

## Weekly Post Series **Products** 2024 #16

Weekly Post Series topics include **Research, Strategies, Products**

---

### CRA Loans: Opportunities

Community Reinvestment Act (CRA) loans offer opportunities to market participants while supporting our communities. However, the details of these loans, such as their purpose, eligibility criteria, and regulatory requirements, are essential to understand their impact on community financial institutions (CFIs) and low-to-moderate-income communities.

Last week, I discussed the use of Income Analytics. As CFIs prepare for Q2 performance reviews, I discussed forward and vol curves in managing Economic Value of Equity (EVE or NEV) and EaR risks. This product post will focus on the CRA loans to address the current supply and demand imbalance of these loans.

Loans can be public policy instruments. The Small Business Administration (SBA 7a and SBA 504 loans) assists small businesses, USDA loans help the agricultural community, and conforming residential loans securitized by Fannie Mae, Freddie Mac, and Ginni Mae government agencies encourage homeownership. Some conforming residential loans may additionally be CRA loans, which assist low-to-moderate-income families. These loans have stipulations for the borrowers and lenders, leading to specific pricing and risk management strategies. Today, I will focus on CRA loans to illustrate the transactional nuances of these loans, such as the use of special loan programs, flexible underwriting standards, and targeted marketing efforts.

#### Challenge

The Community Reinvestment Act encourages federally insured banks to help low—and moderate-income (LMI) communities. On October 24, 2023, the CRA underwent a final rule update, adapting to changes in the banking industry and enhancing its business mission.

Regardless of size, all banks must report their CRA lending activities to their regulators. These activities include economic development through small business loans, community development loans, investments and services for affordable housing, and supporting homeownership in LMI areas through mortgage loans. CRA loans give CRA credits to the investors holding the loans

CFIs are subject to CRA compliance examinations. The objective is to find those institutions whose compliance with regulations displays weaknesses that require special supervisory attention. CFIs are expected to take immediate action to correct the negative CRA rating. Regulators will often shorten the time frame to as little as 12 months until their subsequent examination to ensure the CFI takes appropriate and timely action.

Acquiring CRA loans is urgent for some banks and can create a CRA market. How available are CRA loans for investors? How do you search for such loans?

#### Channels to Purchase CRA Loans

There is demand across the country from banks not in CRA-rich areas. These banks must originate or buy CRA-eligible loans to comply with CRA lending or Investment test requirements. Some CFIs originate loans that are concentrated in CRA-compliant areas or that are made to CRA-compliant borrowers. This creates an opportunity for CFIs to sell CRA loans into investor demand. FutureWave Finance<sup>[1]</sup> and

Memphis Capital<sup>[2]</sup> describe CRA loans and the market below.

*Search for CRA Loans*

Buyers can access a weekly listing of LMI residential loans that they filter for loans offered in an LMI Census Tract or the borrower being considered LMI. With an inquiry (MSA/ZIP/Census Tract), they can locate MBS for multifamily securities with documentation of LMI/Rent Restrictions and specific addresses.

CRA loans can often be bought/sold at a “pay up” above the MBS price, typically related to the expected slower prepayment speeds and regulatory benefits. Because of the demand, CFIs will see a price premium from buyers for their CRA whole loans.

*Securitization*

CRA residential loans are reasonably liquid in the secondary market. They may be sold as whole loans or securitized and sold as CRA Mortgage-Backed Securities (MBS). Securitizing institutions also buy CRA loans as collateral for the MBS. These loans must meet agency eligibility guidelines and low/moderate income or census tract requirements.

*Product Types*

Individual Govt. Guar. SBA/USDA loans generally qualify for CRA (Buyer determination) by specific locations. When purchasing an SBA-securitized pool, with the securitizer’s assistance, the buying institutions can get CRA credit for selected CRA loans. Individual loans can be assigned to the buyer in the SBA CUSIP pool. Buyers of such a securitized pool gain liquidity, receive 100% CRA credit for the underlying specified loan amount, and enjoy the diversity in an SBA pool.

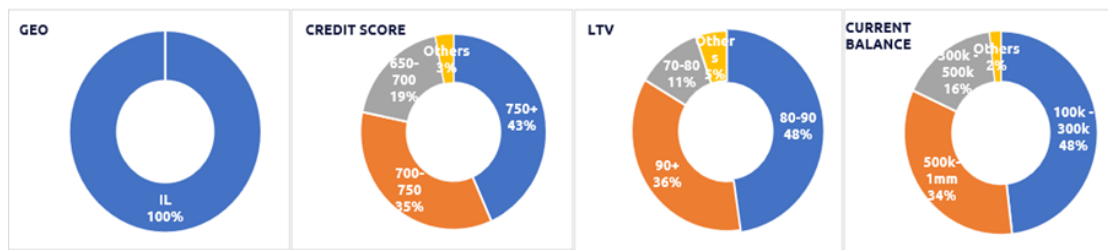
[1] FutureWave Finance LLC is a mortgage correspondent lender and securitizer in the CRA MBS space.

[2] Memphis Capital focuses on creating a mutually beneficial relationship by providing investors with Community Reinvestment Act (CRA) options and other socially impactful solutions to optimize their portfolios.

**Numerical Example**

Loan Central provides a mechanism for clients to sell their CRA loans. Sellers can see the impact of the trade on their balance sheet and earnings before the trade is executed. Buyers can monitor Loan Central for potential CRA transactions, go through the bidding process, and manage/assist the trade through Loan Central.

Below is a sample CRA pool from FutureWave that was available on Loan Central:



PORTFOLIO SUMMARY		CREDIT RISK		Scenario	Price	Price Change(%)	Effective Duration	Average Life	CPR(%)
<b>Price</b>	<b>100.000</b>	<b>Gross Yield</b>	<b>5.678</b>	-300	102.341	6.768	0.866	2.245	41.424
Original Balance (\$)	0	Credit Score / DSR	735	-200	101.007	5.376	1.711	3.153	29.525
Current Balance (\$)	36,613,969	LTV (%)	84.65	-100	98.833	3.108	2.684	4.143	21.499
Number of Loans (count)	139	DTI (%)	39.626	0	95.854	0	3.389	5.116	15.910
Average Loan Amount	263,410	CECL (%)	1.593	100	92.388	-3.615	3.962	6.020	12.123
Servicing Retained	No	PD (%)	1.460	200	88.514	-7.657	4.588	7.042	9.524
Servicing Fee (bps)	0	LGD (%)	29.696	300	84.396	-11.954	4.878	7.936	7.983
Gross WAC (%)	5.809	Credit Score/DSR Duration	1.292	400	80.296	-16.231	5.081	8.686	6.901
NET WAC (%)	5.809	LTV Duration	-7.504						
WAM (mos)	333	Credit Convexity	-8.828						
Seasoning (mos)	19								

The current balance is \$36,613,969, WAL 5.1 years, yield 5.67% assuming 15.9% CPR, with 139 loans with a broad range of credit scores, loan to value (LTV), and loan size.

**Conclusion**

The Community Reinvestment Act (CRA) 2023 deepens the CRA market. Lending banks and credit unions can lend CRA loans, grow origination fees, and gain on-sale revenue and local concentration risk. The buyers receive CRA credits.

For public policy, CRA 2023 further supports low-moderate income families and increases the CRA market liquidity.

**Next Steps:**

Reach out to learn more about Loan Central and buying or selling CRA loans.

To learn more or arrange a demo, Megan Trillet, Director of Marketing, [megan.trillet@thomasho.com](mailto:megan.trillet@thomasho.com)

© Thomas Ho Company Ltd All rights reserved

**Disclaimer**

THC is not a registered investment advisor or broker/dealer and does not provide investment advice to any person or entity. Information contained in this Report shall not be construed as any advice or recommendation for trade or investment or otherwise and is not intended to substitute obtaining any investment or trade advice.

THC is not an accounting firm, legal or tax advisor. Information contained in this Report shall not be construed as any accounting, legal, or tax advice and is not intended to substitute obtaining accounting, legal, or tax advice.

Before acting on any information provided in this Report, you should conduct your own due diligence to evaluate the accuracy, completeness, and usefulness of the information therein, as well as the risks associated with using THC's models and related services. In particular, you should seek independent investment, legal, tax and accounting advice.

© Thomas Ho Company Ltd All rights reserved

Functional Groups as Integral Parts of the Ishikawa Banking



Yield Attribution | Price Attribution | Income Attribution | Performance Attribution | EVE Attribution

**IncomeRisk™ Model**

---

Find more updates and news from Thomas Ho Company on our LinkedIn [here](#).

Thomas Ho Company Ltd., 55 Liberty Street, Suite 4B, New York, New York 10005

[Unsubscribe](#) [Manage preferences](#)