The Community Reinvestment Act and NSP: A Banker's Perspective

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"Mind the gap! Please mind the gap! Mind the gap between the train and the platform!"

On a recent trip to London, my children were entertained by every variation of this continually repeated warning on the Underground. From the recorded soundtrack at the airport to the conductor at the Notting Hill Gate Tube stop, we heard reminders of just how dangerous the space between the train and the platform can be. These warnings become little more than background noise to those who take the Underground on a regular basis.

In similar fashion, the Community Reinvestment Act (CRA) bank regulators are continually cautioned to "mind the gap" between the written regulations and the reality of what is going on in the world of banking and community development. Interest groups abound. Bankers implore regulators to give them credit for this or that innovation in lending, investment, or service. Banks, for example, believe direct credit as Community Development Loans should be given for letters of credit supporting affordable housing. Community groups, on the other hand, say that there has been "grade inflation" in CRA exams and that every bank is graded as an A or B student. These groups point out the areas where they feel regulators have missed the mark, as well as the banking practices regulators should pay more attention to. Large cities would like more focus on important urban cores, while rural communities say that their needs are ignored in much of the discussion. With all of these apparently competing interests, it is sometimes difficult for regulators to discern the true nature of communities' needs and banks' CRA efforts as the advocacy voices become background noise from frequent repetition.

In the case of the proposed expansion of the CRA regulation to encourage banks' support of National Stabilization Program (NSP)-eligible activities, the regulatory agencies are "minding the gap" between the regulation and the real world with a positive move to address the issue of vacant and abandoned properties in some of the country's hardest-hit communities. As we move beyond the subprime crisis, through the foreclosure crisis, and on to the growing crisis in vacant and abandoned properties, communities are increasingly saddled with empty, deteriorating houses that devalue neighboring properties, attract crime, and demoralize neighborhoods.

The four bank regulators—the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision—have proposed some changes in the CRA to address the growing problem of vacant and abandoned houses. How banks manage, dispose of, and support the rehabilitation of their real-estate-owned (REO) property[1] can have a significant impact on the survival of a street, a block, a neighborhood, and a city. This new CRA proposal gives banks an added incentive to work with community partners to address this serious issue.

The four regulatory agencies announced the proposal on June 17, 2010, and accepted written comments through August 31. They also

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held public hearings in three U.S. cities in July and August. A final announcement on the proposal is pending at the time of this publication.

As someone who has worked in the community development field for nearly 20 years, I find it painful to see the hard work of committed community development corporations and other community development professionals being undone by the abandonment of homes, quickly stripped of everything of value, to become a blight on our neighborhoods. While a great deal of this damage is concentrated in low- and moderate-income neighborhoods, a significant number of middle-income areas are also being negatively affected by this issue either directly or through contagion.

The proposed change to the CRA articulates how banks can partner with community organizations to address swelling inventories of REO properties and help stabilize neighborhoods. For example, as written, the CRA applies only to low- and moderate-income borrowers and census tracts, defined as those whose residents, on average, have less than 80 percent of the area median income; however, the NSP allows funds to be used "with respect to families *whose income does not exceed 120 percent of the area median income.*" This discrepancy has made it difficult for banks to determine whether their support of NSP projects would qualify for CRA consideration. The proposal addresses this discrepancy; specifically, it would

> *revise the interagency CRA regulations by adding to the definition of 'community development' loans, investments, and services that support, enable, or facilitate NSP-eligible activities in designated areas identified in plans approved by HUD under the NSP … A financial institution would receive favorable CRA consideration for a donation of Other Real Estate Owned (OREO) properties to non-profit housing organizations in eligible middle-income, as well as low- and moderate-income, geographies.*

In their request for comments, the regulatory agencies asked several questions about this specific proposed change. One asks whether regulators should restrict CRA consideration for NSP activities to only those that are specifically part of a HUD-approved NSP plan. From a banker's perspective, such a narrow rule would be short-sighted. Given the severity of the vacancy and abandonment issue, particularly in those communities hit hardest by the foreclosure crisis, it is important not to restrict credit for these activities simply because they are not specifically spelled out in an NSP plan.

It is difficult to foresee everything that should be included in a plan in advance of beginning the work. As NSP recipients work through their plans, changes, such as the involvement of a new community partner or a change of physical location because of an inability to gain control of an important structure, are often needed to meet a community's shifting reality. Regardless of whether it is directly tied to an NSP project, if that activity is consistent with the goals of NSP it should be included for CRA credit. To artificially exclude consideration of all activities consistent with NSP's intentions, and include only those activities that are part of a plan, would be overly restrictive and would stifle the intended commitment to addressing the current housing quagmire.

Another aspect of the proposal is also welcome—that which would allow banks to take CRA credit for NSP-eligible activities outside of their assessment areas. This part of the proposal recognizes that many institutions have done mortgage lending—and therefore have REO properties—outside of their assessment areas. This provision, of course, comes with the usual caveat that an institution must have "adequately addressed the community development needs of its assessment area(s)." Allowing banks the flexibility to receive credit for NSP-related activities outside of their assessment areas provides banks the opportunity to take a global look at their real estate portfolios instead of segregating the properties inside from those outside their assessment areas. This expansion allows institutions to move forward with engagement in NSP activities *regardless of the location* of the properties involved, assured that some CRA benefit will accrue to them.

Overall, the proposal will probably have a limited effect on banks' CRA activities. Banks that are engaged with their communities and are in discussions concerning NSP-eligible projects have already assumed that these activities, by their very nature, would qualify for CRA consideration. Because most NSP activity takes place in low- and moderate-income areas, the activity is presumed to qualify, and any issues would be worked through with banks' examiners at their next CRA exam.

While the proposal provides greater certainty about banks' receiving CRA credit and will simplify recordkeeping, it will not be the driving force behind their engagement with communities. The proposal should make institutions with large REO portfolios take a second look at—and perhaps a fresh approach to—how they manage their portfolios outside their assessment areas and evaluate what they can do to work with community groups in middle-income neighborhoods as well as low- and moderate-income areas to facilitate the transfer of properties.

The proposal will, however, increase the banking industry's consciousness of the importance of NSP initiatives and responses to the vacant and abandoned property issue without significantly increasing banks' compliance burden. It may prompt bankers to think and work creatively on ways to address this serious issue. This proposal is a positive sign that the regulators are finding ways to react more nimbly and sort through the cacophony of voices coming at them from different directions. Regulators have heard where financial institutions' and communities' interests have aligned to "mind the gap" between regulation and the very real problem of foreclosed and abandoned properties besieging our communities.

It is the collective responsibility of bankers, along with community groups, to advocate for the needs of our communities and to speak up when we think an important issue is being overlooked by the regulation that has had such a positive impact on the redevelopment of our neighborhoods over the past 30 years. This proposed change to the CRA may be a precursor of more agile regulatory responses in the future. As we have seen over the past few years, circumstances can change rapidly; interagency regulatory change, with its complicated procedures, can be slow and cumbersome. The ability to adapt quickly, with sufficient prudence, will determine the success of the Community Reinvestment Act in helping to address as-yet-unforeseen issues through the remainder of this crisis.

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Endnote

[1] The proposal refers to this as "other real-estate-owned property," or OREO.