1. **Overall economic conditions:** What are the Council members’ assessments of overall economic conditions for low- and moderate-income (LMI) communities?

We gather at a time of extraordinary shifts in the nation’s economic and demographic foundations. While the nation faces rising inequality in income and wealth, America is in the midst of a profound demographic shift that has already altered and will continue to alter the racial and ethnic composition of our communities, our workforce, and our population. By the end of the decade, the majority of all children age 18 and under will be of color, and by 2044, the U.S. Census Bureau predicts America will be a multiracial, majority people-of-color nation.

Yet people of color are far more likely to be unemployed, live in poverty, earn low wages, and lack sufficient savings to bounce back from economic setbacks or invest in long-term assets. Low-income households of color continue to have few opportunities to live in thriving neighborhoods with good schools, retail, high-quality services, safe parks, and infrastructure that connects residents to regional economic opportunities. The National Equity Atlas\(^1\) illustrates this combination of a new American demography driven by the growth of communities of color and persistent racial economic inequities across all 50 states, the country’s 150 largest regions, and its 100 largest cities. The Atlas also tallies the cost of inequities: if workers of color had earned the same incomes as their white counterparts of the same age and income bracket in 2012, the U.S. economy would have been $2.1 trillion wealthier and every region would have been more prosperous.

The Great Recession further damaged the promise of economic mobility and integration for LMI Americans, particularly people of color, immigrants, and people living in rural and tribal communities. Although the unemployment rate has decreased to nearly pre-recession levels, there are still large segments of the population that cannot find work or can only find part-time work. This can lead to significant monthly income variances that exacerbate financial hardships for low-income people. The rise in the poverty rate since 2000 is in part a reflection of stagnating wages, but is also an indication that our workforce may not have the skillset, educational attainment, or soft skills necessary to find and retain long-term employment. This problem is particularly pronounced in rural communities where diversity of employment opportunities is limited. The small manufacturing that was once the anchor for many small communities’ labor force left long ago, and nothing has been able to replace it.

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\(^1\) The National Equity Atlas is a comprehensive data resource to track, measure, and make the case for inclusive growth.
Furthermore, many populations have not regained the wealth that was lost during the Great Recession due to declines in the value of stocks and real estate. The Federal Reserve Bank of St. Louis reported that while total inflation-adjusted net worth in the United States in 2012 had returned to 87.5 percent of its level in 2007, the inflation-adjusted net worth of black and Latino families with two- or four-year college degrees in 2012 was at 31.3 percent of the 2007 level. The Pew Research Center reported in a December 2014 release that, “even as the economic recovery has begun to mend asset prices, not all households have benefitted alike, and wealth inequality has widened along racial and ethnic lines.”

Addressing racial barriers to economic opportunity and full inclusion is critical within every area examined by this Council.

Our economy is faced with a fundamental and long-term challenge: the people who are the demographic future of our nation are not well positioned to lead our economy. While we are conscious of these disparities and challenges, we fundamentally view LMI people as an investment opportunity. America’s long-term economic future hinges on addressing this imbalance, removing racial barriers, and ensuring our emerging majority can access the resources and opportunities needed to reach their full potential in the economy—as workers, entrepreneurs, innovators, and leaders.

The economic recovery is clearly not benefitting all Americans. The extraordinary extent of the disparities in our economy in terms of access to capital and wealth-building render many traditional economic indicators less useful. The Federal Reserve should place a greater emphasis on disaggregated data that illustrates economic conditions for segments of the population and the economy that are experiencing conditions that significantly diverge from aggregated indices. These disparities cannot be footnotes; rather, they need to be included in the headlines.

Finally, while the challenges facing the lowest-income families were daunting before the recession and continue to be, it is also important to note that there continue to be challenges to families in the 80 percent to 120 percent of Area Median Income band. Many in this income band had made employment gains before the recession and bought homes that were increasing in value. The huge loss of jobs during the recession hit them hard, and the impact was compounded by the drop in value of their homes. The ripple effect is still quite apparent in many LMI communities. Economic health should be viewed in the context of overall community health. The interrelatedness of the economy, jobs, and community must be viewed in a much more holistic manner.

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2. **Current lending conditions**: What is the Council’s view of the current condition of, and the outlook for, loan markets and financial markets generally?

Although lending conditions have been relatively stable for the past several years, credit standards have remained tight since the Great Recession. There is generally strong competition for the most credit-worthy borrowers while less credit-worthy borrowers face significant challenges to accessing capital. This reality is having an adverse impact on economically underserved people and regions, including people of color, immigrants, and residents of rural and tribal areas. This discrepancy feeds the disparity between borrowers with prime credit and many borrowers in LMI communities.

The Council recognizes that various factors are limiting access to capital, including significant imperfections in established methodologies for measuring risk, the need for greater regulatory clarity with regard to numerous areas of lending, and the need to better define what is predatory or abusive lending. The Council also recognizes that bias and discrimination continue to distort access and outcomes across lending markets in the United States.

Credit scoring in the United States is a less accurate tool for estimating credit risk in many lower-income households and households in communities of color. It is important to better understand how and when credit scoring may be artificially limiting lending to these populations. Credit scoring is a significant factor in reinforcing disparities in access to credit and capital by race, ethnicity, and income.

The Council recognizes that the full and productive participation of reputable private-sector lenders in meeting the needs of LMI consumers requires regulatory clarity in a number of fields, including but not limited to the Federal Housing Administration (FHA) and Department of Justice’s (DOJ) oversight of the mortgage market, capital set-aside requirements, and reform of government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.

There is a need to better define what kinds of lending activities are predatory and to clearly distinguish predatory lending from innovations that open access to capital. The Council recognizes that there is a difference between a loan product and a debt trap. Among the most important factors for distinguishing legitimate lending is the existence of a reasonable underwriting process to assess the borrower’s ability to repay.

While access to capital is a challenge, the Council also recognizes the need to invest in the capacity of borrowers. Wage stagnation is a primary factor in this lack of capacity. Mortgage defaults, health care costs, and educational debt are further impacting the capacity of borrowers across all lending market areas, and are also affecting the underlying viability of multifamily housing investments. There is a need to focus lenders on the risk-mitigating value of borrower education and other supports that demonstrably mitigate the risk of default and the sustainability of the borrower’s household.
The Council recognizes that targeted lending to LMI households and people of color is critical for addressing the widening gap between the mainstream banking sector and an increasingly large portion of the U.S. population that falls outside of traditional credit-risk guidelines. Community Development Financial Institutions (CDFIs) and nonprofit lenders that reflect the communities they serve and that deliver culturally relevant services are disproportionately important in responding to these markets, which are the future of “Main Street” America.

a. Small business lending: Has credit availability for, and demand for credit from, small businesses changed significantly?

In the wake of the Great Recession, banks pulled back from business lending under $250,000, and by and large have not returned—even though business lending in general has been on the rise. Small business loans on the balance sheets of banks are down about 20 percent since the financial crisis, while loans to larger businesses have risen by about 4 percent over the same period.4 The Council believes there are a number of reasons for this, including (1) an exam and regulatory environment that discourages loans to businesses with variability in cash flow; (2) low interest margins; (3) unintended consequences of home loan modifications to small business home owners; and (4) industry refusal to fund startups, outside of the use of Small Business Administration lending. The problem has been particularly acute among microenterprises with five employees or fewer and for businesses owned by people of color. The Small Business Administration, Department of Commerce, and U.S. Senate Committee on Small Business and Entrepreneurship have all released reports in the last three years documenting the disparity in capital access specifically for businesses owned by people of color.

While banks have withdrawn from this lending, there has been a tremendous growth in alternative lenders offering loans to small businesses and startups, some of which are charging significant upfront fees, high rates, and extremely short amortization periods—all of which combine to negatively impact the borrower’s cash flow. A recent *New York Times* article highlighted some of the problems borrowers have faced from such lenders, akin to payday lending and even the subprime crisis in some scenarios: “Moody’s Investor Service, the credit-rating firm, warned that the marketplace industry bears some similarities to mortgage lending in the period leading up to the 2008 financial crisis because the companies that market the loans and approve them quickly sell them off to investors. Marketplace companies do not suffer losses directly if the borrowers default, which may embolden them to lower their credit standards.”5 Also of concern is that these lenders are capitalized by private sources such as hedge funds and investment firms, eager to expand their base of

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borrowers quickly. There is a pressing need for more research on the character and quality of lending from unregulated, for-profit entities in the small business market.

On a more positive note, CDFIs have also been entering this marketplace, and there is dynamic growth and innovation among CDFIs in small business lending. CDFI small business and micro lenders are serving markets that are not being served by banks. There is an enormous and time-sensitive need to scale CDFI small business lending. Banks should be encouraged to form referral partnerships with CDFIs and other community organizations that provide safe and affordable loans to small businesses.

Finally, although not often considered small business lending, it is worth noting that there has been a significant rise in lending need for community facilities like schools, health facilities, arts and culture facilities, and workforce training facilities. For these loans as well as standard business loans, there continues to be a need for training and technical assistance to accompany the loans.

b. **Home mortgage lending:** What changes has the Council seen in the mortgage market since the beginning of the year? Is a trend developing to increase, decrease, or cease home mortgage originations, and if so, what are the likely causes for and effects of this trend?

The home lending market is recovering. But while mortgage originations have been on the rise, this may be masking disparities for certain markets, including “weak markets” (where homes are relatively affordable but lenders have not provided resources), persons of color, LMI families, and households in rural communities. There has been a notable shift among banks away from FHA products, suggesting that banks are focusing on the highest credit-quality borrowers. Public subsidies in support of homeownership are scarce and shrinking; down payment and closing costs assistance funds are a major need. In stronger markets, LMI families are being priced out of neighborhoods where they have lived for decades.

Although single-family lending markets have shown strength over the past year, there are dramatic challenges for residents of LMI communities and communities of color to get access to mortgage loans. One factor is the credit requirements established by the new Qualified Mortgage and Qualified Residential Mortgage regulations. While it is essential to have underwriting standards that ensure the stability of the loan and the ability of the borrower to repay, it is clear that many creditworthy borrowers from these communities may be incorrectly excluded because they do not fit many of the standard credit criteria. Some consideration for additional credit factors, such as on-time bill payment, should be considered. There is strong experience to show that other intentional steps can appropriately strengthen the outcomes of lending in low-income communities and communities of color, including dedicated local loan officers, reasonable down payment requirements with financial assistance, and reasonable credit score and income requirements.

There is still a relatively high rate of nonbank mortgage lenders—40 percent of all loans nationwide. This is somewhat concerning given the relative lack of oversight they have versus bank lenders. Furthermore, there are a significant number of anecdotal reports of
predatory lending in the home equity and rehab lending markets in recent years, but insufficient research on this aspect of home lending. This is an area of ongoing concern.

Fannie Mae and Freddie Mac are playing an essential role in establishing a healthy lending market and are guaranteeing a substantial percentage of all mortgage loans. Ongoing uncertainty around the status of the GSEs and a lack of clear mission goals is problematic. It is possible that pressure on the Federal Housing Finance Agency (FHFA) to increase the GSEs’ affordable housing goals, together with pressure from advocates to ease lending criteria and looming competition from Wall Street, will help make home mortgages more accessible over time. Nevertheless, there is a need to continue to focus on the process by which the GSEs and large banks dispose of distressed assets. This process holds risks for communities where there are concentrations of distressed notes, but also presents an opportunity for community stabilization and the introduction of quality, affordable housing into the market.

Finally, there remains a need to refocus the mortgage industry on the risk-mitigating value of homebuyer counseling, and potentially connect regulatory relief with lending to buyers that have completed a reputable/certified homebuyer counseling program. In addition, the FHA, the Consumer Financial Protection Bureau, and the DOJ could provide greater regulatory clarity around mortgage lending and servicing, especially regarding FHA products.

c. Multifamily and affordable housing lending: What is the Council’s view of the availability of credit for multifamily and affordable housing projects? Have Council members seen any changes in the demand for multifamily and affordable housing loans since the beginning of the year?

The multifamily housing market in general is quite strong. While demand for affordable housing is also strong, meeting that demand in many markets is challenging. Particularly in “hot” markets, rents can rise too quickly and affordability may be threatened. In these markets, it is particularly important to preserve existing units. The strong market provides an opportunity for localities to adopt inclusionary zoning requirements, but unfortunately, very few are.

In some particularly hot rental markets (e.g., New York City, Seattle, and the San Francisco Bay Area), loans that do not meet responsible underwriting criteria lead to a type of discrimination known as “overleveraging” or “predatory equity.” This is when lenders assume a deliberate strategy of encouraging high rates of turnover in order to raise rents, forcing those residents to leave their long-standing homes and neighborhoods. Furthermore, overleveraged loans and other bad underwriting practices may get credit under the Community Reinvestment Act (CRA). Regulators should scrutinize the quality of CRA loans and not give credit for any loans that have a destabilizing impact on residents.

Notwithstanding the strength of the multifamily housing market, it is difficult to finance smaller projects (less than $5 million, less than 100 units). In addition, smaller, nonprofit community development corporations (CDCs) have trouble accessing capital from banks. Investments in nonprofits by banks tend to be low across the board, as banks prefer to invest
in for-profits or in private and government funds such as mortgage backed securities. In New York City, for example, less than 1 percent of the total community development loan volume in the past four years went to local CDCs. This is a problematic trend, as local nonprofits are most likely to engage community residents and maintain the affordability of properties and their value as a community asset.

Affordable housing development generally requires very deep subsidies, and as the need has grown for affordable housing, federal dollars have been on the decline. The low-income housing tax credit (LIHTC) remains a critical tool; however, the 9 percent credit is very competitive and increasingly is concentrated with larger and more sophisticated developers and syndicators, and some states have exhausted their housing bond caps, making it hard to use the 4 percent credit.

The GSEs play a critical role in supporting the multifamily market by setting underwriting standards and purchasing loans. Small and mid-size banks tend to hold loans, but the large banks sell them. The underwriting standards set by the GSEs support responsible lending. As such, FHFA must remain committed to quality underwriting standards and to supporting an appropriately high level of lending.

d. Consumer lending: What changes have Council members seen in consumer lending?

In the wake of the financial crisis, many depository institutions scaled down or eliminated personal loan products. Today, access to responsible personal loans has returned for individuals with good credit scores; in fact, innovation in the “fintech” space has led to significant price and term competition that has benefited prime and super-prime customers. Depository institutions, however, still remain reluctant to rescale or introduce personal loan products to those with low credit scores or to those that lack credit scores. A few banks offer responsible small-dollar “credit-building” loans, but these and other innovative products are not frequently offered. At present, there are insufficient responsible alternatives available for LMI consumers and people of color.

Predatory lenders, title lenders, and pawn shops are filling this vacuum. They charge exorbitantly high interest rates on small-dollar loans (e.g., the average APR in Missouri on loans offered by payday lenders was 451 percent6), operate almost exclusively in low-income communities, and are much more likely to be located in a neighborhood that is black or Latino. The ability of these lenders to use merchant processing as well as automated clearinghouse access to control and exploit borrower cash flow is pushing many individuals and small businesses into payday debt traps, further contributing to inequitable participation in the economic recovery, especially for LMI communities and people of color.

High levels of student debt also continue to be a drag on wealth building. In 2014, 43.3 million borrowers held a total of $1.157 trillion in debt, with an average debt burden of $26,700 per person.\footnote{“Average Annual Percentage Increase in Outstanding Education Debt, Number of Borrowers, and Average Balance,” College Board, http://trends.collegeboard.org/student-aid/figures-tables/average-annual-percentage-increase-outstanding-education-debt-number-borrowers-and-average.}

While the Council recognizes that technology is changing how many access and use financial services, we believe that bank branches are a particularly important asset for a community. Studies show that the physical presence of bank branches has a direct, positive impact on small business lending; can lead to individual wealth building through opening savings accounts and establishing credit history; and that the absence of branches can open opportunities for predatory lenders. Banks need to be encouraged to open and maintain branches in low-income communities, to offer safe and affordable checking and deposit accounts, and to customize products to meet the needs of low-income and immigrant populations.

A bank branch provides a place in which products can be explained (sometimes in a language other than English), cash can be exchanged between the consumer and the service provider, and a relationship can be developed. For many consumers, branches and physical interaction can be a good complement to services provided via online or mobile means.

In short, there is a need to spur responsible innovation in consumer lending, particularly among community banks and credit unions—many of which have strong balance sheets and are in a position to take incrementally more risk. Regulators need to provide a “safe space” for innovation to encourage banks to engage in more consumer lending and to also encourage substitutes for or alternatives to traditional products (e.g., general purpose reloadable prepaid card accounts).

Another area that needs to evolve is the use of traditional credit scores to make lending decisions. The lending industry generally relies on FICO scores, but that type of credit scoring is a less accurate tool for estimating credit risk for lower-income households and for many people of color. Furthermore, reliance on the traditional credit score is flawed because it does not cover the full population of potential seekers of credit. About 26 million Americans, or 11 percent of the adult population, lack credit files and are “credit invisible,” while 8 percent have some history but not enough to generate a score.\footnote{Kenneth P. Brevoort, Philipp Grimm, and Michelle Kambara, Data Point: Credit Invisibles (Washington: Consumer Financial Protection Bureau, May 2015), http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.}

3. **Housing markets:** How have house prices and rental rates changed in recent months? Have there been any changes in housing activity for LMI communities in Council members’ regions?
The for-sale housing market has rebounded considerably since the recession, with home prices rising and housing starts increasing on a consistent basis over the past three years, at least in the stronger markets. However, even in these markets there are few starts in the starter home segment. This is likely driven by the mismatch between the cost of new construction and the ability of first-time homebuyers to pay this level of purchase price. There is often a gap between the cost to construct new homes and the values at which they appraise. In some markets this may mean that lower-income homebuyers may be purchasing older homes with greater needs for rehabilitation that could be costly.

In some of these markets like New York City, Boston, and the San Francisco Bay Area, there is a rental crisis—with housing becoming increasingly unaffordable and eviction rates increasing significantly. Cities with competitive housing markets risk losing their diversity and culture as their low-wealth communities of color are displaced to the outer fringes, where they may not have access to jobs, transportation, and services. The importance of paying attention to these trends is reinforced by the work of economist Raj Chetty, which underscores the high correlation between place and economic well-being and opportunity.

In addition, bad credit, petty criminal records, and other issues have segregated a portion of the LMI population out of more traditional low-income housing opportunities, leaving them vulnerable to predatory landlords, substandard properties, and even homelessness. Low vacancies and rising rents have also put pressure on low-income families with tenant-based Section 8 vouchers who are increasingly unable to find properties available for rent within programmatic payment and housing quality standards. In markets where rents are rising, even units that are deemed “affordable” using LIHTCs at 60 percent of median income are too expensive for many lower-income borrowers.

Many of the weaker markets, particularly those that have suffered major population losses, continue to struggle with vacant and abandoned homes, with repair needs that are significantly higher than the appraised values of the properties. In some cases, the lack of a robust for-sale housing market puts additional pressures on the rental market, where the supply of affordable housing units cannot keep up with the demand. As an example, last year in the city of Detroit, there were approximately 23,000 home sales and only 598 mortgages, showing how few sales are actually financed by mortgages to owner occupants.

Another issue putting a strain on the rental markets, in both strong and weak housing markets, is demographics. Millennials are forming families later and may be less interested in buying a home, either because of what happened to home prices in the recession, or because they are more interested in mobility than owning a home. At the very least we know that millennials are buying homes later, leading to declines in homeownership rates.

Finally, many LIHTC and other affordable housing properties are becoming market rate after their use restrictions end. The huge amount of capital available for investment is putting tremendous pressure on these owners to sell their properties for high prices; and the new owners must raise the rents significantly to be able to repay their investors and provide the expected return. Even if original owners want to retain their properties, they often require
major renovations. Absent significant new subsidies for these renovation costs, the owners may have no choice but to raise rents.

4. **Labor markets:** How have the labor markets in which Council members operate changed in recent months? In particular, assess the degree of job loss or gain (how much and in which industries). What changes to wages for LMI earners have Council members observed in the past year?

The loss of manufacturing jobs is taking a toll on the economy. These jobs were highly sought after and offered a lifetime career with benefits, but there has been significant downsizing in the wake of global competition. In the health care field, there are more jobs available, but wages have stayed flat, and we have seen an increase in “1099 employees.”

In transportation, there is an increase in hiring and some wage increases for delivery companies (those with commercial drivers’ licenses). In the construction industry, wages have increased, and there has been an increase in recruitment for apprenticeships; however, heavy construction is suffering due to a lack infrastructure investments, like the rebuilding of roads. In the public sector, there has been some increase in hiring, but this may be reaching a leveling-off point.

Income inequality is a pressing issue with wages continuing to stagnate in job sectors that are crucial to creating economic opportunities for LMI people. The current unemployment rate does not well reflect the reality of people living in LMI communities. For example, in Minnesota as of September 2015, unemployment for blacks was up to 12.1 percent, from 10.2 percent the year prior, while the unemployment rate for whites was down to 2.8 percent, from 3.8 percent a year ago. A 2013 report found that 52 percent of black working-age men in New Orleans—more than 35,000 individuals—were jobless.

The Council sees sustained wage growth among low-wage workers as a better indicator of a broadly strengthening labor market. Many people are now working multiple jobs in an effort to reach their pre-recession income or because employers are unwilling to pay the benefits for full-time employees. This leaves no time to gain ongoing education, which could help them advance from an entry-level job to a career. The picture is dire for low-income workers without college degrees. Minimum wage workers, in particular, face especially challenging conditions. Their wages in 2016 will be effectively lower than minimum wages in 1968, while housing, childcare, and health care costs have increased dramatically.

5. **Additional matters:** Have any other matters affecting consumers and communities emerged from the work of the Council members that they want to present at this time?

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9 “1099 employees” as it is used here refers generally to contract or other nontraditional employment arrangements.


Strengthening the Community Reinvestment Act
As discussed previously, there continues to exist great income, wealth, and opportunity disparities in this country. The CRA has been a critical tool in mitigating these challenges, and we join the Federal Reserve Board in strongly supporting the CRA.

It is also true that the CRA could be made even stronger through modernization efforts, and we offer three key examples:

- **Digital Banking and Branches**
  Broadly speaking, the prevalence of credit card usage and increases in online banking challenges the convention that geographic targeting of the CRA should be driven only by physical branches. There should be an opportunity to expand CRA lending into more LMI communities regardless of branch location.

- **Economic Development**
  Investments that receive CRA credit are not all equal in their impact, but there is little impact assessment to differentiate between “box checking” strategies and innovative investment. For example, consideration should be given to using the CRA to drive equitable economic development. On a national basis, just 10.6 percent of all CRA-eligible community development loans, investments, and grants support economic development. The regulators should not only encourage investments in economic development, but also provide more credit for activities that create quality jobs and economic opportunities.

- **Service Test**
  The CRA service test should be explored for opportunities to map service test elements to activities that have an evidence base for effectiveness in achieving the aims of the CRA.

The Community Advisory Council believes that this critically important tool for equity in the United States could be made even stronger by exploring the questions above. The Council is considering a deeper dive into this topic for future meetings.

Federal Reserve Role in Community Development Industry
Finally, we make an additional point as a Council:

- As far as dissemination of information, the Federal Reserve has appropriately placed important focus on the community development industry. The Fed should continue its investment in publishing and highlighting the diversity of effective and impactful community development practices. In addition, the Fed should consider an analysis of credit scoring models to determine whether they may be artificially distorting the market by overestimating and generalizing risks for low-income people and populations of color.