Statement

of

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On Behalf of the National Association of Affordable Housing Lenders on Proposals to Enhance the Community Reinvestment Act

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CELEBRATING 30 YEARS OF SUCCESSFUL COMMUNITY INVESTMENT

INTRODUCTION

My name is Judith A. Kennedy and I am the President and CEO of the National Association of Affordable Housing Lenders. In preparing for the hearing, I kept thinking of Senator Ted Kennedy's moving tribute to CRA three years ago at a memorial service for Senator William Proxmire.

Senator Kennedy eulogized Senator Proxmire as "another profile in courage", and I expected him to describe the long crusade for the United States to adopt the genocide treaty, most often mentioned as Senator Proxmire's signature achievement. But before discussing that treaty, Senator Kennedy paid tribute first to Senator Proxmire's Banking Committee work, saying that

> *"And nearly 30 years after he passed it, his Community Reinvestment Act has produced literally hundreds of billions of dollars worth of private sector investment in our nation's urban and rural communities. How many others can lay claim to such an accomplishment? <u>He made America a better place with CRA."</u>*

NAAHL represents America's leaders in moving those hundreds of billions in private capital to those in need: 100 organizations committed to increasing lending and investing private capital in low and moderate income (LMI) communities. This "who's who" of private sector lenders and investors includes major banks, blue-chip, non-profit lender CDFIs, and others in the vanguard of affordable housing.

NAAHL's mission is to increase responsible, private capital lending and investing to low (under 50% of area median) and moderate (under 80%) income persons and areas. Over the past decade we have worked to thwart attempts to gut CRA, in our belief that CRA has provided incentives for insured depository institutions to increase access to LMI persons and areas, consistent with the institutions' "safety and soundness". For nearly a decade, we have also worked to revitalize CRA through an updating of a very complex and prescriptive regulatory regime, most of which is now nearly 15 years old and does not reflect what we have learned and evolving best practices. NAAHL has also fought repeatedly to restore CRA's good name, prevent overburdening CRA by expanding it to new purposes, and preserve its focus on meeting Community Development credit needs.

The unprecedented private-public partnership fostered by CRA has evolved and matured over the past 30 years. For-profit and non-profit lenders and investors, developers, community leaders, and government at all levels, have all learned to collaborate as partners in devising new solutions and creative strategies for financing affordable housing and other Community Development (CD) activities.

As policymakers consider proposals to enhance the Community Reinvestment Act, NAAHL recommends two simple principles to guide the process.

- *First, and most important, address the weaknesses in the current regulatory structure that discourage bank participation in important Community Development work that benefits LMI communities, and restore meaningful regulatory incentives for high impact activities that reflect contemporary best practices. The rules and the process are ripe for change.*

- *Second, do no harm. For more than 30 years CRA has encouraged insured depositories to help meet the credit needs of their communities. Any changes to the law should be carefully considered, practical to implement, and incentivize lenders to engage in high-impact activities that fall outside of their normal course of business.*

Based on our three decades of experience, NAAHL practitioners are delighted to answer your questions to witnesses about how to update CRA and the law's successes and current challenges in helping to meet the credit, economic and Community Development needs of their communities. Thank you for soliciting our input.

<u>Committee Question 1:</u>
Please discuss what role that CRA has played in increasing access to credit, investments, and services in previously underserved communities, as well as how the Act could encourage more CRA-related economic activities in more communities.

SUCCESSFUL COMMUNITY INVESTMENT

- **CRA is a success story in emerging markets and a very big business**. The magnitude of real estate investment from CRA is not well known: banks have invested nearly <u>$100 billion dollars</u> in Low Income Housing Tax Credits (LIHTCs) alone over the past twenty years, and another <u>$30 billion dollars</u> in New Markets Tax Credits in just eight years. In addition, CRA <u>annually</u> funnels another <u>$400 billion dollars</u> in loans and investments to LMI households and communities, financing affordable rental housing, home purchases, charter schools, daycare facilities, and small business and microenterprise loans.

- CRA has created **a cadre of bankers who now recognize the good business potential of lending in underserved areas, on fair terms.**

- CRA has been, and will continue to be, **critical to the preservation and expansion of rental housing affordable to LMI communities, encouraging more than $50 billion annually** in each of the past 5 years in reported private capital lending and investing in affordable rental housing. CD loans and investments also support critically needed urban revitalization, rural development, job creation, and other emerging local needs. They do so in a manner that is not only beneficial to the communities served, but also ensures their profitability, safety and soundness to the banks, often through multi-investor funds that pool banks' funds and diversify their risks.

The following are just a few examples of the little known but very successful work our members do.

- Over the past decade, the **Alabama Multifamily Loan Consortium (AMLC**) has originated more than $75 million in mortgages financing over 4,000 affordable apartments across the state, all at or below 50 percent of median income. For example, in the Birmingham area, AMLC originated loans for the New Haven complex, an elderly 56-unit property in Pratt City, and a new complex under construction, the 56-unit South Hills in Pell City.

- Over the past 17 years, the **California Community Reinvestment Corporation (CCRC**) has provided more than $856 million in affordable housing loans and made 26,000 apartments available to residents who earn 60 percent or less of area median income (AMI), including preserving the "Curtis Johnson Homes" in Los Angeles, where some residents continue to pay as little as $25 per month in rent.

- In 2008, during California's delay in approving its state budget, the **Low Income Investment Fund (LIIF**), in partnership with San Francisco and Alameda County, provided emergency repayable grants (bridge loans) of over $2.5 million to support the continued operations of child care centers for low income families. But for LIIF's funds, parents would have had to scramble to find alternatives for child care so that they could go to work. All loans to the centers were repaid, 2,600 children received care, and some 300 center jobs were saved. CRA directly enables CDFIs like LIIF to leverage scarce funds and to develop innovative products and strategies to serve disadvantaged communities.

- The Community Investment Corporation of the Carolinas (CICCAR) which began accepting applications in 1991, has financed $158 million for 189 affordable housing developments, producing 8,800 units of low income housing. Those developments are located throughout the Carolinas, financing mostly housing with allocations of LIHTCs, and all were new construction or substantially rehabilitated multifamily, senior, or special needs housing developments.

- A recent survey of our nonprofit lender members found that they currently hold more than $1.5 billion of seasoned multifamily loans.

How the Act Could Encourage More CRA-related Economic Activities in More Communities

- **Since 2001 NAAHL has highlighted the importance of applying the same rules, oversight, and transparency to all of the key participants in the mortgage market.** Some estimate that CRA-regulated depository institutions share of household assets and consumer loans has fallen as much as 40% over the last 30 years. The Federal Reserve has documented that only 6% of higher priced loans in 2006 were made by CRA-covered institutions or their affiliates to lower income persons or neighborhoods in their assessment areas, and only 10% of all loans were CRA-related.

Leveling the regulatory playing field is key to addressing the dual mortgage market problem. Expanding the affirmative obligation of CRA, safety and soundness supervision, and enforcement of consumer protection laws to all primary and secondary market lenders, would also increase the number of participants involved in community investment, lending, and philanthropy.

- **Deferred maintenance in updating the regulations and a very granular approach to examination by some has chilled bank investment in Community Development, and in disaster areas such as the GO Zone. For one example, some exams have undermined the long-established principle that investments in statewide and regional funds receive full CRA credit**. Exams are discounting banks' investments in multi-investor funds when the affordable housing financed by the fund is outside a bank's own assessment areas. This has undermined forty years of successful investment in multi-bank funds that offer banks the opportunity to do jointly what they lack capacity to do separately to meet emerging local needs: pool their funds, diversify their risks, and hire the appropriate skill set for underwriting, originating, and servicing 30 year fixed rate multifamily mortgages on LIHTC affordable rental housing. The dozens of banks in the state financing LIHTC rental housing do not decide where the properties will be located in any given year; those decisions are made by the state's housing finance agency, using locally determined criteria (e.g., priority for places which have never had allocations).

Committee Question 2:
Are the current examination criteria sufficient to ensure that institutions are adequately meeting the lending, investment and service needs of the communities they serve? Please provide recommendations, if any, for improving the CRA examination process.

UPDATING CRA REGULATIONS
The rules and the exam process are ripe for change.

- **Outdated regulations emphasize quantity over quality and actually discourage large bank participation in important Community Development work that benefits LMI communities.** While the CRA law is simple and brief (see attached), hundreds of pages of complex CRA regulations and accompanying "guidance" put a straight jacket on large banks, tying them up in trying to justify activities meeting emerging local needs that are not specifically enumerated in outdated regulations and performance tables.

- **The current unpredictability of "what counts", has stymied innovation and responsiveness to contemporary LMI credit needs.**

- **Regulators need to adjust the regulations and examination process to encourage banks' responsiveness to local needs rather than making measurement easier for examiners.** Examiners should be trained in community and economic development, so that they understand and appropriately value high cost/high impact activities that meet local needs.

Key Policy Recommendations

- Reward high-impact, innovative, high-quality, often costly Community Development lending, services and investments that respond to a local government/community's needs assessment.

- Ensure that the regulations are sufficiently flexible to align with emerging community needs, local policies, new markets, and financial instruments.

- Eliminate unrealistic bank "benchmarks" that have contributed to some market distortions by requiring specific market shares regardless of profitability or responsiveness to community needs.

- Provide meaningful incentives for an Outstanding rating.

- Reform regulatory techniques for evaluating performance. Increasing emphasis on the quantitative versus the qualitative impacts of Community Reinvestment Act (CRA) activities has discouraged risk-taking and innovation, and undercuts support for Community Development Financial Institutions (CDFIs). Provide more flexibility to encourage banks and others with affirmative obligations to reach deeply into underserved areas.

As other opinion leaders have noted:
From "*Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act", Federal Reserve, February 2009:*

- ***Roberto Quercia/Janneke Ratcliffe:*** *Fine-tune the measurements to remain in step with shifting markets.*

- ***Gene Ludwig:*** *Enhance the professionalism of supervision.*

<u>Committee Question 3:</u>
Please describe the adequacy of the enforcement mechanism for CRA compliance. What specific changes should be made to improve the regulatory enforcement of CRA?

Make CRA less complicated and more effective. As former OTS Director Ellen Seidman testified in February, 2008

"CRA has become a complex regulatory regime, especially with respect to the service and investment tests. The question of 'what counts' is the subject of endless, and frequently frustratingly unpredictable, discussion, debate and guesswork. Regulatory enhancements are an extremely long process (the most recent started in 2001 and ended in 2007), and development of the questions and answers that provide a practical gloss on the regulations can take almost as long. Moreover, the complexity focuses largely on inputs (e.g., how many branches, how many loans) rather that outcomes (e.g., how many lower-income people served) or—admittedly more difficult—impacts (e.g., how have their lives been improved). The "bean counting" feature of the lending test, especially for residential loans, has resulted not only in excessive focus on home loans, but also on a press for quantity with limited (and only recent) attention paid to quality… for lasting impact over a broad range of issues in an industry that changes quickly, a basic statutory scheme that is broadly directive but now overly prescriptive is preferred."

<u>Committee Question 4:</u>
Please explain what kinds of reforms would enable financial institutions to participate, to a greater degree than currently, in high impact economic development activities in low- and moderate-income areas?

- **As described in our answers above, the rules need to be revised to provide more consideration to the qualitative impact of CRA activities, especially those supporting Community Development.** The 1995 CRA regulation emphasizing quantity rather than quality has been unproductive. "Community Development lending" gets very little CRA credit despite its high cost and significant impact. For example, multifamily mortgages on multi-subsidized properties affordable to LMI households, charter schools and child care and health facilities are treated as just "icing on the cake" despite their high cost and significant impact.

  In partnership with the late Federal Reserve Governor Ned Gramlich, NAAHL tried to update the rules in 2002 to give Community Development loans meaningful CRA credit. The agencies fixed the weighting problem, but only for "intermediate small institutions." As Mark Willis, now at the Ford foundation and a former banker and city housing director, recently put it, the 1995 rewrite of the CRA regulations "steered the CRA toward rewarding dollar and unit volumes rather than focusing on rewarding those deals that do the most to strengthen and revitalize communities … many of the measures chosen to measure performance were fatally flawed."

- **Banks' investments in Letters of Credit that take the top loss risk on local public agencies' bonds financing LMI housing should be credited for the amount of the risk.** This innovative bank financing, in pioneering cities like New York, lowers the rate at which the agencies can borrow, allowing them to do more development or preservation of affordable units.

- **Liquidity for performing, seasoned, multifamily mortgages on affordable rental property requires reforms in other Federal supports.** Banks have been steadfast in their CRA commitments to CDFI lenders with strong track records and are some of the few investors left for LIHTCs.

  But recycling precious capital into additional affordable rental housing still lacks Federal support. The Federal Housing Finance Agency (FHFA) stated in its final 2009 rule on Fannie Mae and Freddie Mac's affordable housing goals that it "expects each Enterprise to actively purchase CRA-related multifamily loans from portfolio lenders, among other venues, in meeting the special affordable multifamily housing sub goal" but there has been no evidence that they will do so.

  FHFA should finalize the Housing Economic Recovery Act (HERA) provisions establishing, for the first time, affordable housing goals for the Federal Home Loan Banks (FHLBs), and permit CDFIs to borrow directly from the FHLBs with reasonable collateral requirements. FHFA has made clear its intent to issue the final rule permitting non-depository CDFIs membership in the FHLB system early in the fourth quarter of 2009, and said that "in general, the proposed rule was well-received." But given the liquidity crisis and the fact that the rule was well-received, FHFA should act sooner rather than later.

Committee Question 5:
Have changes in the structure of the financial services industry reduced the effectiveness of CRA? How could expanding CRA to additional financial service providers improve the intent of the law? How specifically would CRA-like responsibilities work in new areas, if they were covered?

Leveling the playing field for all mortgage lenders with licensing, compliance exams, and public availability of loan data, accompanied by affirmative obligations to meet LMI credit needs, as Massachusetts has done, requires legislation but would greatly support responsible community investment.

- **For more than 30 years CRA has encouraged insured depositories to help meet the credit needs of their communities.** It is important to maintain the focus of CRA on LMI borrowers and neighborhoods in local markets where financial institutions have a physical presence and staff. Broadening CRA's objectives to address a wide range of social and economic problems, and expanding the geographic reach beyond where banks can effectively engage in CRA activities risks diluting the positive impacts of the law for Community Development.

- As former Harvard Professor Bill Apgar pointed out, "as a result of the dramatic restructuring of the mortgage market over the past quarter century today the largest share of mortgage capital flows through a wide range of unsupervised or only marginally supervised entities." This alternative network of mortgage originators was not subject to the same CRA, fair lending, and safety and soundness supervision and enforcement as insured depositories, and so a dual mortgage market developed that allowed the unregulated to prey on consumers.

- Recent changes in the financial services industry include the appearance of banks with little customer interface, such as Goldman Sachs and Morgan Stanley, and Internet banks, and also Industrial Loan Corporations (ILCs).

  Treating these banks like wholesale bank charters that permit them to have nationwide assessment areas would expand support for rural areas and regional and national funds.

<u>Committee Question 6:</u>
Please discuss whether federal banking regulators are properly taking into consideration an institution's compliance with fair lending laws in determining the institutions' CRA rating.

Closing the compliance gaps for nonbanks should be a priority to bring more scrutiny and visibility to their practices. Banks are regularly examined for their compliance with fair lending and other consumer protection laws, so agencies have a record of a bank's compliance with these laws when a regulator conducts a CRA evaluation. Mandatory inclusion in the CRA Public Evaluation of a negative finding by examiners resulting in a downgrade in CRA rating is available from a scan of CRA ratings (specifically downgraded ratings) and listings of major factors that support the assigned rating, listed in CRA Performance Evaluations.

<u>Committee Question 7:</u>
Please describe, in detail, other factors that may reduce the effectiveness of CRA.
The factors are described above.

<u>Committee Question 8:</u>
What other changes should be made to the CRA statute, regulations, guidance or compliance examination to improve the effectiveness of CRA and/or reduce regulatory burden associated with compliance?

Meaningful incentives for Outstanding performance in CRA would also help to restore innovative, high impact activity by banks. States are experimenting with tax incentives for opening branches in underserved areas. New York and Louisiana lawmakers have passed legislation that directs state government deposits to insured depository institutions that open branches in underserved communities. Other incentives for Outstanding ratings would include: 1) a safe harbor for the next application following the rating; 2) reduced FDIC insurance premiums; 3) longer periods between exams.

CRA is, by definition, local; it requires banks to meet their community's needs. Greater emphasis on Community Development lending requires bringing qualitative judgment, and serious consideration of the performance context in which the bank operates, back into the rating process. The alternative is a burdensome "numbers' game" that undervalues important CD work that banks do to allow credit to flow to communities that would otherwise be underserved, and is a particular challenge for large national banks that have hundreds of assessment areas.

The lack of predictability about what counts for CRA credit is a deterrent to lending and investing in emerging markets. More training for bank examiners about the nature of Community Development lending and investment would help banks and thrifts better achieve the policy goals set forth in Federal Legislation. Community Development lending and investment is quite specialized, more like an art than science. Banks should be given the benefit of the doubt, not the third degree.

- Multifamily Community Development loan originations and loan purchases, as well as CD investments (such as for Low Income Housing Tax Credits) in the statewide or regional areas where a bank has any assessment area;

- Letters of Credit taking the top loss on local public agency bonds; and

- Community Development loans to CDFIs.

The liquidity crisis in affordable rental housing is so severe that **Congress should consider enacting NAAHL's longstanding recommendation for a Federal insurance program modeled on the state of New York's mortgage assurance corporation (SONYMA).** This major tool helps to provide permanent financing for the development of affordable housing in New York. SONYMA insurance has enabled sales to Freddie Mac and Fannie Mae. A Federal mortgage insurance program could enable Community Development lenders to replenish their loan funds, providing for greater amounts of affordable rental housing.

CONCLUSION
CRA's track record in lending and equity investing can be seen in more and more communities, from Birmingham to Los Angeles, and in our own metro area in the Columbia Heights redevelopment, Anacostia's resurgence, and even the expansion of Alexandria's St. Coletta school, one of only a handful of charter schools in the country serving students with autism and multiple disabilities. Given the current crisis in the financial markets, updating the CRA regulations to enable banks to do more of that important work is long overdue.

We agree with Mark Willis, who says:

> *"The brilliance of CRA was its brevity and simplicity. It requires affirmative outreach to communities and left the details to regulators and to interactions between banks and community groups. While this approach left room for innovation, it also expanded expectations beyond what CRA alone could accomplish. To be truly effective going forward, CRA needs more focus on community development; its regulations need more latitude with clear but flexible criteria, and laws that complement CRA should be strengthened."*

In 1977, concerned about the denial of credit to lower income communities—both minority and white—Congress enacted the Community Reinvestment Act (CRA). CRA states that "regulated financial institutions have [a] continuing and affirmative obligation to help meet the credit needs of local communities in which they are charted." The statue goes on to require that federal bank regulators both "assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of such an institution" and "take such record into account in its evaluation of an application for a deposit facility by such institution."[3] Institutions are given one of four ratings, from Outstanding to Substantial Noncompliance, and examination reports (called Public Evaluations) are made public.

[3] 12 USC 2901.

Alabama Multifamily Loan Consortium