Outlook Live Transcript
CRA Community Development – Examiner Insights
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OPERATOR: Mike, the floor is yours.

VANDER VELDE: All right. Thank you. Good afternoon and welcome to Outlook Live. I'm Mike Michael Vander Velde with the Federal Reserve and I'll be your facilitator. Today, we'll take a look at the Community Reinvestment Act, Community Development - Examiner Insights, and let me be the first to welcome and thank our presenters. They are Maria Villanueva from the San Francisco Fed, Matt Holt and Lisa Shepherd from the Boston Fed, and we're going to hear from them in just a moment, but first, let's jump over to slide #2 and talk about some logistics for this call.

If you haven't done so yet, go ahead and click on the webinar link that you received after registering. You can also head over to our website, that is www.ConsumerComplianceOutlook.org. There, you can find the session materials for today and past calls, and eventually the archive of this call as well.

Just a quick note on the webinar, we do encourage you to listen to the audio through your P.C., but we have a thousand phone lines available. In the case that you need them, just go ahead and pick up the phone and dial the toll-free number that you see there.

As for questions, our presenters received quite a few in advance and we're going to get through those, but please do submit your new questions and you can do that by clicking the ask question button right there in the webinar tool.

We're going to take those questions at the end of the presentation today. I'd also like to point out something new to the Outlook Live program. We are offering Continuing Professional Education (CPE) credits for attending this session, and if you're interested in that, you have two things that you need to do: First, you have to be registered for this session. So if you haven't done that, make sure you go out and do that now, but second, you have to complete the post-session survey, and there's a little spot on there that says I want CPE credit and you let us know that you want that and we will get that to you.

All right. Let me cover the legal language real quick, and then we'll get started with our content today. The opinions expressed in this presentation are intended for informational purposes and are not formal opinions of, nor binding on the Board of Governors of the Federal Reserve System. And with that said, we are ready to get started. Maria, I'm going to pass the mic to you.

MARIA VILLANUEVA: Thanks, Mike. Let's go over the agenda. In this session, we'll cover which evaluation procedures include community development, we'll give an overview of the categories of community development, talk about the geographic requirements for community development, go over how to qualify community development activities, and offer you some best practices.

I'm going to move on to slide 4. So which type of CRA examinations would we typically see community development activities? Community development activities can be included in each of the CRA evaluation methods.

This slide includes some information about each of the evaluation types. Since we've gotten questions in the past about small and intermediate small banks transitioning to the next test, I just want to mention a few things about transitions.

So if an intermediate small bank is transitioning to a large bank, there's a lag of about three years between the time the bank first crosses the threshold and a large bank examination is conducted. The banks must be over thresholds as of December 31st for 2 years in a row before it is subject to the large bank data collection requirements. The third year comes into play because there needs to be at least 12 months of data available before a bank is subject to the large bank procedures.

Now, for small banks transitioning to be examined under the intermediate small bank procedures, there's no lag time since there are no data collection requirements. Examinations on the wholesale purpose and strategic plan evaluations require designations and/or approvals from a financial institution's regulators.

And for small institutions, the optional community development activity must enhance credit availability. There’s only the lending test for small institutions. Moving on to slide 5. Well, the way I like to approach community development activities is to first figure out which bucket of community development the activity belongs to, and there are basically 5.

Note, if you hear the acronym, LMI in this presentation, we're referring to low- and moderate-income. So we might just say LMI for short. So those buckets are affordable housing; community services; economic development, and this has two tests, which I'll cover later; stabilizing and revitalizing certain types of geographies; and activities related to HUD's Neighborhood Stabilization Program.

Moving on to slide 6. Since we're talking about affordable housing, how do we define what is affordable? What is the standard? HUD defines housing costs that is affordable as 30 percent of monthly income.

When I'm reviewing affordable housing, I like to use a calculation to figure out if the housing is likely to be affordable to LMI individuals. As you can see on the slide, the calculation is there. I first take the area median income and convert it to either low or moderate by multiplying it by 50 or 80 percent, 50 for low and 80 for moderate. Then I divide that calculated income by 12 to get a monthly income figure. I then multiple that by 30 using the HUD standard. Next, I compare this to the monthly rent in the credit memos or other documents. And if the property is for purchase, if somebody's buying the home, I usually use a mortgage payment calculator from the internet to determine monthly payments and then compare this to what I calculated as affordable.

**Remember that Affordability is your starting point. For affordable housing, examiners will need to verify whether LMI benefit, or are likely to benefit, from the housing. Matt will be talking more about affordable housing for LMI individuals later in this presentation.

Moving on to slide 7, for community services targeted to low- and moderate-income individuals, the CRA Q&A, which was updated in 2013, has some great examples showing ways to demonstrate that services benefit LMI individuals.

Some banks I've worked with usually provide web shots with the mission statement of the organizations they work with or FFIEC geocoder pages as documentation. Now, sometimes an organization doesn't have a mission of serving low- and moderate-income individuals exclusively, but they may have a program that targets LMI individuals or families. I've seen this in Lions Clubs and other community organizations. I've also seen hospitals that have specific clinics that target LMI individuals. Again, I've expected web shots or even letters from organizations to document whether or not certain activities qualify as community development.

Moving on to slide 8. So there are two tests for economic development. The first is the size test and the second is the purpose test. An activity must meet both tests to have a primary purpose of community development.

So let's take a closer look at the size test first. The size test pertains to the organization that will benefit from the activities. These organizations can be a loan borrower, the businesses that benefit from investment funds or donations, or it could be an organization that serves small businesses like a Small Business Development Company.

If I'm looking to qualify a particular business, I like to use the SBA Size Standards Table, and you can find this on the SBA's website. If you Google SBA Side Standards, that should bring it up for you, and there's also a link in the presentation. This table is updated periodically, so it's best to use the most current version. The tables used is the North American Industry Codes to determine what is considered small for the industry. In most credit write-ups in loans will include this code.

Moving on to slide 9, the second test is the purpose test. Examiners will consider information that you provide to show that activities meet the purpose test, which relates to the permanent creation, improvement, or retention of jobs in three categories.

First category is a job for low- and moderate-income individuals. The Bureau of Labor Statistics website that lists wages for different job categories by location is helpful. You can then compare these wages to low- or moderate-income in the area. Activities that help with job creation or improvement tend to be particularly responsive to community needs. If you have any information that shows an activity provides opportunities for low- and moderate-income individuals to obtain higher wage jobs such as through work force development or other programs, you'll definitely want to share that information with your examiners.

The second category is jobs created or retained in low- or moderate-income census tracts. Here, I generally rely on the FFIEC geocoder website to determine if a census tract is low or moderate. You'll notice that the Q&A uses the word, "or" which means that the jobs need not be for LMI-individuals; however, qualitatively, examiners would generally give more weight to jobs targeted to low- and moderate-income individuals.

The third category is the creation or retentions job in an area designated for redevelopment by a governing body in the area. You can generally find this information in a credit approval memo or in an investment prospectus. Sometimes banks will take advantage of tax incentives that may be offered in these designated areas, and you may want to check with a bank's accounting department, chief financial officer or treasurer to get that information. Again, the jobs may not be for LMI-individuals or located in the LMI-census track. Lastly, examiners will presume an activity qualifies if it is related to investments or loans to a Small Business Investment Company, a Small Business Development Company, Rural Investment Company, New Market Venture Capital Company, or eligible for new market tax credits.

Moving on to slide 10, activities that revitalize or stabilize generally are those that attract or retain businesses or residents in a particular location; however, there are specific requirements in order to qualify.

First, activities that stabilize and revitalize must benefit certain types of geographies. These include: low- and moderate-income census tracts; a designated disaster area, which, by the way, is generally designated by FEMA; or a distressed or underserved rural middle-income census tract. So the type of geography is important.

Next, we look to the impact of the activity. Attracting or retaining businesses or residents is a pretty broad description, so let's go over a few examples.

How about a working capital loan to an existing business? One could argue that the loan would help keep the business in the area, but how do you know if a working capital loan is business as usual or for community development?

To answer this question, you may need to look further. Credit memo usually provides clues as to the purpose of the funds or the nature of the business, and there are also certain Q&A's that are helpful, and that's §__.12(g)(4), §__.12(g)-2, and §__.12(h)-5.

A working capital loan for an anchored business such as a supermarket that employs or serves residents of the area may be considered to have a community development purpose.

How about a working capital loan to a medical clinic or dental office that provides services to the residents of the LMI census tract? Now, since residents in an LMI census tract would likely be low and moderate, I would say yes; unless you see something in the credit memo that indicates otherwise.

Let's take another example. How about a working capital loan to an investment firm to make overseas investments? Now, here since the funds will not be used to benefit the area, that would not qualify.

So if the funds are likely to benefit the low- and moderate-income area with jobs for low- and moderate-income individuals or services for low- and moderate-income individuals, it would likely qualify.

In addition, if the activity has been approved or is consistent with the revitalization or stabilization plans of a governing board of an enterprise community, empowerment zone, or federal, state, local or tribal government, examiners will presume the activity will be given CRA consideration.

Moving on to slide 11, the last community development category is one that I haven't run into the field. The Neighborhood Stabilization Program was set up during the financial crisis to address areas experiencing high rates of foreclosures.

Next slide, please. So we are now on slide 12. To qualify activities as community development, there is also a geographic requirement. Generally, the activity must benefit the bank's assessment area or a broader area that includes the assessment area. The 2013 updates to the interagency CRE Q&A's clarify guidance, and those are provided in CRE Q&A §__.12(h)-6. If a community development activity benefits the assessment area and is related to one of the five categories I just talked about, then that's pretty much a slam dunk that it will qualify. But what if an organization's activity covers an area that is bigger than the assessment area? The CRA regulation is fairly flexible and allows community development activities that benefit the bank's assessment area or broader statewide or regional area that includes its assessment area.

Now, statewide is fairly self-explanatory, but what does regional mean? A regional area can be within a state like the East Bay in California, which covers multiple cities and counties, or a regional area can cross state lines, like the Pacific Northwest or Mid-Atlantic States.

What if the activity does not benefit the assessment area within the exam period? In that case, examiners would need to look at the purpose, mandate, or function of the organization activity to see whether it includes serving geographies located in the assessment area. For other activities that do not benefit the assessment areas, institutions can still receive community development consideration if they have been responsive to the needs and opportunities within this assessment area and -- and this "and" is very important -- the activities benefit geographies or individuals located somewhere within a broader statewide or regional area that includes the assessment areas.

Moving on to slide 13, so what about nationwide investments? Could banks get consideration for nationwide investments? The answer, and this was addressed in Q&A §__.23(a)-2 from the 2013 Q&A -- so the answer is yes, but only if the purpose, mandate, or function of the fund serves the assessment area or larger area that includes the assessment area. Then the investment meets the geographic requirements of the regulations. So if a bank has a nationwide branch footprint with branches distributed across the country that results in large regional assessment areas with nationwide coverage, an investment in a nationwide fund could be appropriate. In addition, nationwide funds may be appropriate for other institutions if they can demonstrate the investment in the nationwide fund meets the geographic requirements. Examiners will look at a fund's prospectus or other documents to determine the geographic reach of the fund. Now, these investments are not always funded at inception, and sometimes it takes years to fully use or disperse the funds. In these cases, the funds usually send out annual or more frequent status reports on the projects funded, and these typically include information about where the project or businesses are located.

That was a lot of information, so let's go over some examples. Moving on to slide 14, so a California bank invests in a nationwide affordable housing fund that targets states in the East Coast. The bank's assessment area is the San Francisco Bay area. The nationwide fund will not benefit the San Francisco Bay area, but the bank has a satisfactory record of meeting the needs within an assessment area. So the question is, is this activity a qualified community development activity?

The first question to ask, is the housing affordable for low- and moderate-income individuals or does the fund target low- and moderate-income individuals? For this scenario, let's assume it does.

The next question is, does the investment meet the geographic requirements? Does the fund's geographic reach includes the bank's assessment area? Now, from the fact pattern, we know it does not, as the fund targets states in the East Coast, and the bank's assessment area is the San Francisco Bay area; however, the bank has a satisfactory record of meeting the needs within assessment area.

Does that matter in this case? Let's move on to slide 15. This investment involves an activity that is related to one of the five categories: Affordable housing targeted to LMI individuals, but it does not benefit the broader statewide or regional area that includes the assessment area. So while the bank has a satisfactory of record of meeting the needs of its assessment area, this investment in the nationwide fund does not meet the geographic requirements and would not be considered. The satisfactory ratings would, however, allow us to consider other community development activities if they benefitted geographies or individuals located somewhere within a broader statewide or regional area that includes the institution's assessment area even if it will not benefit the bank's assessment area. Bottom line for this investment, however, it will not be considered in this bank's CRA performance evaluation.

Moving on to slide 16, OK, here's another example. A bank in Hawaii makes a donation to the Hawaii Food Bank that operates on a statewide basis that includes Honolulu, which is in the bank's assessment area. The examination just started, so the bank's performance in the assessment area is not known. Would this donation qualify as a community development donation? Do we have enough information? Let's see.

We know that the activity of the organization is related to one of the five categories since it provides services to low- and moderate-income individuals. Do we know that the organization's activity -- the organization or activity meets the geographic requirements of the CRA?

Well, we know that the bank's assessment area is Honolulu and the organization operates in the State of Hawaii, which includes Honolulu and thus includes the assessment area, so this donation does meet the geographic requirement.

Moving on to slide 17 and this basically says the answer is yes, since the food bank operates in a statewide basis, it meets the geographic requirements. And also, since it meets the requirements, this donation would qualify on its own merits and we don't need to take the extra step of determining whether or not the bank is meeting the needs of its community.

Moving on to slide 18, so as with most things, there are exceptions to the geographic requirements. If a bank supports a minority or women-owned financial institution, or supports a low-income credit union, that activity is exempt from the geographic requirement in the regulation. The only caveat to this is that the minority or women-owned financial institution or credit union needs to have a record of meeting the needs of its own assessment area. This can be verified by reviewing the institution's most recent CRA performance evaluation. The slide lists examples of what types of supports that these organizations qualify. What I see most of the time is banks opening certificates of deposits in low- and moderate-income minority owned financial institutions. I've also seen a bank take a leadership role in rallying other financial institutions to provide capital. In this case, to a Hispanic-owned financial institution in California. In this case, the bank would receive consideration for its leadership role in that investment, and leadership is one of the defining characteristics between satisfactory-rated institutions and institutions rated outstanding.

So that covers my section. So now, I'm going to hand things off to Matt.

HOLT: Thanks, Maria. So I am starting on slide 19. In this section of the presentation, we're going to discuss how a bank can analyze its loans, investments, and services to determine whether the activity is likely to qualify as community development.

Additionally, we will discuss the type of information that should be provided and discussed with examiners. Banks take varying approaches to CRA and community development, which is expected given the unique performance context of every bank.

A bank may choose community development activities based on its business strategy, capacity, and constraints and the opportunities and needs of its community. From an examiner's perspective, a bank's loans, investments, and services will be reviewed in accordance with the interagency CRA regulation, examination procedures, and the guidance, primarily the interagency CRA questions and answers.

Note that although many bank activities may have a positive impact on the community, the activities must be qualified according to the regulation and/or the guidance. If a bank requests to have a loan, investment, or service included in its CRA examination as community development activity, consider these five steps to ensure the activity is qualified and given proper consideration by the examiner.

- Step 1: Determine if the activity meets one of the community development purposes
- Step 2: Start the analysis by asking two simple questions, which can likely dictate if the activity can be qualified
- Step 3: Depending on the purpose of the activity, consider common situations which may impact the activity's qualification
- Step 4: Collect and provide the necessary documentation for each activity so an examiner can make a thorough and effective analysis of the activity
- Step 5: During the examination, make sure to communicate qualitative considerations about each activity to the examiner so they can gain a full understanding of the activity's impact on low- and moderate-income individuals and geographies in the assessment area. Slide 20, please.

Before presenting any loans, investments, or services for community development consideration, a bank should ask what community development purpose does this serve. Maria discussed the community development categories earlier.

As a reminder, they are:

1. Affordable housing for low and moderate income;
2. Community services targeted to low or moderate income;
3. Economic development by financing small businesses or farms;
4. Revitalization or stabilization of low- or moderate-income areas, designated disaster areas, distressed or underserved non-metropolitan middle-income areas; and
5. Activities that support areas designated under the Neighborhood Stabilization Program.

For the purpose of this presentation, we will focus on affordable housing, community services, economic development, and revitalization or stabilization as these are the more common community development activities.

It's important to note that the definitions of community development loan, community development service, and qualified investments all include the phrase, "has as its primary purpose community development." Before getting started, it is important to understand what is meant by the term, "primary purpose" as it relates to community development loans, investments, and services. Next slide, please.

I want to point out that the majority of information displayed in the next few slides is contained in the interagency questions and answers. Citations to applicable sections are included.

Q&A §__.12(h)-8, asks: What is meant by the term, "primary purpose?" In summary, a loan investment or service has as its primary purpose community development when it is designed for the express purpose of affordable housing for LMI individuals, community services targeted to LMI persons, economic development by financing small businesses or small farms, or revitalizing or stabilizing LMI-areas, designated disaster areas, or distressed or underserved non-metropolitan middle-income rural areas.

To determine if an activity is designed for an express community development purpose, the agencies apply one of two approaches. The first approach is as follows: If the majority of dollars or beneficiaries of the activity are identifiable to one or more of the enumerated CD purposes, then the activity will be considered to possess the requisite primary purpose. The term, "enumerated community development purpose" is referring to one of the four community development purposes. To summarize, if 50 percent or more of the dollars or if 50 percent or more of the beneficiaries are identifiable or can be attributed to a community development purpose, then the entire activity can be qualified. We will later discuss an exception to the primary purpose provision in relation to affordable housing. Moving on to slide 22, please.

As for the second approach, alternatively where the measurable portion of any benefit bestowed or dollars applied to the CD purpose is less than a majority of the entire activity's benefit or dollar value, the activity may still be considered to possess the requisite primary purpose, and the institution may receive CRA consideration for the entire activity if:

- the express bona fide <u>intent</u> of the activity as stated, for example, in a prospectus loan proposal or community action plan, there's primarily one or more of the enumerated CD purposes;

- the activity is specifically structured given any relevant market or legal constraints or performance context factors to achieve the express CD purpose; and
- the activity reasonably accomplishes or is reasonably certain to accomplish the CD purpose involved.

Note that you must meet all three conditions mentioned in the Q&A to meet the primary purpose of community development. For example, if a developer submits a loan proposal with the intent consistent with the community development purpose such as affordable housing, the activity is structured specifically to achieve that purpose, and the developer has a track record in building affordable housing projects, the entire loan amount would meet the primary purpose of community development because it meets the three criteria mentioned above.

Slide 23, please. Once the bank has determined the primary purpose of community development, it's important to ask two simple questions that will likely dictate whether or not the activity is qualified.

One question is: Was this activity considered under the retail lending or service test? Keep in mind that the only activity that can be counted as both a retail lending activity and as community development is a multi-family housing loan.

The other question is: Does this activity benefit or have the ability to benefit individuals or areas in the bank's assessment area? If the answer is yes, then the bank should present the activity for consideration. If the activity does not have a direct impact on an assessment area or provides benefits within a broader statewide or regional area that includes the assessment area, and the bank has been responsive to community development needs within its assessment area, then the bank should present the activity for consideration.

Earlier, Maria provided some general information about qualifying community development services to low- or moderate-income individuals. I'll expand on that and provide some additional information about this topic. Next slide, please.

CRA, Q&A §__.12(g)(2)-1, asks: What are examples of ways that an institution could determine that community services are offered to LMI individuals. Examples include, but are not limited to,

- The community service is conducted in an LMI area and targeted to the residents of the area,
- The community service is offered at a work place to workers who are LMI based on readily available data for the average wage for workers in that particular occupation or industry,
- The community service is provided to students or their families from the school at which the majority of students qualify for a free or reduced price meals under the U.S. Department of Agriculture's National School Lunch Program,
- The community service is targeted to individuals who receive or are eligible to receive Medicaid,
- The community service is provided to recipients of government assistance programs that have income qualifications equivalent to, or stricter than, the definitions of LMI as defined by the CRA regulations.

For example, if the bank makes a $1,000 donation to a school for the purpose of implementing a financial literacy program, and the school is located in a middle-income tract, then you may think that the donation is likely not to qualify; however, if 50 percent or more of the students are eligible for free- or reduced-meals, then the donation will qualify.

As another example, if a bank makes a $5,000 donation to an organization that provides free health services to low- and moderate-income individuals, such as providing dental care for Medicaid recipients, then the donation would qualify.

Slide 25, please. The next few slides cover situations that banks should always consider when analyzing community development activities. The first point of emphasis for affordable housing is that the consideration hinges on the benefit or likely benefit to LMI-individuals. It would be inappropriate to give consideration to a project simply because the rents or housing prices are set according to a formula that relates to the cost of rentals to the income levels in the area. For example, if a loan is originated for the purchase of an apartment building containing lower cost units compared to more expensive units in the same building, it doesn't mean that lower cost units are considered affordable if LMI individuals are not likely to live there.

As mentioned previously, there's an exception to the primary purpose requirement for affordable housing in the case of mixed-income housing. As explained in Q&A §__.12(h)-8, an institution may receive pro-rata consideration for the portion of such activities that help to provide affordable housing to LMI individuals based on the percentage of units set aside for affordable housing for LMI individuals. Next slide, please.

As an example of what was discussed on the prior slide, if an institution makes a $10 million loan to finance a mixed-income housing development in which 10 percent of the units will be set aside as affordable housing for low- or moderate-income individuals, the institution may elect to treat $1 million or 10 percent of such a loan as a community development loan. Next slide, please.

The performance criteria for large banks, intermediate small banks, wholesale and limited purpose banks all include criteria for community development services. Sometimes there's confusion between the terms, "community services" and "community development services."

On occasion, I've seen banks incorrectly consider any outreach activity or participation in a community event as a community development service. The regulation, however, in related Q&A guidance make it clear that community development services must have a primary purpose of community development and be related to the provision of financial services.

The Q&A guidance explains that providing financial services means providing services of the type generally provided by financial services industry. Providing financial services often involves informing community members about how to get or use credit or otherwise provide credit services or information to the community. An example of a service related to the provision of financial services would be service on a board of directors of an organization that promotes credit availability or finances affordable housing -- slide 28, please.

The next two items are perhaps the most overlooked when qualifying community development services. The guidance provided in Q&A, §__.12(i)-2, explains that services must be provided as a representative of the institution. For example, if a bank employee on her own time and not as a representative of the institution, volunteers one evening a week at a local community development corporation's financial counseling program, the institution may not consider this activity as a community development service.

§__.12(i)-3, which was amended by the supplement Q&A in November 2013, includes many examples of community development services. It also provides examples of technical assistance activities that are related to the provision of financial services and that might be provided to community development organizations. The list is included on the following slide. Slide 29, please.

One addition of particular note that is, providing services reflecting a bank employee's area of expertise at the institution such as human resources, information technology and legal services, is an example of providing a community development service. This revision clarifies that a bank will receive consideration for its employee's participation in community development organizations based on the use of professional knowledge and expertise, even if it is not directly related to credit or financial services. Next slide, please.

Additionally, activities that do not take advantage of an employee's financial or technical expertise such as neighborhood cleanups do not involve the provision of financial services. Accordingly, events such as building houses or serving food at a soup kitchen would not qualify as a community development service. Slide 31, please.

As Maria mentioned earlier, for a loan, investment, or service to have an economic development purpose, it must demonstrate that the activity meets the size and the purpose test. Since this is an area that can be confusing, let's go over some examples.

One example of an activity that could be considered economic development are loans above $1 million to a financial intermediary that meets the SBA's size standard and provides loans and technical assistance to small business startups; these loans would not be reported on the CRA LAR and incorporated into the retail portion of the lending test, and they would pass the size test.

Another example of an economic development activity would be a donation to an organization that provides job training for LMI individuals or within LMI geographies. Moving on to slide 32.

As Maria also discussed earlier, section §__.12(g)(4)(i) of the Q&A, explains that activities which revitalize or stabilize LMI geographies help attract new or retain existing businesses or residents. An example of such an activity would be offering a foreclosure prevention program with the objective of providing affordable, sustainable, long-term loan restructurings or modifications to homeowners in LMI geographies. Other examples would be providing financing to help retain businesses in the area that employ local LMI residents; providing financing to attract a major new employer that will create long-term job opportunities including for LMI individuals; providing financing or other assistance for essential community-wide infrastructure, community services, and activities that provide housing, financial assistance, and services to individuals in designated disaster areas, and to individuals who have been displaced from those areas including LMI individuals.

It should be noted; however, that all loans even if in an LMI geography, do not have a stabilizing effect. Some loans may only provide indirect or short-term benefits to LMI individuals or an LMI geography. For example, a loan for upper-income housing in an LMI area is not considered to have a community development purpose simply because of the indirect benefit to LMI persons from construction jobs or the increase in the local tax base that supports enhanced services to LMI-area residents. Slide 33, please.

If a bank is presenting activities for consideration as community development, the information shown on this slide, supported by source documents, will help examiners to demonstrate the activity's qualifications. Such information includes, but is not limited to:

- The date of the loan origination or renewal or the date of the investment or service;
- The name and address of the borrower or organization benefitting;
- The dollar amount of the loan or the investment;
- A description of the activity and its community development purpose; and
- Supporting documents, such as a note, credit approval memo, loan agreement, investment prospectus, side letters, or investment partnership agreements.
- A prospectus, loan agreement, mission statement, and other relevant documents showing the purpose and details of the investment, including the quality of aspects of performance, will ensure proper consideration is given to an activity.

A best practice is for banks to collect and organize qualifying community development information on an ongoing basis. Lisa will be providing more information about tracking later in the presentation.

Note that for investments, as outlined in Q&A, §__.23(e)-2, examiners will consider the dollar amount of qualified investments that are new, outstanding, or legally binding commitments recorded by the institution according to generally accepted counting principles. Slide 34, please.

In addition to the assessment of the quantitative aspects of a bank's community development activities, examiners also review the qualitative assets of a bank's performance in community development matters as shown on the first bullet of this slide. Examiners will be interested in any information that you have that will show the responsiveness and impact of the community development activities on the community. Sharing the story of a particular activity will help examiners understand the qualitative aspects of the activity and its responsiveness or impact on the community. As an examiner, I am interested in knowing:

- Did the bank identify a specific community development need within the assessment area?
- Was the activity implemented to address that specific need?
- Was CRA considered before the activity was consummated?
- What is the potential or actual impact of the activity on LMI individuals in the assessment area?

- Why did the bank believe the activity was the most effective means of achieving a positive impact?

One important takeaway from today's presentation is that a bank's performance under qualitative criteria may augment the consideration given to a bank's performance under the quantitative criteria of the regulations, resulting in a higher level of performance and rating. This Q&A stresses that the qualitative nature of community development activities can be a deciding factor of a bank receiving a rating greater than satisfactory based on the impact and the responsiveness of its community development activities. Again, sharing the story behind the bank's community development activities enhances an examiner's understanding of assessment area needs and the bank's responsiveness. Without communicating this information to examiners, the impact and importance of a bank's community development activities may not be considered in the performance evaluation. Next, I'll hand things off to Lisa.

SHEPARD: Thanks, Matt. I'm starting on slide 35. I'm going to discuss some best practices in identifying community development opportunities and tracking and monitoring performance. But before we get into that, it's important to understand performance context.

While much of what is discussed in this presentation could be applied to wholesale, limited purpose, strategic plan, or in certain instances small bank examinations, the focus is on intermediate small and large bank examinations. Moving to slide 36, please.

Defining performance context. Performance context is the internal and external factors that frame the bank's performance. The external factors include information about the bank's assessment area, including demographic data such as median family income levels and housing costs, and the number of businesses in the area and the geographies in which they are located. Performance context also considers competition, economic environment, and housing stock, including the age of housing, the values of homes, affordability, and the number of multifamily homes as compared to single-family homes. Moving on to slide 37, please.

Defining performance context continues. Some bank characteristics or internal factors include product offerings and the institution’s size, capacity, and constraints. In terms of capacity - look to areas where management has expertise or strengths. Are there opportunities that a bank could take advantage of in line with this business strategy and strengths? Does the bank have expertise to make complex investments? Are there constraints, such as supervisory restrictions, that limit a bank's performance ability? Considering an institution’s size and financial condition, the regulation builds in some consideration for asset size based on specific thresholds.

For example, rather than having three separate tests evaluating lending, investments, and services, such as in large bank examinations, under the intermediate small bank examination procedures, a separate community development test is used. The intermediate small bank test built in the flexibility that allows an ISB to allocate resources among community development loans, investments, and services in amounts that it reasonably determines are the most responsive to its community’s CD needs and opportunities in its assessment area.

Remember, any information deemed relevant can be provided to examiners to help them understand performance context. Specifically, a CRA officer has more knowledge of their assessment areas than the examiner, so be prepared to explain your bank's unique performance context. Moving on to slide 38.

Moving on to slide 38. Understanding the assessment area and performance context. CRA examinations consider the needs and opportunities within a given assessment area and how well-positioned the bank is to meet those needs.

The first bullet notes that examiners consider the responsiveness community development activities. It is important to understand the needs in the assessment area in order to respond to these needs.

The bank's products offering community development activities should be consistent with the needs and opportunities within the assessment area. Similar to how examiners will conduct community contacts, a bank may reach out and build partnerships with community organizations to identify and serve credit and community development needs.

As a CRA officer, leverage off the knowledge and expertise with your board members and employees. In addition, you may want to consider attending outreach events.

Moving on to slide 39, please. Understanding assessment area and performance context continues. Note, the community development activities may vary based on the characteristics of the community. For example, certain geographies may be more conducive to certain community development activities, and geographies that have experienced the rise of foreclosure and absentee landlords, for example, a responsive community development activity maybe to provide foreclosure prevention programs, affordable housing, rehabilitation and construction loans.

Construction and permanent financing of multifamily rental property serving low- and moderate-income individuals is a qualified community development lending activity, and by the way, also considered on the retail lending test.

However, it is important to remember that community development is not just about geographies. In areas where there are few low- and moderate-income census tracts, partnerships and discussions with community action and government agencies can assist institutions in reaching low- and moderate-income individuals or small businesses. For an example, where correlations have been noted between low- and moderate-income individuals and underserved or unbanked individuals who rely on more expensive, nontraditional forms of financing, providing financial education, coupled with low-cost checking and savings accounts and remittance services to low- and moderate-income individuals constitutes activities that are responsive to the needs of the community and would likely qualify as community development services.

As discussed in Maria's presentation, an institution may also receive consideration for CRA activities that may not have a direct benefit to the assessment area. An example could be a low-income housing tax project which occurs at the state level or investments in Small Business Investment Companies that operate at a regional level.

Recognizing that opportunities to invest or purchase loan participations may be more limited at the assessment area than the state level, particularly for a large bank. Consideration is also given to investments in nationwide funds.

In addition, activities that will not benefit the assessment area may enhance the bank's performance provided the bank has been responsive to community development needs within the assessment area.

So there is always the expectations the bank is being responsive to the assessment area. See Q&A §__.12(h)-6 for additional detail. Also, additional information on community development considerations for activities at the broader statewide or regional level and large bank procedures, please visit the link to the Outlook Live presentation from 2014.

Moving on to slide 40. Earlier, Matt talked about qualitative considerations, which has a large degree to do with responsiveness. Remember, without identifying the needs of the assessment area, it would be hard to determine responsiveness. Responsiveness is considered in all types of CRA examinations. Large bank examinations go a step beyond responsiveness and also consider if an activity is innovative or complex and the degree to which the institution acted in a leadership role. Here too, without understanding the credit and community development needs in the assessment area, it would be difficult to demonstrate the bank develops an innovative solution or acted in a leadership role.

Moving to slide 41. A best practice is to set goals. While internal goals are not required, and examiners do not review performance against goals, many banks find it helpful to set internal goals and monitor performance. Once the bank understands its own performance context, including bank and community characteristics and the community development opportunities available, it will be ready to set goals for meeting the credit and community development needs. To help set a goal, think about the expertise and business strategy of your bank. Reach out to community representatives to discuss community needs and how your bank can help meet those needs. In addition, set measurable goals. Having a target can be constructive. Assume a bank operates in a downtown area that is targeted for redevelopment. One goal may be to provide financing to attract a major new employer that will create long-term job opportunities, including those for low- and moderate-income individuals. In addition, look to partner with financial intermediaries such as Community Development Financial Institutions, New Market Tax Credit-eligible community development entities, or Community Development Corporations.

Bankers also may want to consider including the desired impact within the goals. For an example, an objective statement may include language such as, “within the next three years we would like to originate 10 community development loans with the desired impact of creating 20 units of affordable housing, and five large loans to small businesses in low- or moderate-income geographies with the desired impact of providing needed jobs.”

Moving on to slide 20. Goal setting continues. Consider creating an action plan. A written action plan can help ensure that objectives are met. The plan should identify key employees and specific timeframes. You will want to include any helpful information you can, such as how a bank plans to reach low- and moderate-income individuals. For example, a plan may require specific individuals within the commercial loan department to conduct a certain number of small business seminars annually, with a certain number of participants. If known, you may also want to include where the participants will be recruited, for example, from a local small business incubator. Likewise, the plan may dictate loan offices conduct a specific number of financial literacy training for first-time homebuyer seminars. It is important to note that these trainings must be provided to low- and moderate-income populations. Earlier, Matt spoke about proxies. Recent Q&A allowed for certain proxies to be used to demonstrate individuals in low and moderate income. For example, a bank may consider conducting outreach events or at a business where the employees are low or moderate income based on data published by the Bureau of Labor Statistics.

Many times we see Teach the Children to Save Days or basic banking seminars conducted at local schools. While commendable activity, CRA consideration may only be given if the majority of students are low and moderate income. Visit the website noted on this slide, which will provide the number of students, along with a number of students receiving free or reduced meals. Moving on to slide 43, please.

As a best practice, provide training and tracking. Before tracking, ensure to provide training. Loan officers and other staff should have, at minimum, a basic understanding of what qualifies a community development.

Even if a loan, investment, or service is not tied to a CRA action plan, it may still be qualified for community development purposes. Some CRA officers develop checklists to guide staff in determining if the activity meets the definition of community development. This is provided to be a best practice for them. The checklist may include useful information such as, if the loan is an empowerment zone or will result in affordable housing units in low- and moderate-income geographies.

It is helpful when all qualified activities are collected and organized. In certain instances, I've noticed the use of Excel spreadsheets, which contains information on the activity and how it qualifies as community development.

In addition to capturing activities through a centralized process, it is important to maintain backup documentation such as thank you letters and descriptions of projects and populations served.

The last bullet addresses analyzing the data once it has been gathered. This tracking helps bank management to periodically review activities and determine if the bank is on-track to meet its goals.

Remember, examiners will conduct HMDA and CRA data integrity reviews. In conjunction with CRA reviews, a bank should periodically review its CRA LAR to ensure that community development loans are accurately reported. Included in the slide is the link to the CRA Loan Data Collection Grid, which is a helpful resource in determining how loans should be reported.

Moving on to slide 44, please. The previous slide discussed different formats the bank can use to track community development information. Some banks maintain data on a spreadsheet. For easy reference, it should provide a summary of each activity. No matter what format is used, I want to discuss some information that should always be captured. A best practice is for community development activities to be organized by specific assessment areas, or if the activity benefits or is targeted to the assessment area, state, or multi-state MSA, or when the activity is targeted to two or more assessment areas or at the institutional level.

For community development loans, in addition to identifying the assessment area benefitted, the tracking mechanism should also identify general information about the origination dates, the loan type, or if the loan was a renewal. A useful tool would also include a description of the purpose of the loan, why it is qualified, and the community development purpose. A comprehensive spreadsheet would also include information regarding the beneficiaries of the proceeds and if the activity resulted in the creation of affordable housing units or jobs.

A similar spreadsheet or other mechanism could be used to track investments. This should capture general information on the investment as well as how it is qualified and information on the effect of the proceeds. Also consider maintaining information regarding the book value of prior period investments. Remember, examiners will consider investments that were made prior to the current examination, but are still outstanding.

In terms of donations, remember to include any in-kind contributions. I have noted spreadsheets which include links to the organization's website, which is also useful in determining the community development purpose.

In terms of services, it is important to track the employee's name, position at the bank, and number of hours served. Also include a description of the capacity in which the employee serves. Here, ensure to document how the activity was related to the provision of financial services and required the employee's technical expertise. In order to consider an activity, it is also important to have information regarding the beneficiaries to ensure that the service benefitted low- and moderate-income individuals. Please note, as Matt discussed, services must be provided as a representative of the bank. Moving on to slide 45, please.

The last piece I will speak to is monitoring. Tracking on spreadsheets such as those discussed in the previous slide would serve as an effective monitoring tool. If an institution has measurable goal, reviewing such spreadsheets or other tracking mechanisms on a semi-regular basis, would help determine if the bank is meeting its goals.

It could also be beneficial to review competitors recently published public evaluations. This would help identify if there are community development opportunities in the area that the bank was previously unaware of.

Similarly, maintain contacts with government and community groups. It helps the bank keep abreast of changing needs in the community, such as if an area has recently been identified for redevelopment.

Conduct a self-assessment. No, a self-assessment is not required, but it is a highly effective tool for monitoring performance. The assessment can be scalable, as we recognize not all banks have the capacity to have a full self-assessment conducted, but everyone should have a general idea of where they stand in terms of their CRA performance and know the market in which they operate.

That concludes my portion of the presentation. As we move to slide 46, you'll find some helpful resources for future reference. With that, I would like to turn it over to Amy to see if there are any questions. Thank you.

VANDER VELDE: All right. Very good. So at this time, we are going to take some questions here, and as a reminder, go ahead and click the ask question button right there on the webinar tool and submit those, and for now, we're going to go ahead and read the first one here.

And this question says “can you give examples of qualifying activities for community development for smaller community banks that are not located in inner cities or larger metropolitan areas?”

Maria, do you have a shot at that one?

VILLANUEVA: Sure. For this question, I actually looked up a CRA PE that I did a few years ago. So here are a couple of examples from a $525 million bank that operates in rural areas of California.

The first example is the bank purchased $5 million participation in a $35 million takeout loan. The loan paid off the construction loan of a national chain hotel located in the low- and moderate-income census tract that is also in the downtown redevelopment project area. The activity is consistent with the redevelopment goals, which have specific strategies to develop new hotels to support tourism, maintain the area of the business center, and enhance the area's appeal as a visitor destination. In addition, the project revitalized a low- and moderate-income census tracts by creating jobs. So that's one example.

Another one in there was a total of 86 hours -- service hours were provided at the member of the board and through fundraising activities to an organization that primarily raises funds for hospitals serving a large regional area that includes the bank's assessment area. For this hospital, over 70 percent of the hospitals qualified for MediCal and over 33 percent are from the Stanislaus area.

So if you're looking for more examples, looking up CRA performance evaluations located in rural areas or from small institutions would help you find more examples.

MICHAEL VANDER VELDE: All right. Very good. Thank you for that question and that answer. So the next one says “do you have any suggestions or can you share common errors you've seen for banks transitioning from an intermediate small bank to a large bank?”

MARIA VILLANUEVA: I can take that one. This is Maria again. In terms of reporting CRA and HMDA data, some CRA officers in large banks have asked their lending staff to create mini files that include source documents that the CRA staff can use to conduct their data verifications, and I found that to be very helpful. These mini files that include such documents as copies of promissory notes, credit memos, tax returns or W2's. I've noticed that banks that use this mini file system tend to have very clean data.

On the flipside, the most common error I've seen for transitioning banks that are those that are transitioning from small to intermediate small, in those cases, the most common error is not being able to provide examiners with community development activity. In most cases, the root cause seems to be the lack of knowledge of what types of activities qualify as community development. Bankers who take advantage of community development staff with their respective regulators tend to do better in the CRA exams.

VANDER VELDE: Right. Very good. Thank you for that. And Maria, I'm going to stick with you with this next question, too. It says, "how important is CRA for banks that plan to merge or plan to acquire another bank"?

VILLANUEVA: Great question. Unlike other laws and regulations, examiners don't cite violations for poor CRA performance; however, CRA performance plays an important role in the application process. Bank regulators need to take an institution's CRA performance into consideration when making decisions on applications for mergers and acquisitions. An institution's poor CRA performance can have a negative impact on these types of transactions, and I've actually worked on those transactions. So it's a fact.

VANDER VELDE: Very good. Thank you for that. And so this next question, Matt, we're going to go over to you for this one. It says, "if the mission or purpose of an organization and it's LMI statistics do not change over time, is it necessary to annually update supporting documentation?"

HOLT: Sure. So I would say it's not necessary to update supporting documentation on an annual basis, but you should have up-to-date information about the activity as of the time that activity was carried out so that way when the examiner is assessing that activity, they can see at that point in time everything that went in to qualifying it. And additionally, some banks they do the same activities year-after-year, which is perfectly fine, but the examiner may have not been that previous exam, so they might not be familiar with the organization. So having that information as up-to-date as possible is going to be helpful for both the bank tracking-wise and the examiner who is doing the examination.

VANDER VELDE: All right. Very good. Thanks again for that question and the answer. So let's see. This one says, "would loan investment or service to a domestic violence shelter count as community development," and Matt, can you take that one, too?

HOLT: Yes. So there's an actually Q&A that addresses this. It's section §__.12(t)-4 and the question there is what are examples of qualified investments, and some of the examples given are facilities that promote community development by providing community services for low- and moderate-income individuals such as youth programs, homeless shelters, soup kitchens, health care facilities, battered women shelters and alcohol and drug recovery centers. So this section stipulates that an investment in a domestic balance shelter would be qualified; however, it's important to keep in mind that the service still needs to be focused on low- or moderate-income individuals.

VANDER VELDE: Excellent. Thanks again for that. OK. This questions says, "does service on a board of directors always receive credit as a community development service?"

HOLT: I can hop in for this one, too. This is a question that we get a lot and there's usually a lot of conversation about, but generally, yes, but the organization has to meet one of the community development purposes in and of itself.

There's a Q&A at section §__.12(i)-3 that cites serving on a board of directors as an example of a technical assistance activity because it's related to the provision of financial services, and the commentary from the Q&A's states that all community development services are expected to provide a genuine benefit to a financial institution's community for consideration.

So service on that board would qualify, but as long as what the organization does has that community development hook also.

VANDER VELDE: Excellent. Thanks again for that. This one says, "Can geography alone qualify a CD activity when income statistics are not available? For example, a financial literacy course is taught to members of a church congregation. The church physically resides in the low-income geography. The church does not collect income information from its members."

SHEPARD: I can hop in on this one. So the answer is yes, the Q&A provides some examples of ways that an institution could determine that a community service is offered to low- and moderate-income individuals when income data is not readily available. For the Q&A, those examples include the community services offered by non-profit organizations that are located in and serves a low- and moderate-income geography, which seems to be what we have here in the example. Additionally, the community service could be offered and conducted in the low- and moderate-income area that is targeted to residents who live there. Therefore, the example would likely qualify.

VANDER VELDE: All right. Very good. Thank you for the question and the answer. Next it says, "as a new intermediate small bank reporting for the first time, what are the key items to track? For example, loans, services and community development."

HOLT: All right. I can hop in on this one. So it's an ISB tracking this information for the first time. I think a lot of it would be the same as what we were talking about before. So anytime that there's an activity, you know, basic information such as the date, whether the institution thinks it qualifies as affordable housing or community services, the date the individual is involved, if it's an investment, the dollar volume or same thing if it's a loan, you know, the dollar volume also. So just the basic information that, you know, any organization -- any institution should track. I don't think that the size of it -- the size of the institution necessarily matters, but just getting that vital and pertinent information that an examiner would need to assess that activity would be all that would be needed.

VANDER VELDE: Excellent. Thanks for that. Here's another one that says, "can you give any insight for large banks into the differences in being examined by the OCC and CFPB?"

VILLANUEVA: I can take that one. There shouldn't really be any differences. We're all operating from the same examination procedures. Also, the CFPB I don't think reviews for CRA. I hope I'm not misunderstanding the question.

VANDER VELDE: OK. That sounds good and folks can ask a clarifying question there. So we do have just a few minutes left in our allotted time and we have a bunch of great questions here. I want you to know that if you submitted one, we will get it in the hands of our presenter and formulate some kind of answer either it's going to be another presentation or FAQ or something along those lines. So we do appreciate all those questions that you are submitting and keep them coming. So this next one says, "have you seen SharePoint utilized to organize service, investment, and CD loan documentation? If so, what were the features?"

HOLT: I can't say that I've come across anybody using SharePoint, so to be quite honest, I'm not even sure exactly what that is because I haven't seen it, but primarily when I have seen institutions track the information, it's usually within an Excel file or some kind of internal document that usually just outlines and it will separate it by investment, services, or loans.

VANDER VELDE: All right. Sounds good. I welcome all questions. That's good. Next one says, "can you comment on the size test and qualifying community development loans, specifically using the size standard tool on the SBA website, new business with no revenues, et cetera?"

VILLANUEVA: So I can take that one. OK. So in terms of the size test, if you're trying to qualify a community development loan, that would pertain to one where you're qualifying it under economic development and there is a size test. So the borrower of the loan needs to meet the size standards of the Small Business Administration, but you also have to meet the purpose test because it's a two-pronged test.

VANDER VELDE: OK. Thank you for that. Lisa, if you could answer this one, how is LMI defined?

SHEPARD: Sure. So low- and moderate-income is defined based on the median family income for a metropolitan area, which is done by the US Census Bureau. So low-income is defined as 50 percent or less than the median family income and moderate-income as defined as 50 to 80 percent of the median family income.

VANDER VELDE: Very good. Thank you for that. The next one here says, "will a bank receive credit for donations made to a school or items given when 50 percent of the students qualify for free lunch" and maybe Maria, can you take that one?

VILLANUEVA: Sure. So the free lunch program is a good proxy and there is a CRA Q&A that actually calls out the free lunch program. So that would definitely be a yes. That CRA Q&A is §__.12(g)(2)-1 and it specifically calls out students or their families from a school at which the majority of students qualify for a free or reduced priced meal under the U.S. Department of Agriculture's National School Lunch Program.

VANDER VELDE: All right. Very good. And this one is for Matt. Would a loan for police cars or other community type services count if in distressed areas?

HOLT: For a situation like this, I would have to give the general statement of, you know, I would need more information, but just going based off the question, I would think a loan for a police car would not count.

My mind goes to how is that benefitting LMI individuals, but if the institution had a loan, you know, for something, like, a van to an organization that provided services to LMI-individuals, something like that would be qualified and primarily because if it's an auto loan, it most likely wouldn't be incorporated into the lending test.

So for the police car, I would probably say no just based off that little bit of information, but other types of auto loans could be.

VANDER VELDE: All right. Very good. So that does take us right up to time. Let me sneak one more question in here. Again, we have a bunch of great questions in here and you can continue to submit those. And we're going to gather those and get them in the hands of our presenters even after the session is over. So Matt, let's stick with you with this one. It says, "if employees participate in painting a Habitat house on bank time and they are being paid by the bank for that time, will this qualify as community development service?"

HOLT: This question actually goes back to what I had touched upon regarding CD services and I believe it's Q&A §__.12(i)-1 where it relates that of events such as neighborhood cleanups or anything else of the like doesn't involve the provision of financial services. So just based off the information on that question, that would not qualify.

VANDER VELDE: All right. Very good. So at this time, I'm going to bring us to an official close. I just pushed a survey out through the webinar tool, so if you're seeing that pop up there, please do take just a moment and provide that feedback to us.

I would like to also note that this is going to be sent out in email as well. You just need to fill it out once in either place there and again, we appreciate that. I do also want to mention we understand that there were some difficulty with the slide transitions today and some of the audio. Apologize for that inconvenience. We are working with our provider to get that ironed out. So again, thank you for your patience there.

Thanks again for joining us today and special thank you to our presenters for their time. As a quick reminder, we do have that website, www.ConsumerComplianceOutlook.org. That's where you're going to find the archive of this call along with the session materials and a bunch of other great session information there as well. So definitely take a look at that if you have time.

With that said, have a great day, everyone. We'll catch you next time.