

## Three Keys to CRA Modernization

By Buzz Roberts, Novogradac, February 4, 2019

Modernizing Community Reinvestment Act (CRA) rules presents both threats and opportunities for community development, which under CRA includes affordable housing, economic development, neighborhood stabilization and revitalization, community services, and disaster area recovery.

The Office of the Comptroller of the Currency's (OCC) advance notice of proposed (ANPR) rulemaking last August attracted more than 1,500 public comments. Here are three key issues whose outcome will determine CRA's future role in community development.

### Measuring CRA Activity

The OCC's ANPR presented what it calls the "transformational" prospect of basing a bank's CRA rating on the ratio of its CRA financing to some measure of its size, such as its domestic assets: "For example, a bank with \$1 billion in total assets that conducted \$100 million of CRA-qualifying activities in the aggregate would achieve a 10 percent ratio, if total assets were used for the denominator." Certain favored activities could get additional credit through a series of multipliers.

This concept would certainly be transformational, but problematic.

Many community developers expressed concern that their activities could get lost unless they are considered separately from more numerous and routine home mortgage and small business loans. Given the choice, it would be logical for banks to meet their CRA obligations as easily as possible. Community development activities are safe but often less than maximally profitable, high-touch, complex, non-standard, long-term or illiquid.

Equally important, the amount of financing alone cannot measure the true significance of community development. For example, a low-income housing tax credit (LIHTC) or new markets tax credit (NMTC) development investment or loan deserves recognition based not just on its size, but also on how it addresses local needs, overcomes financing or development challenges, requires innovation and catalyzes other revitalization activity.

A dollar-volume metric also raises a series of structural challenges. First, the same ratio will not fit banks with different business models and product mixes, an increasing concern as the banking industry becomes more heterogeneous.

Second, financing needs and opportunities vary greatly among local markets. It would be virtually impossible to calibrate multipliers at the local level to reflect conditions in every community.

Third, focusing on the dollar volume of activity would favor larger loans. For example, the typical \$150,000 home mortgage in Chicago should not count twice as much as the typical \$75,000 mortgage in Toledo merely because home values are twice as high in Chicago; nor should a \$750,000 mortgage for a high-income homeowner in gentrifying but still low- or moderate-income (LMI) neighborhood in Brooklyn or Oakland count five or 10 times as much as the loan in Chicago or Toledo.

Fourth, an overall dollar volume target would allow a bank to compensate for poor performance in communities where it has branches by doing more elsewhere, a result inconsistent with the core CRA principle that banks should serve their home communities.

Fifth, the ratio would need frequent adjustment to reflect changing national and regional economic conditions, as well as shifting market shares between banks and other lenders, undermining the predictability that a dollar volume metric is intended to deliver.

### **Geography**

Banks are accountable under CRA for serving the “assessment areas”—generally metropolitan areas and non-metro counties—where they have branches. But the CRA currently does not treat all assessment areas equally and credit for community development activities beyond assessment areas is limited and confusing. The result is to constrain the efficient flow of community development financing and create CRA hot spots and deserts.

Updating CRA presents an opportunity to address several geography issues:

- Major banks have too many assessment areas—the biggest banks have hundreds—for examiners to analyze them all fully. Instead, only one or a few assessment areas in each state get a “full-scope” review that addresses the substance of the activities (e.g., their responsiveness, complexity and innovativeness) in addition to the number and volume of activities. These full-scope reviews typically cover the markets where a bank gets the most deposits, generally the largest metropolitan areas. Smaller metro areas and non-metro counties usually receive a “limited-scope” review covering only the number and volume of activities, so a bank gets as much credit for purchasing a Ginnie Mae security backed by LMI mortgages there as for making a LIHTC or NMTC investment or a loan to a CDFI. In this regard, CRA is structurally biased against meaningful community development in rural and smaller metro areas. One fix would be for examiners to conduct full-scope reviews of community development activities in the largest 50 to 100 metro areas as well as in the balance of each state. As such, community development everywhere would get full consideration while making examinations more manageable.
- In theory, a bank can generally get credit today for activities in a broader statewide or regional area that includes an assessment area if the bank shows it is responsive to its assessment areas’ needs. However, this policy has proved unworkable for two reasons. First, a bank will not know if it meets the responsiveness test until it is examined years after it makes a financing decision,

which is a discouraging uncertainty. Second, regional areas are not clearly defined, adding more uncertainty. As one solution, a bank that has served its assessment areas at a satisfactory level based on its most recent exam should get credit for financing community development nationwide. This change would make life simpler and more predictable for community developers and banks alike.

- Branchless banks—including wholesale, limited purpose (e.g., credit card), and internet banks—collectively have assets exceeding \$1.5 trillion and are expected to grow as technology facilitates digital banking. Current CRA policy treats these banks as local banks even though they have little local presence and typically operate nationwide. Branchless banks tend to cluster in a few states (e.g., Utah and Delaware) where community development opportunities are limited, creating hyper-competition and distorting markets. It would make sense to examine branchless banks based on their efforts nationwide, not locally.

### **Defining community development**

The power of CRA is lost when banks are unsure if an activity will get credit until they are examined years after the fact. For example: 80 percent of all affordable rental housing is unsubsidized. Access to bank financing is crucial to sustaining this housing, but its treatment under CRA is ambiguous because banks generally cannot document the income of residents. Clearer rules of the road would make a big difference.

Properties with affordable rents should get CRA credit if they are located in LMI areas or in other neighborhoods where most renters are LMI and rents are generally affordable. Properties elsewhere should also qualify if owners agree to keep rents affordable for the life of the bank's financing.

CRA credit for mixed-income subsidized housing is sometimes discounted if a minority of the units are LMI restricted. For example, if 20 percent of the units in a LIHTC or tax-exempt bond financed property are LMI restricted, some CRA examiners will allow credit for only 20 percent of the financing. State and local policies, such as inclusionary zoning, raise similar issues. Financing for developments undertaken in conjunction with an express government program or policy should receive full CRA credit if at least 20 percent of the units are LMI restricted.

CRA modernization can be either a major plus or minus for community development. A few key decisions will tell the tale.