FEDERAL RESERVE BANK
OF SAN FRANCISCO

Community Investments Vol. 8, Issue 4
The Case for Consortia Lending: A Day in the Life of a CRA Officer

Author(s): H. Fred Mendez, Federal Reserve Bank of San Francisco
Fall 1996

Friday afternoon ... 2:14 p.m. and I'm still trying to figure out what I've forgotten for Monday.

Examiners. Just the word has an ominous tone. You go to the doctor for an examination when you're sick ... not to a bank regulator ... especially when you're healthy! Could I be sick and not know it?

This damned CRA is a good example of what I have to deal with. I can't drink enough coffee to get me through that regulation. I feel like paying a psychic every time one of my loan officers asks me if something is a qualified investment or can be considered "community development."

I'm a small banker with a small bank in a small town with a small assessment area. My regulator calls me a financial institution of less than $250 million in assets and not under a holding company with combined bank and thrift assets of over $1 billion. Kind of makes me feel special inside.

A few months ago, my boss walked into my office with an invitation letter to hear about a bank lending consortium being formed by banks from throughout the county. I figured I had nothing to lose by attending... maybe they'll have bear-claws and some coffee.

Anyway, I got a lot of good information from the meeting but wanted to see if everything that Community Affairs guy from the Fed said about CRA credit and participating in this organization was on the ball. Time for that psychic again.

Turns out there's more to the CRA regulation than meets the eye ... you just have to stare at it a while before it comes into focus, sort of like the 3-D pictures in that cheap calendar I got during the Christmas gift exchange.

The way I see it, my bank can get a lot out of participating in a consortia lending organization. First, sharing the risk eases my fears about some of these "near bankable" loans. Second, the consortium is staffed by experts who know how to put these kinds of deals together, so I won't need to worry about being an expert myself. Third, these are the kind of deals I don't feel comfortable doing on my own. Which leads me to my next and final point: if these loans perform well, maybe we can eventually do them ourselves! This evolution of our products and services will push the consortia organization towards new "cutting edge" products.

As for the CRA regulation, there's a footnote the size of Idaho defining all sorts of community development lending, investment and service activities. These include (1) affordable housing (including multifamily rental housing) for low- or moderate- income individuals, (2) community services targeted to low- or moderate-income individuals, (3) promotion of economic development by financing small businesses or farms, and (4) the revitalization and stabilization of low- or moderate-income geographies.

Large banks have it easy when it comes to community development activities. They get CRA consideration under the Lending Test for their participation in loans originated by a lending consortium. If a large bank decides to make a loan directly to the consortium instead of participating in each individual deal, all it has to do is show its regulator the list of loans made by the consortium (using the bank's loan) to remain eligible under the Lending Test for multiple years. Under the Investment Test, a large bank gets consideration for its investment in capitalizing the consortium. And participation by its employees on the consortium loan committee, board of directors or any other financial services-related role falls neatly into the Service Test.

It turns out that participation in loans originated through a consortium, or a loan made directly to a consortium which then generates other community development loans, helps satisfy the small bank CRA requirements as well. Examiners will look at that when they consider whether the bank is meeting the needs of individuals of different income levels or businesses of different revenue size. What they'll learn is that through the consortium, we are effectively penetrating markets we'd find difficult to serve on our own. On top of that, community development lending acts as a compensating factor for a low loan-to-deposit ratio because we get a bigger "bang for our buck" by leveraging our small loan into significantly larger community development projects.

Finally, by providing community development investments and services to the consortium, we may be eligible to receive an Outstanding CRA rating, assuming we rate Satisfactory in the other areas examiners analyze for small banks, i.e., loans made inside the assessment area versus outside; not neglecting the low- and moderate- income areas; dealing effectively with complaints; having a reasonable loan-to-deposit ratio; and making loans to people of different income levels and businesses of different sizes.

But here's the kicker. Community development loans and activities, by definition in the regulation, support an institution's CRA performance if they benefit a broader statewide or regional area that includes its assessment area. Even though our assessment area consists of a small portion of a large county, we'll get CRA consideration for our participation in a lending consortium that serves the whole county, or even the entire state! It makes sense that the regulators would focus on how well we perform in our assessment area *before* they look at what we're doing elsewhere, but I can finally tell my boss that our participation in the consortium can only help, not hurt, our CRA performance.

Friday afternoon ... 4:30 p.m. and I finally remember what I need for Monday. Bank examiners. I used to be able to keep them happy with coffee and donuts. Now they don't even get excited unless they have a fresh fruit plate and herbal tea. Where is the number for that deli?