Banking Reform Might Chill Affordable Housing Investment

By Valentina Pasquali, Law360, July 13, 2022

When federal regulators set out in the spring to buttress a 45-year-old law aimed at ensuring banks serve the full spectrum of residents in the communities where they operate without bias or discrimination, they may have unintentionally laid the groundwork to diminish banks' vital role as investors in affordable housing.

The Federal Reserve, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency jointly issued a long-awaited, nearly 700-page notice of proposed rulemaking on May 5 comprising dozens of measures the agencies said would boost the effectiveness of the 1977 Community Reinvestment Act and further curb practices like redlining, which makes it harder for people of color to obtain home mortgages or insurance.

In practice, the proposed rule seeks to clarify and enhance the framework whereby federal examiners grade banks on how well they provide lending, investment and other banking services to the range of customers — especially low- and moderate-income individuals and businesses — who live in or around the areas where the banks are chartered or operate.

Multiple industry professionals told Law360 the proposed overhaul in how banks' retail and community development activities are weighed in the CRA exam might have an unintended consequence: steering large financial institutions in particular away from putting up equity for affordable housing projects.

Some intermediate and wholesale or limited-purpose banks would also be affected by the shift.

The deadline to submit a public comment on the rule is Aug. 5.

"I'm sure regulators don't want to see retail lending improve at the cost of decreased equity investment in affordable housing," said Mary Grace Folwell, of counsel at Ballard Spahr in Washington, D.C. "But I think there will be some thoughtful feedback on the rule to try and calibrate those incentives so that we don't end up with an inadvertent chilling of the equity investment in affordable housing because that equity investment is really important."

The Proposed Rule

If finalized in its current form, the reform would affect the real estate sector in a variety of ways. For example, it would require a bank to hold more assets to qualify as a small, intermediate or large institution than under the current framework.

The shift would therefore reduce by more than 760 banks, or 20%, the number of institutions that must provide debt or equity to community development projects under the CRA, a responsibility that applies on an incremental scale to banks based on size, according to an estimate by the National Community Reinvestment Coalition.

On the other hand, it would incorporate in a bank's assessed footprint its provision of significant mortgage or small business loans even in areas where it doesn't have brick-and-mortar operations, thereby likely expanding CRA lending to new geographies.

Finally, the rule would reshuffle incentives for institutions to favor certain banking activities that are eligible for credits under the law over others.

Such activities include home, small business and consumer loans as well as investment and lending for the construction of affordable housing, community facilities like child care or health care centers, disaster recovery and resilience, and economic development. They also include banking services like branch operations and checking accounts linked to those activities.

It is this reshuffle that has industry professionals concerned about the reform's possible impact on affordable housing investing.

At a hearing on CRA reform by the House Financial Services Committee held Wednesday, witnesses from the nonprofit and private sectors declined to respond to a question by Rep. Blaine Luetkemeyer, R-Mo., on whether the new proposed CRA rating system might be "weighted too far toward the retail test performance section rather than the community development preference."

Lawmakers and witnesses otherwise debated at the hearing whether the proposed rule goes far enough in addressing redlining and other race-based discrimination in housing and lending — or if instead it might prompt banks and consumers to engage in unsustainable lending and borrowing — and whether regulators have put too much focus on home mortgages versus other retail and community development lending activities, among other issues.

First, the LIHTC

Banks are major players in the affordable housing space, primarily thanks to the sought-after financial break provided by the Low-Income Housing Tax Credit.

Established in 1986, the LIHTC program funnels more than $10 billion in federal government funds each year to state and local agencies to allocate as tax credits to entities that build, restore or otherwise develop rental properties targeted to lower-income families, according to a June 2022 estimate by the Congressional Research Service.

In practice, said Deborah VanAmerongen, a strategic policy adviser in Nixon Peabody LLP's Affordable Housing practice group, developers secure the credits from localities, then sell them to partners willing to provide cash equity upfront in exchange for a reduction of their federal taxes over 10 years.

LIHTC projects demand an investor's sustained commitment since they must guarantee affordability for at least 15 years or the credits can be clawed back.

As such, they are especially appealing for sophisticated entities with long-term outlooks such as banks, said VanAmerongen, a former commissioner for the New York State Division of Housing and Community Renewal.

"Financial institutions have gotten comfortable with what the life cycle means and what compliance is required under the program, and they have a longer-term horizon on their investment than a lot of other corporations do, so they are the biggest participants in the LIHTC market," VanAmerongen said.

Texas-based Comerica Bank announced July 6 that in 2021, it provided $75 million worth of low-income housing tax credit equity investments to various communities.

National Equity Fund, a nonprofit LIHTC syndicator, said in November 2021 that Ally Bank, BMO Harris Bank, CIBC, Comerica Bank, Fifth Third Bank, KeyBank, PNC Bank, Truist and U.S Bank had committed a combined $85 million to its Emerging Minority Developer Fund, established at the end of the previous year, to boost access to equity under the LIHTC program for Black, Indigenous and people of color, or BIPOC, developers.

Enter the CRA and Its Reform

While LIHTC is available nationwide, the CRA has historically made it even more attractive in its targeted areas by giving regulators an additional seal of approval for participating banks.

On June 14, Norwich, New York-based NBT Bank announced it had partnered with Maine-based CEI-Boulos Capital Management in creating a $10 million investment fund to inject equity in "high-impact, community-supported commercial real estate projects located within the bank's Community Reinvestment Act assessment areas in New York."

March 2022 data from tax advisory firm CohnReznick suggests that the CRA motivated nearly 85% of affordable housing equity investments under the tax program in 2021, in line with previous years.

In fact, the price at which developers can sell LIHTCs in CRA "hotspots," where many financial institutions compete for credits under the law, trend higher than in CRA "deserts," according to previous research by CohnReznick.

"I wouldn't say that financial institutions would not be interested in providing financing to affordable housing transactions but for the CRA," VanAmerongen said. "But it certainly adds to the motivation, as it is something that counts toward their score."

The CRA as it currently stands rates large banks on a three-part scale: 50% of their overall score comprises their lending activities, which span home, small business and consumer loans, as well as community development loans such as those aimed at affordable housing, child care, or health facilities and local economic development.

The other 50% derives in equal part from banks' equity investments in such community projects and the overall banking services they provide.

The proposed rule would shake up that system to establish a new four-part assessment that would, in most circumstances, weigh retail lending, meaning all lending except community development loans, at 45%; related banking services, at 15%; community development financing, at 30%, with no distinction between community development loans and investing; and related services, at 10%.

"Moving community development loans to the community development financing bucket might prompt some banks to shift from equity investing to lending unless equity investments get specific recognition for their impact," said Benson F. "Buzz" Roberts, president and chief executive of the National Association of Affordable Housing Lenders, or NAAHL. "An equity investment is more risky, has less seniority and requires banks to hold more capital than loans."

Because banks are such large players in the LIHTC space, any retreat would have serious repercussions on the affordable housing sector.

"It appears that bank activities in the affordable housing space will be less of a factor when they are rated under the CRA, and the concern is that they will do less than they have been doing traditionally," VanAmerongen said. "And it's not as if there's another alternative group of investors who is ready to step up."

In their notice of proposed rulemakings, federal regulators acknowledged these concerns, but said they were confident the new analysis would still appropriately assess "both community development loans and community development investments."

"Combining consideration of community development loans and investments into a single test would allow banks to engage in the activity best suited to their expertise and that is most needed for the community development project that the bank is financing," the regulators wrote in the rule.

The Federal Reserve, FDIC and OCC declined to comment for this story.

Josh Silver, senior adviser at the National Community Reinvestment Coalition, or NCRC, told Law360 the proposal could be tweaked to ensure that community development financing receives proper consideration, but said it is not "way off balance" as it stands.

On The Plus Side

The proposed rule would otherwise enable banks to receive credit toward their community development financing score for relevant activities at the institutional level, meaning nationwide, an expansion from the current criteria that only accounts for activities in a bank's CRA assessment area or "broader statewide or regional area that includes the institution's assessment area."

"That has been a very uncertain provision, and because of that lack of certainty, it has had a certain chilling effect on the willingness of banks to go beyond their branch footprint," Roberts said. "In the world of LIHTC, for example, we've gotten used to CRA hotspots and deserts, and I think this element of the proposal will be really helpful in diminishing those differences and help bring capital to all communities."