

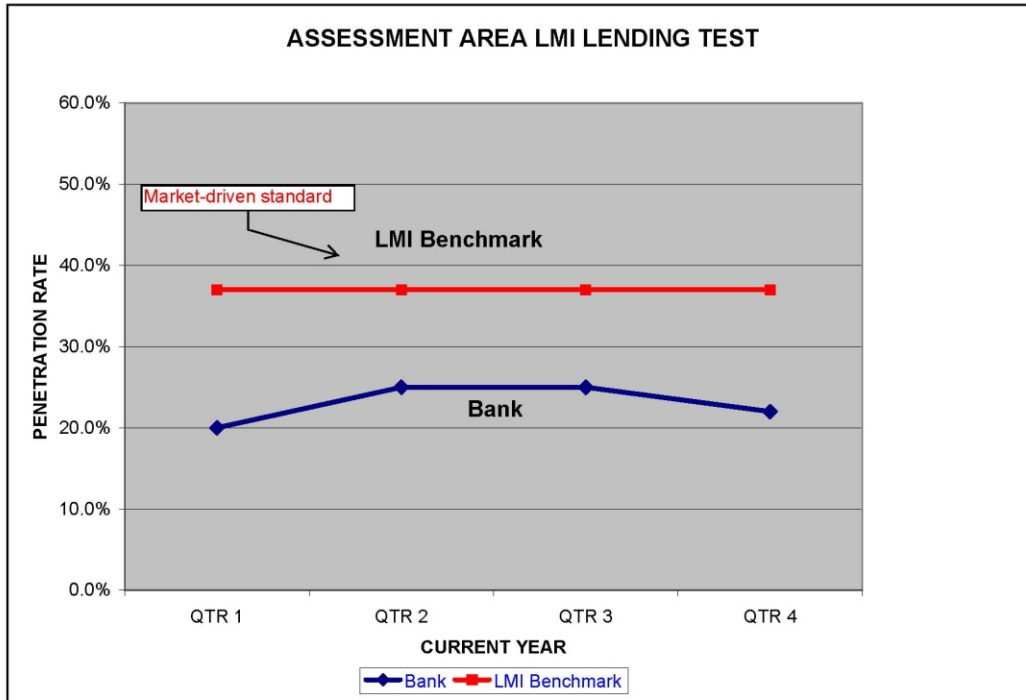


CRA COMPLIANCE GUIDE

**Delineate Your Assessment Area to Comply With CRA
and to Minimize Performance Pressure**

“Do you feel the “*pressure*” to reach impossible or ill-defined CRA Performance goals”?

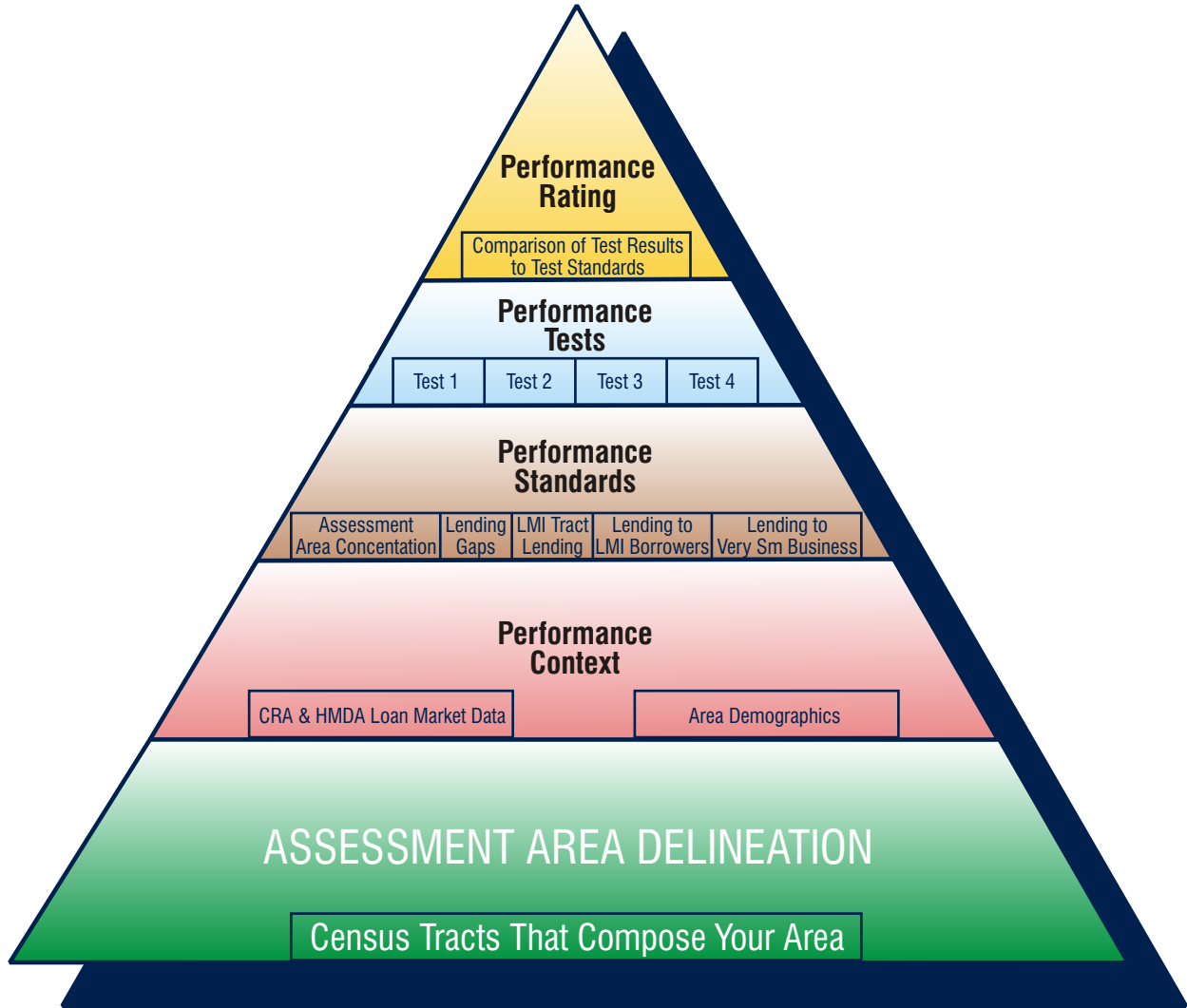
CRA LENDING TEST 4



How you delineate your Assessment Area may be your problem.

Introduction... as a *CRA Officer*, the most important decision you will ever make is **how you define your bank’s Assessment Area(s)**. Why? Because it affects every test that examiners use to measure and rate your performance. Furthermore, failing to do it properly can put you in violation of technical provisions in the Regulation. But banks do not even consider the impact of Assessment Area delineation on performance standards. As a result, you may have inflated the performance standards against which your performance will be measured.

This report will cover the performance implications of your Assessment Area Configurations and show you a step by step approach on how to successfully achieve this critical function.



CRA Performance Pyramid

The Relationship... in order to appreciate the impact of Assessment Area construction on performance expectations, it is necessary to understand the relationship between Assessment Area and Performance Tests and Standards. The *CRA Pyramid* illustrates this relationship. (see p3)

To make sense of your CRA performance, you need to know not only the tests applied by examiners, but the standards for those tests, as well. As the Pyramid shows, CRA Performance Ratings are based on CRA performance tests that use performance standards which are derived from performance context demographic and loan market data that are determined by how you define your Assessment Area. Examiners compute standards using the demographics and loan market data that is extracted from the unique combination of tracts that compose your Assessment Area.

For example... examiners will compare the Low and Moderate-income tract “penetration rate” of HMDA reporting lenders (the % of all reported mortgages in your community inside the Assessment Area low and moderate-income tracts) to your penetration rate in those tracts. If your rate is 15%, you need to compare it to the market experience of other lenders in order to form a value about your performance.

| Assessment Area LMI Penetration Rate | | |
|--------------------------------------|------|--------|
| | Bank | Market |
| UNITS | 15% | 20% |
| – \$ – | 13% | 22% |

Footnote: “Penetration Rate” is determined by dividing HMDA mortgages within the Assessment Area LMI tracts by total HMDA mortgages in the Assessment Area. The results for your data and the market-reported loans of all lenders are compared by examiners.

Consequently, any time you change your Assessment Area, you are changing the demographic and loan market data that drives the standards.

When you define your Assessment Area you must know how your performance and the standards used to judge it are affected by your choice!

Step 1 - Review Assessment Area Configurations for Technical Violations of Section __.41...

Section __.41 of the Community Reinvestment Act affords bankers wide latitude in the construction of an Assessment Area. (Section __.41 is in the shorthand used by Regulatory Agencies, eliminating the first part of Section number, 25 for OCC, 228 for the FBR, 345 for the FDIC, and 563(e) for the OTS because the suffix is identical for all the Agencies). Subsection (c) defines the prescriptions of the Act, Subsection (e) lays out the proscriptions, and Subsection (d) describes the adjustments banks can make.

Essentially, there are few technical issues to be considered but,

An Assessment Area:

- (1) must include tracts in which a bank maintains its deposit-taking facilities.
- (2) must consist of whole geographies that must be contiguous.

An Assessment Area:

- (1) cannot reflect illegal discrimination.
- (2) cannot arbitrarily avoid low and moderate-income tracts.
- (3) cannot extend substantially across the boundaries of an MSA.

A bank may make adjustments to its Assessment Area “to include only the portion of the political subdivision it reasonably can be expected to serve”.

These requirements would appear to be simple and easy to follow, but *GeoDataVision* has observed a significant number of violations among the hundreds of banks for whom we have developed Assessment Area maps since 1994.

Mastering these issues is the start to creating an Assessment Area that meets regulatory requirements and minimizes the performance pressure on your bank. Review the above rules and make certain your current Assessment Area does not violate Section __.41.

Step 2 - Apply CRA Lending Tests...

All Banks are examined under the “Lending Test” measurements of bank performance as follows:

Test 1. Assessment Area Loan Concentration

What is the relative volume of loans inside the Assessment Area?

Test 2. Gap Analysis

Are there any conspicuous groups of contiguous tracts in which the bank has done little or no lending?

Test 3. LMI Tract “Penetration Rate”

What percentage of your loans is inside your AA low- and mod-income tracts (your penetration rate)?

Test 4. Lending by “Borrower Characteristics”

What the percentage of your HMDA mortgages and consumer loans (if you exercise your elective) is to low- and moderate-income borrowers and what the percentage of your small business loans is to very small businesses (<=\$Mil/Yr)?

The best way to develop the “ideal” Assessment Area is to calculate your performance using each of the above tests and determine how each Assessment Area configuration affects the results. Good CRA software allows you to run your lending data through a series of alternative Assessment Area configurations from which you can create comparisons. You need to establish appropriate tables that reflect the results of each individual scenario.

Table 1 below allows for comparison of your performance under each of the elements described above.

Table 1 - CRA Lending Test

| Alternative Assessment Areas - Lending Test - (Insert Your Bank Data) | | | | | | | | |
|---|----------------|--------|-----------------------------|----------|-----------------------------|--------|--------------------------------|-------------------------------|
| TEST # → | #1 AA Ratio | | #2 GAP Analysis | | #3 LMI Tract Penetration | | #4 | |
| | HMDA | SBUS | (COMBINED PORTFOLIOS) | | HMDA | SBUS | LMI BORROWER PENETRATION | VERY SM BUS PENETRATION |
| 1 | ____ % | ____ % | Lending Gaps Observed | Y/N / | ____ % | ____ % | ____ % | ____ % |
| 2 | ____ % | ____ % | Lending Gaps Observed | Y/N / | ____ % | ____ % | ____ % | ____ % |
| 3 | ____ % | ____ % | Lending Gaps Observed | Y/N / | ____ % | ____ % | ____ % | ____ % |

This table allows comparison of your performance under each element of the Lending Tests for various alternative Assessment Area configurations. Insert in each cell the percentage you have calculated for each test in each Area. This is a critical step but not the final one in an organized process to make the best decision for your bank.

*AA Ratio

Calculate by taking your loans *inside* your Assessment Area divided by total loans for the portfolio (loan numbers & values).

**Loan Gaps

Do you observe any groups of contiguous tracts in which your bank has originated *no loans*?

***LMI Tract Penetration

What percent of your loans *inside* your AA are in the Assessment Area LMI Tracts?

****LMI Borrower Penetration

What percent of your HMDA loans *inside* your AA are to low and moderate income borrowers?

*****Very Small Business Penetration

What percent of your Small Business loans *inside* your AA are to Very Small Businesses (\$1M GAR or Less)?

STEP 3 - Determine Performance Standards...

Having computed your “Lending Test Performance” for each alternative Assessment Area, the next step is to develop the standards that will be used to evaluate your performance for each Assessment Area configuration. Except for the Assessment Area concentration ratio, which is the only quantitative performance standard enumerated in the Regulation (50% minimum), the performance standards used to judge your performance will change with each adjustment you make to your defined community. Adding or subtracting tracts will affect the demographic and loan-driven performance standards used to assess your CRA performance. Therefore, it is imperative that you construct your Assessment Area with an awareness of how alternative configurations affect the performance standards that will be used to judge your performance.

See Table 2 below.

Table 2 - CRA Performance Standards

| Alternative Assessment Areas - Lending Test Performance Standards (Insert Market Data) | | | | | | | | | | |
|---|-----------------|------|-----------------|------|-----------------------------|------|------|--------------------------------|--------------------------------|--------------------------------|
| TEST#→ | #1 AA Ratio | | #2 Loan Gaps | | #3 LMI Tract Penetration | | | #4 Borrower Characteristics | | |
| | AREA CONFIG. | HMDA | SBUS | HMDA | SBUS | HMDA | OOHU | SBUS | LMI BORROWER PENETRATION | LMI FAMILIES PENETRATION |
| 1 | 50% | 50% | NA | NA | % | % | % | % | % | % |
| 2 | 50% | 50% | NA | NA | % | % | % | % | % | % |
| 3 | 50% | 50% | NA | NA | % | % | % | % | % | % |

*The AA ratio standard is always 50% and loan Gap Analysis is not driven by comparisons. Calculate these results based on the market data to determine the market driven performance standards.

OOHU is the percent of Assessment Area owner-occupied housing in Assessment Area LMI Tracts (e.g. 100,000 OOHU in Assessment Area of which 20,000 are in AA LMI tracts =20%)

LMI Families Penetration is the percent of Assessment Area families that are qualified as LMI families (e.g., 50,000 Assessment Area families of which 15,000 are LMI families = 30%)

STEP 4 - Compare Performance to Standards...

Now that you have calculated your performance under each lending test for each Assessment Area alternative and determined the performance standards associated with each Assessment Area configuration, all that's left is to compare your performance with the standards under each scenario in order to identify the best configuration for your bank.

The data to be filled in this Table should show the results of the performance calculations with the performance standards as revealed in Tables 1 & 2. If the comparison is negative, there should be an indication. We suggest using (-) numbers to depict performance shortfalls.

Now you can evaluate the performance advantages and disadvantages of your alternative Assessment Area scenarios. See Table 3 below.

**Table 3 - Comparison
Performance to Performance Standards**

(Fill in these cells with the difference (+ or -) between your performance and the standard for your performance)

| Alternative Assessment Areas - Lending Test Performance Standards (Compare - Bank Data to Market Data) © GDV 2007 All Rights Reserved | | | | | | | | | | |
|---|------------------|-------|-----------------------------|----------|-------------------------------|-------|-------|----------------------------------|--------------------------------|------------------------------------|
| TEST # → | (#1) AA Ratio | | (#2) GAP Analysis | | (#3) LMI Tract Penetration | | | (#4) Borrower Characteristics | | |
| AREA CONFIG. | HMDA | SBUS | (COMBINED PORTFOLIOS) | | HMDA | OOHU | SBUS | LMI BORROWER PENETRATION | LMI FAMILIES PENETRATION | VERY SM BUSINESS PENETRATION |
| 1 | ___ % | ___ % | Lending Gaps Observed | Y/N / | ___ % | ___ % | ___ % | ___ % | ___ % | ___ % |
| 2 | ___ % | ___ % | Lending Gaps Observed | Y/N / | ___ % | ___ % | ___ % | ___ % | ___ % | ___ % |
| 3 | ___ % | ___ % | Lending Gaps Observed | Y/N / | ___ % | ___ % | ___ % | ___ % | ___ % | ___ % |

OOHU = owner-occupied housing. How it is distributed by tract income class is an important demographic variable used by examiners

LMI families are another important demographic variable. Examiners will compare the distribution of LMI families as a percent of all Assessment Area families to the percent of your Assessment Area mortgages extended to LMI families in the community.

You may want to augment the tabular approach with graphs depicting the comparisons to make them more observable.

In Conclusion...

Of course there are other factors to consider when making your final decision, but this step by step process will help you to organize the most important factors and show you the performance advantages and disadvantages of your potential choices.

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