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OPPORTUNITIES FOR LEADERS TO SHAPE
THE FUTURE OF COMMUNITY REINVESTMENT

Remarks by

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To

The National Association of Affordable Housing Lenders

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Thank you for inviting me here to discuss the future of the Community Reinvestment Act. My remarks are going to focus not just on the Community Reinvestment Act but on community reinvestment in general. And what better place to have this discussion than among the members of NAAHL, an organization that has demonstrated its commitment to the goals of CRA by providing valuable leadership in affordable housing and community development. In fact, in recognition of your expanded membership and accomplishments, I suggest that you would do well to rename your organization the National Association of Affordable Housing Leaders.

It is to your sense of leadership that I want to appeal today.

Much has happened in the twenty-three years since CRA was enacted. Industry consolidation, new entrants, and technological change have altered the CRA landscape. In 1977, bricks and mortar defined an institution's community. Branches were the means by which banks and thrifts took deposits and provided loans. Regulators expected institutions to ascertain the credit needs of their communities through community outreach efforts and provide appropriate credit products in response to the needs identified. Responsibility for CRA was typically handled by an institution's president or loan officer on a part-time basis.

Today, financial products are delivered using mail, telephones, loan production offices, agent relationships, affinity relationships, and the Internet. Deposits are not necessarily the primary source of funding for loans and are not necessarily gathered locally. The current regulation, promulgated in 1995, is more performance-oriented in its evaluation of an institution's efforts to help meet the credit needs of its community, and recognizes the importance of community development investments and of services to low- and moderate-income areas and individuals. CRA responsibilities are now an acknowledged aspect of business operations throughout a bank

or thrift. And today's CRA Officer plays an integral part in the business development strategies of the most enlightened and successful depository institutions. Community reinvestment has also become a recognized market opportunity for many financial institutions that have no legal obligation under the Act.

And yet, the fundamental basis upon which CRA was enacted has not changed: institutions are chartered to serve communities, however defined, and they have an obligation to help meet the needs of all segments of those communities, particularly the low- and moderate-income segments. The question for us now, particularly as we approach 2002, when the banking agencies have committed to conduct a full review of the CRA regulations, is how best we can continue to serve the purposes of the Act.

I would like to share some of my thoughts on this subject with you and, in return, I ask that you consider these issues and give us your feedback as we move forward with our efforts to take CRA to the next level. Your input into this process as practitioners and as leaders in community reinvestment is extraordinarily important.

The Success of CRA

Planning for the future starts with recognizing the successes of CRA. Homeownership is at an all time-high – 67.2 percent of all American households owned their homes as of the second quarter of this year. Homeownership rates among minorities and young married couples at the end of the first half of this year were 47.6 percent and 60.3 percent, respectively – both up nearly a full percentage point over even the year-ago numbers. These records are certainly attributable in large part to a robust economy. But CRA, which encourages financial institutions to expand access to credit among low- and moderate-income borrowers, has also been critically important.

CRA created the impetus for more financial institutions to become involved in community and neighborhood revitalization efforts, helping to foster the kind of public/private partnerships that have become the norm in community development work. And, as the 1990s ended, many of those who took up the challenge, including some not subject to CRA, have discovered that bringing back communities is profitable business.

Make no mistake about it. The Federal Reserve's July 2000 study on The Performance and Profitability of CRA-Related Lending confirmed that home mortgage lending to lower income borrowers is profitable – and for most lenders responding to the survey, it is as profitable or more profitable than their overall mortgage-based lending. Loss rates for CRA loans are quite low. At the median, the difference between charge-off rates for CRA home mortgage loans and all mortgage loans is zero. And two thirds of the institutions surveyed for the Federal Reserve Study indicated that CRA home mortgage lending has led to additional deposits and profitable business opportunities providing services for new customers. A recent "Reinvestment Alert" issued by the Woodstock Institute confirmed that lower-income people with deposit accounts are more likely to have a major credit card, a first mortgage or a car loan than low-income people who do not have such accounts.

Elements of a Successful Reinvestment Strategy

Planning for the future also requires that we reflect on what we've learned about what makes

community reinvestment a successful business strategy for a financial institution. As we regulators have said from the beginning, community reinvestment is not about making bad loans or engaging in imprudent business activities. It is about reinvesting in your community in a way that promotes a net benefit to you, to your customers and to your community as whole. To accomplish these results, community reinvestment must be done strategically, responsibly and in conjunction with other key players in a community.

What does this mean? Here are what I think are the elements of an effective reinvestment strategy based on the successes we've seen and the standards set by leaders such as yourselves:

FIRST is the importance of understanding the market and accurately assessing business opportunities in new markets. When we observe what is happening in many urban markets, it is apparent that there is a lot of pent up demand and untapped consumer spending power that is now fueling new business. Retailers, at least, are starting to notice. Businesses that are able to recognize the untapped potential in "undervalued" communities have a key competitive advantage.

Take the example of a thrift we regulate in Milwaukee, Wisconsin. In response to reports about the disparity in lending between whites and non-whites in Milwaukee, the thrift began to explore opportunities to better serve the Hispanic market there. After determining that no one was really serving this market and seeing tremendous unmet needs, they opened a storefront branch in the heart of the Hispanic community, hired Spanish-speaking employees, and developed a mortgage loan product to help meet the community's needs. Based on their success, they were then able to work with the Housing Finance Agency to develop a bond program that provided an even better mortgage product for this community. Understanding the demographics and the real economic drivers in a community or neighborhood is critical. With increased competition, it is a business imperative that financial institutions seek new markets and find ways to better assess business opportunities in those markets.

SECOND is the importance of a community reinvestment vision and strategy. This is key. Take the example of a small, community thrift in northeast Georgia. The institution serves individuals across the economic spectrum. Many community residents are hard working, low wage earning families. Like you and me, they need a decent, affordable place to live; they need access to credit for their business, their home repairs, their children's education; they need to find a safe place to put their savings. This segment of the community, however, was not well housed and not well served financially. The thrift set out to help meet their needs by developing an innovative in-house, first-time homebuyer program. Following the success of this program, the institution began participating in the USDA leverage loan program, which provides home purchase or construction funds for low-income families, and started participating in the first-time homebuyer programs offered through the Georgia Department of Community Affairs. Ultimately, by helping to put lower income families into a home, the bank was able to develop long-term relationships. The home-buyer programs brought the institution tremendous new account activity, in part because the borrowers came back for checking accounts and sent their family and friends to the institution for new accounts. According to the institution, a recommendation from a satisfied customer was the best marketing tool they could have.

For this institution it wasn't about whether one first-time homebuyer loan was going to be a hugely profitable venture in the short run. Rather, it was about the long-term opportunity to

develop a stable, loyal and profitable customer base. Ultimately they were more successful than they had hoped. Obviously the institution gets CRA credit for these activities, but that really wasn't their goal. And, that's in part why they were successful. Individuals, such as you, who have been able to get management and the board to take a strategic approach to community reinvestment, are in large part responsible for similar successes.

THIRD is the importance of partnerships. This is something you know and probably hear about all the time. Yet there are still many institutions that don't fully appreciate the importance of building strategic alliances as part of a community reinvestment strategy. Maybe an institution is dealing with a community whose residents are stable, employed, low wealth families, most of whom are renters but who very much want to be homeowners. A partner is the local community organization that provides homeowner education and counseling for prospective borrowers, offers home maintenance courses, and has subsidy money available to assist with down payment and closing cost assistance. Or the community is comprised of recently immigrated families from one or more Latin American countries – many of whom are small business owners. They don't speak English well; they have a fundamental distrust of banks; and are virtually unbanked and not well housed. A financial institution is unlikely to tap into this market without the assistance of an entity with entrée into and understanding of the needs of the community residents. But it is not just partnerships with community-based organizations that are important. It is often the support of major employers, Realtors, the city council or the like that can make or break the success of a community revitalization strategy. Success is predicated on identifying the stakeholders, the right partners and helping to shape a shared strategy.

The **FOURTH** key to successful community reinvestment activity is being a responsible lender. Being responsible means making loans on responsible terms to people who can afford to pay them back, and making certain borrowers both understand the terms of the loan and have the opportunity to get the best terms available given their credit and financial position. But it also means expanding both the market for and affordability of loan products. It means working with customers to make them more bankable, helping families find the loan that is right for them, and investing in their success and yours by supporting organizations that assist you by counseling these individuals on the front and the back end of a loan. The ability of a firm to develop customer equity – that is, to build long-term customer relationships – is one of the keys to long-term success. Approaching lending responsibly helps institutions enhance their value to and the loyalty of the customers they serve.

LAST is the important role of investments and services in an effective community reinvestment strategy. How investments and services continue to be evaluated for CRA purposes is certain to be among the issues the regulators will face when reevaluating the CRA regulations in 2002. I don't know where you will come out on that issue or where we will come out after having evaluated the feedback. What I do know is that, in the context of developing business in new or underserved markets, the value of investments and services can't be overstated.

Investments in entities or programs such as CDFIs, loan funds, and consortia are often an important way to reach individuals and businesses that banks and thrifts find hard to serve directly. Other investments, such as in targeted mortgage-backed securities or low income housing tax credits, have helped both meet a need and create a market.

As many who have succeeded in community reinvestment know, servicing communities with branches and deposit and investment products is often key to profitable lending activity. But

other kinds of service are also important. The institutions whose community reinvestment activities have been most successful create a stake for others in the success of their own efforts by helping to shape their community's vision, by participating on civic task forces, and by helping to build businesses and to market housing. They develop customer relationships by assisting with homeowner education and counseling programs, by creating in-school banking programs, by hosting homebuyer fairs, and by assisting with financial literacy programs. The idea of spending money to make money is not anathema to a financial institution's business – it is a critical component. It is no different in a successful community development operation. Service-related activities really are a bank's advantage in reaching new markets and developing new business.

These critical elements of a successful community reinvestment program – understanding the market, vision and strategy, partnerships, responsibility and focus on investment and service – are not new or novel. I raise them because the key to making CRA and its implementing regulations both effective and supported by financial institutions and communities is that they be consistent with, and encouraging of, the development and implementation of each institution's comprehensive strategy for serving its community. This objective should guide us in our CRA review in 2002.

Key Issues in the CRA Debate

Let's talk for a moment about some of the key issues that are likely to be at the forefront of that review.

When we rewrote the CRA regulations six years ago, we worked hard to get it right. I believe we were successful in making the regulations more performance-oriented. One of the effects of having regulations that set out specific evaluative criteria is that the industry knows objectively what it needs to accomplish to achieve a good CRA rating. This is generally a good thing. It reduces the regulatory burdens associated with compliance and encourages performance.

One of the problems with being so quantitatively objective, however, is that sometimes the numbers, rather than the strategy, drive the decisions. Everyone is chasing after the same business because they know – by the numbers – that it will get them the CRA rating their Boards of Directors want to see. A home mortgage loan to a moderate-income family gets favorable CRA credit. More such loans get more credit. The importance of this link, particularly to the borrower, is not to be minimized. But because of the regulation's emphasis on performance and its quantitative criteria that measure, for example, the number and dollar volume of loans originated or purchased during the exam period, in some markets there is extreme competition for "CRA loans." Competition is so stiff that profit margins are under significant pressure, scaring away smaller community banks. Premium pricing frustrates efforts to broaden market participation. And some institutions feel compelled perhaps to make loans for the sake of getting them on their books – maybe with loan terms that are too flexible, or to borrowers who are only marginally credit-worthy. These trends, if they continue, threaten to play into the hands of those who argue that CRA lending is an unprofitable business. Our goal must be CRA regulations that foster sustainable community reinvestment.

Another issue that will likely be at the forefront of the 2002 CRA discussions is the investment test, and how investments are rated and weighed in the evaluation process. Although the

investment test has recently come under some scrutiny, it strikes me that a statute called the Community Reinvestment Act properly has something to do with addressing needs through investment. The investment test is designed to recognize effective strategies for meeting the credit needs of your community where it is not feasible for you to be the direct credit provider. Nevertheless, I acknowledge industry and community concern about how the investment test is applied in practice to determine how much investment of what kind is appropriate for what rating. This is clearly an area for improvement.

Finally, no discussion about CRA would be complete without mentioning the assessment area definition. The trend toward non-branch delivery systems continues and the reach of these systems transcends the regulation's focus on assessment areas in evaluating CRA performance. As long as the regulation defines the assessment area as the geographic area surrounding branches and deposit-taking ATMs, it fails to recognize the communities that many financial institutions are chartered to serve. If we continue to evaluate institutions that use the mail, telephone, Internet or agents to deliver their products solely on the basis of the activities in a single town, county or metropolitan area where their main office is located, there will be reduced incentives to meet the needs of the low- and moderate-income borrowers in areas where these institutions lend but have no branches.

We need to update our concept of community to reflect today's marketplace so a retail institution's CRA obligation is the same no matter how it chooses to deliver its products. This is by no means a simple problem to solve. There are an impressive variety of business strategies and alternative delivery systems being employed by financial institutions and it may be difficult to craft one assessment area definition to fit them all. Nonetheless, I am confident that we can find solutions to this issue as long as we are guided by the principle that institutions have a statutory obligation under CRA to the low- and moderate-income segments of the communities they are chartered to serve – even if that charter is for nationwide service. Our goal should be to make the regulation flexible enough for all financial institutions to meaningfully meet their CRA obligation within the context of their business strategy and the community they serve.

I believe with CRA that we got it mostly right. Nonetheless, there are aspects of the regulations, as we all know, that do not work particularly well in today's market of internet banks, nationwide lending, alternative delivery and deposit gathering mechanisms. And the regulation clearly has had some unintended consequences. Perhaps there is too much focus on the quantitative aspects of community reinvestment and not enough on the qualitative aspects. These are difficult issues that require thoughtful and candid discussion about what works and what does not work – from the industry's perspective, the regulator's perspective and the communities' perspective.

Current Challenges

As leaders in the area of affordable housing and community development, I appeal to you to weigh in on these issues when the time comes. And as leaders, I appeal to you to take a role in helping to shape an effective industry response to two current affordable housing challenges. I'd like to conclude my remarks by focusing on those challenges. The first is predatory lending. The second is affordable multi-family housing.

Predatory Lending

Combating the problem of predatory lending, particularly in the home mortgage market, requires a three-part strategy: First, active enforcement of laws and regulations; Second, consumer education; and Third, responsible competition. I never cease to be amazed by the fact that in certain low- and moderate-income markets there is active competition among a good cross section of lenders for loans. But in other markets, healthy competition doesn't exist and predatory lenders proliferate. Why? Why does one set of lenders see a gold mine in a market where others see no business opportunity? Competition from responsible conventional and sub-prime lenders in markets being preyed upon by unscrupulous lenders is critical. You need to be that competition, responsibly meeting home improvement and other credit needs as well as providing home purchase loans.

Customer relationships are particularly important in the context of predatory lending. Many of the victims of predatory lenders have banking relationships with a financial institution. And yet these same individuals – often elderly, sometimes financially unsophisticated -- who have had checking accounts and other relationships with financial institutions for years, do not think to come to their banker to ask about loans to fix up their aging homes or deal with medical emergencies.

During recent town meetings, I have asked thrift executives to recognize that the elderly woman who has been bilked by the unscrupulous contractor and creditor, and the blue-collar tradesman who has obtained a payday loan to cover his home heating bill, are often their customers! Why is it that people with existing banking relationships are going to competitor lenders? Often, it's because the competitors are the ones reaching out. Community bankers must also reach out to their customers and their communities, so consumers know that when they have legitimate credit needs, they also have a choice.

Here again, it may be that the emphasis on home purchase lending has obscured the industry's view of opportunities to provide for the credit needs of low- and moderate-income borrowers. But affordable housing is not only about achieving homeownership, it is just as vital to maintain homeownership by making responsible and affordable credit available to those who need to make improvements to their homes or to better manage their lives. Whether it is home improvement loans, loans for medical expenses, debt consolidation loans, or deposit products aimed at building and maintaining wealth and financial stability for aging or other lower-income customers, financial institutions need to look to the full range of customer needs for business opportunities. In this way, we can counter the forces of predatory lenders that threaten to destroy communities.

I support the policy recommendations in the Joint Treasury/HUD report, Curbing Predatory Home Mortgage Lending that address CRA reform, including that:

- The regulators should award banks and thrifts CRA credit for products that “promote” borrowers from the subprime to the prime markets; and
- The regulators should deny banks and thrifts CRA credit for origination or purchase of loans with predatory terms.

Destroying communities through irresponsible credit is not what CRA is about. On an interagency basis, the banking regulators are working to achieve the report's recommendations and to otherwise address the distinctions between favorable and destructive loans to low- and moderate-income borrowers.

Multi-family Affordable Housing

Now let me turn to the problem of affordable multi-family housing. You are probably aware that the stock of affordable multi-family housing in this country is continuing to decline. Some estimates suggest we will lose hundreds of thousands of apartment units over the next five years. We are already losing Section 8 housing stock at a rate of 2500 units per month through market conversions as Section 8 contracts expire. However, most of the affordable multi-family housing stock in this country is not subsidized. It is privately held. And it is this stock that is probably most at risk due to aging and to rising real estate markets.

In very high cost markets, where increasing numbers of residents cannot afford to buy or own a home, the demand for affordable rental housing is escalating. This drives up rents, which leaves low- and moderate-income residents scrambling for places to live. These people are often the backbone of the community: teachers, public safety officials, day care workers and hospital staff.

Last month, the San Francisco Chronicle reported that Bay Area teachers, with average salaries of \$37,000, face home prices of \$400,000 to \$500,000 for a *modest* home. Another article detailed the community concerns over high-end multifamily construction in lieu of affordable multifamily housing projects. These problems are not limited to the Bay Area.

Recently, the American Bankers Association, America's Community Bankers, the Mortgage Bankers Association of America, the National Association of Home Builders and the National Association of Realtors published a joint policy statement aimed at elevating housing as a national priority. The statement emphasized the need to look behind record homeownership rates and recognize the continuing need for affordable housing, particularly among young families.

There are a number of ways depository institutions can participate in multifamily housing initiatives. You can offer products such as:

- New construction financing
- Rehab financing for units in need of updating
- Land acquisition financing, particularly for non profits trying to gain control of scarce land for affordable housing development
 - Bridge financing
 - Permanent or "take-out" financing for bridge loans
 - Letters of credit that can help reduce interest rates, ultimately reducing the cost of permanent financing and making transactions more economically feasible
 - Purchase of tax exempt bonds
 - Purchase of Low Income Housing Tax Credits

As importantly, you can work with others in your community to shape a public/private sector response to the need to preserve existing affordable multi-family housing and to provide new affordable housing stock. Public and private sector cooperation and funding is essential. I urge you as leaders in affordable housing to take up this cause: to determine an appropriate role for banks and thrifts, to educate your boards and your brethren, and to assist in the development of a public/private response to this growing problem.

In conclusion, I appeal to your experience with and commitment to affordable housing and community building to lead the way for financial institutions as CRA matures. I invite you to let me know how we can help in this effort, particularly in terms of providing incentives to lend, invest and provide services to your communities, and to promote a successful community reinvestment strategy. It is time to move far beyond CRA as a group of products to be traded on the open market in time for an examination. We need an emphasis on CRA initiatives that have long-term benefits for both financial institutions and their communities. Many of you are already leading the way.

Thank you for your commitment