



Statement

of

Ellen Seidman, Director

Office of Thrift Supervision

at the

**FORUM ON COMMUNITY REINVESTMENT AND  
ACCESS TO CREDIT: CALIFORNIA'S CHALLENGE**

Los Angeles, California

January 12, 1998

Office of Thrift Supervision  
Department of the Treasury

1700 G Street N.W.  
Washington, D.C. 20552  
202-906-6288



**OTS BRIEFING BOOK**

**ROUNDTABLE DISCUSSION**

**CONCERNING**

**COMMUNITY REINVESTMENT AND ACCESS TO CREDIT:  
CALIFORNIA'S CHALLENGE**

**January 12, 1998  
Los Angeles, California**

**Prepared for Kevin Petrasic**

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**CONCERNING CRA and ACCESS TO CREDIT: CALIFORNIA'S CHALLENGE**  
**ROUNDTABLE DISCUSSION**  
**Monday, January 12, 1998**



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**I. Introduction**

Thank you and good morning. I appreciate Congresswoman Waters' invitation to come here today to discuss what I view as one of the most important public policy issues involving modern financial institutions today—community investment. For two decades now, including the last seven years in Congress, Maxine Waters has forcefully and effectively represented the views of those so often left out of the public policy debates in this country.

Last year marked the twentieth anniversary of enactment of the Community Reinvestment Act ("CRA"). In the two decades since its passage, the CRA has helped to strengthen and improve communities. It has helped prove that if communities have access to capital and are part of the financial mainstream, economic development follows, as do jobs and profits. The CRA is good public policy that is also good business.

The OTS is committed to furthering the objectives of the CRA by assisting communities and thrifts in rebuilding and revitalizing our neighborhoods. Success can only be achieved through a sincere and concerted effort by all parties involved in the process—communities, government, financial institutions, businesses, individuals and non-profit organizations. Partnerships that include all

of these players appear to offer the greatest opportunities for pursuing viable community development programs.

We appreciate your focus, Congresswoman Waters, on building communities through the wider availability of financial services. You have been a longtime and tireless supporter of CRA as well as many other measures aimed at reinvigorating lower and moderate income communities and their local economies. Your work on such important programs as Youth Fair Chance, Youthbuild, Emergency Development Loan Guarantees, and Community Development Banks has had a tangible, positive impact both in South Central Los Angeles and communities throughout the nation. Your commitment to community development issues is legendary.

Today, I will discuss some of the actions the OTS and the institutions it regulates have taken to nurture solid, profitable, community-based lending. These actions include CRA commitments, but go beyond that. I will also explore the interplay between community-based lending and safety and soundness. First, though, let us look at the demographics of South Central Los Angeles and the role of financial institutions, particularly thrifts, in serving this unique community.

## **II. Demographic and Lending Patterns in South Central Los Angeles**

### **A. South Central Los Angeles: Demographic Characteristics**

In many ways, South Central Los Angeles is the perfect community in which to discuss the CRA. There is much wealth in the greater Los Angeles area, and it is not surprising that there are a multitude of mainstream financial institutions serving the residents of Westwood, Hancock Park and Beverly Hills. It is here, though, in neighborhoods such as South Central Los Angeles, that an institution's CRA commitment is truly tested. Although, according to the 1990

census, South Central contains only about 6 percent of the population of greater Los Angeles, its racial, housing, and financial demographics present a serious challenge for institutions committed to nurturing local economic development.

In people terms, that 6 percent figure translates to nearly 511,000 men, women and children.<sup>1</sup> Ninety-nine percent of those people are either Black or Hispanic, with Blacks making up 49 percent of the population and Hispanics 49 percent. The other 1 percent of the community consists of a mix of Asian/Pacific Islanders, Whites and other racial groups. This racial mix differs substantially from the general Los Angeles area. In Los Angeles County, 41 percent of the population is White, 37 percent Hispanic and 11 percent Black.

As I noted, these figures come from the 1990 census and therefore are somewhat outdated. Some more recent data suggest that Hispanics make up an even larger portion of South Central Los Angeles' population than they did eight years ago.

Only 35 percent of South Central's population lives in owner-occupied housing. For Los Angeles County, the figure is closer to 50 percent. This number presents a special challenges for thrifts, which traditionally have focused on single-family residential mortgage loans.

In addition, according to 1996 HUD family income data, 52 percent of the households in South Central are considered low income, and another 40 percent are considered moderate income. Family income is defined as "low" if it is less than 50 percent of the median family income for the area, and as "moderate" if it

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<sup>1</sup> The data discussed in this section can be found at the attached Appendix. The definition of South Central Los Angeles used in this analysis is based on the ZIP codes provided by Congresswoman Waters' staff. Those ZIP codes are: 90001, 90002, 90003, 90011, 90037, 90044, 90047, 90059, 90061 and 90062.

is less than 80 percent of the median for the area. The median family income for the Los Angeles Metropolitan Statistical Area in 1996 was \$47,800. Thirty percent of all households in South Central are below the poverty level.

### **B. Thrifts in South Central Los Angeles**

Given the high concentrations of renters and low- and moderate-income households in South Central, the challenge for local housing lenders is to provide credit services that allow people to live in safe, decent, affordable multifamily dwellings, as well as to borrowers who want to buy single-family homes. A number of institutions are showing that it can be done, and many of those institutions are thrifts.

There are at least seven depository institutions, with twelve branches, located in the South Central Los Angeles area.<sup>2</sup> Four of those institutions are thrifts, each with a branch in South Central. Of the seven institutions in South Central, two are community-based minority-owned institutions, one of which is regulated by the OTS. Another OTS-regulated minority-owned institution is located close-by and also serves the area.

Thrifts are well-represented in South Central. Their physical presence indicates a commitment to the local community. But, as with so many things, a mere presence is not enough—it is what one does with that presence that counts. And I am pleased to note that thrifts are doing quite a bit in South Central.

### **C. Thrift Mortgage Lending in South Central Los Angeles**

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<sup>2</sup> A list of the branches in South Central is included in the Appendix. The list is based on ZIP codes and not census tracts, which do not always correspond. As a result, this list may include branches that are not in the census tracts contained in some definitions of South Central Los Angeles.

Thrift home mortgage lending in South Central can be determined by looking at Home Mortgage Disclosure Act (“HMDA”) reports. HMDA reports distinguish between mortgages for home purchase and those for refinancing existing mortgages. Because mortgages made for home purchase represent a new extension of credit, I will focus on that segment of the mortgage market. Within home purchase mortgages, HMDA reports further distinguish between government-backed home mortgages (primarily FHA and VA loans) and conventional home mortgages.

Government-backed mortgages are the most popular type of mortgage originated in South Central Los Angeles. In 1996, 65.3 percent of home purchase mortgages originated on properties in South Central were government-backed. Thrifts’ share of government-backed originations was 3.3 percent.

However, when the data for conventional mortgage lending are reviewed, the important role thrifts play in South Central becomes evident. Thrifts originated 50.3 percent of all conventional mortgages in South Central in 1996. This is a higher percentage than their conventional lending in the greater Los Angeles area, where thrifts originated 35.5 percent of the conventional home mortgages.

Thrifts also originated a higher percentage of all types of mortgages to minorities in South Central than the overall average in that area. Minorities received 88 percent of thrift originations; the percentage of mortgages going to minorities from other lenders was 80 percent. Of the 88 percent of thrift originations in South Central that went to minority borrowers, 44 percent were to Black borrowers and 55 percent to Hispanic borrowers.

Of the thrift mortgages, 38.5 percent went to low- and moderate-income borrowers (i.e., those with less than 80 percent of the median family income in the Los Angeles Metropolitan Statistical Area). Middle-income borrowers (i.e., those with between 80 percent and 119 percent of the median family income for the area) received 31.6 percent of thrift mortgages, so that fully 70 percent of thrift originations went to low-, moderate-, and middle-income borrowers. The overall rate for all mortgage types and all lenders in the area for low-, moderate- and middle-income families was 72 percent.

Thrifts also do a substantial amount of the multifamily mortgage lending in South Central. In 1996, thrifts originated 35 percent of the multifamily mortgages in the area. As these numbers show, although thrifts represent only a small portion of the more than 250 entities making loans in South Central,<sup>3</sup> they maintain a significant lending presence in this market.

### **III. The Critical Importance of Partnerships and Collaborative Efforts**

In celebrating the twentieth anniversary of the CRA, it is important not only to recognize the progress made toward meeting community credit needs, but also the means by which those accomplishments have been achieved. The efforts and methods that have proven successful to date can teach us how to be more effective in the future.

Financial institutions and the communities they serve must depend on each other to thrive, as well as to effect meaningful change. If disconnected from their communities, financial institutions will inevitably find themselves with no

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<sup>3</sup> As detailed in the Appendix, based on 1996 HMDA Peer data for the Western Region, 257 entities made loans in South Central in 1996 in South Central Los Angeles, based on the ZIP codes provided by Congresswoman Waters' staff. Those ZIP codes are: 90001, 90002, 90003, 90011, 90037, 90044, 90047, 90059, 90061 and 90062.

community to serve. More importantly, if individuals become disconnected from access to basic financial services, their access to many other basic services is substantially diminished.

History teaches us that the key to sustained community revitalization is to build upon the natural and necessary interdependency of all elements in our communities: financial institutions, businesses, medical and social service providers, federal, state and local governments, schools, churches and citizen-support groups. Partnerships that include all of these elements have the power to revitalize neighborhoods and stimulate job creation, economic and business development, and improvements in infrastructure and support services. All of us, not just banks and thrifts, must rededicate ourselves—each using our own particular strengths—to reinvest in our communities.

Thrifts have long been providers of housing loans, including loans for affordable owner-occupied and rental housing. In 1996, Congress expanded thrifts' authority to make small business loans. This expanded authority permits thrifts to have an increasing impact in their communities by being able to respond to a wider range of credit needs.

But with that new authority comes new responsibility. Thrifts must use their new lending authority safely, soundly and wisely. Strategic alliances and partnerships involving thrifts can help assure that the thrift industry's new credit resources are exercised effectively to realize meaningful advances throughout our communities. By using their lending powers in partnership with local residents and community-based organizations, thrifts can participate in and be catalysts of successful community development efforts.

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There are numerous examples of thrifts making significant contributions to local community development organizations right here in Los Angeles. Three large California thrifts, Fidelity Federal, Hawthorne and Home Savings, along with several other financial institutions, have invested in the Operation Hope Banking Center. The Operation Hope Banking Center provides education in the areas of finance, credit, real estate and business development and ownership; computer training for the Internet, on-line banking and on-line bill payment; access to consumer loan products; ATM access; and technical assistance for small businesses.

Home Savings, along with another California thrift, Glendale Federal, have also invested and lent money to the California Economic Development Lending Initiative (“CEDLI”). CEDLI is a community development corporation financed by multiple financial institutions, and is designed to create jobs by providing financing to support small business and community economic development activities that fall outside normal bank lending practices. The contributing institutions created a \$100 million loan pool to fund three loan programs: direct real estate lending, loans to lenders, and co-lending for small businesses.

Home Savings, Glendale Federal, Coast Federal and California Federal have also invested in the Clearinghouse Community Development Financial Institution, which makes direct loans for affordable housing and community development credit needs throughout Southern California. Another California thrift, Girard Savings, has recently agreed to form a partnership with the city of Los Angeles to fund the rehabilitation and operation of an old movie house in South Central that the city hopes to develop as a central location that will spur development of the surrounding area.

In addition, Coast Federal has created a Homebuyer Education Program to provide consumers with the basic knowledge of the home-buying and financing process. The program consists of a free 25-minute video and accompanying written guide, available in both English and Spanish. The program is available to first-time home buyers throughout California, including Los Angeles County where Coast Federal has its largest single-family loan market. Coast Federal recently received a Bank Enterprise Award grant for providing loans, grants and technical assistance to the Orange County Community Development Clearinghouse and the Los Angeles Neighborhood Housing Service.

Another good example of thrift participation in local community development is the efforts of Broadway, an institution with a prominent presence right here in South Central. Broadway, along with several other California-based thrifts, helped establish the Family Housing Fund, which is a first and second mortgage loan participation product developed by the Inglewood Neighborhood Housing Service. Broadway is also a participating lender in the program, which provides a streamlined procedure for financing home purchases by helping first-time buyers with down payments and closing costs. For their good work, Broadway and the Inglewood NHS received the 1997 Social Compact Community Investment Award.

The experience of another local thrift shows that these partnerships need not be one-sided. That thrift was the beneficiary of capital infusions from local businesses active in the community, including an infusion from another California thrift that actually competes in the same market as the beneficiary thrift. Such support shows that not only can an institution serve its community, but that the community in turn appreciates and supports the efforts of community-based, community-focused financial services providers.

Several of the institutions mentioned have applications pending before us that have been opposed by some community groups. We intend to review those protests fairly and objectively. Regardless of the outcome of any pending applications, however, we should give credit where credit is due. All of the examples I have noted today are praiseworthy in their own right.

“CRA commitments” are another example of banks and thrifts engaging with community groups to help meet community credit needs. CRA commitments usually take the form of public corporate pledges to engage in a particular level of business in designated neighborhoods or with certain disadvantaged segments of an institution’s market. The aggregate national level of these commitments made in the past several years is in the billions of dollars. Several of the institutions participating in today’s forum have entered into these CRA commitments.

CRA commitments are privately developed projections for credit programs that respond to expressions of community needs voiced by diverse groups of interested citizens or local government bodies. These commitments are entirely voluntary, are not negotiated by or on behalf of the OTS or any other federal banking agency, and are not submitted to the OTS or any other regulator for analysis or approval. The emphasis for meeting the commitments is on the parties that devise them. This promotes a continuing dialogue and encourages flexibility in dealing with community changes that occur as the period for performance under the commitment progresses.

In accordance with the CRA, the OTS application process takes into account the established record of institutions for meeting the credit needs of their communities. Public lending commitments may serve as positive indicators of institutional initiative, cooperation and responsiveness to be weighed in

appropriate balance with the past performance of the institution in lending, investing and delivering services throughout its entire community. Where an explicit lending commitment is incorporated into an applicant's business plan, the OTS accords it the same level of reliance as it would the most basic business projections. That is to say, we expect a good faith effort to meet the plan's commitments, taking into account the changing economic context over the life of the business plan.

Ultimately, the impact of CRA commitments on a thrift's community is registered in the overall performance of that institution as evaluated by the OTS in the course of an examination. Our examiners review the institution's entire record of helping to meet the credit needs of its community. In doing so, they assess the levels of lending actually accomplished by the institution throughout its markets, with particular emphasis on low- and moderate-income neighborhoods or individuals served. While overall CRA performance is not measured against the private CRA commitments *per se*, the examiner counts lending pursuant to a commitment against the appropriate performance criteria contained in the CRA regulations.

Where a thrift and community representatives agree that an explicit CRA commitment should be used as the proper measure of future CRA performance, the new CRA regulation affords those parties a process to accomplish that agreement—the strategic plan option. This option ensures a role for the public and the agency in previewing the adequacy of a privately negotiated undertaking that is substituted for the otherwise uniform standards for evaluating the institution and its peers.

#### **IV. OTS Initiatives to Promote Community-Based Lending**

The OTS has a strong commitment to fostering innovative banking activities that promote lending and other services in underserved markets. We have undertaken a number of initiatives to facilitate safe and sound lending and investments in areas of greatest need.

In 1994, in response to numerous inquiries about the authority of federal thrifts to engage in various community development related activities, the OTS published a Community Development Investment Authority handbook. The handbook provides detailed guidance to the thrift industry about the types of community development related lending and investment activities that thrifts may pursue. We are presently revising the handbook to incorporate recent regulatory changes.

During the past three years the OTS has issued interpretive guidance and modified existing regulations specifically for the purpose of helping to expand and clarify thrifts' lending and investment authority to promote safe and sound business in underserved markets. For example:

- The OTS Chief Counsel issued interpretive guidance regarding a thrift's ability to make equity investments in real estate for community development purposes under Section 5(c)(3)(B) of the Home Owner's Loan Act. This guidance has enabled thrifts to make both direct equity investments in residential real estate for low- and moderate-income individuals and indirect investments in such real estate via low income housing tax credits. Under this authority, thrifts are also able to make economic development investments (e.g., in infrastructure businesses, such as supermarkets) in under-served communities.

- The OTS issued guidance to enable thrifts to purchase securities issued by the Neighborhood Housing Services of America (“NHTSA”). By purchasing loans and selling loan securities to social investors, NHTSA acts as a secondary market for local Neighborhood Housing Services organizations across the country. These organizations originate low-interest residential loans to low-income individuals and for low-income multifamily housing. Several of our thrifts are actively involved with assisting the work of NHTSA through the purchase of NHTSA mortgage-backed securities and the provision of technical assistance.
- The OTS issued new regulations governing pass-through investments and investments in subordinate organizations. These new regulations also address a number of regulatory impediments to engaging in certain community development activities. For example, the regulations specifically authorize investments in federally designated CDFIs, and make it easier for thrifts to make equity investments in other kinds of subordinate organizations such as CDCs. The regulations also include a de minimus investment authority to enable thrifts to make limited community development investments of the type permitted for a national bank under 12 CFR Part 24.
- In 1996, Congress authorized certain statutory changes to enhance the lending flexibility of thrifts. Thrifts now can originate credit card and educational loans without restriction. In addition, federal thrifts are authorized to invest up to 20 percent of their assets in loans to small businesses and farms. We have encouraged thrifts to utilize this increased small business lending authority and have conducted industry training sessions in this area in each of our five regions.

This guidance is intended to facilitate the types of lending and services that, under the CRA regulations, institutions are encouraged to provide. In the regulations, which were recently updated, thrifts may be evaluated on the extent to which their lending, investments and services benefit low- and moderate-income areas and individuals, and on their “use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies.” The latter performance criteria are designed specifically to encourage thrifts to explore new and creative ways to meet community credit needs—efforts that we encourage at the OTS. We also inform Congress, where appropriate, of ways in which federal law can be updated to allow additional flexibility to institutions for their community development activities and in meeting the CRA’s objectives.

The OTS has also established a Community Affairs Program with Community Affairs representatives in each of our regional offices and in Washington, D.C. The primary objective of the program is to promote sound community development activities at the local level and to facilitate thrifts’ efforts in that regard. We provide educational and technical assistance to the industry and staff on community development issues and opportunities. In addition, we act as an intermediary between the industry, community groups, government officials and others.

Our Community Affairs staff spends considerable time working one-on-one with institutions and community groups in various underserved locales to address particular credit needs or investment problems. Much of the work with institutions is intended to encourage them to form partnerships with community representatives, and to find innovative solutions that are within their regulatory authority. Indeed, many of the specific partnerships I have already mentioned, which have resulted in the investment of millions of dollars in local community

development organizations, are due in part to the ongoing support and participation of the regulators at various seminars and workshops.

In connection with the agency's Minority-Owned Institutions Program, we work to help preserve and promote minority-owned institutions, most of which serve lower income, minority communities. Because of the unique relationships that many minority-owned thrifts have with their communities, we believe that the institutions can play an integral role in the economic revitalization of those communities.

As part of our program, we meet regularly with institutions; provide them with one-on-one technical assistance and training; work with institutions to attract new capital; provide training for boards of directors; and provide training in various other forums such as the annual conference sponsored by the American League of Financial Institutions. We have worked closely with both of the minority-owned thrifts that serve South Central Los Angeles. In another region we developed a pilot mentoring program where larger thrifts provide assistance (in the form of joint ventures, loan purchases, training, etc.) to smaller, minority-owned institutions in their markets.

The OTS is committed to working closely with the thrift industry to do what is necessary from a regulatory standpoint to enable thrifts to actively, and safely and soundly, engage in community development activities in underserved communities.

## **V. Safe and Sound Credit Availability**

The CRA's success depends on institutions making good, solid loans and investments in their communities. No one—not an institution, a community, nor an individual borrower—is served by a poorly underwritten loan. Moreover,

encouraging institutions to make poor lending decisions simply to fulfill their CRA obligations runs counter to the purpose of the law.

An institution's CRA obligation to its community must be met using prudent business practices. The CRA and its implementing regulations explicitly emphasize the importance of safe and sound lending. At the same time, institutions are encouraged to be innovative in creating products responsive to the various needs of a diverse customer base.

Experience clearly shows that lending to low- and moderate-income households and small businesses, when done properly, is good business for both the institution and the community. Frequently, loans are made to school teachers, shop owners, local municipal workers, and retirees who are the fabric of the community. It makes sense to encourage creative ways to meet the needs of these individuals to help develop a strong community.

To ensure that institutions have the support they need to exercise this creativity, the OTS has helped reduce the barriers to lending in low- and moderate-income areas. For instance, in the early 1990s the agency heard several anecdotal tales that safety and soundness examiners were criticizing lending programs that had favorably impressed CRA examiners. After careful study, we ascertained that these stories typically related to a particular loan where the safety and soundness examiners had a specific issue with the loan's underwriting or other aspects of the financing arrangement, not with the programs themselves. Nonetheless, we were concerned about the potential for conflicts between compliance and safety and soundness examinations.

In response, the OTS developed an Affordable Housing course for our safety and soundness examination staff. This training gives our examiners a

flavor of the breadth and variety of lending structures and financing sources that are required to make a safe and sound affordable housing loan. The class uses case studies and outside experts to emphasize the unique underwriting issues that are involved in affordable home lending and identifies the approaches to managing risks and controlling transactions costs. To date, over 70 percent of our safety and soundness and compliance examiners have been trained in affordable housing lending. In the West Region, which includes Southern California, over 75 percent of our compliance examiners are seasoned safety and soundness examiners, enabling them to appropriately consider safety and soundness issues when performing a CRA examination.

We have also sent our Community Affairs staff through a rigorous certification program to become Housing and Finance Development Professionals. This program, sponsored by the National Development Council, provides training in finance as it relates to affordable housing development. We believe that this kind of knowledge helps our Community Affairs staff more effectively communicate the necessary elements of good lending projects to community representatives and to our examiners. We are also sending several safety and soundness examiners through this certification process so that each of our regions expands its expertise in this area.

In 1997, the OTS held five nationwide Small Business Lending Seminars to assist thrifts in understanding the expanded small business lending authority granted to them in the Economic Growth and Regulatory Paperwork Act of 1996. The prospect of having thrifts become more active in small business lending adds a new and exciting dimension to the array of CRA activities available to the industry. We are very aware, however, that we must be proactive in helping thrifts develop the necessary expertise to succeed in this endeavor. Our seminars help ensure that thrifts interested in small business lending, or in expanding their

existing programs, do so prudently. The seminars provide an overview of small business lending, discuss management considerations for entering the market, and disseminate information regarding the resources available to institutions that choose to lend to small businesses.

Finally, I would like to emphasize that every CRA performance evaluation by the OTS takes into account the characteristics of the institution under examination and the community(ies) that the institution serves. Our examiners have been given new tools to assist them in their evaluations, including computers, data analysis software, and access to a number of new data bases. The examination procedures place great importance on understanding economic conditions, population trends, and demographic characteristics of a community before arriving at conclusions about an institution's performance. Examiners also take time as part of CRA examinations to contact representatives of the community to discuss its dynamics and identify its credit needs. These community contacts are an invaluable source of information in our effort to familiarize ourselves with the communities where our institutions do business.

## **VI. Conclusion**

We are proud of the role that thrifts have played in community development. In many ways, providing the means for low- and moderate-income residents of a community to own their own homes is classic community development lending. When people have a stake in their communities, they are more determined to serve the community and make it a better place to live. Thrifts' traditional focus on home lending has kept them close to their local communities and the individuals who live and work there. The simple fact is that millions of consumers and businesses prefer to do business with a local institution that they know and that knows them.

An integral part of our administration of the CRA is soliciting the views of those who are most deeply affected by the credit decisions that lending institutions make every day. Forums such as this provide an excellent opportunity for us to gauge the effectiveness of our efforts in the local communities that the CRA was enacted to serve. I can personally assure you that we are committed to the CRA and the goals and values it is intended to promote. We will do everything in our power to ensure that institutions meet their CRA obligations in a safe and sound manner that will enable them to continue to serve their communities.