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Community Investment in the 1990s: Partnership and Progress

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Good morning, and welcome to "Community Investment '89." I'm Bob Parry, President of the Federal Reserve Bank of San Francisco. As one of the co-sponsors of this conference, I'm going to take some liberties with the program. After all, community investment in 1989 is really just a springboard to the challenges we face in the '90s. So, let's use this conference to be forward looking. I'm sure that Jim Cirona, President of the Federal Home Loan Bank of San Francisco, and the other sponsor of this conference, agrees we need to look toward the 1990s.

But in looking forward, we need to know where we are and where we've come from. So, let's begin by remembering what we've learned in the twelve years since the Community Reinvestment Act was passed. Then, we'll take a brief look at how those lessons are shaping CRA regulation and successful CRA programs. Finally, we'll try to envision how economic and demographic trends will shape community investment in the future.

What We've Learned

What we've learned in the twelve years since the CRA was passed can be summed up in three lessons. First, if you ignore your obligations under the CRA, they don't go away. They may even become more onerous. Second, you can't have a successful CRA program without devoting resources to it. And third, successful CRA programs are just that -- programs, programs that represent an ongoing commitment to community investment.

Regarding the first lesson, I think it's safe to say that CRA is going to be around for a long time to come. In fact, community investment has received more attention in the last two or three years than in any other period since the CRA was passed. The number of CRA-related protests has never been higher. And the Fed's decision in February to deny Continental Illinois' application on CRA grounds shocked more than a few observers, judging by the headlines. Even the congressional debate has heated up, with growing emphasis on the financial industry's obligation to serve low-and moderate-income communities.

This brings us to the second lesson, the need to devote real resources to a CRA program. Some argue that all the heat banks and S&Ls are taking today has to do with not devoting resources to community investment in the first place. Whether true or not, what's past is past. I think it's much more enlightening to look at what's happening today.

Although the protests and heated debate may raise our awareness of community investment issues, I don't think the negative headlines are the real news. What's going on behind the scenes is far more important. And what's going on there is encouraging. There is a growing spirit of cooperation and partnership among community groups, regulators, and bank and thrift executives. This could not have occurred without a commitment of resources. Resources to find out about a community's credit needs. Resources to develop and market products that meet those needs. And resources to forge links between bankers and community groups. It is in these partnerships that we'll see real progress toward the goals of the CRA.

The third lesson -- that successful CRA programs require an ongoing, high-level commitment -- hardly requires elaboration. Only with the highest levels of management involved will an institution shape a meaningful program. One-time agreements between community groups and financial executives made in the heat of a CRA protest can establish communication links and heighten an institution's awareness of its CRA obligations. But we've seen too often that specific lending commitments do not address the long-run problem. It is for this reason that the Fed and the other bank and thrift regulators never have asked for written agreements. The regulators do, however, seek to foster better communication between lenders and community groups. And they encourage banks and thrifts to develop and administer CRA-related programs that will meet community needs on an ongoing basis.

The Changing Face of CRA Regulation

In April, the four federal regulatory agencies announced a new joint policy statement regarding banks' and thrifts' obligations under the CRA. That important statement embodies these lessons we have learned in the last twelve years. In a little while, Grif Garwood and Richard Tucker will discuss the particulars of that new statement, so, I don't want to steal their thunder. But I would like to outline for you the way regulatory policy regarding CRA has evolved in recent years.

As you know, the CRA was enacted to ensure that banks and S&Ls make meaningful efforts to meet the credit needs of their entire communities, including the low- and moderate-income areas. The Act assigns an important role to the federal regulatory agencies in this regard. The regulators are called on to assess the community investment performance of each bank or S&L and to take that performance into account when evaluating an institution's application to open a new branch or acquire another institution.

Soon after the CRA was enacted, the federal regulators established specialized CRA examination programs. These programs provide oversight by examiners trained in the areas of consumer protection laws and the CRA. On the surface, it might appear that little has changed over the last twelve years in the way the regulators evaluate CRA performance. The philosophy that guided these examinations in the past continues to guide them today: namely, the bedrock belief that community investment ought to be an integral part of an institution's operational policy and decision-making.

Today, as in the past, CRA examinations consider, first, the extent to which a bank or S&L has made efforts to become aware of the credit needs of the low- and moderate-income neighborhoods in its community. Examiners still look at the institution's marketing efforts and special credit-related programs for informing the community of its services. Other important considerations include: the actual geographic distribution of the institution's loans, its participation in local community development projects and governmentally-guaranteed loan programs, and its record in opening and closing branch offices. Finally, examiners look at the level of involvement of the institution's board of directors in forming and implementing a CRA program.

And today, as in the past, examiners convey their findings to the institution's management upon completion of the examination. Typically, the examiners point out strengths and weaknesses, making suggestions to enhance performance. When serious deficiencies are noted, the institution still receives close supervisory attention until corrections are made.

Finally, today, as in the past, regulators give careful consideration to an institution's community investment performance when it applies to open a new branch or acquire another firm. An integral part of the applications process still is the opportunity for interested individuals and groups to comment on the institution's CRA performance. The regulators take these comments and protests into serious consideration in making their final decision. In many cases, the institution and those protesting its application will reach an agreement among themselves, but the regulators nonetheless may require improvements in other areas before the application is approved.

In many respects, then, the basic framework for evaluating an institution's performance under the CRA has not changed in the last twelve years. What has changed, however, is the focus of that framework. We've all -- regulators, financial institutions, and community groups -- learned some things about community investment over the years. The new joint policy statement takes advantage of the experience we've gained.

Thus, it strongly encourages banks and S&Ls to expand their public CRA statements to include more specific information about the community they serve, the services they offer, and the efforts they are making to market their services. Importantly, the new policy statement also asks financial institutions to include an assessment of their CRA performance. By encouraging financial institutions to provide more detailed information in their CRA statements, the regulators hope to foster better and more timely dialogue between financial executives and members of community groups. The very process of putting together a more detailed and specific CRA statement likely will require financial institutions to become better acquainted with community groups and state and local government leaders. For their part, community organizations are strongly encouraged to communicate regularly with institutions on their CRA performance, not just when an application is pending.

There is another way the new regulatory policy statement improves on the existing framework. It provides more specific guidance on the elements of a successful community investment program. The experience gained by financial institutions and community groups has been especially valuable in this regard. I don't want to list the many ways an institution can meet its obligations under the CRA, but I think it's important to note one way the thrust of the new policy differs from the old. Specifically, experience tells us that successful CRA programs often now involve non-credit-related elements, such as offering low-cost checking accounts, providing technical and/or administrative support to community development efforts, and offering help in obtaining funds from the various federal, state, and local assistance programs.

The new policy also reflects an evolving view of the applications process. In particular, the new policy is very blunt about serious deficiencies in an institution's CRA record. When such deficiencies exist, commitments to improve performance in the future will not be sufficient to get an application approved. The regulators want to see progress first. That's one reason the Fed denied Continental's application to acquire a bank in Arizona recently; the bank's commitment to improve its CRA performance, though important, was not deemed sufficient. This doesn't mean that Continental won't get another chance, just that it has to get its homework done beforehand.

Partnership is the Key

Looked at as a whole, the changes in the way the CRA is implemented can be summed up in a word: partnership. We've learned that partnership works better than protests. We've learned that partnership really can get a decaying neighborhood turned around. And we've learned that partnership even makes good business sense.

But let me clarify what I think partnership is and what it isn't. Partnership is not credit allocation. The CRA does not require -- and specifically avoids -- government-mandated credit allocation. The financial regulators do not specify the types nor the amounts of loans an institution should make in its designated community. A business-oriented bank, for example, need not extend residential mortgage loans to comply with the CRA.

Partnership also is not charity. I think charity is commendable, but it is not required by the CRA. In fact, the Act provides that lending in low- and moderate-income neighborhoods should be consistent with safety and soundness considerations. After all, what good is a bank or S&L to a community if it's not around for the long haul? Besides, community-based lending can be profitable. As an example, Ameritrust Development Bank in Cleveland, which engages almost exclusively in community development lending, has been profitable all three years of operation.

Finally, partnership is not window dressing. Anyone who has been at this business for any time at all will tell you that a successful program takes a network of contacts with community and local government leaders. Such a network takes time to build and maintain.

Having said what it is not, let me say briefly what partnership is, although I think you know already. It means taking the time and devoting the resources to get to know a community's needs. It means calling on members of the community to market services. Sometimes it means rethinking delivery systems to make services more accessible to ethnic minorities. Such as assigning bilingual employees in an area where a foreign tongue is common. And it may at times mean reconsidering the standard tests of creditworthiness. Perfectly good credit risks in lower-income communities frequently are denied credit when the usual standards are applied inflexibly.

Partnership takes many forms. I want to cite some examples. I'll start with my own organization, the San Francisco Fed. Partnership is the watchword of our Community Affairs Program. Since 1981, this program has encouraged community investment in the nine states that make up the Twelfth Federal Reserve District. Under the guidance of Gordon Smith, our Community Affairs Officer, the San Francisco Fed sponsors conferences like this one, serves as a clearinghouse of information on community lending programs, works with community groups to articulate needs, and publishes a quarterly newsletter on community investment issues. Recently, moreover, our Community Affairs people have begun to target key metropolitan areas within the District for the purpose of preparing a "Needs Assessment Report." In these reports, we provide a review of the economic health of the targeted community, a description of its housing stock, the availability of banking, shopping, and other commercial services, and specific recommendations regarding ways banks can assist in meeting the investment needs of the community.

Another example of partnership is the soon-to-be formed California Community Reinvestment Corporation, or CCRC. The CCRC is a joint initiative of the nonprofit San Francisco Development Fund and the Federal Reserve Bank of San Francisco. Together, these two organizations have provided the necessary administrative backing to launch a task force comprising 26 of the State's most prominent banks. These banks will establish the CCRC, becoming its members and putting up the funds to create a $100 million loan pool. The funds will be used to finance affordable housing developments throughout California. Ultimately, through the sale of those loans to investors, that initial endowment will be multiplied many times. The best part of this whole effort, I believe, has been the enthusiasm of all the people involved. It's contagious!

The Future of Community Investment

I could cite other examples of partnership, but I promised you we wouldn't get stuck in the present. Let's press on. In the future, the need for and the challenges to community investment will be even greater than they are today. So, not surprisingly, partnership will play an even more vital role if the goals of the CRA are to be met.

As I look at the economic and demographic trends that are likely to shape the future, I am struck by several things. First, the need for affordable housing in this State and in many other states, as well, is enormous and growing. In fact, it threatens economic growth in our metropolitan areas. For example, a recent report by the newly-formed Bay Area Economic Forum indicated that as many as 450,000 new jobs will be lost in that area by the year 2005 if housing availability and affordability continue to stagnate. And with housing prices rising more than 20 percent a year in the San Diego area, things aren't going to be much better here.

At the same time, we're seeing an influx of immigrants from Central and South America and other Pacific Rim nations. Assuming current trends persist, projections through the year 2010 suggest that California will be a state of minorities. Whites will account for less than 50 percent of the population, Hispanics will make up nearly 30 percent, Asians close to 15 percent, and blacks about 10 percent of the population. Some scholars have even called the influx of immigrants from South of the U.S. border the "rehispanicization of California."

Take the shortage in affordable housing, add the influx of immigrants, many of whom are low-skilled, and therefore low-paid, and you've got a recipe for increasing racial tensions and economic polarization among haves and have-nots. But this isn't the only recipe. We can design policies and programs to ease the strains that population growth inevitably places on the State's education, transportation, and housing infrastructures. In this recipe, the blending of different cultures and ethnic groups will enrich the State immeasurably.

Community investment has an important role to play in ensuring that the second scenario, and not the first, is played out. Community-based lending to improve the existing housing stock and to provide for the construction of new affordable housing is essential. So is community-based small business lending. It can help to revitalize the commercial areas of the State's central cities.

The Challenge

The task is enormous. And some might even say impossible, now that financial deregulation has loosened banks' and thrifts' ties to their local markets. Depositories can now draw funds from anywhere in the country simply by advertising slightly higher rates than the competition. Likewise, through "securitization," they can invest in projects anywhere in the country. As a result, many worry that financial institutions' search for a few extra basis points' return in a highly competitive world market will weaken commitments to community investment.

I don't see things this way. The economic developments that are loosening financial institutions' ties to their communities can, and are, being pressed into service for the benefit of community investment. Take securitization, for example. The highly successful Neighborhood Housing Services of America organization purchases loans originated by the 280 local National Housing Services programs throughout the country. It then pools and sells these loans to financial institutions and other investors. And in time, Local Initiatives Managed Assets Corporation, or LIMAC, may become the basis for a nationwide secondary market in community development loans, in much the same way Fannie Mae has been the backbone of the secondary mortgage market.

These developments lead me to believe that community investment is not going to be an impossible task in the future. Together with continued assistance and cooperation from the regulators, financial institutions and community groups can team up to use financial markets creatively in the service of community investment needs. It's going to be a big task to revitalize our metropolitan areas, but considering the alternatives, it's worth the effort.