Community Development and the CRA

For the first time, the Community Reinvestment Act specifically defines what is and is not community development.

As a result, financial institutions may choose their community development activities differently. And community organizations may need to make changes when presenting opportunities to financial institutions.

At its most basic level, community development is any activity that promotes the welfare of the community, from providing adequate housing and creating good jobs to fixing streets and building parks and libraries. Community development can also be in the form of financing for these activities.

For financial institutions, community development takes the form of loans, investments, and services. Financial institutions participate in community development when they lend to businesses and home buyers, invest in local municipal bonds, give grants to community development organizations, provide broad access to banking services, and offer their financial expertise to the community.

When the regulators were drafting the new CRA regulation, they recognized the wide range of community development activities. However, they wanted financial institutions to focus on serving the banking needs of individuals and areas with low or moderate incomes, small businesses, and small agricultural operations.

As a result, the new regulation sets out a very specific definition of the loans, investments, and services that can be considered “community development” for financial institutions. “Community development” means:

- Affordable housing for low- or moderate-income individuals
- Community services targeted to low- or moderate-income individuals,
- Activities that promote economic development by financing small businesses or small farms, or
- Activities that revitalize or stabilize low- or moderate-income geographies.

To add even more precision, the new regulation also defines “small” farms and businesses, and “low” or “moderate” income for individuals and areas.

Do these situations qualify as community development?

See if you can determine which of these instances qualify as community development by reading the cover article. Answers are on page 8. Be sure to check out the sidebar, “Examples of Community Development,” on page 7 as well.

Situation 1: A developer of single-family affordable housing needs interim financing and buyers of the homes need mortgages.

Situation 2: A developer is rehabilitating middle-income housing in a low- or moderate-income area.

Situation 3: A developer is building a convention center in a low- or moderate-income area.
Examination Process Under the New Community Reinvestment Act

An interview with Assistant Vice President of Consumer Affairs Jacquelyn Brunmeier

Recently, Community Dividend sat down with Jacquelyn Brunmeier, assistant vice president of Consumer Affairs. This area is responsible for examining all state-chartered member banks in the Ninth Federal Reserve District for compliance with consumer laws and regulations and the Community Reinvestment Act (CRA). Ms. Brunmeier, an employee of the supervision and regulation area since 1982 and previously the manager of Consumer Affairs, has been responsible for the Consumer Affairs section since 1994.

CD What are the most important changes from old CRA to new CRA?

JB Emphasis has changed from a process-oriented procedure to one that asks what kinds of loans the bank makes, where, and to whom. A bank’s level of lending drives its CRA rating, with bank services and investments less important. This change has had an impact on the examination process. Our examiners are looking at a bank’s record of lending, providing services, and making investments, not at its record of meeting with community representatives or its marketing efforts.

CD We understand the new definition of geography has created controversy in the field examinations.

JB I wouldn’t call it a controversy. I’d say a lot of conversation has taken place between bankers and our examination staff, which has lead to a better understanding of what we now call the “assessment area.”

Most of the CRA examination deals with lending activity within the bank’s assessment area. Discussions between bankers and examiners focus on the who, what, when, and where, as it relates to the assessment area. Who the bank make loans to, what kind of loans the bank makes, when these loans were made (that is, since the last examination), and where the bank makes loans, inside or outside of its assessment area, and with the assessment area.

Unless the assessment area reflects illegal discrimination or does not consist of whole geographical areas, examiners will not comment on the designation of the assessment area.

Editor’s note: A geographical area is a census tract or block numbering area delineated by the U.S. Bureau of the Census.

CD Bankers expected the new CRA to reduce regulatory burden. Can you talk a little about banker reaction to the burden reduction?

JB We understand that some bankers, especially large banks subject to new reporting requirements, may not agree that it is burden reduction. Nevertheless, we feel that bankers will realize that the burden has declined because the new CRA does not require: (1) preparation and annual review of the CRA statement; (2) director participation; or (3) documentation of ascertainment and marketing efforts. In addition, the focus on lending should eliminate much of the uncertainty that surrounded the old regulations.

Another item to keep in mind is the streamlined examinations for small banks. Under these procedures, CRA focuses on the small bank’s actual lending, not its CRA processes.

Continued on Page 3
CONTINUED FROM PAGE 2

CD Does the new CRA mean that outreach and marketing don’t matter anymore?

JB No, they still matter in two ways. First, to get a high volume of loans, a bank will need to design lending programs and products that meet the needs of its community and then tell the community that these products and programs are available. Those steps are accomplished through outreach and marketing.

Second, examiners will be looking at a bank’s outreach and marketing efforts as necessary as part of the fair lending examination. The examiners will want to know what level of effort the bank is expending to, first, have programs and products that meet the needs of all residents of the bank’s community and, second, to market those programs and products.

CD Have there been any surprises during examinations under the new CRA?

JB Yes, there have been two surprises. First, a few bankers said they were not aware the new regulation passed when we started examinations. Our examiners spent time educating those bankers on the changes to CRA, including concepts such as assessment areas and geographies, large bank versus small bank examinations, data collection, performance over process, and the definition of community development.

Second, some bankers seem reluctant to believe that examiners will not separately evaluate the bank’s assessment area. As you recall, the old CRA required a review of the bank’s delineated community; under the new CRA, it’s almost a nonissue. I think bankers are so used to examiners judging the size and shape of the old delineated community that they are taking a wait-and-see attitude toward the examination process.

Of course, we have not yet begun examining large banks, so there could be more surprises.

CD What do you consider an improvement about the new CRA?

JB We are finding the new CRA to have many improvements but I think one of the most important differences is in the way public evaluations are written. They now focus on banking performance. The reader can get a much better understanding of what the examiners looked at. Also, because the performance context is presented at the beginning of the evaluation, the reader knows that a bank’s performance is judged within that context.

CD Exactly what is “performance context”?

JB A lending institution’s performance is evaluated in the context of the institution as a whole, its community, and its competitors. Our examiners review the institution’s assessment area, discussing local economic conditions and demographics. Also, the examiners discuss the bank, its major business products, the level of competition it faces, and its financial condition, capacity, and ability to lend or invest in its community.

CD Are contacts with community leaders still part of the examination process?

JB Yes. As in the past, we contact community leaders about community banking and lending needs, and the performance of area banks in meeting these needs. As part of the performance context, examiners need to know the credit needs of the community. Also, for the fair lending examination, they need to know what level of effort the bank is expending to have programs and products that meet the needs of all residents of the community.

CD And what do you consider worse about the new CRA?

JB I’m not sure anything is “worse,” but CRA is new and different. Change can be stressful, and this change has required adjustments for both the bankers and the examiners. Fortunately, the banks have been very cooperative, easing the transition. Also, it has taken time for our examiners to learn the new examination techniques, but they are highly trained and have risen to the challenge.

CD Any final comments regarding the CRA examination process?

JB Yes. We encourage community members to participate in this process. Toward the end of each quarter, banking regulators are required to publish a list of the scheduled bank examinations for the next quarter. These lists are made available to encourage community residents to offer information to the bank’s regulator before an examination. We are most interested in information about local credit needs and the effectiveness of CRA programs of the local banks.

Editor’s note: See “Where to get lists of future CRA evaluations” on page 9.

As a final thought, I’d like to remind banks with questions about the examination process to talk to their regulator.
Federal Reserve Governor Addresses Homeownership Issues

Lawrence B. Lindsey, a member of the Board of Governors of the Federal Reserve System, oversees the enforcement of the Community Reinvestment Act. On November 30, 1995, he gave a speech at the annual Virginia Governor’s Conference on Housing in Hampton, Virginia, on the challenges to homeownership.

He noted that “Our problem has not been a lack of money, but a lack of strategies designed to succeed for the long term.” In this speech, Lindsey discussed what we—as a community and a nation—are doing right, what we are doing wrong, and where the future might lie in homeownership and community development. We found his comments on the future to be pertinent to the issues of CRA and community development of this Community Dividend. This portion of his speech is reprinted here.

To order a copy of this speech in its entirety, call this office at (612) 340-2277.

Where Might the Future Lie

A discussion of what’s right and what’s wrong in the area of community development tends to focus our sights on the future. Where does the future lie? Clearly we need to continue to build our strengths—maintaining a low inflation environment, continuing to build strong, mutually beneficial partnerships, and honing the credit underwriting process to ensure that the criteria used are predictive of creditworthiness and not merely hurdles to homeownership opportunities. And just as clearly, we need to work to eliminate those regulatory or legislative hurdles that impede housing and community development opportunities.

But, what should our guiding principles be?

First, let us recognize that there is only one guarantee of sustained success in any endeavor—a mutually beneficial relationship. Programs which are based on charity or coercion may produce one-time shots of resources, but ultimately they will fail. Sustainability requires a continuous commitment by individuals and institutions.

They must view their role as part of an ongoing endeavor. The Community Reinvestment Act is a clear example of both success and failure in this regard. Many policymakers and community groups have viewed CRA as a way of forcing banks to commit funds to favored projects. Often they have succeeded in getting one-time commitments. Once that money is spent, however, there is no foundation built for a lasting commitment.

On the other hand, CRA’s success lies in the fact that many lending institutions have found the loans they have made to low- and moderate-income individuals quite profitable. Clearly the enormous increase in lending to these groups we witnessed during the 1990s would not have occurred on the scale it did had financial institutions not considered it in their long-term interest. These loans established numerous new customer relationships and cleared the way for financial collaboration in the future. The business relationships developed here are going to be permanent, unlike the temporary grants that may be the result of some charitable impulse.

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Second, success in the future is going to involve much more partnering between institutions and groups who have different talents and assets to bring to the table. For example, financial institutions bring both money and financial expertise to the table. Community groups, on the other hand, often have a keen insight into the types of investments which will prove profitable locally and the individuals who will be the best credit risks.

Working together these two groups can produce a mutually beneficial outcome at a much lower cost than either could produce acting alone.

Community group expertise is particularly important in the area of housing. Often community groups can become involved in the full cycle of lending: working with potential homeowners before they begin shopping for a home to get their credit in line and to become familiar with some of the responsibilities of ownership; working with the family as it shops for a home in order to identify real value in the properties they are considering; helping the home buyer be an educated and effective shopper for credit, while at the same time minimizing the risks to the lender; and finally, working with the homeowner after the closing to make sure that they can handle emergencies and that they continue to develop the skills they need to meet their new-found financial commitments.

I think that in the months ahead, with the increased importance and attention paid to the new Community Reinvestment Act regulations, there will be an increasing value placed on partnering with those community groups that can really bring value to the table. The data on defaults which I mentioned earlier suggests that an effective partnership can significantly enhance profitability.¹ Those groups which can offer the kind of personal interaction with borrowers that reduces risk have a real value to offer the lending industry and will find that the services they provide can be rewarded.

Third, I think that the road ahead calls for redefining the role of government. As I mentioned earlier, there are numerous regulations which are needlessly hampering the access of individuals and families to housing generally, and particularly to homeownership. Government at all levels should adopt the Hippocratic oath, “above all, do no harm.”

But, there are many vital tasks which government can undertake to upgrade the quality of our nation’s housing. At the local level, it is the provision of public services—sidewalks, streetlights, police and fire services, and schools, for example—which becomes vital. Effective community control over the level and quality of these local public goods is essential. This may involve new and innovative thinking regarding how to deliver these services most economically—getting “more bang” from each public dollar. Communities which offer school choice, for example, will be raising the inherent value of the property within their jurisdiction as families living there enjoy a higher stream of consumer services than families living elsewhere.

This exemplifies one of the unique aspects of housing as a consumer good—a wide variety of other services, among them the public goods I mentioned earlier, are purchased along with it. Economists say that this stream of benefits, as well as the taxes paid to supply these services, are capitalized into the home value. Thus, a more efficient provision of local public services raises the capitalized value of homes without necessarily raising the cost of acquiring those homes. Our depressed urban areas offer a particularly attractive opportunity to increase local housing values obtained without further strains on the local tax base through such initiatives as school choice. Further, since local government can, and should, be a full partner in community revitalization, the adequate and efficient provision of local public services is essential to sustainable long-term partnerships between homeowners, lenders, community groups, and local government.

In sum, I see a very different model of housing provision emerging in the future. The cornerstone of this model will be greater consumer choice when it comes to local public services, long-term partnering relationships among institutions with very different skill sets to offer, and a recognition that mutual self-interest is the basis for any lasting relationship. Gone are the days when we can afford to use scarce public housing dollars for grand projects that do not provide what local communities need or want. Instead, we must rely on the long-

¹ Governor Lindsey notes earlier in this speech that studies by Freddie Mac and the PMI industry show higher default rates on mortgage loans with low down payments and questionable credit histories. The data show inadequate screening and home buyer education programs in these cases.
Small businesses and small farms. The definition of small businesses and small farms includes businesses and agricultural operations that have gross annual revenues of no more than $1 million. It also includes all businesses that qualify under the Small Business Investment Company and Development Company programs of the Small Business Administration. Many smaller financial institutions find this definition broad enough to include all of their agricultural and business customers.

Income. The regulation specifically defines low and moderate income using the U.S. Census Bureau definitions:

- Low income means an individual income that is less than 50% of the area median income, or a geography's median income that is less than 50% of the area median family income.
- Moderate income means an individual income that is at least 50% and less than 80% of the area median income, or a geography’s median income that is at least 50% and less than 80% of the area median family income.
- “Area median income” is the median income of the metropolitan statistical area (MSA) that the person or geography is located in, or the statewide nonmetropolitan median income if not located in an MSA.

This income definition is carried throughout the community development activities of lending, investing, and providing services.

The income levels of participants in any community development program are important if a financial institution wants the project considered as community development under the new CRA. Some affordable housing programs, for example, target families with incomes up to 100% or 115% of the area median family income. Under the new CRA, only the portion of the program serving low- or moderate-income families is considered community development.

This same principle holds true for community development investments. In the past, general obligation bonds were considered a community development activity by many financial institutions, particularly those in smaller communities where the market for these bonds was thin. Unless these bonds are issued by a community that is primarily low or moderate income, this investment is no longer considered community development for CRA purposes.

Similarly, activities that provide only indirect or short-term benefits to low- or moderate-income areas or individuals are not considered community development. Financing construction of upper-income housing in a low- or moderate-income area may bring temporary jobs to low- or moderate-income individuals or increase the local tax base. However, these benefits are not enough to be considered community development.

Once a project meets the broad definition of community development, there are three other important issues for financial institutions: does the primary purpose of the activity fit the definition; does the project benefit the financial institution's assessment area; and does it meet the "one-test" rule.

Primary purpose

An activity must have community development as its primary purpose, as defined by the new CRA regulation. If, for example, the purpose of an activity is to revitalize a community but only small parts are low- or moderate-income areas, then this activity is not community development. If, however, the activity is restricted to those low- or moderate-income areas, then it would qualify.

Similarly, activities that provide only indirect or short-term benefits to low- or moderate-income areas or individuals are not considered community development. Financing construction of upper-income housing in a low- or moderate-income area may bring temporary jobs to low- or moderate-income individuals or increase the local tax base. However, these benefits are not enough to be considered community development.

Benefit to assessment area

The community development activity must benefit the financial institution's assessment area or benefit a larger regional or statewide area that includes the assessment area. For example, a bank's...
Examples of Community Development

Community Development Lending

Community development loans might include financing for:

- Rehabilitation or construction of housing for low- or moderate-income individuals or families
- Community development activities of state, local, or tribal governments such as building a library in a low- or moderate-income neighborhood
- Redevelopment, such as environmental cleanup of an industrial site in a low- or moderate-income area
- Community development service providers such as a nonprofit provider of counseling for homeownership
- Facilities that support low- or moderate-income areas or individuals such as a daycare center targeted to moderate-income working parents
- Financial intermediaries whose purpose is community development such as community development corporations (CDCs), minority-owned financial institutions, or credit unions whose mission is lending in low- or moderate-income areas

Community Development Services

Community development services must be related to providing a financial service, such as:

- Credit counseling services
- Low-cost checking accounts
- School savings or banking programs
- Technical expertise for organizations or government agencies for community development activities
- Financial planning services for small business owners
- Homeownership counseling for low- or moderate-income individuals or families

Community Development Investments

The new CRA states that any investment, deposit, membership share, or grant considered under CRA must be lawful. Thus, first the financial institution must be certain that the investment is legal under banking laws and regulations and that it has obtained any required regulatory approval. Activities might include investments, membership shares, or grants to provide the services listed under Community Development Lending, specifically:

- Investment in a project eligible for low-income housing tax credits
- Purchase of municipal bonds issued to provide funds for developing an industrial site in a low- or moderate-income area
- Deposits in financial intermediaries whose primary purpose is community development
the importance of multifamily housing to community development.

Implications for community groups

When a financial institution is weighing participation in a project, CRA is generally not the only consideration. Overall fit with the financial institution’s mission, benefit to the community, degree of profitability, and tax issues are some of the issues likely to weigh just as heavily.

But providing a good fit with a financial institution’s CRA program can help persuade the financial institution to participate. Therefore, community organizations should be ready to respond to questions that a participating financial institution may have about the exact type of population or area served. If a mixed-income population is served, the extent of service to low- or moderate-income individuals or low- or moderate-income areas will need to be quantified.

Third, when evaluating a financial institution’s CRA activities, the regulators consider the complexity and innovativeness of community development activities. Activities that require a good deal of effort to complete or activities that evidence a new approach to community development are considered favorably by the regulators. When asking a financial institution to participate in a new or difficult activity, a community organization might find it worthwhile to mention this.

Similarly, regulators will be assessing the degree to which a financial institution’s community development activities are responsive to local needs. Again, if a program is responding to a critical need, this may be a good talking point with the financial institution. If the organization has information on the level of this need, the financial institution would likely find it useful to pass along this information to its regulator at examination time.

One final note. Each community, which includes community organizations and financial institutions, decides the mix of appropriate development activities based on the needs of the community and not on the requirements of CRA.

Projects such as rehabilitation of middle-income housing located in a low- or moderate-income area or construction of a convention center in a low- or moderate-income area likely fall outside of the “community development” definition outlined above. However, they may still enhance the community and may therefore be worthwhile.

Do these situations qualify as community development?

What about the three situations we posed on the front cover? Which ones qualify as community development and why?

**Situation 1:** A developer of single-family affordable housing needs interim financing and buyers of the homes need mortgages.

**Answer:** The interim financing to the developer would qualify as a community development loan, but the mortgage loans to the home buyers would not because they would be reported under the lending test.

**Situation 2:** A developer is rehabilitating middle-income housing in a low- or moderate-income area.

**Answer:** This project does not qualify because the primary purpose does not fit the definition of community development, namely housing for low- or moderate-income individuals or families. The benefit to the area is only short-term construction jobs or indirect through increasing the local tax base.

**Situation 3:** A developer is building a convention center in a low- or moderate-income area.

**Answer:** This project does not qualify because the primary purpose does not fit the definition of community development. Again, the benefits are only short-term and/or indirect.
Resources

Community Reinvestment & Fair Lending Training Manual, in four parts: Legal Overview, Checklists & Worksheets, Model Forms, Resource Guide. Available for $10 for a hard copy and $2 for a diskette from the Community Reinvestment Clearinghouse, NY Law School, 57 Worth St., New York, NY 10013. Phone: (212) 431-2899. The Clearinghouse also offers technical assistance, a resource library, conferences, and regulatory alerts on new community development legislation.

Enabling Entrepreneurship: Microenterprise Development in the US presents findings from the first year of a five-year study of seven leading microenterprise programs. Available for $18 from the Aspen Institute, P.O. Box 222, Queenstown, MD 21658. Phone: (410) 820-5326.

Community Reinvestment Act: Challenges Remain to Successfully Implement CRA is a 111-page report from the U.S. General Accounting Office, Nov. 1995. (Reference number GAO/GGD-96-23.) Available for free from the U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20884. Phone: (202) 512-3000.

Recent Issues of Community Dividend


Where to get lists of future CRA evaluations

Many of the schedules for future CRA evaluations are now posted on the Internet.

Federal Reserve Bank of Minneapolis
On the Internet at http://woodrow.mpls.frb.us/banking/develop/cra-exam.htm

Federal Deposit Insurance Corporation (FDIC)
On the Internet at http://www.fdic.gov

Office of the Comptroller of the Currency (OCC)
On the Internet at http://www.occ.treas.gov

Office of Thrift Supervision (OTS)
Attention: Ms. Ella Allen
1700 G Street NW
Washington, DC 20552

Now Available!

“Lending in Indian Country: Cultural and Legal Issues” Video and Guidebook

This 5-part video series, produced by the Federal Reserve Bank of Minneapolis, is a live seminar recorded on video. The video explores cultural differences, land and title issues, tribal powers, sovereign immunity, tribal courts, collateral, remedies, and other issues of interest to those seeking to do business in Indian Country. The package is available for $135, and payment must accompany the order.

For a brochure and order form, call (toll-free) 1-800-553-9656, ext. 6008.
July 28 - August 2

August 4-9

August 6-8

August 15

August 26-28

September 9-10

September 29 - October 2

September 29 - October 2

October 2

October 2-4

October 8

October 9-11

November 9-12
Expo Features Housing and Development Finance

On June 5, the Federal Reserve Bank of Minneapolis hosted “Closing the Deal: Affordable Housing and Economic Development Finance Expo” in downtown Minneapolis. Over 200 representatives from government agencies, technical assistance providers, community groups, and financial institutions from the Twin Cities area participated in the roundtables, workshops, and information booths. Topics included:

- Urban, suburban, exurban (outer ring) housing
- Small business
- Housing loan program formation
- Commercial property renovation
- Polluted real estate cleanup finance
- CRA and community development investments
- Economic development micro loan program formation
- State of Minnesota housing and economic development finance programs

Seated at an Expo exhibitor table are Kevin Wilson and LaDonna Eggum, housing specialists for the Federal Housing Administration, department of Housing and Urban Development.

- Federal Home Loan Bank housing finance programs
- SBA loan programs

If you would like mailings for similar events in the future, make sure you are on the Community Dividend mailing list by calling us at (612) 340-2277.
Community Dividend covers topics on community reinvestment and neighborhood lending. It reaches financial institutions, community-based organizations, development organizations, and government units throughout the Ninth Federal Reserve District.

We welcome your questions and concerns. Please write or call:
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or
Margaret Tyndall, Manager
(612) 340-5360
Community Affairs, BSD
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Minneapolis, MN 55480-0291

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Changes in the Community Affairs Section

We recently added a new staff member, Thomas Moore, as finance specialist. Thomas comes to us from the Minneapolis Community Development Agency, an independent agency of the City of Minneapolis. He also has extensive experience as a small business lender, for a very large bank and a small, innercity community bank.

Also, you may notice a new name for our Community Affairs manager. Margaret Bloyer recently married and changed her name to Margaret Tyndall, and most of the time, she remembers to answer her phone with her new name.