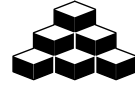


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Web Update 35 Lowering CRA thresholds will cut demand for LIHTC's

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1. Summary

A recent decision by the Office of Thrift Supervision (OTS) to exempt many thrift institutions from the 'community investment' requirement in the Community Reinvestment Act (CRA) will by itself reduce to some degree the demand for Low Income Housing Tax Credits (LIHTC's), New Markets Tax Credits (NMTC's), and other urban-development initiatives.

More broadly, because OTS is only one of four agencies whose jurisdiction touches CRA, this action raises the risk of slippery-slope erosion of the CRA. Because CRA is a proven powerful driver of urban reinvestment generally, for a nation that is not only growing in population but increasingly urbanizing, such a decision should in our view be made not on narrow technical grounds but in the context of what makes sound policy.

2. CRA and affordable housing

Enacted in 1977, the Community Reinvestment Act is by most relevant metrics among the most innovative and successful stimuli of continuing innovation and investment in urban redevelopment and affordable housing. Predicated on the presumption that financial depository institutions (FDI's) that capture capital from a market area should deploy capital back into that same market area, CRA holds financial institutions to two tests:

- *Lending test.* What percentage of the FDI's assets are loaned back into the market area?
- *Investment test.* What percentage are made as *equity investments* in the market area?

Throughout its history, the CRA has served to stimulate not only *bank investment* but also *bank innovation*, particularly in affordable housing. To put out the money, the banks had to learn the business areas. As they did, they increased their knowledge, sophistication, risk tolerance, and ability to handle and manage risk. Knowledge exchanges and partnerships that would have been unthinkable in 1970 have been formed and are now regarded – by both banks and their community-development customers – as valuable intangible assets.

CRA has served as taxpayer-encouraged R&D within these financial institutions, leading them back into the urban fringes and, via the LIHTC and NMTC, into the urban core. It continues to do so today.

In short, CRA is part of a system that works.¹

3. The current CRA regulatory question: How big is 'too small'?

From a regulatory perspective, CRA is interpreted by not one but *four* federal agencies:

- Office of Thrift Supervision (OTS), which regulates thrifts
- Federal Reserve Board (the Fed), which regulates its member banks
- Federal Deposit Insurance Corporation (FDIC), which primarily regulates banks outside the Federal Reserve system
- The Office of the Comptroller of the Currency (OCC), which regulates federally chartered banks

While all these agencies agree that some FDI's are 'too small' to make full CRA application appropriate, they have come to an unprecedented *lack* of consensus on a proposed increase in that threshold, resulting in disjointed unilateral action and deferred decisions.

- *OTS*. On August 18, the OTS published a *final rule* changing its CRA threshold from \$250 million in assets to \$1 billion in assets.² By doing so, the OTS is relieving regulatory burden on a subset of those it regulates (the thrifts) by exempting a significant number of its FDI's.
- *FDIC* has not issued a final rule, but instead issued a revised *proposed rule* seeking more comments on the community development impact.³
- *The Fed* and the *OCC*, both concerned about harm to community development, have declined to raise their minimum-size thresholds and have instead asked Congress to address the issue.

4. Impact on affordable housing of exempting more FDI's from CRA

At issue is not an arcane standard by a huge middle range of institutions. If OTS's threshold (\$1 billion) were adopted by all four agencies, 1,655 institutions with approximately \$757 million in assets would at a stroke be exempted from the community development investment requirement.

The impact on affordable housing will be national, but also worse for specific communities.

1. ***Immediate national impact: reduced demand for tax credits → reduced production of affordable housing.*** The newly-exempted institutions would no longer receive the same benefit for purchasing LIHTC's or NMTC's. Demand for those investments would fall.

¹ The Federal Financial Institutions Examination Council (FFIEC) maintains a CRA resource page with history and analysis at <http://www.ffiec.gov/cra/default.htm>.

² Revised regulations at 12 CFR Part 563e published in the *Federal Register* 8/18/04, [No. 2004-42] RIN 1550-AB48, available at [http://hudclips.org/sub_nonhud/cgi/nph-brs.cgi?d=FR04&s1=2004-42\\$\[NO\]&SECT5=FR04&SECT1=TXTHLB&l=50&u=../cgi/newsdoc_run.cgi&p=1&r=1&f=G](http://hudclips.org/sub_nonhud/cgi/nph-brs.cgi?d=FR04&s1=2004-42$[NO]&SECT5=FR04&SECT1=TXTHLB&l=50&u=../cgi/newsdoc_run.cgi&p=1&r=1&f=G)

³ FDIC press release, 8-16-04, <http://www.fdic.gov/news/news/press/2004/pr8304.html>

CRA-motivated buyers dominate LIHTC demand, with (in our rough estimate) more than 90% of the market. Falling demand will reduce tax credit prices and therefore reduce investment in affordable housing. Currently, the LIHTC is the only major federal program for production of affordable housing, involved in 50-70% or more of all new affordable housing nationwide.⁴ In 2002, the program created 125,265 new affordable apartments using equity provided by tax credit investors.⁵

2. ***Deferred national impact: diminishing innovation/ capacity development in affordable housing and community development.***⁶ Capacity grew in FDI's only over time. Smaller institutions are often best able to reach into marginal or smaller communities to make innovative investments. Raising CRA thresholds takes out of the game the very mid-size players who are, in our view, the main driver of innovation, both as to geography and as to product and investment types. By exempting the innovators, the proposed change will atrophy the R&D essential to the overall financial ecosystem's success.⁷
3. ***Targeted impact: some areas will lack any CRA-required investing institutions.*** Some communities, particularly poorer, rural areas, would find themselves without any institutions required to make CRA investments. Two states – Idaho and Wyoming – will have *no* FDI's above the small institution threshold (see NAAHL's [state-by-state breakdown](#) of affected institutions). The costs of the new regulations in reduced investment for community development would thus be concentrated on those least able to afford the loss.

5. Conclusion: Keep investment-test thresholds low

The CRA has been an ongoing motive for investments in community development. The proposed change, aimed at reducing regulatory burdens, does so at the expense of the most vulnerable communities.

Two agencies are yet to rule, and Congress is likely to revisit CRA soon. There is time to act wisely.

The CRA is an essential part of the affordable housing finance ecosystem. Rising inflation and an expanding economy mean that ceiling should rise from time to time. But the rise should not have the net effect of reducing the overall population of affected institutions.

⁴ Report to the Millennial Housing Commission, *LIHTC Effectiveness and Efficiency*, May 15, 2001, Section 1A *et seq.* <http://www.recapadvisors.com/policy/report1outline.html>.

⁵ Data include allocated 9% credits and 4% credits accompanying volume-cap bond allocations. National Council of State Housing Finance Agencies, *State HFA Factbook*, 2002, p. 59.

⁶ The CRA is unique to the United States – major developed nations such as the UK have no analog. For a detailed US-UK comparison, see http://www.affordablehousinginstitute.org/how/us_uk_ecosystem.html. Such nations suffer from a striking shortage of affordable housing/ community development financial tools and programs, and a diminished capacity both to create complex transactions and to advocate effectively for affordable housing.

⁷ For a discussion of affordable housing ecosystems, see http://www.affordablehousinginstitute.org/how/why_ecosystem.html.

Further reading

- [OTS final rule raising the small institution threshold](#)
- [FDIC revised proposed rule to raise the small institution threshold](#)
- National Association of Affordable Housing Lenders (NAAHL) at www.naahl.org, especially [state-by-state totals](#) of institutions affected by the small institution threshold.