LISC

Helping neighbors build communities

Statement of

Michael Rubinger

President and CEO

Local Initiatives Support Corporation

Community Reinvestment Act and Community Development

July 19, 2010

Statement of Michael Rubinger

Good morning. My name is Michael Rubinger. I am President and CEO of LISC, the Local Initiatives Support Corporation.

I will focus my remarks on one important aspect of the Community Reinvestment Act (CRA): its relationship to community development (CD) activities. CD presents distinct challenges that may well warrant distinct policy considerations. We have not fully considered issues relating to other important aspects of CRA, such as home mortgage or small business lending, which tend to be more standardized and higher volume activities

I also want to commend the banking agencies for debunking the insidious myth that CRA was somehow responsible for irresponsible and abusive nonprime lending that has destabilized families and communities, as well as the broader financial system, housing market, and economy. As you know, CRA-eligible loans comprised only 6 percent of high-cost home mortgages. Nonprime loans were made primarily outside of the regulated bank system. In our experience, banks, regulators, and communities all share a stake in CRA's mandate that lending and investments benefiting low- and moderate-income families and communities can and must be consistent with safety and soundness.

About LISC

Since 1980 LISC has worked in numerous partnerships involving banks and thrifts, nonprofit community development corporations (CDCs), and government at all levels to build sustainable urban and rural communities. LISC invests roughly $1 billion each year in these partnerships. Over time we have invested $9.7 billion, generating $31.3 billion of development activity, including 271,000 affordable homes and 40 million feet of retail and community space, 132 schools, 157 child care centers, and 225 youth sports fields. Most of this money has come from the private sector, about one-half of it from banks, mostly in the form of loans and investments. Our work covers a wide range of activities that contribute to sustainable communities, including housing, economic development, building family wealth and incomes, education, and healthy lifestyles and environments. Our first name is Local, and we operate in 39 states through 28 local offices and a national rural development program, so we see low-income communities and how CRA is working up close.

Why Community Development (CD) is Important

While residents and businesses are the immediate beneficiaries of community development, it also contributes to the economic and social vitality of cities and towns, their surrounding regions, and the nation as a whole. As Federal Reserve Board Chairman Ben Bernanke recently remarked:

> “Indeed, this community stabilization work is important for the overall economic recovery. Healthy and vibrant neighborhoods are a source of economic growth and social stability. CDFIs and other community groups are already responding to the evident needs, but they will require many willing partners to ensure success in the long run, including governments, mortgage servicers, and mainstream lenders. Strong community organizations can accomplish a great deal, but their capacity will be severely limited without the willing partnership of many other institutions.”

CRA is Integral to CD

CRA-motivated bank financing is an integral part of CD. In the context of CRA, CD involves bank and thrift lending, investment and services to support low- and moderate-income families and communities through:

- multifamily rental housing;
- home construction and rehabilitation;
- retail and other commercial real estate such as grocery stores and business facilities that revitalize neighborhoods and rural areas;
- community service facilities such as health clinics, charter schools and child care centers; and
- CDFIs and nonprofit developers.

Motivated by CRA, banks have made billions of dollars of successful CD loans and investments that have generated over one million affordable rental homes, the construction and rehabilitation of numerous affordable owner-occupied homes, and many millions of feet of economic development and community service facilities. While CD financing can be challenging to structure, it has proven to be both safe and profitable.

One of CRA’s signature achievements has been to create successful partnerships among banks, all levels of government, and both nonprofit and for-profit developers. Most federal housing production and other CD policies now depend on these partnerships, which help leverage limited public funds. Bank participation has also brought business discipline to the CD process, greatly increasing the success of public programs. CD projects often anchor the stabilization and revitalization of low- and moderate-income communities, and complement responsible lending to individual consumers and small businesses in the same communities.

In our experience, CRA remains the primary driver of private financing for CD. While we have had some considerable success in attracting financing from other sources, we fully expect banks to remain the dominant source of CD lending and investment. Most banks tell us that CRA is a threshold consideration in the volume and location of their CD financing.

But CRA's Treatment of CD Needs Revision

Unfortunately, however, CRA's effectiveness in encouraging CD has eroded over the past several years. Although current problems in housing and commercial real estate, finance, and the economy have certainly added to the challenge, the trend was well under way before these problems arose.

Divided consideration of CD activities diminishes effectiveness. One reason why CD activities can be overlooked is that their consideration is divided among the three CRA tests – the lending, investment, and services tests. This fragmentation obscures a clear view of how banks are applying the various tools at their disposal to address the needs and opportunities of different communities in an integrated and responsive way. It also contributes to some more specific problems.

- CD loans are considered within the lending test. The number and volume of CD loans tends to be small relative to standard home mortgage and small business lending so they tend to get little or inconsistent consideration, even though CD loans often have a disproportionately positive impact on communities. In addition, examiner guidance further diminishes the importance of CD loans by treating them not as integral but rather as extra credit – i.e., the absence of CD loans will not adversely affect a rating but the presence of CD loans may positively affect a rating. Finally, our bank partners report they receive inconsistent consideration – and often none at all – for providing credit enhancements like loan guarantees and letters of credit – even though they may be as valuable as making loans directly. This is especially true in a financial world where Wall Street is a greater source of long-term capital than bank deposits.

- In many communities there are a limited number of truly valuable CD investment opportunities, such as LIHTC or New Markets Tax Credits developments. Many banks purchase conventional home mortgage backed securities targeted to these communities expressly to pass the CRA investment test, even though the underlying home mortgages do not serve a CD function and a broader market exists for these securities.

- The services test currently focuses on the distribution of branches and the services available to consumers. CD services, including banks' efforts to build effective partnerships with state and local governments and nonprofit CD organizations, should be considered under the CD test.

For much of the industry, CD activities get little attention beyond the largest metropolitan areas. There is little incentive for the major multistate banks – which have most of the banking system's deposits and assets, as well as considerable capacity – to undertake CD activities beyond the largest metropolitan areas. CD practitioners increasingly characterize these areas as “CRA hot spots” and other areas as “CRA dead zones”, as if CRA were not truly a national policy. The geographic distribution of CRA needs better balance.

Less than 1.5 percent of the 8,184 banks and thrifts in the system – 117 institutions – have at least $10 billion in assets each, and these relatively few institutions have 69 percent of the system’s deposits. The ten largest banks have 39 percent of the system’s deposits. While other smaller institutions remain important, it is essential that CRA’s CD policies effectively connect very large banks that operate in multiple states or even nationwide with local and national CD needs and activities in both the largest metro areas and the rest of the country.

While CRA policy recognizes that how a bank responds to local needs is essential to evaluating the bank’s CD activities, examiner guidelines direct that, for most multi-state banks, activities in only one or two parts of each state are to receive any such qualitative review. A multistate bank receives only a limited review of the number and volume of its CD activities in most of its communities – an inherently inadequate analysis – and activities in these communities generally do not affect the bank’s rating. Banks understandably focus their CD lending and investments on those markets – usually the largest metropolitan area in each state – likely to undergo a full review of both quantitative and qualitative aspects.

As just one consequence of this policy, Low Income Housing Tax Credit (LIHTC) investments are far more available in these major metropolitan areas than elsewhere. LIHTC investments are often unavailable on any reasonable terms in “CRA dead zones” – including most rural areas, many mid-sized and smaller cities, and even some entire states served by few multistate banks. When LIHTC investments are available in these places, rates of return must be substantially higher to attract investors, so the investment proceeds are substantially lower. Many developments become financially infeasible on this basis. We see similar trends in other aspects of CD finance as well.

Recommendations for Revising CD Policies

We believe that CD deserves better attention under CRA than it currently receives. While other aspects of CRA – including home mortgages, small business lending and depository services – remain important and complement CD, there needs to be a better balance. Compared with home mortgage lending, CD activities may be modest in volume, but their positive impact on communities is often disproportionately large. In assessing CD activities, volume is important but so is an understanding of how they address community needs. This qualitative aspect often gets lost as CRA has become, as our bank partners report, predominately numbers-driven.

The federal banking agencies should revise the way CRA considers CD activities.

Create a new CD test. We recommend that a new CD test replace the current investment test on the CRA exam for large retail banks. We would propose keeping the current general lending test and the services test, although their relative weights should be reconsidered. The CD test concept is not new to CRA, since one already applies to wholesale and limited purpose banks as well as to intermediate small banks.

- A new CD test would include all CD activities primarily benefitting low- and moderate-income families and communities, including multifamily housing, commercial and economic development activities that revitalize low- and moderate-income areas, community service facilities, construction and rehabilitation of single-family homes, and support for CD organizations such as CDFIs and CDCs.

- The CD test should include all forms of participation, including loans, investments, credit enhancements, services, and support for nonprofit and public partners. CD loans would be moved from the current lending test. Purchases of home mortgages, including such mortgage backed securities, which are now part of the investment test, should be considered along with direct home mortgage lending as part of the lending test, and not as part of the CD test. CD services should include nonfinancial activities geared to CD, including advice to nonprofit and public CD entities. Because we recognize that capable nonprofit and governmental partners are not available in all communities, we recommend that banks' partnership building activities receive recognition.

Revise CD assessment areas. To recognize and encourage CD activities in both large metropolitan areas and in other communities, we propose a revision in the way CD needs are determined and CD activities are examined. We recognize that under the current system, some of the largest banks have 200 to 300 (or more) assessment areas. It is impractical for examiners to determine the CD needs for each of these areas *de novo* when it prepares to examine each bank. It is also impractical to expect banks to set and meet targets for each of these areas. We also recognize that the same CD opportunities will not be available in all communities in all years. What is needed is a more manageable, consistent and predictable approach that includes all communities and recognizes different local needs and opportunities. We recognize this is a difficult challenge but it is also an important one. In that sprit, we propose for consideration one possible new approach:

- The banking agencies should jointly conduct a CD needs assessment for each of the 50 largest metropolitan areas as well as for the balance of each state – a total of 100 assessments nationwide. Each needs assessment would describe economic and housing market conditions generally and in low- and moderate-income communities, as well as CD needs and opportunities. Balance-of-state assessments would take note of important variations within the area. Input from communities and the banks would be solicited in conducting the needs assessments. The agencies could contract for outside assistance if needed. The needs assessments would be updated periodically – perhaps every three years. The result would be a benchmark that is clear, consistent, responsive to local needs and opportunities, transparent, broadly vetted, and avoids duplication.

- These needs analyses would be the basis for the CD component of CRA exams. As such, CD activities in all communities would be fully recognized. Major metropolitan areas would continue to get attention, but now smaller metro areas and rural areas would get more attention as well as part of the balance-of-state areas. At the same time, the number of assessment area targets would be more predictable and manageable for all interests. Banks unable to do everything everywhere could at least know that the totality of their activity will be fully considered in an appropriate context. Bank efforts to build the partnerships important to implementing many CD activities would also receive recognition.

<u>Differentiate CD responsibilities for various types of large banks.</u> We believe it will be important for the agencies to recognize that different kinds of large banks can contribute to CD activities in different ways. Before interstate banking was authorized in 1994, most banks and thrifts operated primarily through bricks-and-mortar branch networks within a single state, and a few wholesale and limited purpose (e.g., credit card) banks operated otherwise. Now the industry is arrayed very differently. Banks that operate locally, banks that operate locally in multiple states, and banks without significant bricks-and-mortar branch networks all have different capabilities and should have different CD responsibilities. This will be important to ensuring that CD needs are more adequately addressed. For example:

- *Large retail banks that operate within a local community or one or a few states* should be required to address CD needs within those areas. Satisfactory performance in these areas in the aggregate should be required for a bank to receive a satisfactory rating on the CD test. In addition, a bank should get full extra credit for helping to address CD needs elsewhere, though it would not be expected to do so.

- *Very large banks with branch networks in multiple states and regions* should be required to address the CD needs in those areas. Satisfactory performance in these areas in the aggregate should be required for a bank to receive a satisfactory rating on the CD test. In addition, the totality of their CD activities nationwide should receive full consideration, including helping to provide leadership, address national needs (e.g., those requiring special expertise such as homeless housing, transit oriented development, or charter schools), and the needs of traditionally underserved communities (e.g., rural areas).

- *Banks that do not operate significantly through traditional bricks-and-mortar branch networks* are becoming much more important. These include internet banks, investment banks, credit card banks, wholesale banks, and U.S. outposts of some foreign banks. Since these are not truly local banks, they should be assessed primarily on a nationwide basis, including how they help to address national needs and the needs of traditionally underserved communities. Whether these nontraditional banks should have only a CD test (as now applies to wholesale and limited purpose banks) or should also have lending and services tests (as now applies to traditional retail banks) should depend on the degree to which a non-local bank is active in retail banking.

<u>CRA examiners should get CD training.</u> Assessing CD activities requires CRA examiners to exercise some judgment about the responsiveness of a bank to community needs, just as safety and soundness examiners bring judgment to bear. It will be important for CRA examiners have good familiarity with CD and clear guidance on how to apply appropriate judgment. We often hear that many CRA examiners are unfamiliar with how CD works and how to assess the value of banks' CD activities in the context of CD needs and opportunities. We also hear that different examiners interpret CRA policies very differently, so that it is often difficult for banks to anticipate with confidence whether they will get full (or any) recognition for bona fide CD activities, including innovative or locally responsive activities that require genuine leadership. We therefore encourage the agencies to provide extensive and ongoing training to CRA examiners responsible for CD activities.

This concludes my testimony. I would be happy to address your questions.