Proposal: 1723 (AF94) Reg BB - Community Reinvestment Act

Description:

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From: Merritt Community Capital Corporation, Ari Beliak

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Subject: R-1723 Community Reinvestment Act

Comments:

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SUBJECT: Community Reinvestment Act Regulations
1723 (AF94) Reg BB - Community Reinvestment Act
To Whom It May Concern:
Merritt Community Capital Corporation ("Merritt") welcomes the opportunity to comment on the Federal Reserve Board's Advance Notice of Proposed Rulemaking (ANPR) regarding to revise the agency's Community Reinvestment Act ("CRA") regulations.
Merritt Community Capital Corporation ("Merritt") is a mission-based non-profit that provides equity capital for affordable housing exclusively in California. We raise capital from CRA motivated banks and invest with mission-aligned affordable housing developers throughout California to ensure the most critical communities are developed or maintained for low-income residents; many of the communities we invest in other investors shun because they are considered too complex, "uneconomical" for profit motivated institutions, or too risky. Since 1989, the organization has financed more than 9,000 affordable homes for nearly 30,000 low-income people and invested approximately $950 million in 22 separate funds. Merritt is the west coast member of the National Association of State and Local Equity Funds (NASLEF).
We believe CRA has been and continues to be absolutely essential to the success of the Low Income Housing Tax Credit (LIHTC) program which is by far the most productive federal program for affordable housing development and preservation. CRA investors make up 100% of capital in Merritt funds; our experience has been non-CRA investors are motivated solely by return, which is nearly impossible to achieve with the high-impact projects Merritt invests in. Any changes to CRA that weakens incentives for LIHTC investments will make it more difficult to raise capital for the most difficult to develop higher-

impact, complex projects for the communities of greatest needs, such has people experiencing homelessness, special needs populations, and other smaller projects from community-based organizations.

Working to arrange equity financing for affordable housing, we are aware of issues with the current regulations which sometimes impede our business, cause a misallocation of capital among geographic areas, impose unnecessary burdens on banks, and create confusion about qualification for CRA credit and/or inconsistent application of the rules. While we support modifications to clarify and simplify the regulations, those changes should not obscure the fundamental purpose of CRA which is to make sure that insured depository institutions serve the communities in which they are located. The fundamental objective of CRA reform must be first focused on continuing to expand banks service of LMI communities. Reform must not let the desire for simplicity and to remove burdens from commercial banks outweigh this fundamental objective.

We are concerned that some contemplated changes to the CRA will disrupt the housing credit market, diminish the resources flowing to the program, and make it nearly impossible for organizations, like Merritt, to invest in high-impact projects. The result of such changes will shrink the total number of new homes it creates in a period of unprecedented need.

RESPONSE TO SELECTIVE QUESTIONS

Question 8. Should delineation of new deposit- or lending-based assessment areas apply only to internet banks that do not have physical locations or should it also apply more broadly to other large banks with substantial activity beyond their branch-based assessment areas? Is there a certain threshold of such activity that should trigger additional assessment areas?

While we don't have a specific recommendation with respect to a threshold of activity, we do believe assessment areas based on the location of loan production offices, ATMs, and back-office operations would help expand the reach of CRA into rural and other areas of the country that have fewer bank resources. This will assist demand for investment in LIHTC properties that currently find it more difficult to attract such equity capital.

Question 42. Should the Board combine community development loans and investments under one subtest? Would the proposed approach provide incentives for stronger and more effective community development financing?

Based off discussions with our investors and knowledge of the LIHTC market, we believe combining community development loans and investments under one subtest would have a material detrimental impact on bank incentives to make equity investments. Our belief is based on the fact that debt is easier, cheaper, shorter duration, and has a much greater volume, so banks would favor debt over equity.

Easier Due to Debt Structure & Knowledge Requirements: It is easier not only because banks are in the business of lending but also collateral, loan to value limitations, etc. reduce the sophistication necessary compared to taking equity risk. To incentivize banks to invest the extra resources, the CRA incentive is crucial.

Cheaper Due to Operational and Capital Costs: It is cheaper not only because banks can utilize their existing infrastructure/operations for lending but also due to investments duration and Basel III capital requirements. Long-term equity investments require banks to utilize the cost of long-term funds compared to short-term funds for construction etc. Further, Basel III capital requirements that assign higher capital requirements on a bank's investment in housing -- bank investments in housing credits are assigned a risk weight of 100% that does not diminish over time, as is the case with debt & favor debt over equity investment.

Shorter Duration is Naturally Favored by Banks: Banks naturally favor shorter duration investments/loans not only because of the costs referenced above but also matching assets/liabilities, risk, and liquidity reasons. As you know, LIHTC is a long-term and illiquid investment.

Much Greater Volume of Debt: Community Development naturally has a larger volume of debt due to myriad sources of debt and the acquisition and development cycle are primarily funded by debt.

Because of these factors, we have strongly encourage you to retain a separate investment test.

Question 47. Should the Board use impact scores for qualitative considerations in the Community Development Financing Subtest? What supplementary metrics would help examiners evaluate the impact and responsiveness of community development financing activities?

Yes, we strongly believe that CRA rules should continue to encourage banks to undertake complex and innovative investments that have the most consequential impact on communities in alignment with state and regional economic development plans. The use of multipliers, impact evaluations, and supplementary metrics should only be assigned to the most complex community development transactions.

Community development investments and equity equivalent transactions are not normal banking practice, and banks should be awarded some addition community development test credit (impact points) for making LIHTC and NMTC investments as well as underwriting a CDFI for a possible loan or investment.

Question 54. Should the Board specify certain activities that could be viewed as particularly responsive to affordable housing needs? If so, which activities?

Bank investments in LIHTC properties and investments/loans to CDFIs should be view as particularly responsive to affordable housing needs. Additional credit should be given to investment in more difficult to develop affordable housing that has deeper income targeting (below 40% of AMI), serves residents, including the homeless, in need of supportive services, and otherwise fulfils a critical housing need.

We also believe that CRA incentives can be significantly strengthened if banks are not given full credit for purchasing qualifying mortgage-backed securities, especially those MBS purchases made just prior to their CRA examinations, often which are then sold shortly afterwards to another bank. We believe these practices have little positive impact in the community.

Question 71. Would an illustrative but non-exhaustive list of CRA-eligible activities provide greater clarity on activities that count for CRA purposes? How should such a list be developed and published, and how frequently should it be amended?

The development of a list of CRA-eligible activities would provide appropriate clarity with the caveat that a list that too broadly identifies activities of questionable community development would undermine the rule.

CONCLUSION

Despite generally shared criticisms of the current rules, the Community Reinvestment Act has fundamentally been a major success. CRA has increased the level of bank activity that serves LMI communities and has been absolutely critical to the success of the Low Income Housing Tax Credit program. The future of affordable housing in this country depends on CRA continuing to incentivize LIHTC investment and we urge you to be cautious that potential changes to CRA not undermine the intent of the program.

Thank you for your attention to our comments.

Ari Beliak
President and Chief Executive Officer
Merritt Community Capital Corporation