SAN DIEGO CITY-COUNTY REINVESTMENT TASK FORCE

February 16, 2021

Comment regarding the Federal Reserve's Community Reinvestment Act (CRA)
Advanced Notice of Proposed Rulemaking (ANPR)
Docket Number R-1723 and RIN Number 7100-AF94

On behalf of the San Diego City-County Reinvestment Task Force (RTF), we are writing to provide feedback as requested by the ANPR and register our support for changes proposed by the Board of Governors of the Federal Reserve System to strengthen the Community Reinvestment Act, the nation's preeminent law promoting economic inclusion and opportunity.

CRA encourages banks to serve all people and neighborhoods, regardless of wealth. Changes to it must honor, fulfill and expand on the original intent, purpose, and legislative mandate of the law – building low and moderate-income people's credit, financial strength and housing stability. The work under CRA has not been completed, and there is still much to do.

The Reinvestment Task Force is a 43-year-old, joint City and County Commission tasked with monitoring banks' CRA activity in our region. Our stakeholders and 15 appointed board members, representing public, private and nonprofit organizations active in affordable housing, small business, home ownership and community development, work to increase bank reinvestment across San Diego County, the fifth-largest county in the United States with 3.3 million residents. Our members include representatives of local government, the nation's largest banks, affordable housing providers like Wakeland Housing and MAAC Project, and the local offices of national community development nonprofits like Accion and LISC.

The RTF's work includes programs that increase opportunity in low and moderate-income (LMI) communities, investigating emerging affordable housing funding sources, and promoting innovative ideas for improving the economic lives of the San Diego region's low and moderate-income residents. We produce yearly assess-ments that track, analyze and chart more than $3.4 billion in annual countywide CRA activity by our national bank partners. We are committed to the goals of CRA and deeply invested in seeing CRA's tools used to improve the lives of San Diego County's low and moderate-income residents and communities of color through family asset building, affordable housing and small business ownership.

Updates Must Prioritize CRA's Original Purpose.

CRA's founding purpose, which must remain central, was to extend lending to LMI persons and neighbor-hoods, even if those loans and investments were less profitable than serving wealthier customers. This was our nation's direct and proper response to the discriminatory redlining of the past. Since 1977, trillions of dollars have flowed into LMI communities because of CRA. In San Diego County alone, this resulted in more than $25 billion in loans, investments, and grants from 2013-2018 that have directly and specifically improved the lives of LMI families, an enormous impact.

As the Federal Reserve moves forward with the rule-making process, we urge you to fulfill the original intent of CRA through the following policies and practices:

1. Strengthen CRA's Historical Focus on Serving Low and Moderate-Income Residents.

The sole criterion for giving CRA credit to a business activity should be its direct, significant, and exclusive benefit to LMI people, in keeping with the original intent and purpose of CRA. CRA-qualified lending and investment should focus on those activities that specifically reduce the cost of housing for LMI families or push asset-building capital into the hands of LMI and minority residents who continue to have their needs neglected by financial institutions. Financial education should only receive CRA credit when provided to LMI consumers.

Providing CRA credit to activities that only partially or temporarily benefit LMI people is CRA mission creep away from the core tenets of the law. The positive impact on LMI people – not on LMI census tracts, all incomes if an infrastructure project has a community purpose, or other projects that partially, not principally, benefit LMI people – must be the central requirement for CRA qualification.

If activities lack strong, positive and direct community impact on LMI people and minorities – or worse, contribute to gentrification, higher rents, and displacement – CRA is deeply undermined.

2. Prioritize People Over Place When Defining an LMI "Community."

CRA speaks of "LMI people or communities," but the benefits accruing to LMI communities from CRA activity should flow directly to and be measured by their positive impact on LMI residents and workers. LMI "communities" and "neighborhoods" are composed of people, and the impact of CRA policies on those LMI people should be the priority, not the benefit to inanimate places or non-LMI property owners.

CRA activity that benefits the buildings but not the people – or worse, that benefits the non-LMI property owner at the expense of the LMI resident, worker or small business owner – is not desirable. This includes activities that attract, reward or speed gentrification, unaffordably rising rents, and physical and cultural displacement.

An updated CRA should erase the distinction between "LMI people" and "LMI communities," instead treating them as one and the same, defining "communities" and "neighborhoods" as the LMI people who live and work there, not the places, buildings or infrastructure located there. If CRA attracts investment into a neighborhood's buildings but LMI people don't directly benefit, this should not be an appropriate use of CRA.

3. Incorporate Considerations of Race and Fair Housing.

CRA was enacted as a direct result of past racist redlining and intended to provide incentives to help correct disparities in lending to people of color. Instead of explicitly designating race and ethnicity as criteria for determining an activity's CRA eligibility, however, income level was used instead, erasing the impact of race in creating unequal access to credit, financial opportunity, and intergenerational wealth.

Given this historical context, CRA should have included considerations of race and fair housing/fair lending from the very beginning, and this omission should be corrected in CRA's update. Disparities in not only originations, most important, but also pricing, terms, collections and marketing should be recorded, evaluated, and incorporated into a financial institution's CRA assessment. Although CRA incentivizes mortgage lending to LMI borrowers and small business loans for smaller enterprises, CRA should also incentivize mortgage and small business lending to under-served minorities.

CRA must work to reverse the damage national policies and practices have wrought on communities of color. These policies have contributed to an ever-widening wealth and opportunity gap built on historical discrimination that conferred or withheld economic opportunities generally, and asset-building loans specifically, on the basis of race. These policies have also created advantages or disadvantages that have been passed down through generations, continuing to grow the racial wealth gap.

In 2020, the nation witnessed widespread events that raised awareness of the racial wealth and homeownership divide in communities throughout the country. The time is right to correct omissions in the original CRA.

4. Incentivize and Reward Origination of Home Purchase Loans to LMI and Minority Borrowers.

As the nation looks to expand economic inclusion and family wealth-building by increasing sustainable homeownership among LMI and minority borrowers, the most essential, most-needed CRA mortgages are those for the LMI homebuyer's original home purchase. Home purchase mortgages are more challenging to underwrite than refinancing or home improvement loans. They should be evaluated separately from loans for home improvement and refinancing, and should get twice or more CRA credit than refinance and home improvement loans. This action would incentivize banks to increase their originations of these loans that are more difficult for would-be LMI and minority homebuyers to obtain.

In 2018 in San Diego County, a region with 3.3 million residents, the Reinvestment Task Force found that the six largest national banks originated home purchase loans to only 192 LMI borrowers, or four percent of all the home purchase loans these banks originated. Non-bank lenders, with their less-attractive terms and higher interest rates, were our region's largest originators of LMI loans for a home purchase. CRA updates must incentivize banks to be more active in this space, a segment of the market that even the largest banks with the best CRA programs have effectively abandoned to high-cost, non-bank lenders.

We support the Federal Reserve's proposal to count the number of loans to LMI borrowers and LMI census tracts and use the percent of home loans given to LMI borrowers and to LMI census tracts vs non-LMI borrowers and non-LMI census tracts as performance measures in an institution's CRA retail lending test. We do this in our own annual reports and also evaluate average loan size for the different borrower groups, comparing both the number of originations and average loan size to peer lenders. Smaller average loan sizes are a quantitative proxy showing greater effort by a lender to serve the more difficult, less profitable, and lower-dollar segment of the mortgage market that is in greater need of mortgage opportunities and is the target of CRA's intent and incentives.

5. End Credit for Mortgages to Non-LMI Borrowers in LMI Census Tracts.

We strongly advocate removing CRA eligibility from mortgages provided to non-LMI homebuyers in LMI census tracts. These kinds of loans, whether for single-family residences or multifamily properties, personify gentrification. They do not build LMI family wealth, often lead to displacement, divert CRA capital from LMI borrowers, and should not be incentivized by or rewarded with CRA credit.

If regulators do not want to withdraw CRA credit for these mortgages, they could cap eligibility for non-LMI home borrowers in LMI census tracts at 120% of area median income (AMI). Loans to middle-income homebuyers who fall within 80-120% of AMI could also receive only partial CRA credit. We could support this limited exception for middle-income housing because we believe it will reward banks for helping middle-income African Americans, Latinos, Native Americans, Pacific Islanders, and other minorities with lower homeownership rates than the national average to achieve homeownership and narrow racial wealth gaps. This is particularly important if the regulators decide not to include race in CRA.

6. Reduce or Eliminate CRA Credit for Other Activities That Are Low-Impact, Promote Gentrification, or Draw CRA Capital Away From High-Impact Activities.

Purchases of loans originated by another financial institution are low-impact CRA activities and should be ineligible or given diminished credit. Similarly, low-impact activities like financing non-income restricted apartment buildings in LMI census tracts should be disallowed or given reduced CRA credit, especially in active, high-cost real estate markets where rents are rising and gentrification and displacement are significant concerns, antithetical to the intent of CRA.

CRA updates must carefully consider their impact on gentrification and displacement. CRA must not be used to fund gentrification and must act affirmatively to reduce incentives to gentrify. Extending CRA credit to activities that increase gentrification – whether immediately or in the future, as a neighborhood changes rapidly – is destructive, counterproductive and undermines the intent and purpose of CRA.

Question 61 of the ANPR asks how an updated CRA might incorporate larger “essential community needs and infrastructure investments,” such as roads and hospitals. In order to have direct and high impact for LMI people, such projects must have CRA-defined community development as their primary purpose, overwhelmingly benefit LMI people not census tracts or all residents, and increase LMI or minority family wealth, rather than just helping LMI people generally. CRA must retain the focus on financial asset-building (including through affordable rents), which was undermined by the credit redlining that led to the creation of the CRA.

Equally important, funding low-impact activities or projects that fuel gentrification will attract CRA capital away from much-needed and underfunded affordable housing, small business, and family wealth-building activities. Higher-impact activities, which are harder to execute and provide lower profit margins to lenders, need the incentives provided by CRA. The other activities don’t need these incentives, and providing CRA credit for them reduces financial institutions’ motivation to fund traditional CRA-eligible projects such as subsidized affordable housing, LMI and minority homeownership, and very small business loans, diverting capital from these critical needs.

Banks will look elsewhere for their CRA credits and turn down traditional CRA projects when they have other easier and more profitable options. However, that’s the whole point of CRA: to provide an extra incentive to undertake lending and investment that is valuable to society but generates lower profits because of its size, difficulty or cost.

7. Support Naturally-Occurring Affordable Housing (NOAH) Only If It Carries Rent Covenants.

We believe using CRA’s incentives to effectively subsidize naturally-affordable, non-rent protected buildings would be misguided. Most important, it would divert desperately-needed CRA-eligible capital from traditional income-restricted, subsidized affordable housing that provides permanently affordable apartments to LMI families. Subsidized affordable housing construction, preservation and rehab projects are already incredibly hard to finance, and this change would reduce bank interest in pursuing these loans, raise financing costs, or worse, prevent genuinely and permanently affordable projects from acquiring the financing they need to come to fruition at all.

In addition, market forces will make loans for naturally-occurring affordable housing most likely to happen in areas that are gentrifying, where rents on a new or newly-rehabbed property are unlikely to stay affordable for very long, effectively “wasting” the de facto subsidy provided by CRA incentives. If, however, property developers and owners are willing to undertake voluntary deed-restricted affordability covenants in exchange for concessionary or flexible CRA loans, that would be a high-impact use of CRA dollars that would justify creating a competing category of projects seeking valuable CRA-eligible capital.

8. Bank Branches in LMI Neighborhoods Are Still Critical.

The presence of bank branches in LMI communities continues to be extremely important, even in an era of expanding online banking made even more popular during the COVID-19 pandemic. In San Diego as elsewhere, LMI residents, including elderly LMI people, have a stronger preference and greater reliance on in-person banking at their branch. Furthermore, they rely more than other customers on public transit, which severely limits their ability to access a non-neighborhood bank branch. This is especially difficult in San Diego and other suburban-urban regions where LMI populations live in dispersed, low-density neighborhoods with challenging terrain and infrequent public transit service.

Bank branches located in and serving LMI communities and people, and basic bank accounts for LMI customers, must continue to be a priority that is given heightened attention in CRA exams. Any diminishing of the importance of bank branches in CRA evaluations will lead to branch loss in LMI communities. This will be followed by greater reliance by LMI consumers on predatory, unregulated financial service providers at a time when the industry’s focus is on increasing, not decreasing, financial inclusion and use of the formal, regulated banking system. Equally, it will result in a decrease in lending at regulated financial institutions, which is contrary to the goals of CRA.

9. Don’t Increase the Size of “Small” Businesses and Farms. Give Double Credit to the Smallest Small Business and Farm Loans.

We are deeply opposed to any consideration of expanding the definition of eligible small business loans by raising the already-high revenue or loan thresholds. There is a crisis in truly small business lending including to small farms, of which the greatest number in the country reside in rural San Diego County. CRA’s existing small business caps are already too high, pushing lenders to make the largest “small” business loans.

Instead, financial regulators should reward and incentivize banks by providing them with double credit or impact scoring for the smallest small business loans. Small business loans of less than $100,000 are the most challenging and expensive loans to underwrite, and yet are the ones most needed for small business creation and expansion, especially for LMI people, and the hardest loans for small business owners to get approval for.

Raising the loan and enterprise size for small business and farm borrowers will incentivize banks to seek their CRA credit from the largest, easiest-to-serve customers. That was not the intent of CRA – just the opposite.

10. Don't Combine Community Development Loans and Investments.

We have grave concerns that the proposal to combine community development lending and investments will reduce demand for Low Income Tax Credits and further decrease their value – already dampened by the changed incentives created by federal tax reform. Together, these impacts increase the subsidy required from local government to ensure affordable housing deals are feasible, which will have a crushing impact on high-cost regions like San Diego. Since governments have a limited pot of money from which to help fund housing projects, increasing the size of the required subsidy means that fewer affordable housing units will be built.

Furthermore, combining the Community Development Lending and the Investment categories, instead of evaluating the volume of activity in each category, will increase the incentive to focus on whichever of the two financing tools is easier – loans or investments. This will be to the detriment of the other, equally-needed form of affordable housing finance, raising project costs and decreasing construction. Both are equally important and should be examined separately.

Because the proposal to encourage patient community development (CD) lending has logic but may create a bigger problem than it solves, we urge proceeding with caution. Perhaps other tools, such as impact scoring, could accomplish the same goal without distorting the parts of the system that are working.

The need for subsidized housing for LMI communities is tremendous, and regulatory policy must not do anything to reduce incentives to fund these projects or direct CRA capital to other purposes. In San Diego County, the Reinvestment Task Force's six member banks financed a record $496 million in loans for affordable housing projects in 2018. Yet in California's strong economy and overheated housing markets, even nearly $500 million a year isn't enough to build affordable housing fast enough to dent demand. San Diego and other regions need CRA to maintain and increase the number and value of loans and investments for rent-restricted affordable housing.

11. Measure and Evaluate Each CRA Sub-Activity Area Separately.

We don't just believe community development loans and investments should be assessed separately – we believe *all* of a bank's CRA activity areas and sub-activity areas should be evaluated separately, with a high minimum threshold of activity, calculated as a percentage of deposits, in each area. The distribution of a bank's CRA activity is equally important as the sum total of its activity. Each financial institution will have areas of greater strength, but no CRA activity area should be abandoned or allowed to underperform. The data should be sliced, diced and evaluated, with CRA sub-activity categories like "LMI mortgage borrowers in LMI census tracts" compared to benchmarks, peers, and related sub-activity areas within the same lender.

The Reinvestment Task Force uses metrics rigorously to calculate local CRA evaluation measures by both dollar value and as a percentage of each bank's local deposits. We do the same for each of the main categories of CRA activity, calculating the number, value, and percentage of deposits assigned to home mortgages (by each loan type), small business loans (split into larger loans/enterprises and the smallest loans and enterprises), small farm loans, tax credit affordable housing lending and investment, other community development lending, and CRA-qualified grants. We support the regulatory agencies doing the same.

12. Analyze Additional and More Nuanced Quantitative CRA Activity Metrics.

We support the Federal Reserve's proposals to more accurately evaluate and understand financial institutions' CRA performance. In particular, we support the proposal to assess home mortgage and small business lending by the number, not only value, of loans in order to avoid inadvertent biases in favor of fewer, higher-dollar value loans, as we do in our own annual San Diego region report.

We also applaud the proposal to measure mortgage lending performance by creating a borrower distribution metric that calculates the percentage of a bank's number of loans made to LMI borrowers relative to its overall number of mortgage originations, as we do in our report. (We also evaluate each bank's number of loans for home purchase separate from refinance and home improvement loans.) In addition, we calculate the average loan size for both mortgages and small business loans, giving the highest value to smaller loan balances, which show greater community responsiveness and bank effort than large loan balances.

We strongly support the proposal to collect enhanced data on community development loans, particularly for affordable housing projects. This data should include information on the lending purpose – construction, acquisition, rehab, permanent – and whether or not the loan is an extension. Evaluation of loans should include the percentage of deposits calculation as a gauge of effort and ability (ANPR Question 43).

Lastly, any lending and investments for infrastructure projects must quantitatively document the community development need and purpose, direct benefit for LMI individuals, and the specific LMI populations or residents served by census tract, income level, etc. Metrics that could identify investments that are likely to – or hopefully, not – fuel gentrification and displacement must also be documented, such as recent increases in census tract median income.

13. Enhance Rewards for Providing Funding for Innovation and Creative Solutions.

All of the CRA activity categories continue to suffer from inadequate funding, even from the largest national lenders with their sophisticated CRA functions and outstanding performance ratings, and even in a high-volume CRA market like San Diego County. New solutions, creative thinking, and rewards for risk-taking are necessary to meet today's challenges.

In reply to ANPR Question 54, which asks if CRA should specify certain activities that could be viewed as particularly responsive to affordable housing needs, the answer is "yes." We also recommend the following: 1) creation of innovative products, and/or investments in pooled funds that support **multifamily affordable housing** solutions, such as matching gap funding for tax credits for multifamily projects; 2) first-time **homebuyer assistance**, deferred or silent-second loan products, or other innovations that lower monthly loan costs for historically under-represented homebuyer groups; and 3) loan products (construction loans, combined home purchase and construction loans, etc.) that encourage homeowner production of rent-restricted **accessory dwelling units**.

We also support providing enhanced CRA credit or impact scores for lending to naturally-affordable, market-rate properties that undertake voluntary deed-restricted affordability covenants. In addition, wherever there might be unintended consequences of a change to CRA, or new distortions, as in (possibly) changes to CD lending and investments, CRA evaluations can use impact scoring to provide "extra credit," instead of changing how a metric is measured, or what is measured.

14. Enact a Unified Regulatory Standard.

We applaud the Federal Reserve for staying firm to the purpose of CRA and preparing a thoughtful reworking of CRA modernization instead of joining in on the Office of the Comptroller of the Currency's deeply-flawed new rule. We stand with others who support a uniform, consistent set of rules that is shared and implemented by all three regulatory agencies, and not two separate systems for the nation's banks. We urge the three bank regulators to converge in the CRA update process begun here by the Federal Reserve and adopt a unified CRA regime.

Strengthen CRA.

More than 40 years after CRA's passage, small businesses, affordable housing developers, and LMI homebuyers in the San Diego region and across the country still struggle to get financing. The goal of CRA is to ensure that low and moderate-income families like the San Diegans we represent and seek to assist have access to wealth-building tools like home mortgages and small business loans, and that there are market incentives through CRA for banks to finance rent-restricted affordable housing. We must retain a laser-like focus on these goals until there no longer is a need for them.

The members of the Reinvestment Task Force thank the Federal Reserve for soliciting and considering stakeholder feedback as the Board works to update CRA and ensure that it is always responsive to community needs. Public engagement and input are not only the cornerstone of democracy; they lead to better decision-making and stronger policies. No one knows a community's needs and solutions better than community members themselves. We urge the Board to include enforceable public participation provisions in the rules governing both banks and the regulators' own CRA examination processes and procedures.

We commend the Board's leadership in developing this ANPR and moving the quest for an updated CRA forward. In a perfect world, we'd like to see the banks incentivized to do even more, providing billions of dollars more each year in home purchase loans for LMI borrowers, small business loans under $100,000, and tax credit investments and multifamily loans that build the thousands of affordable housing units that San Diego County and much of the country needs.

Like the rest of America, San Diego's middle class has been hollowed out by economic, political, and technological changes that have pushed families down the income and wealth ladder, instead of building their wealth and financial strength from one generation to the next. The economic impact of these long-term challenges has been compounded by COVID-19. Strengthening CRA will help more San Diegans and other Americans re-build their financial stability and family wealth by starting small businesses, securing affordable housing, and moving up into homeownership. Strengthening CRA will help rebuild America's middle class.

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