



Testimony of

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Community Reinvestment Act

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Good morning, Mr. Chairman and members of the Committee. I am pleased to speak today about the Community Reinvestment Act (CRA). CRA addresses the needs of individual consumers (including home mortgages and depository services), small businesses and small farms, and community development, all to benefit low- and moderate-income people and places. CRA has shown that such financing can be both safe and profitable. Although some have claimed that CRA contributed to subprime lending and foreclosures, the Federal Reserve Board has found that CRA covered only 6% of high-cost (subprime) mortgages.

Since 1980 Local Initiatives Support Corporation (LISC) has worked in numerous partnerships involving banks and thrifts, nonprofit community development corporations (CDCs), and government at all levels to revitalize urban and rural communities. LISC invests roughly \$1 billion each year in these partnerships. Over time we have invested \$9 billion, generating \$28 billion of development activity, including 245,000 affordable homes and 36 million feet of retail and community space. Most of this money has come from the private sector, including 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 through 30 local offices and a national rural development program, so we see low-income communities and how CRA is working up close.

LISC also collaborates with other nonprofit leaders in the field of community development finance. Enterprise Community Partners and the Low Income Investment Fund share LISC's perspective on the challenges facing our field and endorse the recommendations regarding CRA modifications that I propose.

CRA and Community Development

I will focus my remarks on the relationship between CRA and community development activities, which include lending and investment for: multifamily rental housing; retail and other commercial real estate such as grocery stores and business facilities in low- and moderate-income neighborhoods and rural areas; community facilities such as health clinics and child care centers; construction and rehabilitation of owner-occupied homes; and community development financial institutions (CDFIs) that provide financing and technical assistance that banks cannot offer directly.

Motivated by CRA, banks have made billions of dollars of loans and investments that have generated over one million affordable rental homes and millions of feet of economic development and community service facilities. Although community development financing can be difficult to structure, it has proven to be both safe and profitable. Indeed, one of CRA's signature achievements has been to create partnerships among banks, all levels of government, and both nonprofit and for-profit developers. Most federal housing production and other community development policies now depend on these partnerships, which help leverage limited public funds. Bank participation has also brought business discipline, including sound underwriting and ongoing monitoring, to the community development process, greatly increasing the success of public programs. Community development projects often anchor the

stabilization and revitalization of low-income communities, and complement responsible lending to individual consumers and small businesses in the same communities.

Federal Reserve Board Chairman Ben Bernanke recently remarked: “During much of the past century, federal community development efforts were large-scale, top-down affairs. As we have seen in the sphere of international development assistance, centralized, large-scale development efforts--though not without their successes--often imposed a one-size-fits-all approach that failed to take sufficient account of the particular needs and characteristics of local communities. In many cases, the results were disappointing or worse; for example, the so-called urban renewal programs of the 1950s and 1960s had what ultimately proved to be devastating effects on some areas. In response, the policy focus has shifted over time toward using tools that allow more-customized approaches to local needs, such as block grants and housing vouchers. The growth of local CDCs and the passage of the Community Reinvestment Act in 1977, which required most deposit-taking institutions to lend and invest throughout their business areas, exemplified the trend toward a more bottom-up approach to development. . . .

“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.”¹

An Erosion of Efficacy

Unfortunately, however, CRA’s effectiveness in encouraging community development has eroded over the past several years. A number of practitioners liken today’s financing environment to pre-CRA days. The current problems in housing, finance, and economy have accelerated the process, but the trend was well under way for several years as CRA policies have fallen further behind the transformative changes in the banking and financial systems as well as in low- and moderate-income communities.

Since many of these changes are well known, I will summarize them here only briefly. The CRA statute has changed little in 32 years. At that time, banks and thrifts were the predominate lenders; now, other institutions play important (and sometimes the primary) roles. In 1977, local bank deposits were the source of most loans; in the modern era, capital markets fund most lending and investment. In 1977, banks could not open branches beyond a single state, and some states permitted only single branches; today, major banks operate in multiple states, and many newer kinds of banks have a truly nationwide customer base. When CRA was enacted, community development as we now know it was still experimental; today, as discussed earlier, community development is a vital force for economic development, physical renewal, and affordable housing.

CRA still encourages banks to finance community development to some extent, but its effectiveness has dwindled. As a result, communities already hit by foreclosures and

¹ “Community Development Financial Institutions: Challenges and Opportunities”, speech at the Global Financial Literacy Summit, Washington, D.C., June 17, 2009.

unemployment cannot get the capital they need to create jobs, housing and services they need for their own recovery and to contribute to national prosperity. Without active bank participation, community development activities will depend more on governmental financing sources, whose scarcity ensures that fewer people and communities will benefit, and what does get done will lack the same private business discipline.

- Affordable Rental Housing. Low Income Housing Tax Credits are the federal government's principal tool for producing and preserving affordable rental housing, having financed over 2 million affordable rental homes since 1987 with an extremely low foreclosure rate of less than 0.1% annually. Each LIHTC apartment creates 1.5 jobs and generates state, local and federal tax revenue. However, LIHTC investments have dropped from an estimated \$8.4 billion in 2007 to \$5.5 billion in 2008 (source: Ernst & Young) and probably even less this year. The withdrawal from the market by Fannie Mae and Freddie Mac, which cannot use tax credits because they are unprofitable and have no taxes to offset, accounts for much of the decline. Banks, and especially the largest banks, are still investing thanks in part to CRA, but not always at previous levels. LIHTC investment is still adequate in some communities where strong and sophisticated banks seek CRA recognition. But LIHTC investments are hard to find in most places. Rural areas, smaller cities, the Gulf Coast disaster area, and some states are having the greatest difficulty. But even some traditionally CRA-rich states cannot find enough LIHTC capital. For example, California reports that 75% of the housing awarded LIHTCs in 2008 could not find investors, and many projects in Massachusetts cannot find investors. Moreover, investors are rejecting well structured but complex projects that address acute housing needs – for example, those serving the homeless, preserving HUD or USDA assisted properties, and in economically distressed regions and neighborhoods.

Unfortunately, CRA has not been effective in broadening the investor base. Regional and local banks, many of which have not made LIHTC investments before, often want to invest through a national or regional investment pool so they can diversify risks, tap the experience of co-investors, and minimize administrative burdens and technical complexity. However, CRA does little to encourage such investments, because it recognizes only investments near a bank's branch network and, at its federal examiner's discretion, the surrounding region. Each state determines the location of LIHTC properties based on a competitive process and different communities may get projects every year. It is both essential and extremely difficult for a bank to know if an investment decision they make today will result in CRA credit a year or two later when its regulator examines it. As a result, the overall level of affordable housing production, jobs and community revitalization are much lower than they should be.

- Economic development. Practitioners also report a reduction in bank lending for economic development in low- and moderate-income communities. To be sure, banks are losing substantially from commercial real estate, but again, most of these losses have occurred outside the scope of CRA. A principal federal tool for economic development, the New Markets Tax Credit, has so far been able to attract equity investments, but here too, investors are getting more cautious and requiring higher rates of return, and attracting loans for NMTC projects has become very difficult. We are concerned about a possible shortage of NMTC investment capital. Again, CRA could do more to encourage bank participation.

- Community Development Financial Institutions. CDFIs are public purpose lenders, many of them nonprofit organizations. Today, nationwide, there are about 1,000 certified CDFIs with a collective \$25 billion in assets at work to rebuild low-income communities through housing, economic development, and community services. As Fed Chairman Bernanke recently observed: “In many ways, the formation of CDFIs represented an important milestone in the ongoing evolution of policy strategies for community development and revitalization.” CDFIs raise capital, often from banks, and provide financing that conventional lenders find too risky, complex or time consuming to offer alone. However, as Chairman Bernanke observes, “mainstream financial institutions have reduced their support of CDFIs, both by providing less direct funding and by extending less credit in support of projects done in partnership with them.” As a result, many CDFIs are unable to meet their communities’ urgent and growing needs.

Recommendations for Modernization

Congress should modernize CRA to make it more effective, especially for community development activities including affordable housing and economic development. In general, it would be advisable to keep the statute broad rather than prescriptive so that regulators can readily update implementation policies as financial services institutions and communities change. Setting clear goals and allowing institutions broad flexibility to achieve them has been important to CRA’s success in the past.

1. Recognize community development as a formal objective of CRA. As noted, modern community development was still experimental when CRA was enacted. CRA currently undervalues high-impact but low-volume community development loans and investments in a mostly quantitative analysis. In short, community development offers extra credit in a pass-fail CRA exam. Community development should be an integral component of CRA along with lending to consumers, small businesses and small farms, and depository services.
2. Expand the range of institutions that CRA covers. Today’s limited applicability of CRA to insured depositories is archaic, fails to serve communities adequately, and creates an unlevel regulatory playing field among financial institutions. In addition to banks and thrifts themselves, CRA should apply to all activities of bank holding companies and financial services holding companies, as well as lenders that participate in federal credit enhancement programs such as those of the Federal Housing Administration, USDA, Veterans Affairs Department, Small Business Administration, and the Government Sponsored Enterprises. The federal government provides substantial benefits to these institutions. It is appropriate, important and fair for them to share an affirmative obligation to help meet the needs of low- and moderate-income people and communities, consistent with safety and soundness.
3. Reach rural and other underserved areas. A hallmark of the modern financial system is its ability to move capital to places and customers that need it. However, CRA too often fails to encourage capital mobility for the benefit of low- and moderate-income people and communities. As mentioned above, most rural areas, many small to mid-sized cities, and even some states have great difficulty attracting community development financing. A particular dilemma is that many

small, local institutions lack the capacity to address sophisticated community development challenges and CRA does not reward capable, large institutions for community development activities beyond the location of their branch network even if they generally do business nationwide. Credit card banks, internet banks, investment banks, wholesale banks, bank subsidiaries of some financial services holding companies, U.S. satellites of foreign banks, and lenders participating in federal credit enhancement programs are more typically nationwide than local institutions in ways that CRA could not anticipate in 1977. These nationwide institutions should have a CRA responsibility to low- and moderate-income people and communities nationwide, including to rural and other underserved areas. In addition, the statute should recognize (but not require) bank participation with CDFIs even outside of a local bank's geography, as is the case for bank participation with minority- and women-owned banks.

4. Strengthen performance incentives and enforcement tools. The great majority of banks receive a CRA rating of Satisfactory, a rating that does not differentiate among a wide range of performance. In addition, institutions have little incentive to achieve an Outstanding rating. Moreover, the only consequence of a poor rating is that regulators will take that into consideration if the institution seeks to merge with another. While this prospect has some utility, it is too episodic and narrow to make CRA as effective as it should be. Many institutions can effectively ignore CRA entirely because they have no intention to merge. In addition, since it may help a community if a poor CRA performer is acquired by a strong CRA performer, the threat of disapproving such acquisitions is counterproductive. Most recently, the federal government itself has arranged major mergers to protect the financial system, a circumstance in which CRA considerations will understandably recede. Accordingly, we recommend:
 - a. More rating levels for institutions. Currently, the statute authorizes CRA ratings that roughly correspond to school grades of A (Outstanding), B (Satisfactory), D (Needs Improvement) and F (Substantial Noncompliance). At minimum, there should be a "Low Satisfactory" rating similar to a school grade of C in addition to a "High Satisfactory" rating.
 - b. Remediation plans for low performers. Institutions receiving a Low Satisfactory or lower rating should submit a remediation plan for approval by its regulator following public comment, and then follow the plan.
 - c. Incentives for Outstanding performance. One possible approach would be to reduce deposit insurance premiums for banks that receive Outstanding ratings within a revenue neutral system. Participants in federal credit enhancement programs might similarly pay a lower guarantee fee or insurance premium if they receive an Outstanding rating.
 - d. Broader enforcement tools. In addition to considering CRA performance if an institution performs poorly, the same regulatory enforcement authorities available to good performance generally should be available with respect to CRA.

This concludes my testimony, I would be happy to address any questions you may have.