Final CRA Regulations Provide New Opportunities for Affordable Housing and Community Development

By Peter Lawrence, Novogradac, November 29, 2023

Recently released final Community Reinvestment Act (CRA) regulations could have a substantial impact on affordable housing, community development, historic preservation and renewable energy. For affordable housing, it will be influential beyond the low-income housing tax credit (LIHTC) world.

The Office of the Comptroller of the Currency (OCC), Federal Reserve Board of Governors (Fed) and Federal Deposit Insurance Corporation (FDIC) released final regulations Oct. 24, roughly 18 months after issuing proposed regulations and nearly 30 years since the last major update to CRA regulations in 1995. The Federal Reserve also released a fact sheet, overview of key objectives and a Board memo on the final rule.

The highlights (discussed on the Nov. 14 Tax Credit Tuesday podcast) include an emphasis on investment in low- and moderate-income (LMI) communities and households regardless of geography and four tests for large banks to measure CRA compliance:

1. Retail lending test, worth 40% of the overall CRA examination,
2. Retail products and services test, worth 10%,
3. Community development financing test (which combines community development equity investments with community development loans), worth 40%, and
4. Community development services test, worth 10%.

Furthermore, the final regulations establish a community development investment metric. The specifics of how the CRA regulations will be enforced depends on sub-regulatory guidance expected to be issued in the coming months, presumably in the form of joint guidance from the OCC, Fed and FDIC.

CRA History

The CRA was enacted in 1977 to address inequalities in access to credit, particularly in LMI communities. Until 1995, CRA regulations focused on the policies and processes financial institutions used in lending. But after 18 years, the regulations were overhauled in 1995 with a shift to measurable data and bank performance, focused on a series of tests for banks based on their size. The large banks–which make most community development equity investment–faced a lending test (50% of its score, including retail and community development lending), investment test (25%) and services test (25%). The CRA is a significant factor in community development tax incentive investment. CRA-motivated institutions make more than 80% of annual LIHTC and new markets tax credit (NMTC) equity investment.

The focus of the 1995 regulations was on the location of the investments relative to the deposit base of the bank. Over time, banking changed (more mobile and online banking, for starters), leading ultimately to practical reasons for updates to CRA regulations. The OCC went alone and published a final rule in 2020, but that was rescinded before most provisions were implemented after a change in the presidential administration and leadership of the OCC. Community development stakeholders were relieved because a simple metric in the OCC regulations was presumed to devalue tax credit equity investment.

In May 2022, the OCC, Fed and FDIC jointly issued proposed regulations–and after some significant changes, the three regulators issued the final rule in October.

What's New

The 1,494-page CRA regulations cover a broad swath of bank responsibilities, but for those in the community development world–more specifically, in the LIHTC and NMTC spaces–there are three major changes from the previous and proposed regulations beginning when the new rule is fully implemented (the final regulations start to be implemented on April 1, 2024, but for large banks whose three-year examination cycle begins on or after Jan. 1, 2026, the new evaluation framework will be applied):

Geography: The final regulations allow more certainty of positive CRA consideration for community development activity outside a bank's branch and deposit network, a change that will likely lead banks to consider a broader geographic range for investment–particularly LIHTCs and NMTCs, which are specifically identified as CRA-eligible investments in the regulations.

That change in policy will likely reduce the disparity in LIHTC equity pricing in CRA "hot spots" and "deserts," such as rural areas and smaller cities.

Banks previously received generally less CRA credit for community development investment in rural communities and smaller cities due to smaller deposit bases in those areas and the lack of certainty for receiving CRA consideration outside assessment areas. The shift in CRA demand will likely mean such rural areas and smaller cities will have a larger pool of potential investors in tax credit equity, which presumably will create upward pressure in equity pricing.

That change doesn't necessarily mean that major metropolitan areas will experience downward pressure on equity pricing due to CRA changes, only that there will likely be an increase in investor demand over a broader geographic swath. Among areas that may experience a downward pressure in equity pricing are the few regions with concentrations of deposits from certain banks because of the 1995 regulations, which led to more CRA-motivated investment there and higher-than-average LIHTC equity pricing.

Investment Metric: The regulations call for a nationwide community development investment metric for large banks, dividing community development equity investments by deposits, with the score compared to a national metric of peer banks.

Impact and Responsiveness Factor: The final regulations provide a non-exhaustive list of 10 qualitative factors to measure the impact and responsiveness of community development equity investment. That list includes a variety of factors, and the agencies were explicit in saying the list was illustrative rather than exhaustive. However, during various events focused on the final CRA regulations after they were released, the federal banking agency principals specifically mentioned that the LIHTC and NMTC were particularly responsive and will be positively recognized by the impact factor.

Effect on Community Development Tax Incentives

Changes in the new regulations–particularly when compared to the proposed regulations–will encourage LIHTC and NMTC investments, although sub-regulatory guidance and other factors will affect the magnitude.

As noted above, the geographic change will likely lessen the geographic disparity in LIHTC equity pricing. The broader potential area for CRA-rewarded investing should increase competition among potential investors and exert upward pressure on pricing.

An additional notable change is the final regulations provide more certainty for areas that receive disaster tax credit allocations. For instance, when Hurricane Katrina hit in 2005, billions of dollars in various tax credits were authorized and allocated to assist with the recovery. However, the 1995 regulations did not motivate such investment, since few major national tax credit bank investors had notable deposits in bank branches located in the Gulf Coast. That uncertainty contributed to a lack of investment demand until the regulatory agencies issued clarification that those investments would qualify for CRA credit even if the bank did not have any assessment areas in the Gulf Coast. The new regulations specifically say that activities that promote the recovery of a designated disaster area automatically qualify for CRA credit.

While banks will get credit for every LIHTC and NMTC investment under the new CRA regulations, investments in historic tax credits (HTCs), renewable energy tax credits (RETCs) and the opportunity zones (OZ) incentive are not treated similarly. Like the 1995 regulations, banks making community development tax incentive investments beyond LIHTC and NMTC face uncertainty as to whether they would count toward CRA credit. It may be even more difficult to get CRA credit under the new regulations, as they tighten the ability of banks to receive positive CRA consideration for place-based activities by forcing banks to demonstrate the benefits of those place-based activities for LMI households. Sub-regulatory guidance will determine how to demonstrate benefits, so HTC, RETC and OZ investment would profit if examples of many such investment are included in the list of non-exhaustive illustrative examples expected to be published by the regulatory organizations in the coming months.

Community Development and Affordable Housing Redefined

The final regulations include a series of 11 community development categories that will receive consideration for CRA performance:

- **Affordable housing** (with important clarifications for unsubsidized and mixed-income housing);

- **Economic development** that supports small businesses and small farms (mostly evaluated under the retail lending test);
- **Community supportive services**;
- **Six types of place-based activities**:
1. **Revitalization activities** (with significant changes from 1995 regulations);
2. **Essential community facilities**;
3. **Essential community infrastructure**;
4. **Recovery activities in designated disaster areas**;
5. **Disaster preparedness and weather resiliency activities**; and
6. **Qualifying activities in Native land areas**.
- Activities with **minority depository institutions**, **women's depository institutions**, **low-income credit unions** and **Treasury-certified community development financial institutions**; and
- **Financial literacy**.

Furthermore, the final regulations detail the following five components of affordable housing activities:
1. Rental housing in conjunction with a government affordable housing plan, program, initiative, tax credit or subsidy;
2. Multifamily rental housing with affordable rents;
3. One- to four-family rental housing with affordable rents in a nonmetropolitan areas;
4. Affordable owner-occupied housing for low- or moderate-income individuals; and
5. Mortgage-backed securities that are backed by loans that the bank did not originate and which are either home mortgage loans made to low-or moderate-income individuals or loans financing multifamily housing affordable to low- or moderate income households.

The final regulations included an explanation that commenters' feedback on the proposed rule led the agencies to modify the affordable housing definitions to allow for flexibility to address community needs. That includes the consideration of the one- to four-family affordable rental housing properties in nonmetropolitan areas, which was not part of the affordable housing components in the May 2022 proposed rule.

The final rule includes CRA credit for loans to and investment in unsubsidized rental housing affordable to low- and moderate-income households (sometimes referred to as "naturally occurring affordable housing," or NOAH housing), which is defined as a property where the monthly rent does not exceed 30% of 80% of the area median income (AMI) for the majority of the units. That clearly can include non-LIHTC properties.

The final regulations also include a provision that the geographic criterion (that the housing is in a LMI census tract) is one of the ways to ensure that affordable housing is likely to benefit LMI individuals.

The final rule ultimately intends to encourage investment in affordable housing–whether LIHTC-financed, U.S. Department of Housing and Urban Development-financed or unsubsidized. The inclusion of owner-occupied housing further demonstrates that the agencies are interested beyond rental housing.

For those who build and renovate housing that meets the standards for multifamily affordable housing, the CRA regulations provide more clarity and certainty.

What's Next

As expected from a 600,000-plus-word document that makes the first substantial change in CRA regulations in 28 years, there is a significant amount of sub-regulatory guidance coming from the OCC, Fed and FDIC to govern how to measure provisions. For community development stakeholders, the list of eligible activities will be crucial as supporters of the HTC, RETCs and OZ incentive will push for inclusion of multiple examples of those investments on the list. Stakeholders also await guidance on the promised expedited and streamlined pre-approval process for CRA activating as well as how bank examiners should enforce and measure provisions in the regulations, how to consider various impact and responsiveness factors, and more.

One outstanding question is how the CRA regulations would consider investment in affordable housing through the proposed Neighborhood Homes Investment Act, which would create a tax credit to cover the gap between the cost of building or renovating a home in a distressed area and the price at which it could be sold. It's unclear whether the affordable housing provisions in the final CRA rule would automatically cover such equity investments and the regulatory agencies are consistent on their refusal to provide speculative guidance before legislation is enacted.

Meanwhile, Novogradac's Low-Income Housing Tax Credit Working Group, New Markets Tax Credit Working Group, Renewable Energy Working Group and Opportunity Zones Working Group will each be involved in working with community stakeholders to communicate industry concerns, priorities for sub-regulatory guidance and desires to the regulatory agencies. Membership of each group is open. Please contact Karen Destorel if you are interested in joining.