The Slow Pace of Evolution in CRA and Studying Operating Expenses, Cash Flow and Vacancy Rates

January 28, 2015
The Glacial Pace of “CRA Reform”

• 2009 - OCC, Federal Reserve and FDIC announce a CRA reform initiative followed by a series of public hearings in 2010

• 2010 - A CRA reform “Working Group” was formed;

• March 2013, changes were proposed to the Q&A’s

• November 2013, final Q&A’s were issued

• April 2014 – Large Institution CRA exam procedures changed

• July 2014 – FFIEC Webinar to explain the “new” Q&A’s
The November 2013 Q&A

• The Agencies concede that CRA guidance was being inconsistently applied and that additional guidance was needed in a number of areas, including:

• When consideration should be given for community development activities that take place in a broader statewide or regional area (BSRA) that includes an institution’s assessment area
• When consideration should be accorded for Investments in nationwide funds
• What the agencies meant by the term “regional area” and
• Whether the agencies viewed the practice of getting CRA “side letters” as mandatory
Community development activity in the “broader statewide or regional area”

• Community Development activities in a BSRA that includes the bank’s assessment area are considered

• Community development activities that will not benefit the bank’s assessment area may enhance a bank’s performance evaluation if the bank is being “responsive” to the community development needs and opportunities in its assessment area(s)

  - The agencies emphasized that “Responsiveness” was a concept reflected throughout the CRA regulations
  - But did not provide a definition for the term
Last July the agencies conducted a webinar to explain the new guidance ...... which virtually no one seems to have seen. I would strongly encourage you to have someone in your organization listen to the webinar, the link for which is shown below.


The next couple of slides are screenshots taken from that presentation.
How is Responsiveness Measured?

• In assessing whether a bank is being responsive to the community development needs of its assessment area, examiners will:

  • Include activities that directly benefit the assessment area,

  • Include activities with a purpose, mandate, or function that includes serving that assessment area(s), even if the specific activity does not benefit that area or areas, and

  • Consider the bank’s “performance context” during the period under review – its profitability, whether qualified investments were available, the competition for those investments, etc
How community development activities in the BSRA are determined

**Always considered**

- Direct benefit to AA(s)

**May be considered**

- OR -

  Purpose, mandate, or function to serve the AA(s)

- If the bank has been responsive to the needs and opportunities in its AA(s) –
  Activities that do not serve and will not benefit the AA(s)
Example 1: The bank has defined the Buffalo metropolitan statistical area (MSA) as its AA, and bank offers technical assistance in its AA.
Example 2: The bank makes an investment in a Native American CDFI. The CDFI serves Indian territory within the bank’s AA and home state.
Example 1: The bank makes a loan related to a LIHTC project within the state, but that will not benefit the bank’s AA.
Example 2: The bank makes a qualified investment in the Pennsylvania State Housing Finance Authority which benefits multiple communities outside of the bank’s home state, but within the broader regional area.
The Economic Growth & Regulatory Paperwork Reduction Act of 1996

- Under the EGRPRA, the FFIEC must hold hearings once every ten years to identify unnecessary or unduly burdensome regulations and consider how to reduce the regulatory burden on banks.
- The hearings are attended by the Comptroller of the OCC, a member of the Board of Governors of the Federal Reserve & the FDIC Commissioner.
- These hearings provide AHTCC members with the opportunity to make five minute presentations on CRA matters as well as the opportunity to submit written comments.
Economic Growth & Regulatory Paperwork Reduction Act

- The first hearing was in L.A. in December, a second will take place in Dallas on February 4th.
- Additional hearings will be held:
  - In Boston on May 4th
  - In Chicago on October 19th
  - In Washington on December 2nd
- I encourage the Coalition and/or its members to register and make presentations.
- More information is available at this link:
## 2014 Housing Credit Equity Volume by Investment Type

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 10 Syndicators</td>
<td>$5,666,300,000</td>
</tr>
<tr>
<td>Remaining Syndicators</td>
<td>$3,545,000,000</td>
</tr>
<tr>
<td>Direct Investors</td>
<td>$3,286,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$12.497B</strong></td>
</tr>
</tbody>
</table>
LIHTC Performance Metrics

• Several months ago, we published data on the performance of roughly 18,000 LIHTC projects that are still within their 15 year compliance period.
• We estimate that this sub-set represents roughly 2/3 of all the “active” LIHTC projects.
• The data is very positive, particularly when seen in historical perspective.
2005
- Stabilized properties analyzed 11,239
- Physical occupancy 96.0%
- Median DCR 1.15
- Median cash flow p/u $240
- % underperforming 34%
- Cum. foreclosure rate 0.35%
BETTER...

2010
- Stabilized properties analyzed 15,399
- Physical occupancy 96.6%
- Median DCR 1.24
- Median cash flow p/u $419
- % underperforming 24.7%
- Cum. foreclosure rate 0.57%
2012
- Stabilized properties analyzed 15,588
- Physical occupancy 97.0%
- Median DCR 1.30
- Median cash flow p/u $498
- % underperforming 20.2%
- Cum. foreclosure rate 0.63%
WHY HAVE THE PERFORMANCE METRICS IMPROVED?

- Better underwriting is just part of the answer
- Low interest rates have allowed us to bail out many weak performers
- We believe that economic occupancy has increased considerably in recent years
- The demand for affordable units has resulted in lower turnover rates, and asset managers are telling us that rent collections are stronger
WHERE DO WE GO FROM HERE?

- CohnReznick is rolling out its next performance study in April and every syndicator with whom we have spoken has agreed to participate.
- By adding direct investment data from the Top 5 banks, the study will include 20,000 units.
- For the first time we will request and analyze:
  - Both physical and economic occupancy
  - Operating expenses
  - Data on projects in areas that have experienced zero/negative growth in AMI.
## Operating Expense Data Request

### Per Unit Operating Expenses

<table>
<thead>
<tr>
<th>Misc. Operating Expenses</th>
<th>Salaries &amp; Employee Benefits</th>
<th>Repair and Maintenance</th>
<th>Management Fees</th>
<th>Insurance</th>
<th>Utilities</th>
<th>Property Taxes</th>
<th>Replacement Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500</td>
<td>$1,100</td>
<td>$1,000</td>
<td>$450</td>
<td>$350</td>
<td>$1,600</td>
<td>$900</td>
<td>$400</td>
</tr>
</tbody>
</table>

**CohnReznick:**

- Suggested expense line item inclusions:
  - Employee leasing commissions and bonuses
  - Office salaries
  - Maintenance payroll
  - Payroll taxes
  - Payroll fees
  - Workers compensation
  - Health insurance

**Utilities**

$1,600
It's Time for the LIHTC Industry to Give up its Horse and Buggy