Pedcor Investments, a Limited Liability Company

February 16, 2021

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Community Reinvestment Act Advance Notice of Proposed Rulemaking
Docket No. R-1723 and RIN 7100-AF94
Notice: Reforming the Community Reinvestment Act Regulatory Framework

To Whom It May Concern:

Pedcor Investments, A Limited Liability Company (we or Pedcor) is grateful for the opportunity to comment on the Federal Reserve's (you or Federal Reserve) Advance Notice of Proposed Rulemaking (ANPR) regarding the Community Reinvestment Act (CRA). It has been our experience that CRA strongly encourages banks to participate in the creation of multi-family affordable housing, but we also believe that select changes to the CRA will encourage greater participation and investment in affordable housing for low- to moderate-income individuals.

We agree that it is again an appropriate time to update and modernize the CRA to synchronize the Act with the manner in which banks now deliver modern banking services resulting from changes in technology over the years, and to account for and fairly accommodate modern finance structures and techniques that are most effectively used to finance community development in the multi-family affordable housing arena. As described below, we suggest that any CRA modifications:

(1) either allow banks greater flexibility relating to the geographical limitations of their respective assessment areas or that they be given some level of CRA credit for all community development investments and loans made nationally,

(2) allow banks to treat certain "qualified investments" as "loans" for purposes of CRA, and

(3) retain the "investment test" component of current CRA regulations or at a minimum strongly incentivize CRA investments to assure continuing robust support for community development investments as opposed to loans generally, and in particular in support of investments in low-income housing tax credit financed developments.

Pedcor believes that the changes we are suggesting here are those that will have the most positive impact and yield the greatest benefit to financing for the development and construction of multi-family affordable housing projects for low- to moderate- income individuals and households. We believe that the proposals in the ANPR contain significant missteps and hope that the Federal Reserve will take this opportunity to address certain of these deficiencies before it finalizes changes to the CRA.

I. RELEVANT BACKGROUND

Pedcor has developed multi-family affordable housing for low- to moderate- income individuals for the past 35 years. Over this timespan, Pedcor has financed, developed, constructed and/or managed more than 20,000 units of affordable housing in 20 states, using various financing structures of debt and equity that generally involve the low-income housing tax credits (LIHTC) and tax exempt private activity bonds credit enhanced with letters of credit or HUD sponsored insurance via FHA 221d4 (new construction) or 223f (refinancings) with a GNMA wrap. Pedcor and its affiliates currently are developing and constructing across the nation approximately 1,500 to 2,000 affordable housing units annually which benefit of low- and moderate- income individuals and communities. Pedcor has worked with more than 100 banks and other partners to finance construction of these apartment complexes. These banks routinely participate by (i) purchasing equity interest in the entities that own or will own the projects, and/or (ii) providing debt financing through traditional loans, issuance of letters or credit or purchase of GNMA backed tax exempt bonds for these projects. We estimate that 1 out of every 500 families in the United State have lived in affordable housing that Pedcor or its affiliates have financed, developed, constructed and/or managed over the past 35 years.

In our experience, financing affordable housing takes creativity, and is very complex and challenging when compared to developing similar market rate multi-family housing. An overwhelmingly difficult factor in the development of affordable housing is locating banks to participate in various debt and equity aspects of such financings. Banks are incentivized to participate in affordable multi-family projects as a result of CRA requirements, but their motivation wanes when such developments are outside of their respective assessment areas.

We believe that this is based upon the narrow interpretation of "local community" under the CRA. The current regulatory interpretation of "local community" may have made sense when the CRA was initially enacted in 1977, but it has become somewhat inconsistent with the way modern banking occurs today. In view of the overarching goals of CRA – to facilitate the financing of community development for the benefit of low- to moderate income individuals, we believe that the implementation of these goals must evolve to take notice of the way banks do business in the internet era.

In addition, we believe that the legal framework and structure that you propose to deploy under the ANPR will continue to discourage banks from using the types of financing structures that allow banks to most efficiently deploy capital in the affordable housing arena so that banks

can maximize the good that banks may do for LMI individuals and communities. For example, as we will discuss in the Section III, there is no reason for the CRA to treat certain types of **investments** (that we will describe in the next Section) differently than it treats **loans** in many instances, nor is there any compelling reason to ignore bank letters of credit that credit enhance tax exempt or taxable bonds that finance affordable housing. For large banks, the ANPR suggests a framework that will require 4 distinct tests for banks, including the "retail lending subtest" (that examines the ratio of loans to deposits) and separate and distinct "community development financing subtest" (that examines certain investments). As proposed, there are items for which banks will only receive credit under the community development tests. Banks should have the option of receiving credit under the community development test, or lending tests and loan to deposit ratios.

Banks should be given the option to designate certain investments (as defined under the current version of the CRA and proposed in the ANPR) as "loans" for purposes of the retail lending test. Treating these items differently in this context is arbitrary, and not providing banks with the option creates bad results for the LMI individuals and communities, and for banks.

The retail lending test, similar to other lending tests in the current version of the CRA, will become a limiting factor in our ability to develop affordable housing in LMI communities because it forces banks to manage to a **ratio of loans to deposits** and completely ignores and excludes investments, such as Federally Guaranteed Qualified Investments (as defined below), that provides greater benefits to the LMI communities and are safer and sounder funding than conventional loans. This requirement or oversight is an arbitrary limit that on the margins has the practical effect of impeding the safe and sound deployment of capital to meritorious affordable housing projects. The CRA should be updated to encourage use of this modern financing structure to finance affordable housing instead of discouraging such use. For a detailed example please see Section III.

II. EXPANSION OF ASSESSMENT AREAS

Pedcor believes that the Federal Reserve should expand its concept of local community to make it consistent with modern banking practices and technology. It is our understanding that when the CRA was implemented, assessment areas were based upon the local community surrounding branches. This concept was consistent with the manner in which banks conducted business in 1977, but the current model for conducting business has changed significantly over time and promises to continue to change to encompass larger geographies in the future as technology continues to crowd out brick and mortar bank branches. With the proliferation of technology, many if not most customers of banks conduct the majority of their business via remote technology. Businesses such as many of our apartment complexes, instead of taking rent deposits to bank branches, now deposit rental revenues via remote deposit capture technologies. These improvements allow us to bank more efficiently and to conduct business with banks anywhere in the nation. It is doubtful that many of our properties are within the "assessment areas" of banks or branches with which they conduct business. Similarly, the concept of local

community has expanded with the proliferation of modern technology. As one example, an individual in a geographic location with advances in communication such as the smart phone and personal computers has the ability to reach out via the internet to immediately commune with like-minded individuals across the same city, the state and even the country with little if any effort. These virtual communities know no geographical bounds but are the functional equivalent of a "local community" for involved individuals.

The concept of "local community" and assessment areas for CRA should be similarly expanded. We believe that expanding assessment areas to include all areas where the bank provides services such as deposit-taking or the making of loans or investments, will have a significantly positive effect on community investment for affordable housing. It will allow funds to efficiently and competitively flow to a broader dispersion of geographies, which will create more competition in the finance of community development such as affordable housing for low- to moderate income individuals and communities. In addition, when banks establish financing relationships with regional or national developers of affordable housing like Pedcor, we believe CRA credit should be available for financings of projects outside any delineated geographic area on the theory that following a customer around the country to facilitate financing of LMI housing is support for the bank's local community to the extent that customer is instrumental in addressing LMI needs within any of the bank's CRA delineated assessment area.

As an alternative to the forgoing approach, we believe that banks should be given credit for all CRA loans and investments that they make nationwide, but that CRA should allow for a multiplier for CRA loans and investments within banks' CRA mandated assessment areas.

We acknowledge and understand that there are countervailing arguments such as allowing banks to more broadly direct this funding will allow banks to take the money out of their respective "local communities" and simply pursue the "low-hanging-fruit" nationwide. We believe that this argument is short-sighted. Community development, especially in the affordable housing arena is very complex and more often involves sophisticated finance structures in which many local banks decline to engage because they lack the expertise or have not invested in the intellectual capital to safely and soundly invest in such finance structures. These structures often involve use of LIHTCs, paired with tax-exempt bonds and/or liquidity enhanced by letters of credit, GNMA or other GSE guarantees. Many small community banks are uncomfortable engaging in these sophisticated financing structures that most often benefit LMI communities.

We believe that broadening assessment areas as described above will allow banks with the appropriate expertise and that have invested the intellectual capital in such areas to make loans and invest in projects (and receive credit under CRA) for these projects that otherwise would not be completed in the local communities of other banks.

III (A). FEDERALLY GUARANTEED QUALIFIED INVESTMENTS

Pedcor request that the Federal Reserve allow banks the **option** to designate and include (i) Government National Mortgage Association (GNMA) issued agency certificates[1] that are "qualified investments" ("**GNMA Qualified Investments**"), and (ii) other "qualified investments" that are guaranteed by the full faith and credit of the U.S. federal government as to the timely payment of principal and interest ((i) and (ii) being collectively referred to as "**Federally Guaranteed Qualified Investments**") as **"loans"** for purposes of its "lending tests" and "loan to deposit ratios" instead of requiring banks to designate them as **"investments"** under the CRA and excluding them from such tests and ratios.

The differences between most Federally Guaranteed Qualified Investments and conventional loans made by banks is at-best form over substance from a structural perspective. Allowing banks to treat these structures as "loans" will yield quantifiable benefits to financing affordable housing, but has no quantifiable risks or disadvantages to banks, LMI individuals or communities, or any other stakeholders that we can discern. Changing this requirement is a very simple way for you to deliver substantial benefits to affordable housing and LMI communities.

From a developer's perspective, there is absolutely no difference between the GNMA Qualified Investment structure and that of "conventional" loans they otherwise use to finance the debt component of multi-family affordable apartment projects. Under the GNMA Qualified Investment structure, loans are made available in amounts underwritten by banks to provide the necessary debt financing to borrowers/developers to construct affordable housing projects, which is the ultimate goal of CRA – to make this funding available for the benefit of low- to moderate-income individuals and communities. From the banks' perspective, they are simply making loans with an additional feature (the GNMA certificate – which is simply similar to a credit default derivative from the Federal government) that credit-enhances the transactions in a manner that mitigates the risk-of-loss to banks from a defaulting borrower. Being encouraged (or, at least not being discouraged) by the CRA regulations to employ this GNMA financing structure makes banks more likely on the margin to finance affordable housing projects. Said simply, banks being incentivized to use the GNMA Qualified Investment structure is of great benefit to developers of affordable housing because it encourages banks to engage in and fund projects in a manner that is less risky to the bank, using credit enhancement techniques that involve the full faith and credit of the federal government as to timely payment of principal and interest on the associated loans.

There is otherwise little substantive difference in financing affordable housing through GNMA credit-enhanced structures but treating this credit-enhanced structure differently from loans under CRA regulations limits the use by banks of this structure in excess of certain CRA thresholds/ratios. In other words, if banks fund "too many" multi-family affordable housing projects or do too much good through this safe and sound structure it causes imbalances in the loan-to-deposit ratios prescribed under CRA (and loan-to-deposit ratios that you propose to

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[1] Specifically, GNMA CLC and PLC certificates associated with HUD 221(d)(4) new construction and substantial rehab and 223(f) HUD refinancings.

continue under the ANPR) because GNMA Qualified Investments are not included as "loans" in the loan-to-deposit ratio under CRA. Making the narrowly tailored change to allow banks the option to include Federally Guaranteed Qualified Investments as loans in the CRA regulation and your proposal under the ANPR will encourage more investment in affordable multi-family housing in a much more safe and sound manner when compared to loans made without this credit-enhancement feature.

III (B). ADDITIONAL CONSIDERATIONS OF STRUCTURING TRANSACTIONS WITH FEDERALLY GUARANTEED QUALIFIED INVESTMENTS VERSUS OTHER COMMUNITY INVESTMENTS

In additional to the discussion of structuring loans, the risk-of-loss profile of Federally Guaranteed Qualified Investments, such as the Qualified Investments and other similar financing structures, from a safety and soundness perspective is **multiples better than other "qualified investments" made for similar purposes** ("Other Community Investments"). Many of the Other Community Investments represent equity interests in enterprises, with risk-of-loss profiles that are generally significantly higher than the risk-of-loss profiles for conventional loans. Most Other Community Investments are structured to take equity interests (i.e., returns based upon financial performance of entities and underlying projects). That is not the case with Federally Guaranteed Qualified Investments where the risks-of-loss is based upon **the solvency and creditworthiness of the U.S. federal government**.

As an example, GNMA Qualified Investments are in substance nearly always loans to entities to construct multi-family apartment complexes for low- to moderate income individuals (and in the case of Pedcor, most often low- to very low-income individuals). To credit-enhance such transactions, the loans are structured to produce and accommodate certificated federal guarantees of timely principal and interest repayment. Under the current CRA rules and those that you propose under the ANPR, banks are forced to treat this slight difference in structuring as a "qualified investment" but not allowed to include them as "loans" for purposes of lending tests and loan-to-deposit ratios under the CRA.

On the other hand, in numerous very similar transactional structures you come to exactly the **opposite result** when you permit banks to treat a nearly identical structure as "loans" for purposes of CRA lending tests and ratios. Loans that are made by banks to finance the construction of multi-family apartments and credit-enhanced with federal insurance from the Federal Housing Agency (FHA), but that are otherwise virtually identical in every other way (to loans described in the prior paragraph, except that FHA does not guarantee timely payment of principal and interest), are treated as "loans" for purposes of CRA lending tests and ratios. The structures (other than the name of the federal agency that delivers the credit-enhancement and the quality of the enhancement) are virtually identical from nearly all other practical perspectives. The result of allowing banks to treat one structure as a "loan" for CRA purposes and denying the other structure such treatment is arbitrary and inequitable to banks that choose

to finance through the GNMA structure[2] and are detrimental to LMI individuals and communities. We agree that the other similar structures should be treated as loans for purposes of CRA, but also strongly believe that the GNMA Qualified Investments structure should be treated as loans for purposes of lending test and loan to deposit ratios under the CRA.

This inequity is further magnified when you consider the fact that GNMA guarantees "timely" payment, and FHA insurance does not. The GNMA structure is a more safe and sound structure for banks than the FHA enhancements, yet the CRA and the proposals under the ANPR effectively penalize and discourage banks from using this modern innovative and complex financing structure beyond a certain threshold by withholding essential CRA credit based upon such an arbitrary distinction between finance structures. We find it somewhat ironic that in no less than 43 places in the current CRA regulation, banks are encouraged to engage in innovative, creative and complex finance structures to promote the goals of CRA, and when banks engage in such activities, they are effectively penalized by the CRA and will continue to be penalized if you implement the proposals in the ANPR without modification. We request that these differences be rectified by changing the CRA rules as described in herein.

If banks are forced in some cases to continue to avoid use of these GNMA guarantees (and other Federally Guaranteed Qualified Investments) to finance such projects, to mitigate additional credit risks, banks will either increase interest rates and debt service to borrowers/developers of affordable housing, lower loan sizes, and/or utilize less safe and less sound credit-enhancement techniques, each of which on the margin may make many of these transactions infeasible, un-financeable, or more likely to fail under the additional financial pressures these often inferior financing structures for affordable housing levy upon projects. Depriving projects of the additional safety-net described in the foregoing sentence, (i) increases the probability that projects will fail because more of the net operating income will be used to pay debt-service on the financing, (ii) decreases the probability that such projects will find the additional equity needed due to down-sizing of loans to adjust for the additional risk, and (iii) increases the probability that banks will not fund otherwise meritorious projects due to additional credit risks; all of which are bad results for low- to moderate-income individuals, and community development projects.

III (C). <u>RECOGNITION BY OTHER BANKING STATUES OF THE DIFFERENCES BETWEEN FEDERALLY GUARANTEED QUALIFIED INVESTMENTS AND OTHER COMMUNITY INVESTMENTS</u>

Pedcor does not believe that it is appropriate to treat Federally Guaranteed Qualified Investments and Other Community Investments as one-and-the-same under the CRA statutes

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[2] In addition to FHA guarantees, loans that are enhanced with investment grade guarantees, LOCs from the Federal Home Loan Banks, and numerous other credit-enhancement structures are categorized as loans for other bank regulatory purposes (such as risk based capital considerations), and there is no reason to treat the GNMA credit-enhancement differently under the CRA. The CRA and rules proposed in the ANPR treat the GNMA instrument as a less favored enhancement, while, as we explain later, other bodies of banking law provide favorable dispensation for GNMA and similar enhancement structures.

and regulations for purposes of the lending tests and ratios. It is also important to recognize that other banking statutes and regulations have no limitations (such as the test and ratios in CRA) or restrictions that limit banks from participating in the GNMA Qualified Investment transactions. Please also note that other areas of banking law, specifically loan-to-one-borrower, lending and investment powers, and transactions with affiliates, permit banks to invest in virtually unlimited amounts in structures that are credit-enhanced with Federally Guaranteed Qualified Investments, but significantly limit the amount that banks may invest in Other Community Investments structures. As a practical matter many of these statutes and regulations encourage banks to make loans and invest through Federally Guaranteed Qualified Investment structures. The statutes and regulations treat the two classes of investment distinctively differently. We believe that it is time for CRA to acknowledge the differences and make similar advances in its legal framework.

There is no good reason to treat Federally Guaranteed Qualified Investments like Other Community Investments (that often have risks of loss profiles that are generally higher than those associated with conventional loans) under the CRA, but there are very good reasons to allow banks to treat Federally Guaranteed Qualified Investments like loans under the current CRA statutes and regulations for purposes of the lending tests and ratios required by the current CRA and that which you propose in the ANPR. Federally Guaranteed Qualified Investments are becoming one of the preeminent credit-enhancement technique to facilitate debt financing of multi-family affordable housing and continuing to <u>not</u> allow banks to treat them as "loans" will force banks to use less than optimal (less safe and sound) finance techniques and structures to support and fund affordable housing projects, or cause banks to not participate in the financing of meritorious community development projects that they would otherwise fund if such arbitrary barriers did not exist. This additional incentive and flexibility is a net benefit to the low- to moderate-income community, banking, and society in general.

All-in-all, we understand the differences in the risks and structures between Federally Guaranteed Qualified Investments, Other Community Investments, and conventional loans. Of the three, (i) Federally Guaranteed Qualified Investments have virtually no-risk of loss due to the federal guarantees of timely payment of principal and interest, (ii) conventional loans have a relatively interim level of risk-of-loss, and (iii) most Other Community Investments generally have the highest risk-of-loss profile. We do not believe that it is appropriate to treat Federally Guaranteed Qualified Investments and Other Community Investments as one-and-the-same under the CRA statutes and regulations for purposes of the lending tests and ratios.

We believe that the Federal Reserve should changes it regulations to encourage the use of Federally Guaranteed Qualified Investments. We again request that the Federal Reserve allow banks flexibility and the option to include Federally Guaranteed Qualified Investments as "loans" for purposes of the lending tests.

IV. LETTERS OF CREDIT

Pedcor believes that letters of credit should also be treated as "loans" for purposes of lending test and loan to deposit ratios and should receive the same consideration as loans made for the same activity. Letters of credit are bona fide extensions of credit for which banks are required to hold capital. In the context of financing multifamily affordable housing for low- to moderate-income individuals, letters of credit are often an indispensable aspect of credit enhancing transactions. Letters of credit in this context facilitate risk-sharing amongst entities and/or transference of risks to more credit worthy entities. Again, other parts of banking law treat letters of credit as loans or extensions of credit, and we believe that any perceived negative impact caused by including letters of credit as "loans" pales in comparison to the benefit that will be derived from encouraging banks to issue these instruments in support of housing and other community development for low- to moderate- income individuals.

V. PRESERVING INCENTIVES FOR INVESTMENTS IN TRANSACTIONS

Pedcor is a member of the Affordable Housing Tax Credit Coalition ("AHTCC") which has submitted its own comments on the ANPR. We strongly support the AHTCC's recommendations on preserving incentives for banks to invest in LIHTC projects. There is a real concern in the development community that elimination of the investment test may lead to dislocations in current investor demand for LIHTC investments with the possibility of causing substantial price declines for LIHTC's. LIHTCs are the preeminent finance technique to raise equity for multifamily housing projects. Retaining some form of the investment test or, at a minimum, incentivizing investments in the LIHTC over loans for community development purposes is warranted.

VI. CONCLUSION

We believe that the Federal Reserve desire to update the CRA presents a real opportunity for the Federal Reserve to modernize the regulations in support affordable housing in the United States, which is an ever worsening crisis across the nation. The changes in the CRA should enable community banks that have developed the intellectual capital and expertise, to receive some level of CRA credit for loans and investments that are outside of their respective assessment areas. Assessment areas should be expanded to coincide with modern deposit taking. Incentivizing banks to make investments vs. loans is of paramount importance to developers of affordable housing because it is the primary way of raising equity for these projects. Maintaining a separate investment test crucially important to incentivize to invest in affordable housing projects through this vehicle, and request that you maintain the separate test.

The changes proposed in the ANPR should also facilitate complex, creative and innovative financing structures such as the GNMA Qualified Investments and other Federally Guaranteed Qualified Investments, instead of limiting the ability of banks to provide funding to affordable housing through this safe and sound structure. Changes to the CRA should clearly treat Federally

Guaranteed Qualified Investments very differently than Other Community Investments. Other areas of banking law clearly distinguish between the various types of investment based upon the risk profile of each, and the updating the CRA to be consistent with these other areas of banking law is logical and in order. In addition, we believe that the CRA should clearly designate letters of credit as loans for purposes of its lending tests and loan to deposit ratios. The foregoing items are low-hanging-fruit that will add tremendously to the flexibility of banks to support affordable housing in a safe and sound manner.