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## BHCs can hold real estate, but there are considerations

By Steve Mumm

We frequently receive questions from bank holding companies about their ability to invest in real estate. Some investments in real estate are permissible for BHCs. However, section 4 of the Bank Holding Company Act limits the types of real estate activities in which a BHC can engage. This article distinguishes between permissible and impermissible real estate investments for BHCs.

The Board of Governors of the Federal Reserve System (the Board) has previously determined that land investment and development generally is not a permissible activity for a BHC. However, the Board has also determined that a BHC may, directly or through a company, hold or operate properties used wholly or substantially by the BHC or any of its banking or nonbanking subsidiaries in their operations. The BHC may also acquire property for future use by the BHC or its subsidiaries.

The Board has established criteria for determining if an investment meets the "substantial use" criterion. Normally, the organization can assume the investment is permissible if it utilizes 50 percent or more of the property's useable square footage for banking activities. The Federal Reserve System will review investments in property where usage of such property by subsidiary banks, the BHC, or nonbank subsidiaries is less than 50 percent to determine its permissibility. Generally speaking, a BHC and its subsidiary bank(s) or nonbanks must utilize at least 25 percent of the property initially and have definite plans to increase use to at least 50 percent within five years for an investment to be permissible. Use of the property by the banking organization can include storage of organization records or bank or company parking facilities in addition to providing banking premises.

In acquiring real property for future use, a BHC must have definite plans for use of the property by the BHC or a subsidiary within a reasonable period of time, typically five years. Property may not be acquired by a BHC and indefinitely warehoused until a need develops.

Section 4(c)(2) of the Act permits a BHC or any of its subsidiaries to acquire assets, including real property, in satisfaction of debts previously contracted (DPC) in good faith. The BHC must dispose of the assets within two years from the date they were acquired. A BHC may request the Board's approval of additional time to dispose of the property for up to three additional years, or a total of five years. Further, the Board may permit additional extensions for up to five years (for a total of 10 years) in certain circumstances. Transfers of the property within the BHC organization do not extend any period of divestiture of the property. That is, in most cases where a subsidiary bank has held property for the statutory holding period, a BHC may not shift the property to another subsidiary or to the BHC to avoid disposing of the property.

Similarly, section 4(c)(1)(D) of the Act allows a BHC to establish a subsidiary to hold real estate acquired DPC by itself or by any of its banking subsidiaries, for the purpose of disposing of the real estate. Permissible activities of this liquidating subsidiary include completion of a real estate development project and other activities necessary to make the real estate saleable.

However, investing funds to change substantially the nature of the asset to increase its value would generally be viewed as engaging in real estate development, which is not permissible. For example, the BHC may complete construction of a building that has been started but it may not prepare raw land for development or begin construction of new structures. This section also cannot be used to extend the time under which a BHC may indirectly hold DPC property. In addition, when real property is transferred between separate entities within the BHC organization, the Board expects that the property will be transferred at a value no greater than the fair market value at the time of the transfer and that the transfer will be made in a normal arm's-length transaction. '

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