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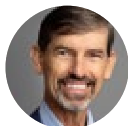
Final CRA Regulations Better than Proposed, Stakeholder Focus Turns to Implementation



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Over the past few years, community development stakeholders have been anxiously awaiting revisions to the Community Reinvestment Act (CRA) regulations, fearing that the elimination of the investment test would adversely affect the tax credit equity investment market. CRA regulations outline the rules bank regulators follow to rate how well banks are addressing the needs of the communities they serve, particularly low- and moderate-income (LMI) households.

The wait ended Oct. 24, when final regulations were released by the Federal Reserve Board of Governors (Fed), Office of Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC). The release was greeted with general gratitude for the directional change from the proposed regulations, and cautious optimism as the focus of stakeholders turns to implementing guidance.

The regulations, which will supplant CRA rules adopted in 1995, include provisions that appear more favorable to community development tax incentives–particularly the low-income housing tax credit (LIHTC) and new markets tax credit (NMTC)–than did the OCC's enacted-and-withdrawn regulations from 2020 and the jointly proposed regulations published in 2022.

How the new CRA regulations will affect community development–including LIHTC, NMTC, historic tax credit (HTC), renewable energy tax credit (RETC) and opportunity zones (OZ) investment–will become clearer over the coming months as the agencies roll out sub-regulatory guidance.

Historically, equity investments in affordable housing and community development have contributed to higher CRA ratings for banks, leading to more than 80% of annual LIHTC and NMTC equity investment coming from such institutions. Because of that, stakeholders in community development tax incentives–particularly in the LIHTC and NMTC worlds–recognized that the CRA discussion was a high-stakes decision that could encourage or discourage tax credit equity investment.

A Short History of CRA

The October regulations came 28 years after the most recent major overhaul and following years of discussion.

President Jimmy Carter signed the CRA into law in 1977 to address inequalities in access to credit, according to a fact sheet issued by the three agencies that issued new regulations. The CRA requires banking regulators to ensure that banks help meet the credit needs of the communities in which they do business, particularly LMI neighborhoods.

In the 18 years after the enactment of the CRA, regulations focused on lending policies and processes,

including marketing and evidence that discrimination was occurring, then in 1995, the regulations were overhauled, and the focus shifted to performance and measurable data, including a series of tests for institutions based on size. Large banks faced a lending test, investment test and services test, with the lending test making up 50% of the CRA score and the other two each making up 25%.

Those 1995 regulations focused on the location of deposits, which over time led to a distortion in tax credit equity investments, since banks focused CRA-motivated investments where deposits were made, rather than in LMI areas with less deposit activity. Over the past three decades, there was also a dramatic increase in mobile, interstate and online banking, which meant the banking ecosystem changed substantially.

A series of hearings in 2009-2010 focused on updating the regulations. The results were updated Q&A documents that provided specific guidance with respect to the interpretations of the 1995 regulations.

More discussion followed, culminating in the OCC (without the Fed or FDIC) adopting final regulations in 2020 that many affordable housing and community development groups opposed, primarily due to the imposition of a simple metric to measure community development activities (a calculation that was seen as devaluing tax incentive investment). In 2021–following the election of Joe Biden as president and a change in the leadership at the OCC–the OCC rescinded the regulations before implementing most provisions.

The OCC then worked with the Fed and FDIC to issue joint proposed regulations in May 2022. The final regulations followed in October.

New Regulations Basics

The final regulations include different standards for different sizes of banks. For purposes of this discussion, we'll focus on the rules for the largest banks–those with at least $10 billion in assets, which make most community development tax incentive investment.

The final regulations include four tests to measure CRA compliance: retail lending, retail services and products, community development financing (which includes both community development equity investment and community development lending), and community development services. The community development and retail tests each constitute 50% of the CRA score, which is a victory for the community development world after the 2022 proposed regulations called for a split of 60% retail and 40% community development.

The final regulations begin to be implemented starting April 1, 2024, but most general provisions will become applicable Jan. 1, 2026, and some won't be applicable until Jan. 1, 2027. For large banks whose three-year examination cycle begins on or after Jan. 1, 2026, the new evaluation framework will be applied.

The final regulations feature specific changes for the community development evaluation from both the 1995 regulations and the proposed regulations. The most notable are a shift in the geographic standards for investment and a new metric-based measurement and a community development investment impact and responsiveness factor.

Three Major Changes

The details as to how the new standards will be measured and implemented will be determined over time through sub-regulatory guidance, but three major changes from the proposed regulations are expected play a big role in promoting community development tax incentive investment:

Geography

After decades of measuring individual banks' CRA score by emphasizing investment where the bank receives deposits, the final regulations allow for greater certainty of positive CRA consideration for community development activities *outside* a bank's branch network. The likely outcome of this change is that banks will consider a much broader geographic range for investments–particularly in LIHTC and NMTC equity. That will presumably reduce the

disparity in LIHTC equity pricing in CRA "hot spots" and "deserts," such as rural areas and smaller cities.

Banks previously received generally less CRA credit for community development investment in rural communities and smaller cities due to smaller deposit bases in those areas. The shift to emphasize LMI areas for investment means those areas will likely have a larger pool of potential investors in tax credit equity, which presumably will create upward pressure in equity pricing.

That change doesn't necessarily mean that major metropolitan areas will experience downward pressure on equity pricing due to CRA changes, only that there will likely be an increase in investor demand over a broader geographic swath. Among areas that *may* experience a downward pressure in equity pricing are the few regions with large bank concentration, which previously led to more CRA-motivated investment there and higher-than-average equity pricing.

Investment Metric

The final regulations include a nationwide community investment metric for large banks, in which total community development equity investments are divided by deposits nationally. Each bank's score will be compared to a national metric of peer banks.

Community Development Investment Impact and Responsiveness Factor

While the investment metric will provide a *quantitative* ratio to compare with other banks, the community development investment impact and responsiveness review will provide a *qualitative* measurement. According to the final regulations, the impact and responsiveness review will include (but not be limited to) a set of 10 specific qualitative factors, including whether the investment benefits or serves persistent poverty counties; whether it benefits or serves low-income individuals, families or households; whether the investment directly facilitates the acquisition, construction, development, preservation or improvement of affordable housing in high opportunity areas; and more. In discussions after publication of the final regulations, leaders of the FDIC, Fed and OCC emphasized the need for banks to be responsive to the community development needs of the communities they serve–with each stressing that banks must understand those communities.

This measurement will require a way to measure the community impact and responsiveness of those investments. Perhaps more than the other two major changes discussed above, this measurement will rely on forthcoming guidance to dictate how bank evaluators should evaluate impact and responsiveness.

Effect on Community Development Tax Incentives

Changes in the new regulations–particularly when compared to the proposed regulations–will encourage LIHTC and NMTC investments, although sub-regulatory guidance and other factors will affect the magnitude.

The geographic change will likely lessen the geographic disparity in LIHTC and NMTC equity pricing. The broader potential area for CRA-rewarded investing should increase competition among potential investors and exert upward pressure on pricing.

An additional notable change is the final regulations provide more certainty for areas that receive disaster tax credit allocations. For instance, when Hurricane Katrina hit in 2005, billions of dollars in various tax credits were authorized and allocated to assist with the recovery. However, the 1995 CRA regulations did not motivate such investment, since few major national tax credit bank investors had notable deposits in bank branches located in the Gulf Coast. That uncertainty contributed to a lack of investment demand until the regulatory agencies issued clarification that those investments would qualify for CRA credit even if the bank did not have any assessment areas in the Gulf Coast. The new regulations specifically say that activities that promote the recovery of a designated disaster area automatically qualify for CRA credit.

While banks will get credit for every LIHTC and NMTC investment under the new CRA regulations, investments in HTCs, RETCs and the opportunity zones incentive are not treated similarly. Like the 1995 regulations, banks making community development tax incentive investments beyond LIHTC and NMTC face uncertainty as to whether they would count toward CRA credit. It may be even more difficult to get CRA credit under the new regulations, as they tighten the ability of banks to receive positive CRA consideration for place-based activities by forcing banks to demonstrate the benefits of those place-based activities for low- and moderate-income households. Sub-regulatory guidance will determine how to demonstrate benefits, so HTC, RETC and OZ investment would benefit if examples of many such investment are included in the list of non-exhaustive illustrative examples expected to be published by the regulatory organizations in the coming months.

Guidance Will be Crucial

The OCC, FDIC and the Fed will issue plenty of sub-regulatory guidance, presumably on a joint basis. Expect it to include a series of Q&As and other guidance to answer many of the outstanding questions and to include sample lists of eligible activities and provide clarity on other outstanding issues. Bank examiner guidance will also be crucial.

After that, stakeholders will see how bank examiners use the guidance to measure CRA performance. It may be 2027–three years from now–before we have a grasp on how the new regulations will affect investment in community development tax incentives.

To make it clear, though: the job isn't done.

Novogradac's Low-Income Housing Tax Credit Working Group, New Markets Tax Credit Working Group, Renewable Energy Working Group and Opportunity Zones Working Group will be active in encouraging sub-regulatory guidance and membership in each group is open.

Stay engaged. After years of waiting, banks and community development stakeholders should be active in poring over the new regulations, asking for specific guidance, encouraging examiner training and more. ❖

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