N A A H L

NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

January 24, 2005

The Honorable James E. Gilleran
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

RIN number 2004-53

Dear Director Gilleran:

The National Association of Affordable Housing Lenders (NAAHL) represents America's leaders in moving private capital to those in need---200 member organizations committed to increasing private capital lending and investing in low- and moderate-income (LMI) communities. Members are the "who's who" of private sector lenders and investors in affordable housing and community and economic development: banks, thrifts, local and national nonprofit providers, mortgage companies, loan consortia, financial intermediaries, pension funds, foundations, and public agencies. The Community Reinvestment Act (CRA) has been central to our work, and is crucial to achieving President Bush's goal of an "Ownership Society".

We appreciate the opportunity to comment on OTS' proposals to: (1) "revise the definition of "Community Development"; and (2) "provide additional flexibility in assigning CRA ratings." CRA is one of the least known but perhaps most remarkable success stories of domestic policy. Originally intended to stop so-called "redlining" of neighborhoods, the law requires insured depository institutions to meet the credit needs of their communities, including low- and moderate-income communities. As Federal subsidies for affordable housing and community and economic development have diminished, the availability of private capital provided by these institutions has been critical to non-profit providers and local governments that try to leverage limited subsidy dollars.

To put CRA's importance in perspective, recall that the annual HUD budget is approximately $31 billion, but after renewal of existing subsidy contracts, only about $12 billion remains to address all of the other affordable housing and community development needs throughout the country. Insured depository institutions, in partnership with local non-profit organizations and governments, fortunately leverage limited federal and state dollars many times over.

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Our practitioners' experience is that mid-course corrections to the 1995 regulations are critical to the long-run effectiveness of CRA. Current regulations discourage banks from providing really innovative, responsive, complex, community development loans and investments. NAAHL has been a leader in identifying what rules do need updating to provide a better balance between the quantitative and qualitative measures. For just one example, pioneering efforts to provide conventional mortgages on tribal lands have value over and above the actual number of LMI families housed as a result of the prototype deal.

FIRST, DO NO HARM

As senior members of the House Financial Services Committee wrote to you about the OTS raising the threshold for the large bank exam from $250 million to $1 billion:

> **"Merely exempting some mid-sized financial institutions from the investment test does not address the underlying problem with how investments are currently evaluated...The proposal would not solve this problem. Instead of trying to remedy the problem of having a significant portion of financial institutions chasing after the same type of community investments, the proposal would simply eliminate the investment requirement for more than 1100 mid-sized financial institutions."**

We agree, and encourage you to revise this proposed rule, and focus on an interagency rule which incorporates the NAAHL proposals for practical solutions to existing problems through an optional Community Development Test (see attached 4/5/02 letter).

SECOND, UPDATE AND SIMPLIFY THE REGULATIONS

NAAHL's proposal for an optional Community Development Test would provide institutions actual CRA credit for all community development activities, including loans and services as well as investments. This would provide greater encouragement to do the very high cost (labor intensive, lower yield) community development lending. It would also put greater emphasis on whichever activity is most needed in a community.

How well a bank meets the credit needs of its community should be more important than whether financing takes the form of a loan or investment. We are happy to review this meaningful alternative in detail with you and your staff. However, we also recommend that any changes to CRA regulations be guided by two very important principles.

- **<u>Due Process</u>**
  It is critical that any change in the CRA rules occurs through the regular, democratic process for obtaining public input, with full public disclosure and opportunity for comment by all who are affected. The unprecedented volume and incredible range of comments on the FDIC proposal concerning institutions under $1 billion demonstrates how integral the Community Reinvestment Act is to meeting the broad and diverse credit needs of communities throughout our nation.

  This NPR now suggests quite substantial changes to the regulations, yet it provides no specific language changes, except for the definition of community development. Instead, it poses a series of provocative, open-ended questions. Specific language of any regulatory changes that may be contemplated as a result of answers received to your questions should be subjected to public scrutiny through another NPR, published in the Federal Register.

- **<u>Collaborative Rule-making</u>**
  We now know that extreme swings in the rules only generate backlashes: today there is clearly a backlash against the investment test, while tomorrow could bring another backlash against insured institutions that results in new requirements beyond the existing rule. We continue to hope that the agencies will come together in a joint rule that does not disadvantage LMI individuals. It is also very disruptive to institutions and to communities to have very different rules across agencies. Communities expect Federal regulators to work collaboratively, and not competitively, to achieve common regulations that are both transparent, and also support and encourage insured institutions' efforts to meet the credit needs of their communities.

<u>NPR Questions</u>

NAAHL comments on specific questions included in the November, 2004 NPR are as follows.

<u>Solicitation of Comments on the Definition of "Community Development"</u>

Would it be appropriate for the definition of ''community development'' to expressly provide that community development also includes, in any area (rural or not, low- or moderate-income or not): (1) Community services targeted to individuals in areas affected by natural or other disasters or other major community disruptions; and (2) activities that revitalize or stabilize areas affected by natural or other disasters or other major community disruptions?

NAAHL believes community development credit for activities benefiting individuals and/or areas should continue to be focused on low- and moderate-income (LMI) individuals or within LMI areas. It is our view that many activities in rural areas can be shown to benefit primarily LMI persons, so the emphasis should be on training your examiners and simplifying the exam documentation, rather than just making eligible activities that primarily serve upper- income households.

Similarly, NAAHL supports community development credit for activities undertaken in response to natural or other major disasters, but only if it appears that LMI individuals suffered disproportionately. Once again, examiners trained in the performance context should obviate the need for excessive documentation.

As proposed, OTS would not expand the third paragraph of the definition of "community development" to include activities that promote economic development by financing businesses or farms in rural areas without regard to their size or gross annual revenues. Would it be appropriate to cover such activities? Are there difficulties with financing business or farms of various sizes or gross annual revenues in rural areas that could appropriately be addressed by revising the definition of "community development?"

NAAHL believes that it would be inappropriate to expand the third paragraph of the definition of "community development" to include activities that promote economic development by financing businesses or farms in rural areas without regard to their size or gross annual revenues. If the CRA were expanded to include all customers in rural communities, including, for example, all corporate farming conglomerates, it would undermine the legislative intent by distracting its focus from those households and communities that have been underserved historically. Large corporations have never had trouble finding their way to Wall Street, or Wall Street to them.

Solicitation of Comment on the Definition of "Rural"
Would a definition of "rural" be helpful? If so, how should "rural" be defined?

Counting all rural activities as eligible for CRA eligibility is too expansive and could result in counting the development of affluent golf and skiing communities. This was clearly not the intent of Congress when it passed the CRA. Because low-income households are often less geographically concentrated in rural areas than in urban areas, it is important that the regulators recognize that rural areas without large "pockets of poverty" still may have many low-income households who benefit from institutions detailing their lending, investment, and services. At the same time, it is reasonable that the OTS and other agencies pay more attention to and evaluate the performance of banks in their rural markets as well as in their large urban markets. Urban markets receive far greater reinvestment scrutiny due to the concentration of bank deposits in large cities and the large, dense population of LMI households.

Solicitation of Comment on Eliminating the Investment Test
Would a preferable alternative be to eliminate the investment test? If so, why? If not, why not?

This test should not be eliminated, but the rule should offer insured institutions the option of a new Community Development Test that recognizes that community development lending and services, as well as investments, are essentially different from more standardized and higher volume home mortgage and small business lending. Community development activities may not generate as much volume as home mortgage and small business lending, and they often require more time to structure. But community development activities are also essential to address critical needs, and can add value disproportionate to their size.

CRA investment dollars have been the primary source for funding low-income housing credits, New Markets' Credits, Historic Credits, charter schools and community homeless shelters. They have funded many other innovative community and economic development initiatives. Some institutions may continue to invest in their communities without a Federal requirement, but the question is whether even they will do so at the same level.

Over the past two decades, the Community Reinvestment Act has helped funnel trillions of dollars of private capital to mortgage lending, affordable housing, and community and economic development.

Every government and academic study of CRA, including one by the Federal Reserve Board, has documented insured depository institutions achievements in carrying out their affirmative obligations to make loans, investments, and provide services in underserved rural and inner city communities. CRA is the key to building emerging markets for the future, and lending and equity investing in underserved communities has already spurred economic growth and demand, thereby increasing opportunities to make more loans and sell more services. It is crucial to President Bush's vision of an "Ownership Society". Done properly, CRA business is sustainable.

We look forward to working with the OTS and the other 3 regulatory agencies to ensure that the CRA rules continue to encourage credit availability to underserved individuals and communities.

Sincerely,

Judith A. Kennedy

Judy Kennedy
President

April 5, 2002

John D. Hawke, Jr.
Comptroller of the Currency
Office of the Comptroller of the Currency
Independence Square
250 E Street, SW
Washington, DC 20219-0001

Dear Jerry,

This responds to your challenge to NAAHL to develop a proposal for updating the CRA regulation. By way of background, the 3 principles underlying NAAHL's approach to CRA and Community Development and informing this proposal are:

Sustainability: No loan or investment should be made which is not viable in its own right – meaning that it can achieve its developmental purpose over time without continued sustaining financial intervention. However, a comprehensive community development (CD) strategy will include grants and other types of financial assistance to low- and moderate-income (LMI) individuals and organizations.

Flexibility: The key to what is allowable and creditworthy under CRA should be "what works", i.e., what loans, investments, and services contribute to improvement in the lives of LMI individuals.

Responsiveness to community/market needs: Banks should be able to create, change, and modify their CRA oriented programs to reflect changed conditions in their markets and communities. Examiners should recognize such changes in community and market conditions and reward CRA programs that work.

<u>The Community Development Oriented Plan:</u>

As an option (not dissimilar to the choice available with the "Strategic Plan"), a bank could choose as an alternative to the standard Lending, Investment, and Service Tests, to be assessed under two new tests which differentiate between the community reinvestment responsibility to provide financial services to the institution's assessment community on the one hand, and the narrower but pressing need to assist LMI individuals and/or revitalize the communities within which they live or work. These alternative tests would be:

- Retail Banking Test – consisting of mortgage loans, small business loans, consumer loans (optional), and retail banking services. This would be similar in scope to the existing small bank test.

- Community Development Test – consisting of community development lending, community development investments, and community development services.

The Retail Banking Test will measure the institution's success in meeting the credit and financial service needs of its assessment area. These activities (whether lending or services) will be included in the Retail Banking Test as a component of the institution's assessment area activity and to ascertain the institution's distribution of these activities within the assessment community.

The Community Development Test -- Definition and Purpose:

Community Development encompasses those activities of a financial nature or otherwise, which have the effect of improving the life condition of LMI individuals, or of stabilizing and revitalizing the communities in which they live or work. In order to receive community development credit for CRA purposes, a project need not have community development as its "primary purpose", so long as a significant consequence of the project or activity benefits LMI individuals or communities. For example, all of a mixed-income development transaction where the market-rate units *enable* affordable units should count (not just the affordable portion) because the transaction meets the community's need for LMI housing. Another example is a city-sponsored project in a community, which is not LMI, where the institution finances or supports downtown revitalization or rehabbing of an older shopping center where LMI individuals are likely to find employment. In addition, it should not be required that an activity be explicitly "financial" if it works to the benefit of LMI individuals or communities.

The Community Development Test will include, but not be limited to, activities such as the following:

Funding of CDFIs and other community development intermediaries;
Funding community development venture capital funds;
Loans/investments/grants in projects or to organizations which provide housing affordable to LMI individuals, or to LMI communities;
Loans/investments/grants in projects or to organizations which provide jobs, supportive services, or other relevant benefits to LMI individuals or LMI communities;

Facilitating the creation of affordable housing through the use of low income tax credits;
Purchase of mortgage-backed-securities backed by loans to LMI individuals;
Participation in government sponsored programs, such as the SBA, with evaluation based on the LMI definition that the specific government entity uses;
Grants to organizations engaged in community development activities;
Providing financial education and banking services tailored to the needs of the unbanked;
Equity investments in organizations, small businesses, or other projects for the purpose of community development;
The initiative shown by the institution in developing unique/special LMI targeted lending programs; and
Related activities such as:

- Providing standby letters of credit or other credit enhancements supporting community development projects (to be included and itemized in the CRA Loan Disclosure);
- Applications to the Federal Home Loan Bank for support of community development projects, the contingent liability taken on with such projects, and employee time spent in administering and monitoring these activities;
- Employee time devoted to a large variety of community development activities, such as construction of homes through the auspices of organizations such as Habitat for Humanity;
- Bank officers and other employees participating in community development organizations, even if they include non-financial activities.

When examining an institution's community development program, the Examiner would look to the totality of the bank's community development activity, recognizing that the balance among community development lending, investments, services and other related activities may vary substantially from bank to bank and community to community so long as the total impact of the bank's community development outreach is consistent with its performance context and institutional expertise, and meets a reasonable standard related to community needs.

Weighting:

If an institution were to choose this alternative plan for satisfying its community reinvestment responsibility the weighting for each test would be agreed upon prior to the examination, with the weighting for the Community Development Test to be no lower than 25% and no higher than 50% of the total. In keeping with the overriding consideration of flexibility in the direction each institution takes in meeting its community development responsibilities and the flexibility Examiners have to evaluate the totality of an institution's program without rigid adherence to hard and fast allocations, we believe that weighting should be determined within the context of the individual institution's business strategy and the needs of its community. As an example, an institution which does not offer a particular product line would be evaluated with weightings based on the products it does offer.

HDMA, Small Business, and (Optional) Consumer Loans:

HMDA and Small Business loans will continue to be reported as they currently are, and considered in the retail banking test. Standby letters of credit or other credit enhancements supporting community development projects will be reported and included under the Community Development Test, as noted above. There will be no double counting of loans, investments, or services. For examination purposes, all activities will be categorized as falling under the Retail Banking Test or the Community Development Test.

Determination of Which Test to be Examined under:

At the time when the Regulator notifies a bank of an upcoming CRA Examination, but no more than 12 months prior to an exam, the bank will inform the Regulator of its wish to be examined under the standard Lending, Investment, and Service tests, or its preference to be examined under the Retail Banking and Community Development tests. This flexibility allows that even though a bank might normally be expected to opt for and develop its CRA plans for one or the other of the alternate examination processes, changing bank circumstances and community/market conditions may prompt the bank to change its program in such a way as to make the alternative testing standard appropriate.

Thank you for the opportunity to suggest this approach. We would look forward to continuing our dialogue on these important matters.

Sincerely,

Judy Kennedy
President