



State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF BANKS

P.O. Box 41200 • Olympia, Washington 98504-1200
Telephone (360) 902-8700 • TDD (360) 664-8126 • FAX (360) 586-5068 • <http://www.dfi.wa.gov>

ISGC – 2005 – 002 - DOB

March 15, 2005

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

RE: Request for Permission to Make Equity Investment in Community Development Entity (CDE) Managed by Wholly Owned Subsidiary of [REDACTED] County Consolidated Housing Authority Pursuant to Federally Authorized New Markets Tax Credit Program

Dear Mr. George:

By letter dated February 9, 2005, you requested from the Director (“Director”) of the Division of Banks of the Washington State Department of Financial Institutions (“Division”) guidance on and permission for [REDACTED] Bank to make an initial investment of up to \$2,000,000 (followed by succeeding investments of additional amounts) in a Community Development Entity (“CDE”), known as [REDACTED] (“[REDACTED] CDE”), which is a wholly owned subsidiary of the [REDACTED] (“Housing Authority”).

1.0 Summary Determination

After reviewing this request in detail, the Director hereby grants permission for [REDACTED] Bank to make an initial investment of up to \$2,000,000 in [REDACTED] CDE, subject to the terms, conditions, restrictions and limitations set forth below in Section 4.0 of this letter. Further, the Director hereby grants permission for [REDACTED] Bank to make subsequent investments in [REDACTED] CDE or another CDE sponsored by the Housing Authority incident to the same New Markets Tax Credit Program (“NMTC Program”), provided that such succeeding investments also meet the same terms, conditions, restrictions and limitations set forth below in Section 4.0 of this letter.

In reaching this determination, the Division takes the opportunity in this letter to set forth the legal and regulatory standards, as set forth in Title 30 RCW, upon which the Division will evaluate and determine the suitability of investments of this type.

2.0 Assumptions Relied Upon

The Division has relied upon the following assumptions:

- [REDACTED] Bank will commit to and subscribe for an initial investment of up to \$2,000,000, as a non-managing investment partner in [REDACTED] CDE, a limited liability company chartered by the State of Washington Secretary of State pursuant to Chapter 25.15 RCW.
- [REDACTED] Bank has expressed a desire to make additional investments in either [REDACTED] CDE or another CDE sponsored by the Housing Authority pursuant to the same NMTC Program.
- The U.S. Department of the Treasury certified [REDACTED] CDE as a CDE under the auspices of the federal NMTC Program in February 2003.
- In April 2004, the [REDACTED] CDE was granted by the U.S. Department of the Treasury a New Markets Tax Credit (“NMTC”) allocation in the amount of \$40,000,000.
- [REDACTED] Bank seeks to be an initial (and majority) investor in this tax credit pool investment, with [REDACTED] CDE as the investment vehicle.
- Another subsidiary of the Housing Authority, unknown to the Division, will act as managing partner of the [REDACTED] CDE (“[REDACTED] CDE Managing Partner”).
- The NMTC Program would call generally for [REDACTED] CDE and other CDE’s created by the Housing Authority to make loans to develop real estate or invest in capital equipment in low-income areas of [REDACTED] County, Washington. The target project include, initially and without limitation:
 - A new [REDACTED] acre retail development that is part of a [REDACTED] revitalization of a large public housing project;
 - A hotel and restaurant that will be part of a new conference center complex that will rejuvenate an older downtown area; and
 - A [REDACTED]-unit homeownership housing development that will spark renewal of a formerly industrial waterfront area.

- It is anticipated that the loans in question would likely be combined construction/take-out financings with up to 20 year amortizations, interest only payments and 7-year “call” (balloon) provisions.
- Interest payments would be passed through to the investor bank (in this case, [REDACTED] Bank), less an administrative fee collected by the [REDACTED] CDE to defer the services of the [REDACTED] CDE Managing Partner.
- At the end of the seven year “call” period, the principal amount of the loan(s) in question will be refinanced and the proceeds paid to [REDACTED] CDE and passed through to the investor bank (in this case, [REDACTED] Bank), less an administrative fee collected by the [REDACTED] CDE to defer the services of the [REDACTED] CDE Managing Partner.
- Upon termination of each loan period, each CDE (funding LLC), including [REDACTED] CDE, will be dissolved according to its operating agreement. If no additional tax credits are available to apply for, the CDE, as an LLC investment vehicle (including [REDACTED] CDE), will be dissolved.
- The loan policies of [REDACTED] Bank, including its underwriting standards, will be followed by [REDACTED] CDE with respect to the lending of [REDACTED] Bank’s investment as loans. The credit guidelines of [REDACTED] Bank will be met by all borrowers as if they had borrowed from [REDACTED] Bank directly.

3.0 Analysis & Discussion

3.1 General Authority and Director Approval. RCW 30.04.127 declares:

(1) A bank or trust company, alone or in conjunction with other entities, may form, incorporate, or invest in corporations or other entities, whether or not such other corporation or entity is related to the bank or trust company's business. The aggregate amount of funds invested, or used in the formation of corporations or other entities under this section shall not exceed ten percent of the assets or fifty percent of the net worth, whichever is less, of the bank or trust company. For purposes of this subsection, "net worth" means the aggregate of capital, surplus, undivided profits, and all capital notes and debentures which are subordinate to the interest of depositors.

(2) A bank or trust company may engage in an activity permitted under this section only with the prior authorization of the director. In approving or denying a proposed activity, the director shall consider the financial and management strength of the institution, the convenience and needs of the public, and whether the proposed activity should be conducted through a

subsidiary or affiliate of the bank. The director may not authorize under this section and no bank or trust company may act as an insurance or travel agent unless otherwise authorized by state statute.

[Emphasis added.]

Pursuant to RCW 30.04.127, the Bank may invest in the [REDACTED] CDE, with the prior authorization of the Division Director, if the aggregate amount of all investment in third-party entities, including [REDACTED] CDE, does not exceed 10% of the assets or 50% of the net worth of the Bank, and the Division Director determines that:

- The financial and management strength of the Bank can assume the responsibility of the investment without an adverse impact upon the Bank;
- The convenience and needs of the public are likely to be met by investment in the [REDACTED] CDE; and
- The intended activities are appropriate to be conducted through the [REDACTED] CDE rather than through a typical bank subsidiary or affiliate.

In the opinion of the Division of Banks, [REDACTED] Bank meets this test. [REDACTED] Bank's financial and management strength appears sound enough to assume the responsibility of being a majority investor/shareholder in [REDACTED] CDE of up to \$2,000,000 without an adverse impact upon the Bank. Certainly, there is a strong community development component to this investment, which serves the convenience and needs of the public. Only a structure like [REDACTED] CDE, rather than a typical subsidiary or affiliate of the Bank, can properly conduct the business of [REDACTED] CDE. And, assuming that the investment will not exceed 10% of the assets or 50% of the net worth of the bank, it would be appropriate for the Division Director to approve, in his discretion, the request to make such an investment.

3.2 Need for Clarification or Restructure. Under the terms of [REDACTED] Bank's February 9th letter, [REDACTED] Bank would be a majority owner of the LLC "with the CDE remaining the managing entity." On its face, the February 9th letter is confusing. According to the Bank's CFO, [REDACTED] CDE is a wholly owned subsidiary of the Housing Authority. The Housing Authority is a governmental entity and, it would appear, the present sole shareholder of the [REDACTED] CDE. In order for [REDACTED] CDE itself to be the vehicle for investment, the Housing Authority would have to divest its interest in [REDACTED] CDE.

The investment of [REDACTED] Bank in [REDACTED] CDE is best served by a structure that would:

- Permit continued government sponsorship while maintaining a clear separation between [REDACTED] Bank and the Housing Authority; and
- Permit [REDACTED] CDE to remain intact as a managing entity.

Such a structure is served, with [REDACTED] CDE as the entire operating and investment vehicle, provided that the "managers" of [REDACTED] CDE are a separate management organization assuming

the role of managing partner of [REDACTED] CDE (the existing LLC). Indeed, we believe that the Housing Authority would insist on that separation.

As part of the terms, conditions, restrictions and limitations of our approval, [REDACTED] must, accordingly, supply proof of an acceptable managing partner for [REDACTED] CDE that is distinct from the Housing Authority itself.

3.3 Analytical Conclusion. Therefore, based upon the above analysis, the requested activity is approved in principle based on RCW 30.04.127, and subject to the terms, conditions, restrictions and limitations set forth below in Section 4.0 of this letter.

4.0 Terms, Conditions, Restrictions and Limitations of Directorial Approval

4.1 [REDACTED] Bank must supply proof to the Division of Banks that the managing partner of [REDACTED] CDE is a distinct entity from the Housing Authority, even though it ought to be sponsored by the Housing Authority.

4.2 [REDACTED] Bank must supply proof to the Division of Banks that it has prudently deliberated on and consented to the choice of managing partner for [REDACTED] CDE.

4.3 [REDACTED] Bank must, as a condition of its investment and/or continued participation in the NMTC Program, adhere to the general assumptions set forth above in Section 2.0 of this letter, upon which Division of Banks has relied in granting conditional approval of this activity as suitable. Any material variance from those general assumptions must be approved in advance and in writing by the Division of Banks.

4.4 The total amount of investment by [REDACTED] Bank in the NMTC Program, including [REDACTED] CDE and any future CDE vehicle, may not exceed 10% of the assets or 50% of the net worth of [REDACTED] Bank.

4.5 [REDACTED] Bank shall supply, at the earliest available opportunity, for review and approval by the Division of Banks, the organizational documents, including operating agreement, of [REDACTED] CDE and each succeeding CDE in which it makes an investment under the NMTC Program.

4.6 [REDACTED] Bank shall suspend further new investment in the NMTC Program if for any reason such program loses its tax treatment certifications as set forth in the assumptions made above in Section 2.0 of this letter.

4.7 [REDACTED] Bank shall suspend further new investment in the NMTC Program if for any reason such program loses the entitlement to federal tax credits as set forth in the assumptions made above in Section 2.0 of this letter.

4.8 In the initiation and maintenance of this investment activity, [REDACTED] Bank shall be subject to all other criteria of safety and soundness applicable to commercial banks chartered

under Title 30 RCW, coupled with all conditions of periodic examination pursuant to RCW 30.04.060(1) related to [REDACTED] Bank.

5.0 Concluding Remarks

The statutory standards for making the interpretations in this letter are uniformly applicable for any commercial bank chartered under Title 30 RCW, similarly situated. However, institutions other than [REDACTED] Bank are advised that the facts and circumstances of each activity applied for pursuant to RCW 30.04.127 are likely different; and such relevant facts and circumstances, as applied to the governing law, may result in the Division of Banks reaching a conclusion different than the one made above.

Should you have any questions, please do not hesitate to call upon the Division of Banks at either (360) 902-8700 or (206) 956-3229.

Sincerely,

David G. Kroeger, Director
Division of Banks