CRA Multifamily Guidelines

• In 2013, DFS issued guidelines for bank lending to multifamily properties under the New York State Community Reinvestment Act. (NY Banking Law § 28-b (“CRA”)). The guidelines were updated to make technical corrections in December 2014.

• DFS issued the guidelines after receiving input from various stakeholders that the number of affordable multifamily properties considered in physical and/or financial distress had been rising in New York State.
CRA Multifamily Guidelines, cont.

- DFS conducts CRA examinations of New York state chartered banking institutions to assess their “record of helping to meet the credit needs of local communities… consistent with safe and sound operations of banking institutions.” (NY Banking Law § 28-b (1) & (4)).

- As a part of CRA exams, DFS evaluates the amount and quality of banks’ community development lending.
  - A loan must have a primary purpose of “community development” if it is to be considered for community development credit.
  - New York and federal CRA regulations define “community development” to include a loan for “affordable housing (including multifamily rental housing) for low- or moderate-income individuals” and a loan to “revitalize or stabilize low- or moderate income geographies; designated disaster areas; or distressed or underserved nonmetropolitan middle-income geographies.” (3 N.Y.C.R.R. § 76.2(g) & (f) and 12 C.F.R. § 345.12).

- DFS reviews whether a bank has met its responsibility to ensure that a multifamily loan submitted for affordable housing or neighborhood revitalization credit under CRA contributes to, and does not undermine, the availability of affordable housing or neighborhood conditions.
CRA Multifamily Guidelines, cont.

• Where a concern around overleveraged or distressed lending is raised on a multifamily loan submitted for CRA credit, DFS considers the following factors to determine whether the loan has a primary purpose of affordable housing:
  – Whether the loan adds to or reduces the number of units affordable to families with incomes of less than 80% of an area’s median income;
  – The quality of the housing provided; and
  – Whether the loan was underwritten in a sound manner.

• DFS also reviews the extent to which banks engage in meaningful dialogue with local government housing departments, community groups, and qualified, preservation-oriented developers regarding the quality of affordable housing.

• DFS considers as a positive factor whether banks proactively monitor their loan portfolios, including whether multifamily buildings are properly maintained and do not have multiple and egregious building code violations.
CRA Multifamily Guidelines, cont.

- A loan on a multifamily property would not be found to have a community development purpose and would not be CRA eligible if it:
  - Significantly reduces or has the potential to reduce affordable housing;
  - Facilitates substandard living conditions as evidenced by factors such as a high number of housing code violations, emergency repair liens, water bill liens, or indexes;
  - Is in technical default based on the repeated violations of covenants in the loan agreement, even if the borrower is not in payment default; or
  - Has been underwritten in an unsound manner, based on the assessment of market rents, building expenses and overall debt loads.
CRA Best Practices

• DFS also identified the following best practices to help avoid reductions in qualitative or quantitative CRA credit on multifamily loans:
  – **Due Diligence**: Banks engaged in multifamily lending should adopt due diligence processes that ensure that all new and existing borrowers adequately manage multifamily properties securing any loans.
  – **Property Management**: Banks originating, holding or servicing multifamily loans should take steps to ensure that multifamily properties are adequately maintained by borrowers.
  – **Community Relations**: Banks engaged in multifamily lending should develop written community outreach strategies that seek to build or enhance relationships within the neighborhoods serviced by the bank and help to provide a mechanism for the disposition of multifamily properties.
2018 Rent-Stabilized Multifamily Guidance

• DFS issued additional multifamily lending guidance in September 2018.
• The guidance was intended to address allegations of tenant harassment and displacement by landlords, which lending institutions may (knowingly or unknowingly) facilitate through the terms of a loan.
  – For example, the terms of a loan may force a landlord to embark on a hyper-aggressive plan to drive up rents in order to pay off the loan within a relatively short period of time, which the lender should have known could not be executed without disregarding tenants’ rights and the landlord’s legal obligations.
  – In addition, in some instances lending institutions should know or be able to predict that a landlord default is likely based on the real rent rolls of the building, resulting in mismanagement of the building and other violations.
• The guidance describes best practices for pre-loan due diligence and post-loan monitoring.
2018 Rent-Stabilized Multifamily Guidance, cont.

Pre-Loan Due Diligence

• Lenders should evaluate experience and reputation of property owners. For example, lender should:
  – Conduct background checks and lien searches;
  – Engage with tenant organizations, and review information available from tenants and tenant organizations;
  – Search for tenant lawsuits; and
  – Review available tenant complaints, available landlord alert lists, and media coverage concerning property owners or problems at the property.

• Lenders should conduct appropriate due diligence on properties. For example, lenders should:
  – Inspect and review the property’s condition prior to closing;
  – Conduct due diligence regarding outstanding housing code and building violations, including enhanced diligence when a property has a relatively high number of violations; and
  – Conduct due diligence regarding building permits, eviction rates, high vacancy rates, and loss of rent regulated units.

• Lenders should ensure realistic and sound underwriting terms for any loan involving a multifamily residential building. To achieve this outcome, lenders should:
  – Hire reputable, independent appraisers;
  – Establish a debt service coverage ratio that is based on the specific facts of each loan and on realistic assumptions that utilize only current in-place rents (including preferential rents) and legally permitted rent from existing vacancies at the time of closing;
  – Use realistic operating expense levels; and
  – Ensure that additional debt is not placed on a property without the lenders' prior consent.

• Lenders should ensure that their loans do not become displacement financing; for example, through use of the loan for the purpose of tenant buyouts that may lead to their displacement.
Post-Loan Monitoring

• Lenders should establish covenants or procedures to ensure that emergency and hazard repairs, including needed repairs cited as building code violations, are corrected within six months of the loan closing.

• Lenders should take into consideration the level of responsiveness and willingness of a property owner in addressing concerns about building code violations, as a factor for future loans to the property owner.
Objective Risk Evaluation

- **Borrower Diligence**
  - Property Compliance Agreement (1 or more residential units)
  - Borrower must maintain properties in a clean, safe, and habitable living condition at all times in accordance with all applicable laws
  - Review applicable Borrower/Landlord diligence (available lists, etc.)
  - Diligence on Property Managers
• **Property Diligence**
  – Proper Inspections
  – Review of current and historical code violations (and nature thereof)
    • Consider enhanced due diligence with regard to code violations
    • Include consideration of level of past Borrower responsiveness
    • Require prompt corrective action (as a covenant/EOD)
  – Underwriting considerations
    • Debt Service Coverage
      – Careful evaluation of Stabilization Plans

• **Underwriting Considerations**
  – Debt Service Coverage
    • Careful evaluation of Stabilization Plans
Lender Liability Considerations

• Control
  – A lender in “control” of a Borrower creates fiduciary duty and can result in ownership risks (constructive mortgagee in-possession)
  – Control must be “actual, operative, and total control”
  – “Substantial control”

• Duty of Good Faith and Fair Dealing
  – Any undue pressure outside of contractual obligations can result in “bad faith” claim

• Course of Conduct
  – Patterns of behavior/action can modify contractual obligations if “consistently deviating” from negotiated terms

• Narratives
  – Avoid editorial comments and business suggestion
Serving the Community

• Displacement Lending
  – Evaluate loan documents with regard to market rent requirements and Lender approvals
  – Evaluate Loan Documents (holdbacks, etc.) for Stabilization
  – Ensure covenants that all Stabilization efforts are done in accordance with all applicable laws (including rent-stabilization and rent-regulation ordinances)
  – DFS Guidance in NY
  – Ellis Act in California

• Post-Closing
  – Loan and Borrower/Landlord Monitoring
  – EOD for failure to cure outstanding code violations
• **Reputational Risk Considerations**
  – Training mandates – awareness is key
  – Community Engagement Top of Mind
    • FRB, for example, has a Community Advisory Board including Board
    • Beyond CRA and Fair Lending
    • Doing the ‘Right Thing’
  – Reputational Impacts
  – Regulatory Impacts
About the Firm

Since the Firm’s inception in 1933, Buchalter has established itself as a full-service law firm that provides counsel to clients at all stages, and helps them navigate any legal challenges and decisions they may face.

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Michael Flynn is a member of the Firm’s Corporate Practice Group in the Los Angeles office.

Mr. Flynn applies his unique background as the former Acting General Counsel of HUD, and the former General Counsel of PNC Mortgage and Flagstar Bank, to counsel clients on a variety of regulatory, mortgage, consumer financial services, FinTech and real estate matters.
If an institution and its transactions are covered by the Home Mortgage Disclosure Act (12 USC 2801 et seq.) and Reg C (12 CFR 1003.1 et seq.), for any covered mortgage loan it must collect and report to the federal government on 48 different data points, with approximately 100 permutations. Reporting requirements are somewhat more limited for multifamily than for 1-4 residential properties, but are still heavy.
A heavy operational and oversight burden:

• Very complex and detailed collection and reporting requirements
• Opportunities for unintentional errors
• Costly to maintain systems, collect and store data, and test it
• Stresses on operational and oversight functions and processes
• HMDA data is often used by regulators to investigate potential discrimination and as evidence in enforcement actions. The data is also used by private litigants.
What is HMDA?

HMDA and Reg C are a set of legal requirements for defined mortgage lending institutions to collect and report to the federal government very detailed information about covered mortgage loans, applicants, borrowers and properties.

HMDA is designed to provide the government with data for three purposes:

- Helping to determine if financial institutions are serving the housing needs of their communities
- Assisting public officials in targeting public-sector investment to attract private investment to areas where it is needed, and
- Assisting in identifying possible discriminatory lending patterns and enforcing antidiscrimination laws.
- Depository institution – a bank, savings association or credit union that:
  o On the preceding December 31, had assets in excess of the asset threshold published by the CFPB (presently $46 million).
  o On the preceding December 31, had a home or branch office in an MSA.
  o In the preceding calendar year, originated at least one home purchase loan or refinancing of a home purchase loan, secured by a first lien on a 1-4 residential property
  o Meets one of the following:
    ▪ Is federally insured or regulated, or
    ▪ Any loan referenced above was insured, guaranteed or supplemented by a federal agency, or was intended by the institution for sale to Fannie Mae or Freddie Mac
Covered Institutions

- Meets one of the following:
  - In each of the two preceding calendar years, originated at least 25 closed-end mortgage loans, or
  - In each of the two preceding calendar years, originated at least 500 (200 after January 1, 2020) open-end lines of credit.
  - If meet only one of these two thresholds, must collect and report only as to that type of loan.
Covered Loans

Key definitions:

- A closed-end mortgage loan is an extension of credit secured by a lien on a dwelling and is not an open-end line of credit. 12 CFR 1003.2(d). If a transaction modifies, renews, extends or amends an existing loan obligation, but the existing debt is not satisfied and replaced, it is not considered a new extension of credit unless it falls within one of two exceptions:
  - An assumption of an existing loan
  - A transaction under a New York State consolidation, extension and modification agreement

- Multifamily lending is expressly covered: A dwelling is “a residential structure, whether or not attached to real property . . . [that] includes but is not limited to a detached home, an individual condominium or cooperative unit, a manufactured home or other factory-built home, or a multi-family residential structure or community.” 12 CFR 1003.2(f). (Emphasis added.)

- A multifamily dwelling means “a dwelling, regardless of construction method, that contains five or more individual dwelling units.” 12 CFR 1003.2(n).
Covered Loans

Dwellings include:

– Principal or other residence
– Vacation home
– Second home
– Investment properties
Covered Loans

For multi-family, dwelling includes:

- Multi-family apartments
- Condominiums
- Co-ops
- Manufactured home communities if secured by liens on one or more individual dwellings.
- Mixed use facilities if primary use is for residential (can be determined by any reasonable standard):
  - Long-term assisted living facilities
  - Supportive housing for persons with disabilities
Covered Loans

But dwellings do not include:

- Transitory residences (hotels, student dormitories)
- Hospitals, skilled nursing, rehabilitation and other short-term medical care facilities
- RV parks
- RVs such as boats, campers and travel trailers
- Loans secured by liens on unimproved property
- Purchases of covered loans from other institutions
- Purchases of an interest in a pool of loans
- Purchases of participations or partial participations in covered loans.
Thus, commercial loan transactions are within the definition of mortgage loan if they are:

- A home purchase loan
- A home improvement loan, or
- A refinancing loan

They include construction to permanent loans, but not construction only loans or other temporary financing.

- What is construction to perm? It depends on whether the construction loan automatically converts, or is designed to convert, to separate permanent financing extended by any financial institution to the same borrower at a later time. 12 CFR 1003.3(c)(3), see Official Comment 1003.3-3(c)(3).
Odds and Ends

– Pre-approvals and pre-qualifications are not covered for multi-family properties.
– Replacement or substitution of guarantors – not counted as part of 25 loan threshold, but a covered institution must track and report them.
Partial Exemption – allows an institution to collect and report in regard to only 22 of the 48 data points.

Requirements:

– A Financial Institution must be an:
  o “Insured credit union” as defined in Section 101 of the Federal Credit Union Act, 12 USC 1752; or
  o “Insured depository institution” as defined in Section 3 of the Federal Deposit Insurance Act, 12 USC 1813.
Odds and Ends

Requirements:
- An insured depository institution must not have received either of the following in the two most recent CRA ratings as of December 31 of the preceding year:
  - A rating of “need to improve record of meeting community credit needs” during each of its two most recent examinations under Section 807(b)(2) of the CRA; or
  - A rating of “substantial noncompliance in meeting community credit needs” on its most recent examination under Section 807(b)(2) of the CRA.
    • For closed-end loan requirements, the institution originated fewer than 500 Closed-End Mortgage Loans in each of the two preceding calendar years.
    • For open-end line of credit requirements, the institution originated fewer than 500 Open-End Lines of Credit in each of the two preceding calendar years.
– Would raise the closed-end threshold to either 50 or 100 loans in the two preceding calendar years.
– Would extend the temporary 500 open-end line of credit threshold to January 1, 2022, then set it at 200.
– Comment period has closed.
May 2, 2019 Advance Notice of Proposed Rulemaking

– The Bureau is soliciting comments on whether to make changes to the data points.

– In addition, the Bureau is soliciting comments on the requirement that institutions report business or commercial purpose loans made to a non-natural person and secured by a multifamily dwelling.

– Comment period closed July 8, 2019.

– Bureau’s specific questions re multifamily reporting:
  o The value that data on such transactions provides in serving HMDA's purposes;
  o Other benefits associated with reporting such transactions; and
  o The burden imposed by the requirement to report data on such transactions.