

## **INTERPRETIVE LETTER NO. 98-10 (SEPTEMBER 8, 1998)**

**State banks may engage in real estate development activities or projects, subject to the same restrictions that apply to insured savings associations. State banks' real estate development authority may have to be conducted through a subsidiary with the approval of the FDIC.**

The Office of Banks and Real Estate ("Agency") has been asked to determine whether Illinois state-chartered banks ("state banks") are authorized to engage in real estate development activities. For the reasons and subject to the limitations discussed below, the Agency has concluded that a state bank, through a subsidiary, possesses real estate development authority.

Public Act 90-665 added subsection (25) to Section 5 of the Illinois Banking Act ("Act") granting state banks the power to offer any product or service, except real estate brokerage, that is authorized for insured savings associations. The exercise of this authority is subject to the same restrictions and limitations that apply to an insured savings association. 205 ILCS 5/5(25). Both state-chartered and federally-chartered savings associations are authorized to engage in real estate development. However, each is subject to conditions and requirements specified in the respective state or federal laws and regulations.

Subsection (7) of Section 6003 of the Savings Bank Act provides that, with the prior written consent of the Agency, an Illinois savings bank may invest in the initial purchase and development, or the purchase or commitment to purchase after completion, of home sites and housing for sale or rental. 205 ILCS 205/6003(7). This development authority includes projects for the reconstruction, rehabilitation, or rebuilding of residential properties to meet the minimum standards of health and occupancy prescribed by appropriate local authorities, and the provision of accommodations for retail stores, shops, and other community services that are reasonably incident to that housing. Savings banks may also engage in such real estate development by owning shares of a corporation that owns one or more of those projects and that is wholly owned by financial institutions. A savings bank's investment in real estate development under Section 6003(7) may not exceed 15% of the total capital of the savings bank per project, and the savings bank may not invest more than 50% of its total capital in all such projects.

Under Section 5(25) of the Act, Illinois law now authorizes the above-referenced real estate development activity for state banks, subject to the same limitations and restrictions that apply to insured savings associations. However, this new grant of authority to state banks involves an activity (i.e., real estate development) that is prohibited for national banks. Therefore, a state bank planning to exercise this authority must comply with 12 U.S.C. 1831a and 12 C.F.R. 362, which are the federal statute and regulation administered by the Federal Deposit Insurance Corporation ("FDIC") pertaining to investments and activities of state banks.

Pursuant to 12 C.F.R. 362.3, a state bank is prohibited from making "any equity investment of a type, or in an amount, that is not permissible for a national bank." The term "equity investment" includes "any equity interest in real estate," which in turn is defined to include "any form of direct or indirect ownership of any interest in real property...." 12 C.F.R. 362.2(j) and (k). While the prohibition stated above in 12 C.F.R. 362.3 may prevent a state bank from directly acquiring an interest in real estate for development purposes, the FDIC has permitted state banks to establish subsidiaries that engage in real estate development. The acquisition of an interest in real

estate, which would be treated as an impermissible "equity investment" if done directly by a state bank, is treated as an "activity" if done through a majority-owned subsidiary of the state bank. 12 C.F.R. 362.2(a). Under 12 C.F.R. 362.4(d)(4)(iii), a state bank may file an application seeking the FDIC's consent to engage in real estate development through a majority-owned subsidiary.

The FDIC may approve the state bank's application if the FDIC determines that the state bank meets the minimum capital standards established by the state bank's federal regulator and that the conduct of the activity in question will not pose a significant risk to the deposit insurance fund. 12 C.F.R. 362.4(a)(1). Also, the FDIC may make its approval subject to conditions that the FDIC may impose on the state bank and its subsidiary. 12 C.F.R. 362.4(f).

A copy of 12 C.F.R. 362 is enclosed for your reference. Notwithstanding the above statements and analysis concerning 12 C.F.R. 362, a state bank should contact the FDIC directly to confirm the FDIC's positions, requirements and procedures whenever a state bank proposes to engage, directly or through a subsidiary, in a new activity (including real estate development) that is not permissible for national banks.

Based on the foregoing, the Agency concludes that the real estate development authority specified in Section 6003(7) of the Savings Bank Act is now permissible for a state bank pursuant to Section 5(25) of the Act, provided that the activity is conducted through a majority-owned subsidiary established pursuant to Section 5(12) of the Act and provided further that the state bank receives any necessary approval from the FDIC.

A federal savings association may indirectly engage in real estate development through a "service corporation" pursuant to regulations promulgated by the federal Office of Thrift Supervision ("OTS"). 12 C.F.R. 559. The investment limitations and procedural requirements applicable to service corporations of federal savings associations are set forth in that OTS regulation. For the reasons discussed below, however, the authority for a federal savings association to engage in real estate development through a service corporation may not be a viable source of authority for state banks. Section 5(25) would suggest that state banks possess the authority to conduct real estate development activity through a service corporation (comparable to federal savings associations pursuant to 12 C.F.R. 559). However, the requirement in the FDIC's regulation (i.e., 12 C.F.R. 362) that the activity be conducted through a "majority-owned subsidiary" may contradict the ability of a state bank to form a service corporation with other financial institutions. In the event that a state bank wishes to pursue a service corporation as an option, the state bank would have to comply not only with 12 C.F.R. 362, but also with the same restrictions that are applicable to federal savings associations (i.e., 12 C.F.R. 559) and with the federal Bank Service Corporation Act (12 U.S.C. 1861 et seq.).

Because each real estate development project requires the prior written approval of the Agency, a state bank (or its subsidiary) must submit an application supplying the information deemed necessary by the Agency. The Agency would accept a copy of any application that the state bank files with the FDIC pursuant to 12 C.F.R. 362.4(d)(4)(iii), as long as the application contains the information necessary for the Agency to make the required findings under Section 6003(7) of the Savings Bank Act.

We hope that this letter adequately addresses questions you might have concerning the authority for state banks to engage in real estate development activities. If you have additional questions or

if we can be of further assistance, please feel free to contact us.