Partners

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Fed Chairman Speaks Out on CRA

Federal Reserve Board Chairman Alan Greenspan addressed participants of a conference sponsored by The National Community Reinvestment Coalition on February 8, 1994 concerning CRA and lending discrimination. His prepared statement is excerpted here.

In dealing with the Community Reinvestment Act, the Home Mortgage Disclosure Act, discrimination in lending and other consumer issues, the National Community Reinvestment Coalition plays a vital role in many of the most pressing concerns facing financial institutions and their communities. Consequently, I particularly appreciate the opportunity to discuss a few of the many issues surrounding the provision of credit to low- and moderate-income people.

I have little doubt there are many in this audience who have profoundly differing views from those of us at the Federal Reserve on the way CRA should be interpreted and implemented. To be sure, I do not think we disagree on the central objective of CRA: to expand profit-making lending to all elements of the community—including those that have been overlooked in the past.

I do believe, however, that we have significant differences in certain of our

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Analysis

New CRA Proposal Raises Many Issues

By Courtney Dufries

The Community Reinvestment Act was passed by Congress and signed by President Jimmy Carter on October 12, 1977. In short, the law says that financial institutions have an affirmative obligation to help meet the convenience and needs of the communities they serve, including low- and moderate-income areas, consistent with safe and sound banking practices.

A proposal recently published for public comment would dramatically change the regulations implementing the law. The public comment period expired March 24, and the regulators are reviewing the comments in the hope that the changes better implement the CRA.

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Innovations From the Secondary Market

NHSA to preapprove nonprofits' home purchase/rehab loans; lenders book presold loans

The secondary market is critical to successful home purchase and home rehabilitation loan programs because financial institutions are reluctant to book long-term fixed rate loans and many lenders lack the staff and expertise to effectively control risks associated with home purchase/rehabilitation loans. In response to these problems, Neighborhood Reinvestment Corporation (NRC) has announced a new program designed to create 10,000 new low- to moderate-income homeowners in 183 communities over the next five years. With this program, participating lenders can fund and immediately sell these loans to Neighborhood Housing Services of America, Inc. (NHSA).

Local nonprofits who are members of NRC's NeighborWorks affordable housing delivery network, typically Neighborhood Housing Services (NHS) organizations, will prescreen and educate potential borrowers, help complete their loan applications, and obtain prior approval from NHSA for their ultimate sale after funding. Participating lenders will receive the preapproved loan applications and can fund and sell the loan on the same day.

NeighborWorks organizations in 20 cities were selected to participate in the first year of the program, including the cities of Chattanooga, TN, New Orleans, LA, and Savannah, GA. The program was recently expanded to include Birmingham, AL, and Shreveport, LA.

New Orleans NHS Board members attending a conference at the New Orleans branch of the Atlanta Reserve Bank. Pictured are Executive Director Lauren Anderson, President Richard Ainsworth (on right), and former Board member Bob Leeds (on left).

As Jonathan Jones, NRC Southern District field service officer, says, "The key is to provide opportunities for stronger partnerships between lending institutions and local programs. By setting goals for increasing home ownership opportunities, we allow local nonprofits and lenders to really focus on the problem."

NRC requires the local nonprofit to agree to regular training and technical assistance programs on topics such as homebuyer development, loan production and underwriting, and media relations. In addition, the NRC provides a one-time $15,000 grant to be used at the nonprofit's discretion for staff development, loan assistance, or other uses that further the program goals.

According to Richard Ainsworth, community affairs officer at Whitney National Bank, New Orleans, "One great feature of the program is that money to rehabilitate homes is provided by NHSA. The NHS then provides construction oversight, and the bank gets a prequalified, presold loan for a rehabilitated property." By eliminating the rehabilitation loan risk, local lenders are more inclined to participate in the program.

In addition to this program, many NeighborWorks organizations can provide homebuyer education programs, prescreen applicants, offer downpayment or other loan assistance programs, offer construction or rehabilitation loan expertise and funding, and serve as a liaison for lenders to low- and moderate-income communities.

NEIGHBORHOOD HOUSING SERVICES (NHS) is the name used by many local nonprofit organizations dedicated to neighborhood revitalization. Locally controlled, they frequently work in only one or two neighborhoods, although some work in larger areas. NHS is often funded with fee income from loan originations, fees from home construction or rehabilitation work, and by grants from financial institutions, insurance companies, governments and others. Most, but not all NHS programs are affiliated with Neighborhood Reinvestment Corporation (NRC) through the NeighborWorks Network. Most NHS programs operate revolving loan funds for revitalization efforts.

NEIGHBORWORKS NETWORK is a registered trademark used to designate nonprofit organizations affiliated with NRC. Many neighborhood-based nonprofits choose to join this network because it provides access to extensive training programs, access to a secondary market for loans they may originate, and some limited funding for special needs or programs. Affiliated organizations must meet minimum standards established by NRC to remain in the network, including, but not limited to, required financial reporting systems and annual audits by NRC field service officers. The NeighborWorks Network is the largest neighborhood-based nonprofit network in the United States. Two other similar networks would include the Local Initiative Support Corporation (LISC) and the Enterprise Foundation.

NEIGHBORHOOD REINVESTMENT CORPORATION (NRC) was chartered by Congress in 1978 as a public, nonprofit, tax-exempt organization that receives direct Congressional appropriations and is charged with promoting local neighborhood-based revitalization efforts. The NRC board of directors is comprised of a member of the Board of Governors of the Federal Reserve System, the chairpersons of the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation, the secretary of Housing and Urban Development, the Comptroller of the Currency, and the Administrator of the National Credit Union Administration. Governor Lawrence B. Lindsey of the Federal Reserve System is chairman of the board of NRC. NRC has 9 regional offices.

NEIGHBORHOOD HOUSING SERVICES OF AMERICA, INC. (NHSA) is a national secondary market established in 1974 to purchase loans made by local NHS organizations. In addition to income generated from service fees and other operations, NHSA receives most of its administrative and capitalization support from NRC. A member of the NeighborWorks Network, NHSA has purchased over $100 million in loans from 102 local revolving loan funds as of September 1993. NHSA typically packages the loans in a mortgage-backed security which is then sold to institutional investors who desire socially-responsible investments.

SIXTH DISTRICT NRC REGIONAL OFFICES

NRC Southern District Office
Thomas Rocky Wade
District Director
404-331-7428
(Georgia, Florida, Alabama, Mississippi, North Carolina, and South Carolina)

NRC Great Lakes District
Gloria Ortega
District Director
513-684-3774
(Tennessee, Kentucky, Ohio, Indiana, and Michigan)

NRC South Central District
Ron Johnston
District Director
512-229-4100
(Louisiana, Arkansas, Oklahoma, and Texas)

NEIGHBORWORKS NETWORK

Birmingham NHS, Inc.
205-939-0470

Clearwater NHS, Inc.
813-442-4155

NHS of Fort Pierce
407-465-2544

Neighborhood Housing and Development Corporation of Greater Gainesville
904-334-3114

Springfield NHS of Jacksonville, Inc.
904-355-1248

Miami-Dade NHS, Inc.
305-836-2162

St. Petersburg NHS, Inc.
813-821-6897

NHS of Tampa, Inc.
813-221-5516

NHS of LaGrange, Inc.
706-883-2055/2058

NHS of Savannah, Inc.
912-238-0647

NHS of Lafayette, Inc.
318-269-1353

New Orleans NHS, Inc.
504-822-3852

NHS of Shreveport, Inc.
318-632-5500/5501

Chattanooga Neighborhood Enterprise, Inc.
615-265-4114

Knoxville Neighborhood Housing and Commercial Services, Inc.
615-637-0825

Greenspan: Utilize Existing Networks

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approaches. These are disagreements mainly of process and effect. By nature community groups may be less inclined to trust market forces than we do. You may view our caution with regard to the CRA reform proposal as hostility, while we see it as prudent decision making. You may tend to see issues appropriately from your vantage point of community development, while we are required to be looking at the same questions in a somewhat broader economic context. What you may view as ultimately critical short term gains, we may often see as counter-productive in the long run to our common goal. I grant we at the Fed may be wrong on some of this, but so may a number of you. The appropriate approach is debate in a democracy, before Congress and in open forum. I hope that my remarks today will contribute to that process.

Let me first dwell on the Community Reinvestment Act. As an economist, I suspect I approach CRA a bit differently than many of you. We economists tend to think that what makes good market sense makes good long term social sense as well. CRA can be good business, and can meet that market test.

CRA has helped financial institutions to discover new markets that may have been underserved before. That has been its great strength.

We at the Federal Reserve have stressed this market aspect of CRA and will continue to do so. Activities developed by banks to meet credit needs in low- and moderate-income neighborhoods should be well-planned and thoughtfully implemented within their overall business plan. Banks should not try to throw money at a problem or "just write the check"—that's not using the market to anyone's advantage. The latter type of activity will not be sustainable over the long haul.

This is surely evident to most of you, but I think it bears repeating, for CRA must meet the test of the market if it is to provide the long-term benefits of revitalization that we all desire. It's worth reminding all of us—community groups, policy makers and even bankers—of this fact from time to time, since it's sometimes tempting to emphasize short term benefits at the expense of long term commitments.

Nowhere have the benefits of sound community development lending practices been more evident to me than on a recent community tour which I took in southeast Washington, D.C. There I witnessed low-income multifamily housing and retail projects which have been financed by a local institution with a professional, experienced community development lending group. This bank has forged productive partnerships with local non-profit and for-profit entrepreneurial developers.

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SOUNDBITES

The Mercedes-Benz Plant, to be built on 966 acres in Vance, Alabama, is expected to generate $7.3 billion in payroll and tax benefits to state and local governments over 20 years according to an economic impact analysis prepared by Troy State University. The plant is expected to employ 1,500 people and will produce 60,000 passenger vehicles a year beginning in January 1997. Construction on the 1.2 million square foot building will begin in the spring of 1994.

Congregations for Affordable Housing in Atlanta has established a housing hotline telephone service in partnership with the Atlanta Journal/Constitution newspaper to inform people of the availability of affordable housing in metro Atlanta. The hotline number is (404) 222-2739.

First American National Bank in Nashville, Tennessee is offering a Disc Checkbook-Plus software program to its small business customers to assist them with their accounting. The program was developed by Disc Inc., Owings Mills, MD, and will help customers reconcile their bank accounts and import the data into a spreadsheet format for further analysis.

First-time homebuyers who purchase a new energy-efficient home in Georgia may be eligible for downpayment and closing cost assistance. The new Georgia Energy Incentive Partnership Program is being offered by Georgia Power Company, Atlanta Gas Light, and Fannie Mae. For more information, call: The Home Builders Association of Georgia (1-800-248-2453), Georgia Power Co. (1-800-524-2421), or Atlanta Gas Light (1-800-564-6040).

Taking Care of Business in Hattiesburg, Mississippi

Nonprofit CDC provides loans to eager entrepreneurs

Southeast Mississippi Community Investment Corporation (SEMCIC), in Hattiesburg recently announced the formation of a new Community Development Center (CDC). The center is designed to create jobs by lending money to help develop new businesses or expand existing businesses. Utilizing government funds and bank financing, the CDC now has over $3.9 million available to lend to qualified applicants in Forrest and Lamar counties. But you better hurry. Within 60 days of the formal announcement on October 1, over 150 loan applications had already been requested.

SEMCIC is a subsidiary of the Area Development Partnership (ADP), an organization that also included the Chamber of Commerce. SEMCIC is responsible for providing technical assistance and administering the established loan program.

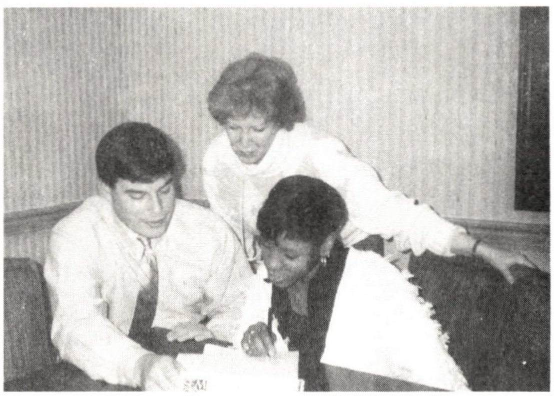
All seven local banks in Hattiesburg have committed $25,000 each to fund the CDC, and each bank's president is a SEMCIC board member. SEMCIC's Director, Ms. Joanna Matheny comments, "I'm really proud of our bankers--they are really coming through with amazing amounts of time and staff support. They are totally dedicated to making this CDC work for the good of the community." Although formal relationships with organizations other than financial institutions are lacking, SEMCIC recognizes the potential to expand and develop affiliations in various areas throughout the community.

In addition to the funding by local banks, SEMCIC was granted $800,000 in Community Development Block Grants from the State of Mississippi and the Forrest County Board of Supervisors. Also, $2.5 million in the state's Minority Revolving Loan Fund (MRL) have been approved for use by the CDC. These funds, administered through the Mississippi Business Finance Corporation, can be used to finance up to 25% of a loan request. The remaining financing will be derived from bank funds (45%), and SEMCIC funds (25%). The state program requires at least 5% equity to qualify for a loan.

The Mississippi Business Finance Corporation has also granted SEMCIC $500,000 from their Small Business Assistance Program. Ms. Matheny reported that, "The funds will be leveraged as much as possible, using MRL money and others as appropriate."

Expectations for the program are high and it has received national attention. SEMCIC was the only bank CDC chosen from a field of approximately 300 non-profit community development organizations to receive one of 10 technical assistance grants from the federal Department of Housing and Urban Development.

Hattiesburg, MS is centrally located between Jackson, Meridian, Mobile, Biloxi-Gulfport, and New Orleans. It extends into both Forrest and Lamar counties, and has been named by *The Rating Guide to Life in America's Small Cities* as one of the top 10 small cities in the South.



ADP President David Rumbarger and SEMCIC Director Joanna Matheny discuss the new program with a potential applicant (seated).

CRA: Sweeping Changes to Regulations

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More Performance Based Criteria

President Clinton requested more objective, performance-based assessment standards that minimize the compliance burden while improving performance. The proposal succeeds in addressing many of these concerns. The proposal also tries to address the industry criticism that existing standards require excessive amounts of paperwork. That burden is reduced for smaller financial institutions, many of which rely on community development lending as their primary source of business. Significantly stronger enforcement powers improve on the existing regulations.

For most retail banks, the proposal would eliminate the current 12 assessment factors and replace them with three tests covering lending, service, and investment activities. The proposed regulations are numbers-driven, looking primarily at loans actually booked, investments and grants actually funded, and the number and location of branches that are easily accessible to low- and moderate-income communities. Additional data collection of approved and denied loans is required of institutions having more than $250 million in assets. Different evaluation standards are proposed for smaller institutions.

No longer would banks document their outreach and marketing efforts. No longer would regulators routinely require documentation of credit needs assessments or of directors' participation in CRA activities. The proposal assumes that financial institutions would do these activities anyway to comply with CRA.

Stronger enforcement powers for poor performance are comparable to the sanctions associated with safety and soundness concerns. In addition, the public can participate in the examination process due to notification at least 30 days before the examination begins. And although the proposal is not intentionally designed to provide a "safe harbor" for banks with favorable ratings, examination frequencies would change based on the ratings. The better the rating the less frequent the examinations, and vice versa.

New Examination Procedures

Four examination options are available for institutions, depending on their size and type. These options include the lending, service, and investment tests for retail institutions; an investment test for special-purpose or wholesale institutions; a streamlined examination for smaller institutions; or a pre-approved strategic plan.

Because of distinct orientations, special-purpose and wholesale banks will be evaluated differently than retail banks. The lending test will serve as the basis for rating retail banks; the rating can be adjusted up or down based on the results of the service test, or up based on the investment test. However, special-purpose or wholesale banks' ratings will be based primarily on the investment test. Any financial institution that fails to pass

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READING FILE

- *Closing the Gap: A Guide to Equal Opportunity Lending*, 27 pps., Federal Reserve Bank of Boston. For copies, call (617) 973-3459
- *Small Steps Toward Big Dreams: Enterprise Development Programs for the Disadvantaged*, Charles Stewart Mott Foundation, 17 pps. For free copies call (313) 766-1766.
- *Banking in a Changing World*, speech by Susan M. Phillips, Governor, Federal Reserve Board, June 1993.
- *Detecting and Eliminating Possible Discrimination in Financial Institutions*, speech by John LaWare, Governor, Federal Reserve Board, March 1993.
- *Tools for Lenders: A Guide to Successful Community Reinvestment*. The Woodstock Institute has prepared this publication to help guide financial institutions as they assess their CRA compliance (1990). The manual is available for $50 for the first copy, $25 for additional copies. For copies, call (312) 427-8070.
- *A Path to Community Development: The Community Reinvestment Act, Lending Discrimination, and The Role of Community Development Banks* is the sixth public policy brief published by The Jerome Levy Economics Institute for Bard College. For copies, call (914) 758-7412.
- *Sound Loans for Communities: An Analysis of the Performance of Community Reinvestment Loans*, The Woodstock Institute. For copies, contact Malcolm Bush or Kathryn Tholin at (312) 427-8070.
- *The 1994 Metropolitan Atlanta Affordable Housing Directory* is available for $15.00. Payment should be mailed to The Atlanta Affordable Home Association, 1731 Commerce Drive, N.W., Suite 109, Atlanta, GA 30318 or call (404) 351-6666.

Copies of materials produced by the Federal Reserve System can be obtained by writing or calling the Community Affairs section at (404) 589-7307.

CRA: Community Involvement Encouraged

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the established discrimination criteria will receive a needs to improve or substantial noncompliance rating.

The other two examination options are the CRA plan or a small bank streamlined examination. A CRA plan can not exceed two years and must have measurable goals against which performance can be evaluated. If an institution fails to meet the "preponderance of the measurable goals", it will be evaluated under the lending, service, and investment tests.

Small banks and thrifts (generally less than $250 million in assets) can choose to undergo a streamlined examination process. Under the small lender's test, the institution is presumed to have a satisfactory rating if it has a reasonable loan to deposit ratio, makes most of its loans locally, has a good loan mix (including a variety of loans and a fair distribution across income levels), has no legitimate, bona-fide complaints from community members, has no discrimination noted, and has a reasonable distribution of loans if required to report under the Home Mortgage Disclosure Act (HMDA).

A reasonable loan to deposit ratio is currently assumed to be 60 percent. As of June 30, 1993, 51.6 percent of the nation's insured commercial banks with assets under $250 million had loan to deposit ratios of less than 60 percent.

Public Comments Sought

Public comment on the regulations was not only invited but strongly encouraged. The proposal asked for comments on 11 specific items or issues. Of course many more issues have been identified since the proposal was published, only a handful of which are discussed here.

"Is the proposal better than the existing regulations?"

Due to the complexity and importance of the issues, the public comment period was extended an additional 30 days. Now begins the arduous task of analyzing the comments and either incorporating changes to the proposal, developing a new proposal, or possibly even modifying the existing regulation if the proposed changes prove unworkable.

Market Share Test

One of the most significant issues identified is utilizing a market share, determined by reporting institutions, to evaluate performance under the lending test. The bank's market share of loans in low- and moderate-income areas is compared with its share in other parts of its service area. Because finance companies, small banks, and other lenders do not report their loans, the market share is only an estimate and could be misleading. As a result, examiner judgement will sometimes be required to adjust the initial ratings.

Larger institutions could choose to aggressively seek market share in low-income communities by underpricing loan products or by engaging in unsound loan underwriting. Below market rate lending is almost always less profitable and frequently unsustainable. Some lenders and advocates worry that this could have the effect of reducing the total amount of funds available from financial institutions to address other community development lending needs. In addition, improperly underwritten loans normally result in higher past due rates and defaults, which is unfair to depositors, stockholders, and (low-income) borrowers.

Increased Data Collection

Another significant issue being widely discussed is the data collection requirements. Lenders with more than $250 million in assets (or subsidiaries of holding companies with more than $250 million in bank or thrift assets) may be required to report data on mortgages, small business loans, and consumer loans. The data would include information on the borrower's/business' location, the number and amount of loans made or purchased, and the number and disposition of applications received. Unlike the Home Mortgage Disclosure Act (HMDA), no data on the race, income, or gender of the applicant would be required.

The reporting requirement excludes data on auto loans, credit cards, and open-end credit. Therefore, if an institution makes home equity lines of credit available in

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Greenspan: Quantification Could Do More Harm Than Good

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The result has been an impressive array of projects which provide housing and retail services to large segments of a previously underserved low- and moderate-income community in Washington. The result for the bank has been two-fold. It has attained a high degree of visibility for these projects and they have realized a profitable portfolio. Yes, some of this was accomplished with the aid of special government programs to fill gaps. But on the whole, the role of government was rather inconsequential.

> ***"We should not entertain false hopes of curing the ambiguity problem."***

As you know, the four regulatory agencies were asked by the President to rethink CRA by placing more emphasis on performance, rather than process and documentation. We are in full accord with this objective. The public comment period ends on March 24, and if you have not already done so, I encourage you to submit comments to the regulators. These public comments weigh heavily in agency decision making.

I would like to make some points which I think need to be considered when the agencies adopt a final rule. First, although it's clear that actual performance, not procedures, should be the major emphasis in CRA, the agencies must not cross the line into credit allocation. By this I mean taking into their own hands the decisions about the best use of credit to meet the needs of localities. Certainly this is done by the Congress from time to time—for example, through the tax code and credit subsidies. But this is not, and should not be, the role of banking supervision. Despite its problems, CRA has had a unique strength in that it has not been a bureaucratic, Washington driven, program that substitutes "inside the beltway" decision making by non-elected officials for the give and take of local community control. Yet it does seem clear that some greater direction from the regulators is needed, and the question is how that guidance should be provided.

This has been one of the most difficult issues that we have tackled in this revision process—trying to maintain some flexibility, yet further quantifying what is required for good performance.

Second, quantifying CRA may be viewed as an improvement in some quarters in that it would add some certainty for bankers on their rating, and better allow community groups to assess performance. It would also make our examiners' lives much easier by removing the need for them to make judgments on "how much is enough." In the public hearings which were held on CRA reform, many bankers requested that we "just tell them what they need to do." Many community groups echoed this theme. And it's easy to understand the desire for a clearer road map. However, complete quantification could do more harm than good by removing incentives for creativity in the implementation of projects. By allowing some judgment to remain, it increases the chances that banks will look more closely at the specific needs of their communities, as they are influenced by local groups, and develop innovative solutions for addressing those needs. A laundry list of allowable activities may preclude certain distinctive projects. It may cause banks to concentrate all their resources on the more common projects which are known to get so-called "CRA credit". It would be most unfortunate if unique and well thought out projects remain unfunded because they aren't on some list that we in Washington have devised.

Third, let me mention a positive aspect of the reexamination of CRA—a more direct recognition that CRA is not just about housing. Initially when CRA was enacted the emphasis was on housing for several reasons. One, the statute was passed as part of the Housing and Community Development Act of 1977. Second, the major community organizations which lobbied successfully for the passage of CRA

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Greenspan: CRA Is Not Just About Housing

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were mainly housing advocacy and development groups. Third, with the existence of HMDA data, housing was the only area for which the public had quantifiable data on an institution's performance. However, the importance of small business financing and development to low- and moderate-income communities and to our economy as a whole, cannot be minimized. I believe the proposed CRA reforms will assure that this important area receives proper consideration.

We have tough work ahead of us. Although there seems to be common agreement that reform of CRA is desirable, there are difficult decisions to be made. Although data-based, the rating system being proposed will still—properly in my view—depend on considerable examiner judgment. We should therefore not entertain false hopes of curing the ambiguity problem that engendered so many of the complaints that prompted the review process. The core question is whether the new complicated evaluation system will better advance the cause of CRA for all concerned.

Closely related to changes in CRA are the various proposals for funding community development financial institutions. Without taking a stance on any specific piece of legislation, as a general principle I think it is very important to utilize existing financial intermediaries and institutions as much as possible. In general, in my view, we should support the capacity building efforts of these existing organizations rather than trying to create a network of new institutions.

Let me turn briefly to a matter of serious concern to us all. That, of course, is the specter of racial discrimination in the mortgage granting process raised by the HMDA data, our own research and enforcement activity, and findings of the other agencies. I know of few issues that need such prompt and decisive action—on behalf of both the regulators and the industry—as do the questions that have arisen about the fairness of the mortgage market.

We simply cannot as a nation tolerate unfair and illegal activity that puts some of our citizens at a disadvantage as they try to participate in the credit markets. We all know that the raw HMDA numbers are not a reliable gauge of whether discrimination is at work or to what degree. But the general story they tell cannot be encouraging to anyone, and is a strong signal that work needs to be done. The cumulative evidence seems clear to me. We have a problem whose magnitude may be unknown, but whose presence is undeniable.

To be sure, much discrimination, perhaps most, in today's society is subconscious, the result of habit and culture. But whether it is deliberate or not, the consequence is the same. Free market capitalistic systems rooted in individual freedom cannot and should not abide such unjust behavior. To the extent that individual contributions to the market place are judged, and rewarded on any basis other than economic values, the system suffers, and the nation's standard of living is impaired. We may never reach perfection in this regard, but we should never cease to persevere.

"... We cannot tolerate unfair and illegal lending activity ..."

But the solution to these problems will depend on a very significant commitment by the industry itself. We have been encouraged by efforts of individual institutions to review loan processing procedures, reexamine credit granting criteria for unintended unfair consequences, institute special training for loan officers, and establish second review programs. All of these efforts deserve aggressive support, and I would urge each and every institution to undertake a self examination.

In closing, let me say that the existence of the National Community Reinvestment Coalition—conceived to largely represent the views of grass roots organizations—is a welcome addition to the Washington scene. In bringing the views of its constituent organizations to the attention of the Federal Reserve and others, it is playing a most crucial role in the formation of our nation's policy on the critical issues of economic development. Despite our differences, I very much appreciate having the opportunity to address you.

Coastal Georgia Addresses Small Business Development Needs

By Hank Helton

In Glynn County, Georgia, local area financial institutions working with an area development authority have created a program that provides existing and potential small businesses with more than just loans.

Announced in August 1993, the Enter-Prize Program is a partnership between seven local financial institutions, the Coastal Area District Development Authority (CADDA), the University of Georgia Small Business Development Center (SBDC) in Brunswick, and the Consumer Counseling Credit Service (CCCS) in Savannah, Georgia.

The program informs potential and existing business owners of business development resources, provides counselling and training, and provides qualified applicants with start-up or expansion loans. To date, 4 loans totalling $101,000 have been made; approximately 40 applications have been submitted.

According to Rod Lueth, President of Frederica Bank and Trust, "The Enter-Prize Program facilitates the process of going from an idea to reality. We have a lot of different resources here for business development. The clients just have to know how to tap into them and that's where we come in."

Under the Enter-Prize Loan Program, the financial institutions receive the applications, analyze the pro-

Pearl Brown opened Karmen's Hot Bar in Brunswick, GA with a loan and assistance from the Enter-Prize Program.

posal, make the credit decision, and ensure proper loan documentation, but provide only half of the loan amount. The remainder of the loan is funded by CADDA, utilizing its revolving loan fund. Initially, CADDA limited its commitment to $100,000 for the program. Any increases in this amount based on demand will have to be approved by the CADDA Board of Directors.

Personal guarantees are required of the borrowers. The banks and CADDA are secured by a first lien on the project assets by sharing collateral on a pro-rata basis.

Loan amounts range from $5,000 to $50,000. The loans can be used to acquire land, buildings, machinery, equipment, and inventory. The funds can also be used for working capital, leasehold improvements, or building renovations. Interest rates are Prime plus 2 percent with repayment terms ranging from 5 to 20 years. The borrower is required to have an equity injection of at least 10 percent.

Borrowers must be able to demonstrate management experience in the type of business they are expanding or starting. The borrower must also agree to accept ongoing assistance with management issues, preparation of financial statements, and other matters pertaining to the day-to-day operations of the business.

Ed Pinckney, Jr., Vice President of Trust Company Bank of Southeast Georgia, said, "The biggest problems we have are getting financially qualified applicants and applicants with adequate business plans. The community was concerned that they could not obtain business loans. We sat down and put a mechanism in place so the applicants could have a process to follow to get these loans."

If a loan application is rejected because of bad or insufficient credit history, the applicant is referred to the CCCS for free budgeting and money management advice. Applicants who need assistance with developing or fine tuning their business plan, completing financial statements, or establishing record-keeping systems are referred to the SBDC.

In addition, the banks are establishing a network of legal, insurance, accounting, and other professionals to assist borrowers. Once the credit problems are resolved, an adequate business plan is

See ENTER-PRIZE, page 11

DID YOU KNOW?

The Revenue Reconciliation Act of 1993 permanently extended the low-income housing tax credit.

ENTER-PRIZE
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established, and any other problems addressed, the borrower then reapplies for the loan.

"This is more of a cooperative effort than a competitive effort. Communication is the key. This program has not only helped break down barriers between the community and the financial institutions, but also barriers within the financial community," Mr. Lueth stated.

The financing component of the program is a partnership between Barnett Bank of Southeast Georgia, Coastal Bank of Georgia, First Bank of Brunswick, First Federal Savings, First Georgia Bank, Trust Company Bank of Southeast Georgia, Frederica Bank and Trust, and the development authority.

CADDA was created in 1976 by the Coastal Area Planning and Development Commission to administer a $5 million Department of Commerce grant. It serves the 8-county coastal Georgia region. The authority, now self-supporting, administers the CADDA Revolving Loan Fund (RLF) which was the first and now the largest rural revolving loan fund in the United States with $8.3 million in outstanding loans. In addition, CADDA is an SBA Certified Development Corporation and is involved in numerous federal and state financing programs.

For more information call, the Coastal Area District Development Authority in Brunswick, Georgia, (912) 261-2500.

CRA ANALYSIS

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wealthy neighborhoods, these loans are not reported. But if the same institution makes home improvement loans available in moderate-income neighborhoods, they are reported. Some advocates complain that only closed-end credit may be offered in low- and moderate-income areas in order to boost the lender's reported market share.

Some lenders have complained that if an institution identifies small dollar consumer loans and car loans as the most significant credit need in a low-income area, the proposed CRA reporting requirement would fail to capture the information or provide the bank with CRA "credit". Of course, a lender could rely on an examiner's subjective decision that an upgrade in the rating is appropriate, but one of the goals of the new regulations is to reduce subjectivity.

High Reporting Costs

The new reporting requirement increases the cost of lending, both to the 3,400 institutions who have to file the loan reports and to the regulators who compile them. Although very difficult to gauge, the business reporting system alone is estimated to cost the industry roughly $21 million a year.

Nobody knows the cost that regulators will incur to generate the business and consumer loan reports. It currently costs about $4 million a year to process HMDA reports. The obvious question: Are the added costs worth it? A lot depends on who has to pay. Will these costs be absorbed by the industry or passed on to the consumers?

Other Issues To Consider

Many would argue that in all fairness, institutions should be able to evaluate their CRA performance on an ongoing basis. However, under the lending test, market share can not be accurately determined until all reporting data has been processed by the agencies, resulting in an after-the-fact review.

Another side-effect results from the calculations required under the investment test. The calculation adds the total investments and grants provided for community development projects, community development corporations, equity funds, etc. and divides that amount by total risk-based capital. Institutions that are poorly capitalized will need fewer investments or grants to fare favorably under the investment test. This may be appropriate. After all, if a bank is on rocky ground, its resources are likely more efficiently and effectively employed through channels other than generous grants.

However, if a bank is well capitalized, which is desirable from a safety and soundness viewpoint, it may be more difficult to pass the investment test. Problems could arise if retail institutions may perceive that the investment test is too difficult to pass, and focus instead only on the lending test. As a result, some low-income housing developments that require high levels of equity to

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Calendar

April

Federal Reserve Bank of Kansas City and the New Mexico Bankers Association, April 5, Clovis, NM, Development Finance Workshop. Contact (816) 881-2890. This workshop will be repeated April 6 in Roswell, NM, April 7 in Hobbs, NM, April 13 in Las Vegas, NM, April 14 in Espanola, MN, April 20 in Gallup, NM, and April 21 in Farmington, NM. Contact (816) 881-2890.

The Institute for Professional and Executive Development, Inc., April 5-6, *Housing Tax Credits 1994 Workshop,* Washington, D.C. Contact 202-331-9230.

National Association of Development Organizations, April 17-19, *NADO's Washington Conference*, Washington, D.C. Contact (202) 624-7806.

National Council For Urban Economic Development, April 17-20, *Annual Conference,* Philadelphia, PA. Contact (202) 223-4735.

The National Coalition for the Homeless and the Minnesota Coalition for the Homeless, April 21-23, *Homelessness Conference,* Minneapolis, MN. Contact (612) 870-7073.

May

American Bankers Association, May 18-20, 1994 *Community Development Lending Conference,* Baltimore, MD. Contact (202) 663-5274.

Information provided on upcoming events of other organizations should be viewed as strictly informational and not as an endorsement of their activities.

maintain low monthly rents, may actually be structured with more debt for CRA purposes and thus drive up the rents. Also, could institutions who believe it is too difficult to pass the investment test reduce their level of charitable donations or investments in CDCs with no consequence?

Many of the terms in the proposed regulation are not defined. What does "good loan mix," "bona-fide complaint," "significantly exceeds," "very few," "vast majority," and "readily accessible" mean? Many people are concerned that hundreds of interpretative issues may arise.

Finally, some people have complained that the proposal does not fully consider loan demand. Some markets have limited loan demand. Low demand results in lower loan to deposit ratios and as a result, a higher percentage of these small institutions would not qualify for a streamlined CRA examination. And suppose an upper-income area experiences a building boom. If a construction lender meets that demand and a nearby low-income area does not experience comparable demand, the lender could fare poorly under the CRA.

From this examiner's viewpoint, regulators will continue to encounter problems implementing this law. Suppose for example, a small retail institution establishes a CRA Plan but fails to meet the preponderance of the measurable goals. Examiners would then attempt to evaluate performance utilizing a streamlined CRA examination. But if the institution fails to qualify for the streamlined examination, the examiner looks to the lending, investment, and service test. The examiner must be proficient in evaluating the bank under three different scenarios. And because small banks are not required to report loan activity (other than HMDA reports), evaluation under the lending test becomes much more challenging. Most people agree that regulators should spend considerable time and money to ensure that well-trained examiners are available to conduct these examinations.

Nobody has said that this proposed regulation is perfect. The fact is, it has many favorable features but also raises many issues and concerns. Is it better than the existing regulations? The jury is still out.

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