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Affordable Housing Insiders Keep Close Eye on CRA Reform Proposals

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The Community Reinvestment Act (CRA) has been around for more than 40 years and its current regulations are 23 years old.

Change is on the horizon.

"I think it's needed," said Tony Alfieri, managing director of tax credit investors at RBC Capital Markets. "[CRA regulations] have been out there over 40 years and change is needed because the banks' operating landscape has changed dramatically. It's also needed [to improve] efficiency."

The CRA requires three agencies–the Office of the Comptroller of the Currency (OCC), the Federal Deposit Investment Corporation (FDIC) and the Federal Reserve (Fed)–to oversee whether depository institutions meet the credit needs of their surrounding communities, particularly low- and moderate-income neighborhoods. One of the biggest factors in that is affordable housing, which has increasingly been defined by investment in low-income housing tax credit (LIHTC) equity.

"The regulation is very broad," said Buzz Roberts, president and CEO of the National Association of Affordable Housing Lenders. "[CRA regulations] talk about affordable housing and investments. The way that has played out has focused on the LIHTC."

The OCC issued an advanced notice of proposed rulemaking (ANPR) in August 2018 about updating the regulations and further action is expected this year.

"There are probably developers in major metro areas who want the status quo, because they think they might lose something if CRA regulations change, but the reality is that the reform that is expected won't hurt them and might help," said Peter Lawrence, director of public policy and government relations at Novogradac & Company LLP. "We know that affordable housing developers in less-populated areas see reform as a clear benefit. And banks hope that CRA changes will provide more clarity and a quicker response time to assure a quicker turnaround."

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CRA reform appears inevitable.

"The CRA is the air that affordable housing breathes," said Roberts. "We don't pay attention as long as it's clean, but if it's polluted or there's not enough oxygen, we've got problems."

Why CRA Matters

The original CRA regulations were enacted as part of the Housing and Community Development Act of 1977 and had their last major update in 1995. The August ANPR from OCC Chairman Joseph Otting included 31 questions about the CRA and sought comments on ways to modernize the regulations.

There were more than 1,500 comment letters filed by the November 2018 deadline.

"I think CRA reform is necessary if done right," said Michael Gaber, executive vice president at WNC, which has made affordable housing investments in 47 states. "The problem is that it was written in the 1970s and what's missing is all the things that have happened [with technology]. … From that perspective, it's important."

Roberts agreed.

"We think it's important for a few reasons," Roberts said. "The banking industry has changed dramatically since the current CRA regulations were written in 1995. Cities, communities and towns have changed. The practices of affordable housing and community development have changed, too. It's time for an update."

Kenji Tamaoki is a principal at PGIM Real Estate Finance, the commercial mortgage business of Prudential, which is not subject to the CRA. He still sees the importance of the CRA.

"Part of the reason the CRA needs to be revisited is that today, many companies recognize that addressing social issues needs to be part of their business plan," Tamaoki said. "Prudential has had an impact investing group since 1976, which makes it a pioneer, but when you look around, every company has some kind of awareness of social responsibility as a corporate citizen. CRA might be more effective if it leverages a company's social responsibility priorities."

Lawrence cited the importance of the CRA to affordable housing. Under current CRA regulations concerning affordable housing, the examinations value lending as 50 percent of the test, with investment and services each counting for 25 percent.

"Most of the comment letters [to the OCC] point out that while the regulations can be improved, there is a need to sustain or expand the affordable housing provisions," Lawrence said. "The reforms should simply help it work better."

Statistics back up Lawrence's point: An estimated 85 percent of LIHTC investment is made by CRA-motivated banks. How the CRA is enforced is important.

Which brings up a question: when reform comes, how should it look?

What Should Be Included

There is concern about affordable housing provisions in updated CRA regulations–particularly after the ANPR suggested the use of a simple mathematical ratio.

"The big concern is with the idea the OCC floated in the ANPR, that one of a limited number of ratios determine a CRA score," Roberts said. "The dollar volume of a bank's CRA financing could be divided by some measure of the bank's size. This presents challenges."

Roberts specified that banks' product mix, sizes and communities differ, adding that a simple formula would, for instance, make an investment in a high-cost

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area count far more than in a low-cost area. That could result in less investment in rural communities and smaller metropolitan areas.

Roberts and others said the reaction from the affordable housing industry and other regulatory bodies suggest that the simple ratio approach might not be implemented.

Otting has reportedly suggested doubling the value of affordable housing investments, which affordable housing supporters say could result in banks needing less investment to meet CRA demands.

"The worst-case scenario is one in which the investment in LIHTC properties get preferential treatment, but that results in banks actually decreasing their investments in LIHTC to meet the CRA test," Gaber said. "If banks are able to meet the CRA test with either lending activity or investments, most banks would gravitate toward lending since it is more liquid and has a much shorter holding period. Above all, it is critical that any changes to the CRA maintain or increase the current level of investment in LIHTC and affordable housing."

Tamaoki suggested that expansion, not reduction, of requirements is possible.

"The CRA might be able to accomplish even more if it builds on what's already in a company's social responsibility plan and focuses on incentivizing priorities that would not otherwise be addressed," Tamaoki said.

Much of the desire for change focuses on timeliness and clarity.

"One of the things to address in the CRA is a lack of consistency from regulator to regulator," Gaber said. "Also the timeline. Banks have to wait three years sometimes [to find their CRA score. The regulatory agencies] need to establish clearer standards."

"Another key issue is geography," Roberts said. "There are CRA hot spots and deserts because some markets have a lot of competition from banks–particularly larger, more specialized banks–and others don't. You can get CRA credit not only around your branches, but beyond, but that guidance is unreliable. There's no clear standard to get credit outside your assessment area. That's not determined until later."

Meanwhile, Roberts highlighted another significant issue: what about affordable housing that doesn't get subsidies from the government?

"The affordable housing needs extend far beyond what the LIHTC offers," Roberts said. "There's more and more emphasis on unsubsidized affordable housing, which makes up about 80 percent of affordable rental housing, but the CRA treatment [of it] is murky. Getting clarity on how unsubsidized affordable housing counts would go a long way."

Roberts said much of banks' investment in non-subsidized affordable housing amounts to guesswork.

Alfieri explained in simple terms what is at stake.

"The best outcome is the LIHTC continues as the most favorable investment and the examination process is faster," Alfieri said. "The worst would be the LIHTC is somehow diminished with either additional products that could score CRA points or a formula that disincentivizes extra investment."

Next Steps

As the potential new regulations go through channels, insiders emphasized that the OCC still needs agreement from the FDIC and the Fed before beginning a process that involves reviewing and reacting to comments.

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"The OCC can't do this unilaterally," Gaber said. "Even though the OCC probably controls two-thirds of the equity market, they still have to work hand in hand with the Fed and the FDIC. They also have to work with all the stakeholders and address all their needs."

Alfieri said the affordable housing community needs to be on alert.

"I think it's very important that there ends up being a lobbying effort," Alfieri said. "The affordable housing crisis is real and any activity that lowers investments would be catastrophic. I think the industry will band together to ensure that LIHTC investment isn't diminished."

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