

# The Economic Importance of Being Educated

**INSIDE:**

Early Childhood Education

Consumer Finance

Mortgage Counseling

**PLUS:**

Q&A with Laurence Meyer



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## Reader Comments



### A Proposal: Using the CRA to Fight Vacancy and Abandonment

In 2009, banks became the reluctant holders of more than 1,000 foreclosed properties in Cuyahoga County, Ohio. Most of these houses are in Cleveland, worth \$100 to \$150, and in danger of remaining vacant for the foreseeable future—destined to define neighborhood decay.

Cuyahoga County is not alone in the wake of the housing bubble. In fact, it is one of the most distressed in the nation, with a high unemployment rate and a high percentage of vacant homes. At the same time, the county is home to a large number of low-income households—many of whom are struggling to pay their mortgages. In fact, the county has one of the highest rates of mortgage delinquency in the nation.

For a decade after the housing bubble burst, banks would like to hold onto foreclosed homes, but community groups have been pushing for their sale to local investors. That is, the banks have been reluctant to sell the homes to local investors.

In 2009, banks became the reluctant holders of more than 1,000 foreclosed properties in Cuyahoga County, Ohio. Most of these houses are in Cleveland, worth \$100 to \$150, and in danger of remaining vacant for the foreseeable future—destined to define neighborhood decay.

### A Proposal: Using the CRA to Fight Vacancy and Abandonment

*Update: On June 17, 2010, federal regulators, including the Federal Reserve, announced a proposed change to the Community Reinvestment Act (CRA). The change would encourage banks to support the Neighborhood Stabilization Program administered by the U.S. Department of Housing and Urban Development. The proposal is similar to, and was influenced by, the Federal Reserve Bank of Cleveland's recent recommendation aimed at easing the vacancy and abandonment crisis (Forefront, Spring 2010). The Bank's proposal would amend the CRA to increase banks' incentives to provide community groups with loans, services, and investments that support neighborhood recovery efforts.*



Mark Willis

I commend the Cleveland Fed for entertaining this proposal for modifying the system for determining the CRA ratings of large retail banks, i.e., those with assets greater than \$1 billion. If adopted, the proposal would break new ground in six important ways:

- First, it would demonstrate that CRA can be amended on a timely basis to address changing economic conditions.
- Second, it would set a new precedent, albeit subject to some significant restrictions, for giving these banks full credit for activities regardless of the geography being served.
- Third, it would elevate the importance placed on non-lending activities such as demolition that also help to stabilize and revitalize a community and thus improve the ability of local individuals and institutions to access credit.
- Fourth, it would give these banks the ability to increase the relative importance of the investment and service tests in determining overall CRA ratings.
- Fifth, it would offer, but not mandate, an alternative way for these banks to serve communities that have been particularly hard hit by the current housing crisis.
- Sixth, it would provide an automatic trigger for suspending or reinstating the special rules depending on economic conditions and not contingent on future votes that would require the regulatory agencies to reach consensus in a timely manner.

Adopting the proposed regulatory changes, however, is only part of the battle. Banks will need more details in order to evaluate the relative merits of sticking with the current system or going with the new option. Most banks already have a good idea of what they need to do under the current system to achieve the same rating again at their next exam. For evaluating the new option, banks will need to understand, for example:

- How will credit be determined for REO donations—number of properties donated, the market value of the properties at the time of the donation, or some other measure?
- Will donations of property be given more than the nominal credit now given to philanthropic grants under the investment test?
- Similarly, how much value will technical assistance be given under the service test, which is now mainly about bank branch services?
- How much in “extra points” will be needed to get an *outstanding* rating on one or more of the lending, investment, and service tests, and how will the scores on the three tests be combined to determine the overall rating?

Without clear upfront answers to these types of questions, it may be hard to get banks to make the hoped-for changes in their CRA business plans.

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Janneke Ratcliffe

The Community Reinvestment Act did not cause the current foreclosure crisis, but it might be able to ameliorate some of its consequences. A recent proposal by the Federal Reserve Bank of Cleveland would deploy the CRA to reward banks for resolving the vacant and abandoned stock of real-estate-owned (REO) properties, even if those properties were located outside the CRA assessment areas usually used to measure compliance.

The CRA was created in 1977 to counter the practice of denying access to credit to particular communities. The principle held that if banks were going to set up shop and accept deposits from a community, then they should reinvest those funds in that community. But recent developments in banking and financial services have made this premise outdated.

Not only have a variety of alternative sources of financial services arisen, but the neighborhood-centric concept of traditional banking has given way to large interstate or even multinational banking conglomerates. Consequently, the collapse of the housing market has left banks holding onto foreclosed properties far from their CRA assessment areas.

The proposal would allow banks to receive CRA consideration for donations or sale of REO properties to community development groups, as well as technical assistance and

lending to such groups, as long as the investment needs of the assessment area are satisfactorily met. This is an entirely reasonable way to encourage stabilization, even in neighborhoods where the bank does not have a branch office but still has a financial stake due to mortgages made there.

That is not to say that branch offices have lost their importance. In the REO context, a local presence facilitates cooperation with community groups and a better understanding of community needs, which can lead to more productive efforts to stabilize neighborhoods. Efforts to fight the tide of foreclosures should also provide impetus for banks to aggressively and productively resolve REO within existing assessment areas.

What is most significant about this proposal is its recognition of the latent power inherent in the Community Reinvestment Act through regulatory discretion. Flexibility within the statutory framework is vital to the ability of the Act to keep up with changes in the market and address evolving issues, insofar as the spirit of those requirements remains strong.

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## Small Businesses: Credit Where Credit Is Due?

I appreciate the information in your new *Forefront* magazine. In the article entitled "Small Businesses: Credit Where Credit is Due?" while good points were made, one significant, troubling area of concern was missed: the negative effects of over-regulation on businesses.

I have been a small-town banker for 25 years, and I understand "burdensome regulations." But talking with small business owners over the last 10 years, I have witnessed an increasingly uphill battle for all businesses to comply with ever-expanding regulations.

I personally know of many businesses in our local community that have closed up shop because they could no longer afford the costs of regulation. As such, prudent bankers understand how these costs directly affect the bottom line of business owners, and we add it to the risk factors when making credit decisions. These concerns become ever more relevant in a stagnant, down economy.

The state of Ohio is particularly tough on both regulations and taxes—as illustrated in its ranking in the top five worst states in the Union in which to do business. In addition to being a banker, I also am involved in the management of two other businesses as well as serve on several boards.

Regulations alone will make one's head swim, but there are so many that are redundant, unnecessary, or just plain ridiculous. And believe me, these are having a very negative effect on nearly every business out there.

Lending to a business to cover regulatory expenses, or to compensate for the cost of complying with regulations—when there is no monetary return on the investment—is risky at best. But many business owners are faced with exorbitant regulatory costs for new installs, upgrades, or remodeling. There is no upside.

Just recently, I helped finance a local fellow opening a very small donut shop. His cost to comply with the various regulatory requirements was \$18,000. He'll have to sell a lot of donuts to recoup that money, wouldn't you say?

It's time to consider ALL risks associated with business lending. Perhaps if the Fed would point out the crushing effects of over-regulation, some much-needed changes would be made that most assuredly would increase business profits. And that would bring a smile to bankers' faces.

Thank you for your time.

**Joe Wachtel**  
**President**  
**Monitor Bank**  
**Big Prairie, Ohio**