footprint would not be attractive to Investor 4.
- The total amount for each project being allocated among investors cannot exceed the total amount the fund is investing in that particular project.

The table on the following page illustrates on a project by project basis that no more than 100% of each project has been allocated. Therefore, there is no overlap between investor allocations in a single property.
Project by Project CRA Allocations

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<tr>
<th>Investor</th>
<th>Property 1</th>
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TOTAL UNALLOCATED: $25 Million

- In addition to not having any overlap, no investor may be allocated more CRA investment than the total amount of that institution’s investment.
- Note that the total fund size is $100 Million but only $75 Million of investment amount is being allocated in CRA to the fund investors.
- The reason for this unallocated portion of the fund investment is that Investor 5 in the fund is an economic investor and does not have CRA requirements. No CRA is allocated to Investor 5 for this reason.
- Investor 5’s investment amount is $25 Million equals the total amount that is not allocated for CRA purposes.
- Investors 1 through 4 cannot receive additional CRA allocation since they have already been allocated the full amount of their respective investments.
• Documenting CRA in a Multi-Investor Fund. This typically occurs through a CRA letter or other type of agreement.
  • Each investor receiving a CRA allocation within the multi-investor fund enters into an agreement with the syndicator setting out the projects and the investment amount for which that institution is being allocated CRA.

5. Timing in CRA Motivated Investments – the CRA Cycle

• CRA requires periodic review of an institution’s record of helping to meet the credit needs of the entire community, including low- and moderate income communities.
• The period of time being examined by a financial institution’s CRA examiner is that financial institution’s CRA cycle.
• The CRA cycle of a financial institution dictates the timing of committing to LIHTC projects and funding investment dollars.
• There needs to be a balance between LIHTC commitments and investment dollars so that they are meeting their CRA requirements without over investing beyond those requirements
  • If an institution has set a goal to invest $20 Million in a specific geographic area of the country during their current CRA cycle, they will manage their investment so that they are not investing significantly more than the stated goal during the specific CRA cycle.
  • If the goal for that location has already been met, they may manage their commitments so that additional investment in that location takes place after the end of the existing CRA cycle and count toward its goal for the following CRA cycle.

6. CRA’s Impact on Negotiation of LIHTC Investment Terms

• CRA acts a factor in many facets of negotiating an institution’s investment in LIHTC projects.
• Because of competition in the larger cities throughout there is competition to present attractive bids to development projects in major markets.
• In high population areas this drives the price investors are willing to pay to invest in these areas.
• In more rural areas where there are a smaller number of banks serving a particular location, the demand for CRA participation in those areas is lower.
• This directly impacts the pricing that developers can expect for their projects in these varying locations.
Additionally, the level of demand for a project due to its location in a high value CRA area has a direct impact on the terms that the parties are able to negotiate into the limited partnership agreement for that project.

This allows developers to dictate more favorable terms for their projects in these high demand areas since they have multiple institutions competing to invest in the limited projects that are available.