Community Development Bankers Association
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September 10, 2012

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Dear Ladies and Gentlemen:

On behalf of the members of the Community Development Bankers Association (CDBA), we are writing in response to the Notices for Public Comment published in the Federal Register on June 7, 2012 by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies). These notices of proposed rulemaking (NPRs) would revise and replace the agencies' current capital rules. This letter comments on proposed revisions to: (1) bank risk-based and leverage capital requirements related to the agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III); and (2) risk-based capital requirements for determining risk-weighted assets for lending activities under the Standardized Approach.

CDBA is the national trade association of the community development banking sector and the voice and champion of CDFI banks and thrifts, which have a mission of serving Low and Moderate Income (LMI) communities. CDBA represents Federal and State chartered banks and thrifts and their holding companies that are certified by the U.S. Treasury Department's Community Development Financial Institutions (CDFI) Fund as Community Development Financial Institutions (CDFIs). To be certified as a CDFI, the bank must demonstrate that at least 60% of its total business activities are targeted to LMI communities and people. In total there are 80+ CDFI banks throughout the

United States. CDFI banks share a common mission of improving underserved communities. CDBA members serve our nation's most distressed and credit starved communities and are engines of economic inclusion throughout the United States.

CDFI banks make a difference in the lives of tens of thousands of people in the communities they serve. CDFI banks are often the only source of credit and financial services in these communities. CDFI banks make loans to build and renovate housing so that people have a decent place to live. Our housing lending, in turn, sparks revitalization of other housing in our neighborhoods. CDFI banks make loans to small businesses so that people will have jobs. The businesses our banks lend to, in turn, act as magnets that draw other businesses into the community. Our lending has a ripple effect throughout the community far beyond our direct customers, changing a community's dynamic.

I. The Proposed Rules Will Reduce Access to Credit in LMI Communities

CDBA is very concerned that the proposed rules will have the unintended consequence of significantly reducing credit availability to LMI communities. The proposed regulations will hurt LMI communities by: (1) placing significantly heavier risk weightings on non-standardized loan products that are often important to meeting the needs of LMI customers; and (2) imposing unnecessarily stringent bank risk-based and leverage capital requirements that will require CDFI banks and other small banks to reduce lending to maintain regulatory compliance.

CDBA fully appreciates the intent of regulators to mitigate risk and ensure the soundness of individual banks and the financial system as a whole. Yet, CDBA's members believe that significant refinements are needed to ensure that the proposed rules do not result in an unnecessary reduction in credit and economic activity among people and places that have historically had tenuous access to the mainstream financial services sector. If the effect of this rule is, as we anticipate, to limit the ability of regulated mission-based and community-oriented banks to serve these markets, the predictable result will be that non-regulated predatory providers will fill the gaps. This is not speculation. As the last decade has demonstrated, when mission-oriented financial institutions are unable to effectively serve LMI communities, the consequences are dire not only for LMI families and communities, but for the economy as a whole. And those consequences last for many, many years.

II. How Basel III Negatively Impacts Credit in LMI Communities

The Basel III NPR proposes to significantly revise and increase the regulatory risk-based and leverage capital requirements for all banks. While the proposal asserts that the regulation is designed to be consistent with Dodd-Frank and Basel III, in fact it goes well beyond the intent of those frameworks. The capital rules of Dodd-Frank and Basel III were conceived as a standard to ensure the health of and contain the damage from the failure of the largest internationally active banks. Instead, the proposed rule unnecessarily reaches beyond the largest banks that pose the greatest threats to the financial system and applies the standards to all banks regardless of size.

Extension of the proposed rule's coverage to all banks is inappropriate and unnecessary because of the critical differences in the business activities of the largest banks and community based institutions. Community banks are focused on meeting the Main Street credit needs of local residents and businesses. CDFI banks serve these same needs within the nation's most distressed urban and rural communities. By contrast, the largest banks are complex financial institutions involved in a vast array of activities, including some highly risky transactions that had dire consequences for the entire financial system and economy. A one-size-fits-all regulatory capital standard imposes inappropriate constraints on institutions that did not cause or contribute to the financial crisis, but which are critically important to the functioning of a healthy economy.

The standards will create new systemic barriers to the availability of credit in local communities as: (1) many financial institutions will need to reduce lending to comply with the new standards; and (2) the ability to use equity capital to leverage new lending[1] is permanently curtailed. Increasing minimum regulatory capital requirements and reducing the ability of banks to leverage this capital has a direct impact on access to credit and economic activity. Our national economic recovery and the ability of the recovery to reach all communities is dependent on borrowers being able to obtain credit to expand their businesses, revitalize neighborhoods, stem the corrosive impact of predatory lending and mortgage foreclosure, and provide affordable housing opportunities.

Even in the best of economic times, the market for raising equity capital among all small banks (including CDFI banks) can be challenging due to investment illiquidity and lack of access to publicly traded capital markets. In the wake of the financial crisis, this challenge has become exponentially greater as the pool of potential bank investors shrinks at the same time pressure to raise new capital increases. In addition, the proposed rule's provision mandating the phase out of Trust Preferred Securities that were previously issued by financial institutions creates tremendous additional pressure to replace this capital at a time that the definition of the Tier 1 capital becomes more narrowly defined.

The proposed rule creates new capital ratios, significantly redefines and narrows what can be counted as Tier 1 capital, raises the minimum capital requirements for all banks, and phases in these changes on an aggressive timeline. The

[1] Under current regulatory capital rules, $1 in Tier 1 capital invested in a CDFI bank or community bank could prudently leverage $12 in new lending. Under the new Basel III rules (which are phased in over 2013-2019), it is estimated that a bank will be able to leverage and loan out $9.50 per each $1 in Tier 1capital by 2019.

proposed rules require all banks to maintain a new common equity to risk-weighted assets ratio of at least 4.5 percent. However, raising new common equity presents unique challenges for CDFI banks in identifying and cultivating new investors whose financial and social impact objectives are aligned with the mission of the institution. Raising capital from investors that do not understand or buy into the need to balance these objectives potentially risks diluting or abandoning the commitment to serving LMI communities.

CDFI banks' capital needs are primarily driven by a desire to do more in their LMI communities. The new regulatory capital framework will make providing services and lending in communities more difficult. Currently, the needs of the distressed communities that CDFI banks serve are acute, as these communities felt the brunt of the recession most severely and most have yet to benefit from any economic recovery. Access to credit for residents of LMI communities has been a long-term challenge and will continue to be in the future unless they have committed, mission oriented financial institutions that are dedicated to improving their economic well-being and provide access to fair and responsible credit.

Over the long term, even under current rules, CDFI banks will need additional capital to grow and provide more enhanced services to their communities. Core capital invested in a CDFI bank enables the institution to lend to borrowers that create jobs and economic opportunity in distressed communities. This lending, in turn, results in more affordable housing, successful small businesses that create new jobs and economic vitality, more residents having access to community services, urban and rural communities that are revitalized, and more customers having access to fair and affordable financial services. This task will be hard; the proposed rules threaten to make it impossible. Thus, creating an exemption for CDFI banks from all or a portion of the proposed new capital rules and instead allowing them to operate under the current rules would effectively balance two important Federal priorities – to increase lending on LMI communities while maintaining the soundness of the financial system.

The rule makes other noteworthy changes that further increase the capital challenges for small banks. For example, the rule proposes to exclude from regulatory capital Accumulated Other Comprehensive Income (AOCI) which includes unrealized gains and losses on securities. Unlike large regional or money center banks that hold such securities to trade or hedge investments, small banks hold securities to earn yield. For small banks this amendment would introduce unnecessary volatility to the measurement of regulatory capital through changes in interest rates and credit spreads. Today interest rates are at historic lows. As rates rise, small banks will record unrealized losses – which will negatively impact capital. A second example is capping at 1.25% the amount of Allowance for loan and lease losses (ALLL) that will be included in Tier 2 capital. ALLL is a bank's first line of defense in preserving capital, and thus, should not be limited for the purposes of determining total risk-weighted assets.

<u>Recommendations</u>: The proposed capital standard rules should be amended to recognize the key differences between the largest banks and community banks, including CDFI banks. CDBA recommends: (1) adoption of a tiered system whereby banks that are not designated as a Systemically Important Financial Institution by the Financial Stability Oversight Council be exempt from the Basel III capital guidelines as currently proposed; and (2) an exemption from the proposed regulatory capital rules for U.S. Treasury Department certified CDFI banks. Under the first recommendation, CDBA urges adoption of a tiered system whereby banks that are not designated as a Systemically Important Financial Institution by the Financial Stability Oversight Council be exempt from the proposed Basel III capital guidelines. Instead, an alternative set of standards with more patient timelines, scaled by asset size and relative risk to the financial system, should be crafted for such institutions. Such a standard should grandfather Trust Preferred Securities issued by institutions with less than $15 billion in assets as approved by Congress in the Collins Amendment to the Dodd-Frank Act. Under the second recommendation, CDBA strongly urges exempting CDFI banks from the proposed new capital rules and instead allowing them to operate under the current rules in recognition of the special role they play in serving distressed communities. This unique role was explicitly recognized by Congress with creation of the Riegle Community Development and Regulatory Improvement Act of 1994 and reaffirmed each year through the annual appropriations process.

CDBA further recommends that: (1) AOCI not be excluded from Tier 1 capital as not to introduce unnecessary volatility to the measurement of capital; and (2) not capping the amount of ALLL counted as part of regulatory capital.

III. How the Proposed Standardized Approach Negatively Impacts Credit in LMI Communities

The proposed Standardized Approach poses a significant threat to the availability of credit in the fragile U.S. economy and to the long term viability of chronically distressed urban and rural communities. CDBA fully appreciates the intent of the regulatory agencies to ensure the soundness of the financial system and understands that the proposed Standardized Approach is intended to address abuses in credit practices identified in the wake of financial crisis. However, CDBA believes that, as proposed, the rule will have far reaching and unintended consequences of curtailing credit availability in LMI markets. CDBA members are particularly concerned about how the rule will impact the financing of affordable single-family housing in these markets. CDBA is additionally concerned about whether the rule sufficiently takes into consideration the complexity of funding affordable multifamily development and neighborhood commercial real estate projects in distressed urban and rural communities.

CDBA believes the proposed changes to risk weighted assets could create permanent and systemic barriers to access to credit in LMI households and communities, doing them irreparable harm. As currently drafted, the risk-weightings will create very strong disincentives for regulated financial institutions to offer the type of tailored or flexible credit products that are often necessary to address the credit needs in LMI markets. Further, the proposed rule will most severely penalize lenders that retain a strong commitment to LMI communities, such as CDFI banks, by further encumbering capital over and above challenges created by Basel III and implementation of the Dodd-Frank Act. By definition, CDFI banks serve economically fragile niche markets that cannot easily be served with standard products provided by the traditional financial services industry. The proposed rule removes much of the flexibility needed to respond to the market challenges of communities CDFIs are devoted to serving.

A. Affordable Single Family Housing

The financial crisis provided many examples of bad actors whose credit products and practices were harmful to customers. CDBA notes that these abuses were perpetrated by a small portion of lenders, many outside the traditional banking system, and believe it would be a serious mistake to adopt a set of rules that over-compensates and creates permanent and systemic barriers to home ownership among LMI households. The rule, as proposed, will force all banks engaged in 1-4 single family lending to make difficult choices about how to feasibility continue to serve their customers in a regulatory climate that creates pressure to limit access to credit. CDBA believes the new rules create capital barriers for modest income borrowers by discouraging banks from making any loans with non-traditional features and higher LTVs. The examples below demonstrate how CDFI banks are safely able to support LMI communities by using flexible terms and structures and how the proposed rules would have very negative consequences.

- North Minneapolis is the lowest income neighborhood in the city of Minneapolis and the hardest hit by the foreclosure crisis. Faced with vacancy rates of unprecedented levels, North Minneapolis is devoid of traditional mortgage lenders. ***University Bank*** partnered with the Greater Metropolitan Housing Corporation (GMHC), Dayton's Bluff Neighborhood Housing Services, and the Family Housing Fund to create the Sunrise Homeownership Alliance. The Alliance leveraged bank loan funds of $3.9 million, GMHC's acquisition, redevelopment and financial counseling services and the Family Housing Fund's patient capital to help aspiring homeowners acquire a house in North Minneapolis. The Alliance has financed 38 new homeowners who now occupy previously vacant homes. The performance of these loans has been strong with no losses or delinquencies. To convince a prospective homeowner to purchase a previously vacant house in the hardest hit neighborhood of the foreclosure crisis demands 100% financing. Due to the sheer number of vacant homes in North Minneapolis and the Alliance's limited resources there is a 5 year balloon feature in the financing to the new home owner. This feature is designed to encourage the borrower to obtain a conventional mortgage and allow the Alliance to recycle its limited funds back into the community to address another vacant property. Under the proposed rule, the balloon feature in the financing structure makes this a Category 2 mortgage and escalates the capital requirement from 100% to 200%. The additional capital cost increases the interest rate to the end borrower making the payments unaffordable for the typical prospective homeowner. Under the new rule, this vacant home recovery program will become obsolete despite the critical role it plays in reversing neighborhood decay and catalyzing others to support neighborhood reinvestment.

- Over 2009-2012, ***Pan American Bank*** provided $3.3 million through multiple loans to a local developer for financing the acquisition, construction or renovation of 29 properties consisting of 1-to-4-flat properties on the South Side of Chicago. Collectively, these properties provide 43 units of affordable rental housing for LMI families. In each property, over 80% of the residents are HUD Section 8 tenants. The loans have either three (3) or five (5) year balloon payments and are all below 80% LTV. This borrower has never been late on a payment on any of these loans. Currently, these loans receive a risk weighting of 50%. However, under the proposed risk weightings, these loans will be considered Category 2 and receive a risk weight of 100%. The proposed changes will significantly limit Pan American's ability to make these types of loans in the future because more than twice the amount of capital will be needed to support the same loans.

- ***BankPlus*** created a Homeownership Stabilization Program in 2009 to preserve home ownership among Mississippi households that are behind on their mortgage payments. Coupled with financial literacy training, the loan modification product converts an existing mortgage and past due payments to a 5 year balloon loan on a 40 year amortization schedule at a fixed 5.55% interest rate. Nearly half (47%) of the borrowers meet HUD's LMI standard and receive a reduced interest rate and all fees are waived. In total, 100 families have gotten a fresh start. The performance of this portfolio has been solid with only 4 of the 100 loans going to foreclosure post workout. Under the proposed rule, the future feasibility of such foreclosure mitigation programs is in question. In the BankPlus example, all loans would be classified as Category 2 with a 100% risk weighting and many would be risk weighted at 200%. The amount of new capital needed to support the higher risk weightings would make it prohibitive for banks engage in this type of activity. These costs cannot be realistically passed on to borrowers that are in tight financial circumstances. Without this program all or most of these families would have lost their homes.

<u>Helping LMI Borrowers Access Credit</u>: CDFI banks provide access to credit and affordable housing to people often overlooked by traditional financial service providers.

- Monita had a full time job working as an office assistant in a local doctor's office. Still living at home with her parents, she wanted to own her own home. In Phillips County (the poorest county in Arkansas), she was able to find a modest home that fit her budget. Yet, no traditional lender wanted to work with Monita because she wasn't interested in taking on more than a $24,000 loan due her modest income. Monita approached ***Southern Bancorp Bank***. To ensure the monthly payments were affordably priced, Southern structured the loan as a balloon amortizing over 20 years. Under the proposed rule, despite Monita's equity contribution and solid credit, this loan would be classified as a Category 2 and risk rated at 100% (versus 50% under the current rule) due to the balloon structure. By doubling the capital requirements, the proposed rule will limit the amount of single mortgage lending banks like Southern can do. Alternatively, lenders could raise the pricing on loans. But, significantly increasing pricing will push modest income borrowers like Monita out of the market. Southern currently has a portfolio of $92 million of similar 1-4 residential loans. Asset quality in this portfolio is strong with only 0.26% charge-offs over the past 4 years.

- ***First American International Bank*** (FAIB) is dedicated to serving the Asian immigrant community of New York City. In response to tightening of underwriting standards by traditional lenders, many immigrant families have been unable to qualify to purchase a home. For example, Fannie Mae lenders do not allow extended family income or alternatives to tax returns and W2s for income documentation. Immigrant LMI families have been negatively impacted – particularly Chinese Americans where three generations of the same family, even adult siblings, customarily live in the same household and family members pool their incomes. To meet the cultural and financial characteristics of its customers, FAIB created the Flexible Mortgage product to allow verification of income by employers and inclusion of extended family income in calculating debt-to-income ratios. Over its first 10 months, the affordable Flexible Mortgage product has enabled 110 LMI immigrant families to obtain loans totaling $35 million. The performance on this portfolio of loans is strong with no charge offs and a 1% delinquency rate. Demand for the product is strong; FAIB has a pipeline of 60+ loans totaling $20 million. Under the proposed rule, these loans are likely to be classified as Category 2 loans because they feature non-traditional underwriting parameters for income verification and may include nontraditional loan structures. The proposed rule doubles the loan risk weighting from the current 50% to 100%; thus making it more challenging to continue to respond to demand from LMI communities.

<u>Meeting Credit Needs in Underserved Rural Markets</u>: Two CDFI banks serving the predominantly rural and chronically distressed Mississippi Delta provide examples of flexible mortgage products tailored to the needs of their communities.

- ***Guaranty Bank & Trust*** created an innovative single family loan product to help home buyers, such as recent medical school graduates, that otherwise could not qualify for a loan. All of the 56 census tracts in the bank's 7-county service area are designated by the U.S. Department of Health and Human Services as "medically underserved." With poof of local employment, Guaranty will make home purchase loans with a loan-to-value ratio (LTV) of up to 100% structured as a fixed rate 5-7 year balloon with a 15 year amortization schedule. This structure allows recent medical graduates with limited or no savings to purchase a home and encourages young doctors to live and serve this medically underserved region. The bank has never experience a loss on any of these types of loans. Under the proposed rule, this type of lending will be strongly discouraged by doubling the risk weighting to 200%.

- ***BankPlus,*** whose headquarters is centered within the farming region of lower Mississippi Delta, was built by making nontraditional loans tailored to the business and household needs of family farmers. Bank Plus developed a borrower-tailored Single Pay loan product to serve family farmers who live on annual crops. With only an annual source of income, farmers typically settle their business and personal finances once a year based on farm performance. Each loan – whether it is for business, a home mortgage, or other purpose -- is tailored to the circumstance of the borrower. While all loans to a borrower for different activities are separate loans, nearly all are structured as a 1 year balloon loan with all loans maturing after harvest time. The bank has engaged in this type of lending for decades and developed an underwriting approach that looks at revenues over a 10+ year cycle of farming yields. If a farmer has a strong harvest they may reduce mortgage principal more rapidly than called for by the amortization schedule. If they have a poor harvest, the bank has developed multiple strategies for prudently managing the immediate challenge. The performance of the Single Pay loans is solid with virtually no delinquencies and charge offs not exceeding 20 basis points. While it can vary by borrower, the typical home mortgage amortization period may be 15 years. Given the rural nature of these communities, finding timely real estate comps are impossible; thus, the bank conducts an internal assessment of valuation and the LTV. Given the unique nature and timing of farming income, the balloon structure of the Single Pay loans is important for serving the customer. Under the proposed rule, all of these loans will be classified as Category 2 and most subject to a 150% to 200% risk weighting despite the strong historic product performance. The proposed rule will hit family farms and rural areas particularly hard.

As illustrated above, CDFI banks have a solid track record of delivering prudent single family lending products that enable LMI families to realize the dream of home ownership, as well as build family assets and financial literacy. These strategies often require flexibility in underwriting and loan structuring. The proposed rule includes several provisions that potentially create systemic barriers to access to credit in their communities. For example, the proposed risk weighting scale for mortgages with higher loan-to-value (LTV) ratios is steep. The scale strongly discourages lending to any prospective borrower with less than a 20% down payment. In households with modest incomes, accumulating a 20% down payment is a difficult – if not impossible – feat. A 2011 analysis by the National Association of Realtors found that it would take the median household earning $50,474 (2010)13.7 years to save for a down payment on a modest $150,000 home (based on the 2010 national savings rate of 5.2%). Many of the customers CDFI banks serve have incomes below the median; thus saving for a down payment will be even more difficult. Furthermore, an analysis of Federal Housing Finance Agency data for 1997-2008 by the Mortgage Bankers Association showed that down payment and LTV have minimal incremental influence on credit performance, but do impact overall access to credit[2]. Another analysis by Vertical Capital Solutions for Genworth Financial and the Community Mortgage Banking Project of 30 million mortgage originations between 2002 and 2008 found that the increase in credit performance attributed to higher down payment was small. But raising down payments to 20% would have knocked between 15- 20% of the homeowners in the data set out of the opportunity to become homeowners.[3]

A second example of a barrier to credit is the proposed rule's classification of all loans with flexible payment structures as high risk Category 2 mortgages. This provision removes important tools to structure loans to meet the needs of modest income borrowers. The experience of CDFI bankers is that if a loan is well underwritten with income properly documented, a balloon loan or other flexible repayment structure can be prudently managed by the household and lending institution. The risks can be further mitigated through provision of pre- and post-origination home owner and/or financial literacy counseling or training. The unintended consequences of dramatically increasing the risk weightings will be to reduce credit availability and contribute to a downward spiral of disinvestment in urban neighborhoods and further drain the economies of poor rural communities.

Finally, the proposed rule would become effective on January 1, 2015. CDBA members are concerned about the potential impact of this requirement on the risk weighting of loans originated prior to the implementation date and the corresponding effect on bank capital. While, as discussed above, we believe substantial revision in the proposed rules is essential, in the interest of maintaining access to credit in LMI communities during the slow economic recovery, it is also important that the risk weighting of loans originated prior to the effective implementation date be grandfathered under the current regulations. Any proposed rule should be applied prospectively to new originations or

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[2] http://www.mbaa.org/files/Advocacy/2011/RiskRetentionPresentation.pdf

[3] http://www.communitymb.com/

refinancings completed on or after the January 1, 2015 effective date. Small banks should not be required to re-risk weight their existing loan portfolios under a set of rules that was not in existence at the time a loan was made.

<u>Recommendation</u>: CDBA urges the regulatory agencies to revisit the proposed rule with the goals of ensuring that home ownership remains a viable option for LMI households and preserving economic stability in distressed urban and rural communities. Specifically, CDBA asks that the final rule: (1) allow all banks significantly greater flexibility in structuring loan products to meet the needs of LMI markets; (2) adjust the LTV risk weighting scales in such a manner that it does not discourage banks from lending to LMI borrowers; and (3) allow for lower risk weighting on loans originated by banks that employ alternative strategies for managing risk in LMI markets, such as pre- and/or post origination home ownership and/or financial literacy counseling or workshops. We strongly urge that CDFI banks be exempt from these proposed Standardized Approach provisions in recognition of the special role they play in serving distressed communities. Finally, we recommend that any changes to existing regulations be applied only prospectively to new originations or refinancings completed on or after the January 1, 2015 effective date.

B. Commercial Real Estate & Multifamily Development Lending

The proposed rule creates a new category of High Volatility Commercial Real Estate (HVCRE) that would generally include any loans with LTVs in excess of the limits established by the regulatory agencies and whereby the borrower has directly contributed less than 15% equity as on "as completed" project value. HVCRE would be risked weighted at 150%. CRE loans not meeting the definition would retain the current 100% risk weighting. The vast majority of CRE loans originated by CDFI banks comply with the LTV limits established by the regulatory agencies. Yet, the needs of LMI communities, even in the best of times, can make assembling a financing package a challenge. CRE lending in LMI communities does not include large scale, risky speculative real estate financing. For LMI communities, commercial real estate financing typically involves small scale projects to house locally owned businesses and/or provide space to nonprofits operating community health care centers, charter schools, day care centers and other uses that provide critical resident services.

Multifamily lending, like other CRE lending in distressed communities, also presents unique challenges. To make most multifamily projects affordable to LMI households, direct grants and/or rent or tax credit subsidies are needed from public programs, philanthropic contributions, and other sources. The demand for affordable rental housing has always exceeded the supply, but is more acute today than ever. The Joint Center on Housing Studies at Harvard University stated in its 2012 <u>State of the Nation's Housing</u> report that:

> *The housing bust and Great Recession helped to swell the ranks of low-income renters in the 2000s, increasing the already intense competition for*

a diminishing supply of low-cost units. According to the American Community Survey, the number of renters earning $15,000 or less (in real terms) grew by 2.2 million between 2001 and 2010. The number of rental units that were both adequate and affordable to these households, however, declined by 470,000 over this period. As a result, the gap between the supply of and demand for these units widened. In 2001, 8.1 million low-income renters competed for 5.7 million affordable units, leaving a gap of 2.4 million units. By 2010, the shortfall had more than doubled to 5.1 million units.

Flexibility is needed for banks seeking to support development efforts in economically distressed areas. Development costs in LMI areas are often high relative to real estate collateral values and project cash flows from rents are often thinner than what can be realized in more robust markets. Flexibility is particularly needed in determining what is considered acceptable project equity. In LMI communities, project equity must often be assembled using a variety of sources, including developer contributions, public subsidies and tax credits, philanthropic contributions, and other creative financing structures.

Neighborhood Commercial Real Estate: CDFI banks have a track record of prudently financing CRE projects that have financed millions of square feet of neighborhood commercial retail spaces. These facilities house the business backbone of local economies by providing jobs, generating local spending, and supplying tax revenues to support schools and local governments. Two CDFI banks provide examples of creative financing structures for assembling project equity from a variety of stakeholders:

- ***City First Bank of DC*** financed the construction of a new IHOP restaurant in Ward 8 – one of the most chronically poor neighborhoods of Washington DC. The project was the first sit-down restaurant built in Ward 8 in decades and generated 40 construction jobs and 60 permanent jobs most of which employ neighborhood residents. This project was financed with a bank loan and credit enhancement made possible through the NMTC Program. The bank's loan was structured as a non-amortizing, interest only loan for 4 years. The bank will help the borrower refinance with conventional sources at maturity. The loan has performed well since origination. As a non-amortizing loan, if originated after implementation of the proposed rule, the $1.95 million loan would clearly fall into HVCRE category and be weighted at 150% despite an equity contribution well in excess of 15% from a group of tax credit investors. The higher proposed risk weighting of non-amortizing CRE loans will provide a strong disincentive for banks to finance such projects.

- ***Central Bank of Kansas City*** purchased a $3.5 million participation in a $6.4 million leveraged loan originated by another bank to develop a commercial mixed use project. The 39 Rainbow project is the anchor of an effort to revitalize a distressed Kansas City KS urban neighborhood adjacent to the University of Kansas Medical Center. The project includes 30,000 feet of retail and restaurant space, and an 83-room Holiday Inn Express. The project created 150 full time construction jobs with annual wages of $33,700. A total of 250 full time permanent property management and support jobs were created most of which are to be filled by neighborhood residents. The bank loan is structured as a non-amortizing, interest-only loan for a period of 7 years to align with the NMTC compliance period. Although the borrower has contributed only 12% equity, the total equity in the project is 61% that was largely raised from a Municipal TIF program and third party tax credit investors. Under the proposed rule, a similar loan would be classified as a Category 2 loan due to the loan structure and lack of sufficient direct borrower equity. The Grand Opening of the project occurred on September 7, 2012 and the construction loan has a perfect payment history since origination in July 2011. Without Central Bank of Kansas City this project could not have happened; the bank was responsible for bringing the tax credit providers to the table and working with the other lender to jointly finance the construction loan.

<u>Multifamily Development</u>: CDFI banks have a track record of prudently financing multifamily projects that have provided affordable housing to millions of LMI families and contributed to the economic stability of their communities. For example:

- ***Community Capital Bank of Virginia*** operates an affordable housing preservation and acquisition program targeted to older apartment complexes in danger of converting to market rate housing because of expiring public subsidies. For example, Surburbia Fairfax Apartments is an affordable housing project in the high cost Virginia suburbs of Washington DC where affordable rental housing is scarce. The project was built and financed through the HUD Section 236 program which allowed the original owner to offer very low rental rates. To enable the nonprofit developer to acquire and rehabilitate the project into a 54 unit mixed income development (of which 39 units are affordable to families below 60% of median income); the bank originated a $3.9 million loan. Like most of the projects financed through this program, the nonprofit developer had little or no money to directly commit as borrower equity. The equity was raised from third party investors through the Low Income Housing Tax Credit (LITHC) program. Furthermore, the LTV on the bank's loan was in excess of 80%. The performance of this portfolio is solid with 0% delinquencies and 0% charge-offs. Under the proposed rule, the project would be a classified as a HVCRE loan and risk weighted at 150% (versus the current 100%) despite the fact that the project had a firm commitment from the state of Virginia for the tax credits and permanent financing in place. LITHC is one the most important tools for financing affordable multifamily projects in the nation and bank financing is a critical component to the success of these projects. The structure of

Suburbia Fairfax is similar to thousands of affordable LITHC projects. As currently structured, the proposed rule threatens the future of the entire affordable housing finance system because it will significantly reduce bank participation.

- ***City First Bank of DC*** is focused on serving low income urban neighborhoods in Washington DC. The bank provided a $500,000 loan to finance the rehabilitation of the 1415 Girard Street NW Cooperative. Located in the rapidly gentrifying neighborhood of Mt. Pleasant, the low income residents of the development were threatened by displacement when the owner wanted to sell the building. Working with a tenant cooperative that had little equity to contribute and marginal cash flow, City First financed the acquisition and major rehabilitation of the multifamily project. Although the LTV on the project was in excess of 80%, the bank mitigated this risk with subordinate financing that was counted in lieu of equity contributed by its nonprofit affiliate, City First Homes and the District of Columbia's Department of Housing and Community Development. A total of 11 of the 20 units in this multifamily project are affordable to households at or below 80% of median income. With the project structured as a cooperative, the residents now also own their units. The payment history on this loan is strong with no delinquencies. The project recently won the 2012 Capital One Architectural Design Award for the best affordable housing renovation in the greater Washington, DC region. Under the proposed rule, both the LTV and the modest borrower equity contribution on this project would result in classification of this loan as HVCRE and a 50% increase in the risk weighting.

<u>Recommendation</u>: We recommend that any risk weighting of CRE lending (including multifamily) in LMI communities consider not only whether the borrower has directly contributed at least 15% equity -- but also the contributed equity from all sources plus any other nontraditional risk mitigation strategies that are often necessary to make a project feasible in such markets. Strict application of the proposed rule will likely result in fewer high-impact CRE projects in LMI communities getting access to bank financing if they are categorized as HVCRE. It is in the national economic interest to ensure that economic recovery reaches all communities and CRE projects are critically important to stabilizing neighborhoods and reversing a downward economic spiral. We recommend the proposed rules be applied only prospectively to new originations or refinancings completed on or after the January 1, 2015 effective date. We strongly urge that CDFI banks be exempt from these proposed Standardized Approach provisions in recognition of the special role they play in serving distressed communities. Finally, we recommend the proposed rules be applied only prospectively to new originations or refinancings completed on or after the January 1, 2015 effective date.

CDBA fully appreciates the intent of regulators to mitigate risk and discourage financial institutions from offering lending products that could undermine the safety and soundness of individual banks or the financial system as a whole. CDBA members are greatly concerned, however, that the risk weighting, as proposed, will create new systemic barriers to access to credit within distressed communities and among low income consumers. Over the long run, the proposed risk weightings will result in already underserved communities becoming more economically disenfranchised. If this occurs it will be to the detriment of economic stability not only in those affected local communities, but to the entire nation. CDFI banks have successfully demonstrated that lending to LMI customers and communities can be achieved in a safe and sound manner. To be successful, however, often requires patience and flexibility in how products are structured to meet the customers' needs. We strongly urge you not to reduce that flexibility.

CDBA members' thank you for consideration of these recommendations and look forward to working with you to preserve credit availability in distressed communities.

Sincerely,

The Membership of the Community Development Bankers Association

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Broadway Federal Bank
BankPlus
Central Bank of Kansas City
City First Bank of D.C.
City National Bank of New Jersey
Community Bank of the Bay
Community Capital Bank of Virginia
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Metro Bank
Mission Valley Bank
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Park Midway Bank
Peoples State Bank

Southern Bancorp Bank
START Community Bank
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