Recently Modernized Community Reinvestment Act Expected to Increase Investor Demand for Tax Credits

By Amy Oakley and Madeline Ursini

On October 24, 2023, representatives of the Treasury, the Federal Reserve, and the Federal Deposit Insurance Corporation released their final rule with respect to the Community Reinvestment Act (CRA), which is intended to strengthen and modify current regulations (Community Reinvestment Act Final Rule). Per the most recent update, which will apply to banks beginning on January 1, 2026, community development financing activities are more favorable to federal Low-Income Housing Tax Credit (LIHTC) and New Markets Tax Credit (NMTC) developments. However, projects using federal Historic Tax Credit (HTC) financing are not explicitly accounted for by the CRA's community development finance rating.

The CRA, established by Title VIII of the Housing and Community Development Act of 1977, encourages financial institutions to help meet the credit needs of the communities in which they are chartered, including low- and moderate-income neighborhoods. To meet the community credit needs, banks are evaluated using a tiered framework with requirements based on bank asset size. Each tier delineates the type of activities that are eligible for consideration in the evaluation of a bank's CRA performance.

Among the noteworthy developments, the final rule modifies the application of the community development financing test to intermediate banks and allocates equal weight to the consideration of retail activities and community development activities. As a result, large banks, limited purpose banks, and intermediate banks that opt in, are now subject to the community development financing test. This test measures large banks' ability to meet community development financing needs at the institutional level by employing a metric to measure the bank's community investments relative to deposits. The Board of Governors of the Federal Reserve System issued a memo in connection with the final rule that specifies the metric is intended to focus on certain investments including the LIHTC and NMTC. The final rule also provides a broader geographic range for community development activities, which will provide more certainty as to whether a bank can receive positive CRA consideration for LIHTC and NMTC investments.

By explicitly recognizing LIHTC and NMTC investments as a consideration under the community development financing test, the final rule provides an incentive for large banks to invest in such developments. LIHTC and NMTC investments are fundamentally and statutorily tied to CRA regulations because these developments are located within low-income or economically distressed communities, which fall within the bank's assessment area for CRA credit. Because the rule provides certainty that LIHTC and NMTC investments fall under the community development financing test, banks that previously focused on investing within their branch networks will be provided with more flexibility on where to invest in community development activities, expanding the investor base for tax credit equity. As a result, the tax credit equity pricing for LIHTC and NMTC is expected to increase with bank demand for these investments.

Although the final rule fails to explicitly mention the HTC, the rule does not preclude the consideration of HTC investments under the CRA. It is worth noting that historic rehabilitation projects may or may not be located in low- and moderate-income communities. Thus, unlike the LIHTC and NMTC which are "place-based" community revitalization approaches, HTC investments must be reviewed under the CRA on a case-by-case basis. In a Q&A on the CRA published by the Treasury, the Federal Reserve, and the Federal Deposit Insurance Corporation in 2016, the agencies outlined specific instances in which CRA consideration should be afforded to investments in HTC projects that do not meet the regulatory definition of community development, including the definition's geographic restrictions. The HTC loans and investments that are eligible for CRA consideration relate to i) the development of facilities that will house small businesses supporting job creation, retention, or improvement for low- or moderate income individuals in low- or moderate-income areas, thus supporting economic development; ii) the provision of affordable housing or community services for low- or moderate-income individuals; and iii) the revitalization and stabilization of a low- to moderate-income geography, designated disaster areas, or underserved middle-income rural geographies.

Certain proponents of including the HTC in CRA ratings contend that all HTC projects should be eligible under the CRA because of their outsized positive impact on low- to moderate-income housing communities. According to the Annual Report on the Economic Impact of the Federal Historic Tax Credits for Fiscal Year 2020, HTC-related investments generated approximately 122,000 jobs and were responsible for $7.0 billion in GDP in 2020 alone. During that year, 51% of those HTC projects were in low- and moderate-income census tracts, and 75% were in economically distressed areas. Key players in the tax credit syndication industry have expressed hope that the agencies will issue a list of the types of tax credit investments deemed to be worthy of community development consideration, which may include all types of HTC transactions, opportunity zone credit, and renewable energy credits. It is expected that the three agencies will issue more specific sub-regulatory guidance to provide clarity as to how the new CRA regulations will affect investments in community development tax incentives.

To obtain more information on utilizing tax credits with community investments under the Community Reinvestment Act, please connect with tax credit attorneys, Amy Oakley and Madeline Ursini. For additional information and resources, visit Partridge Snow & Hahn LLP's website and Tax Credits page.

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