



Financial Services Management

National Bank Real-Estate Powers

General Counsel

**Corporate Planning
Action Item**

Cite

Comptroller of the Currency

Interpretive Letters

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No. 1043 (July 8, 1993)

No. 1044 (December 5, 2005)

No. 1045 (December 5, 2005)

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Overview

Premised in part on newly-released opinions from 1993, the OCC late last year allowed two national banks to engage in substantial real estate development activities involving not only additional office space for tenants (long allowed), but also condominiums and hotels.

Impact

Bank real-estate development and investment is a longstanding controversy. This is based not only on fears that banks could be undermined by significant holdings in this often-volatile arena, but also that they could use their economic clout to advantage themselves at the expense of other investors and/or the localities in which they do business. Based on these concerns, the National Bank Act generally bars real-estate investment except to the degree that it facilitates bank premises or results from loan foreclosure. When expanding the powers that could be housed in financial holding companies and, thus, be provided by national bank affiliates, Congress was at pains to expand this prohibition. In the 1999 Gramm-Leach-Bliley Act, financial subsidiaries of national banks were allowed to engage in activities not permissible to the bank itself, with the single express prohibition on real estate development or investment.

Despite these concerns, however, the OCC has now moved forward with a significant expansion of these powers for national banks, premised on the view that nothing in the National Bank Act precludes real estate development as long as the bank makes a “good faith” judgment of the degree to which the project will support its own business needs and the non-bank aspects of the investment “enhance its utility.” It is not concerned by the prudential impact of these projects because their size is within existing capital limits. Interestingly, the OCC – along with other banking agencies – is more generally concerned with the growing risk of commercial real estate development, with a restraining inter-agency guidance reportedly in the works to control loans to third parties. It is not clear if any conditions in this guidance would apply to national banks directly involved in real estate development.

These opinions create a substantial precedent for a wide range of development and investment activities by national banks that could enhance profitability, maximize the value of owned property, and promote local development. Critics will, however, argue that these new investment opportunities cross precisely the legal lines described above and, thus, raise serious policy concerns.

The two 2005 letters are redacted. However, details left in the released versions permit an informed guess about the banks and projects involved. The mixed-use development project described below is likely one by PNC, in which the Pittsburgh-based bank will consolidate significant property adjacent to its current headquarters to build new office, hotel and condominium space. Part of the OCC’s rationale approving this project is its role in promoting development in a depressed downtown area, a premise on which many other national bank real estate or even commercial ventures could be based going forward. The OCC is not troubled by the hotel or the condominiums, based in part on an independent consultant’s report that these additions to the needed office space significantly enhance the value of the overall project. The OCC also relies on this report to reach its “maximizing the utility” finding that supports approval. Again, this rationale could be used for a wider range of ventures.

The utility-maximization test was of particular importance in the second OCC opinion, which permits a national bank to develop a large hotel adjacent to its

headquarters. Here, the bank involved is likely Bank of America, which the OCC has allowed to build and own a 150-room hotel. The OCC argues that the hotel will be nicer than other options for lodging prospective bank employees and customers, with the improved “quality of experience” part of the rationale supporting the decision that the hotel not only supports the bank’s business purposes, but also maximizes their utility. A smaller high-quality property was not demanded by the OCC because the national bank had selected a hotel-management company that will not work in smaller properties than the one proposed. Like the factors used to approve the mixed-use development, the “quality of experience” factor and the management firm demand create a set of very broad criteria on which future national bank real-estate development and investment projects could be based.

What’s Next

All of these interpretive letters were released by the OCC on December 19, 2005. Despite the fact that several are more than a decade old, they are all included in the OCC’s 2005 series of interpretive letters.

Analysis

A. 1993 Letters

In a letter dated January 21, 1993, the OCC determined that a freestanding national bank that arose from the dissolution of a bank holding company could retain a condominium previously owned by the BHC, but used by bank auditors, consultants and customers due to crowded hotel conditions. The OCC ruled that ownership of the condominium for these purposes was acceptable under applicable law and rule limiting national bank real-estate ownership.

In a letter dated July 8, 1993, the OCC agreed that the bank could not only use the condo for the purposes cited above, but also rent it out. Here, the OCC found that the property not only fulfilled the bank’s business purposes, but also maximized its utility. The OCC notes that nothing in the National Bank Act precludes such broader property use as long as the property is acquired in good faith for bank purposes and the bulk of property usage is for bank purposes. “Token” bank use would not be allowed, but the facts in this case led the OCC to conclude that it is an appropriate transaction and, thus, a permissible one.

B. 2005 Letters

In both of these letters, the OCC notes that the size of the investments do not trigger the need for a formal application. It is unclear if, in light of these new

opinions, other national banks that now want to engage in these expansive activities, keeping the investment size within permissible limits and therefore, consistent with the statute.

1. Mixed-Use Development

In this case, the national bank proposed to develop a new, mixed-use office building adjacent to the bank's current headquarters. The bank has leases set to expire in 2013, for space near its headquarters that houses additional employees. It also anticipated that one of its current headquarters buildings will require substantial renovation that would displace staff. Construction on the new building would begin in 2006, with the project including ground-floor retail, office, hotel and condominium spaces. Once the project is completed, the bank would initially occupy a small percentage of the building, with its likely occupancy increasing over time. The hotel would be a "business-class" one, at which the bank expects to place visiting employees, directors and other related people, perhaps occupying 10% of the hotel space on a regular basis.

Key factors considered by the OCC in the December 5 letter approving the project were:

- reliance on independent consultants, who concluded that the mixed-use building was the most feasible way to achieve the bank's business goals and promote downtown development;
- a view that the mixed-use project is the best way to preserve the bank's investment in its current headquarters; and
- the expectation that the building would enhance the bank's brand and image.

The legal analysis in the OCC's approval relied on the 1993 letters and prior approvals of premise-related real estate development. It also noted that:

- the bank has made a good-faith assumption about the business purposes of the real estate investment and the mixed-use aspect of it enhances the utility of the bank's investment;
- the bank's investment is prudent; and
- prior approvals that conditioned development on a five-year timeframe in which the bank would become a principal tenant are not binding on the OCC and not applicable in this case.

2. Hotel Development

This request was also approved in a December 5 letter. The national bank here proposed to develop a hotel in part to handle its needs for staff, director and customer lodging, with the hotel constructed on existing bank premises and located adjacent to bank headquarters. The bank would be the hotel's sole owner and handle all the development work through contractors, with a hotel-management firm handling the hotel once completed.

Key factors in this approval included:

- the bank's expectation that it would use approximately 37.5% of the hotel's space and more than 50% of expected occupied space;
- the expectation that the hotel would reduce bank lodging costs;
- the expectation that the owned hotel would improve the "quality of experience" of visitors to the bank, thus enhancing the desirability of working for or with the institution;
- a hotel of this size (150 rooms) is the smallest the hotel-management firm will assume and the bank does not wish on its own to manage a hotel; and
- the bank may from time to time need more than the anticipated number of occupied rooms.

The legal analysis approving this project is comparable to the one for the mixed-use development. However, the OCC also notes as a contributing factor to its decision the fact that the investment is deductible for federal income-tax purposes.