

**FEDERAL BANK REGULATORY GUIDANCE CLARIFIES THAT A BROADER
DEFINITION OF COMMUNITY DEVELOPMENT IS APPLICABLE TO ALL
BANKS UNDER THE COMMUNITY REINVESTMENT ACT**

Last year, the federal bank regulatory agencies, by regulation, substantially revised the definition of what constitutes community development so that activity that revitalizes or stabilizes a designated disaster area, as well as similar activity in a middle-income, rural distressed or underserved area, will qualify as community development and will be viewed positively by the regulatory agencies in evaluating the performance of financial institutions under the Community Reinvestment Act (“CRA”).¹ On January 9, 2006, the comment period closed on proposed interagency questions and answers that are intended to provide further clarification on the new community reinvestment requirements. A copy of the proposed interagency questions and answers is available on the federal bank regulatory agency websites, as well as from the November 10, 2005 Federal Register at 68450.

The guidance, likely to be finalized in 2006, addresses the broader definition of community development, along with the expansion of the related lending and investment that will qualify for CRA credit, and also addresses other key changes with respect to the scope of “small banks” under the CRA. Middle-income geographies are now expressly included under the CRA test for community development with certain restrictions. The change from looking at strictly low- and moderate-income persons or geographies is a significant policy shift.

Specifically, under the guidance, a revitalization or stabilization activity in a distressed² middle-income nonmetropolitan geography that helps to attract and retain businesses and residents or is part of a bona fide revitalization or stabilization plan will receive positive CRA consideration. These activities must have a long-term direct effect on the community at large, including low- and moderate-income individuals and neighborhoods. By contrast, in an underserved³ middle-income nonmetropolitan area, a revitalization or stabilization activity is one that facilitates the construction, expansion, improvement, maintenance or operation of essential infrastructure or

¹ The CRA requires the federal banking and thrift agencies to assess the record of each insured depository institution as to how it meets the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution.

² Under the guidance, a middle-income, nonmetropolitan geography will be designated as distressed if it is in a county that meets one or more of the following triggers: (1) an unemployment rate of at least 1.5 times the national average, (2) a poverty rate of 20 percent or more or (3) a population loss of 10 percent or more between the previous and most recent decennial census or a net migration loss of five percent or more over the five-year period preceding the most recent census.

³ Under the guidance, a middle-income, nonmetropolitan geography will be designated as underserved if it meets criteria for population size, density and dispersion that indicate the area’s population is sufficiently small, thin and distant from a population center so that the tract is likely to have difficulty financing the fixed costs of meeting essential community needs.

facilities for health services, education, public safety, public services, industrial parks or affordable housing. These activities generally will be considered to meet essential community needs and qualify for consideration as community development activities, so long as the infrastructure, facility or affordable housing serves low- and moderate-income individuals.

The current CRA regulation was finalized in 2005 prior to the unprecedented hurricane season. There have been additional recent significant CRA developments that have arisen primarily due to hurricane relief concerns. For example, late last month, the Office of Thrift Supervision (“OTS”) issued a letter to chief executive officers (CEOs) confirming that thrift institutions will be favorably reviewed under the CRA if they undertake community development activity on a local, state or regional basis beyond their normal market assessment area to include providing services to the hurricane-stricken areas. The OTS stated: “We will also recognize activities that benefit displaced individuals. We will . . . give significant weight to activities that benefit low- to moderate-income individuals or areas.” This is an important development because, under the CRA regulation, including the OTS’s separate CRA regulation, a bank or thrift does not obtain credit for any community development activity it engages in outside of its own community assessment area. Also, the federal agencies do not typically issue letters to CEOs to communicate such important policy developments, but the need for a quick response to numerous industry inquiries led to the letter. The OTS did acknowledge that the CRA regulation does not set forth an expectation for thrift institutions to engage in activities outside their normal assessment areas, but nonetheless noted that “. . . given the magnitude of these disasters and their impact on the country, if any institution elects to engage in the aforementioned activities, OTS will favorably consider such activities.” In addition, the OTS held a press conference promoting the efforts of Operation HOPE to provide financial counseling to hurricane victims as one source of community development services to be provided in the Gulf region that could be supported by financial institutions; indeed, OTS itself is providing 150 volunteers in that effort.

In sum, the revised CRA regulations provide substantially greater flexibility, and potentially more subjectivity, regarding what constitutes community development. The proposed guidance also explains when housing for middle- and upper-income persons in distressed or underserved nonmetropolitan middle-income geographics or designated disaster areas may be considered a community development activity. The unspoken concern is whether gentrification projects that benefit individuals who do not have low or moderate income but who are assisting in settling and stabilizing an area should be properly included as community development projects. The proposed interagency questions and answers go to great lengths to show that there are circumstances where gentrified community redevelopment efforts garner favorable CRA ratings for banks that lend, invest or provide services.

A one-year lag period is suggested under the proposed regulatory guidance during which a bank may continue to receive considerations for activities in a distressed or underserved middle-income nonmetropolitan area that has been removed from the annual list of such geographies. These CRA developments are significant and mean that real estate developers and other investors may find another reason for banks to favor investment in such instances, although the bank investors may not wish to tolerate the uncertainty of a long-term investment no longer

qualifying for CRA credit, because the geography ceases to be considered distressed or underserved. It is also likely that a combination of investments that qualify for CRA credit, including low-income housing tax credit investments, would be assembled in connection with a major community redevelopment effort. Importantly, there is nothing in the proposed interagency questions and answers that would restrict current practices by bank counsel to allocate redevelopment investments to insured depository institutions that correspond with their market assessment areas, or to place other reasonable restrictions on current and future investors.

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If you have any questions regarding this memorandum, please contact Timothy R. McTaggart at (202) 303-1121 or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

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