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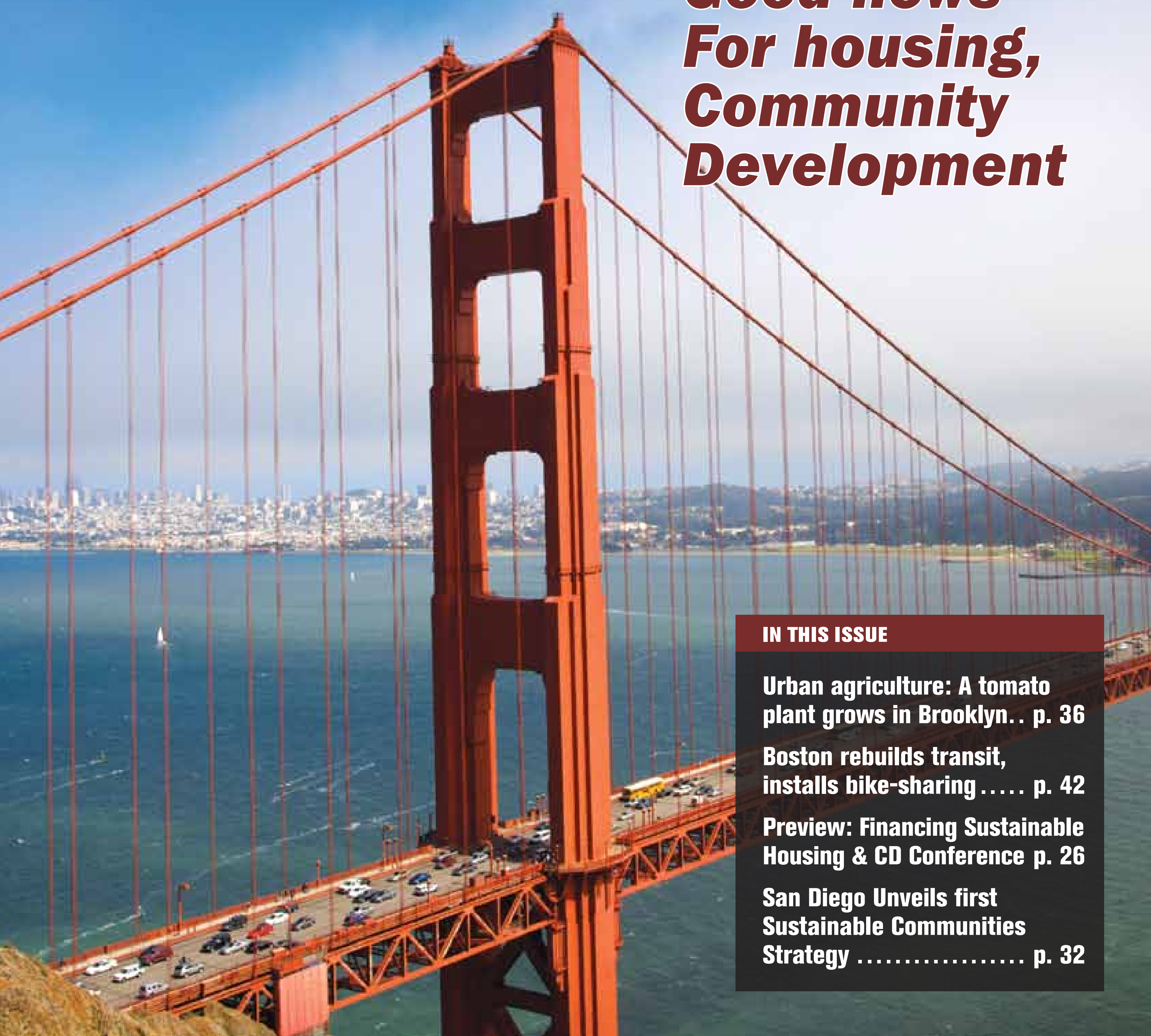
Bridging the Financing Gap:

Good news For housing, Community Development



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Good News for Housing and CD

BACK IN THE BLACK:

Citi Rebounds From Down Years, Resumes Major Housing, CD Role

When the financial services empire that is Citigroup suffered the worst of the recession, the institution's housing and community development programs shrunk to a fraction of their former size. But Citigroup is back in the black, and its affordable housing and development programs are roaring ahead once again.

As co-head and managing director of Citi Community Capital for 11 years. Andrew Ditton watched his department shrink, losing more than one-third of his staff. Now, his operation is expanding rapidly once again. But this time, Ditton says, he hopes there is a durable new discipline in the financing markets, and he is looking to federal financial regulators to help make that a reality.

Few bankers know affordable housing and community development better than Ditton. From 1984 to 1997, he was the executive vice president, chief credit officer, and chief operating officer of LISC, a nonprofit that supports affordable housing and community development nationwide.

At Citi, he and his co-manager Hal Kuykendall, preside over a wide range of financial services, offering to meet most or all the financial needs of almost any housing or community development project.

But even the bank's size and scope of services did not save it from the impact of the recession. "We were very quiet in 08 and 09. Like many of the big banks, certainly those under stress, we contracted in all kinds of ways and reduced the size of our balance sheet." Federal regulators wanted major lenders to shrink, he said, so his operation and every other credit extending Citi business that used the balance sheet had to shrink.

Citi Community Capital went from 180 to 110 people, loan originations dropped dramatically, and equity investment in low-income housing tax credits stopped completely.

Things started to improve in the third quarter of 09, as Citi began rethinking business strategy.

In 2010, Citi began to hire again, and now has a staff of about 160. "We have gone through a volatile time, but have come out of it with a better business strategy, a more integrated product line and a stronger operational infrastructure," said Ditton.

The community capital operation did $5.6 billion in total volume in 2010, including $3.1 billion in lending and $2.5 billion in investments. In 2010, the group financed over 40,000 affordable housing units. The numbers include $600 million in equity investment in low-income housing tax credit projects.

It is on track to do a similar amount of business this year. This compares to about $2 billion per year during the recession.

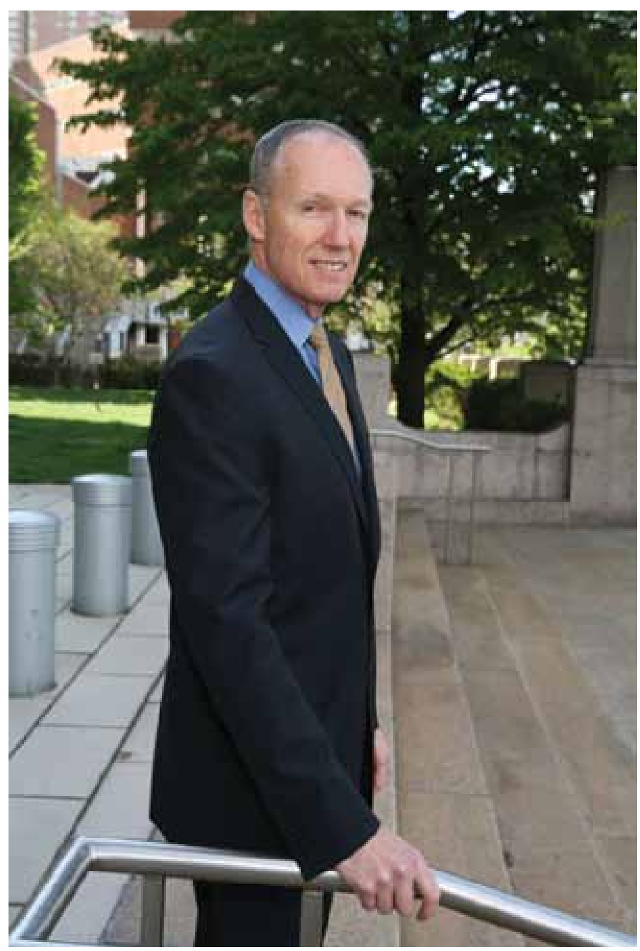

PHOTO: PAULA VLODKOWSKY

▲ **Andrew Ditton**

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▲ **New York City works hard to provide housing for low-, moderate- and middle-income households, like Elliott Chelsea on West 25th Street and 9th Avenue in Manhattan. The $65 million development will provide apartments affordable for people earning from 50 percent to 195 percent of the area median income. Artimus Construction is the developer. Citi Community Capital arranged the financing and is the Freddie Mac lender and made the construction loan.**

The mainstay of the group's business is project financing, primarily for affordable housing using low-income housing tax credits. It typically provides equity investments as well as construction and/or permanent mortgage financing and can be the one-stop shop for most of a project's financing needs.

The group makes loans to Community Development Financial Institutions which in turn lend to transit-oriented development, charter schools and community health centers. It also lends to small businesses.

Ditton does not expect to revisit the lofty heights of 2007 due to both political and economic factors.

In 2007, people would buy LIHTC deals in any location, and the pricing difference was marginal. Most investors paid over $1 for credits anywhere

This was attributable to the sponsors of guaranteed funds, Ditton said. These funds used their balance sheets to offer investors a low, guaranteed rate of return, and they drove the market by paying high prices and competing aggressively for deals. One of the biggest players in the field was SunAmerica, a subsidiary of insurance giant AIG, one of the companies most widely blamed for the implosion of financial markets at the recession's start.

In 2008, SunAmerica boasted that it had invested in more than 1,200 properties in 48 states and the Virgin Islands, comprising more than 146,000 units of affordable housing, and was buying projects at a rate of 70 to 100 per year.

"That's all changed, there is no guaranteed market. All of that has gone away," said Ditton. As a result, he said, investment terms are more conservative.

Another key factor in the resurgence of tax credit investing is the Community Reinvestment Act, which requires banks to invest in low-income neighborhoods within their retail banking service areas. The CRA has been a consistent driver of bank investment in tax credits.

Now, part of the increase in capital flows is coming from insurance companies and other non-banking corporations that are not governed by CRA. Ditton applauded this trend, saying these kinds of investors bring a healthy discipline to the market.

Ditton is also hoping to see changes in the CRA. The primary improvement would be to broaden the current geographic delineation of where a bank needs to invest to get credit for meeting its CRA obligations. Under current law, the definition is fairly narrow. This creates distortions in the tax credit investment market, Ditton explained. It means that major cities served by a large number of big banks enjoy an avalanche of CRA-motivated investment, while rural areas and smaller towns and cities with fewer banks see very little benefit from the law. The complexity of tax credit transactions makes the concentration of investment in major markets even more extreme.

Federal banking regulators are considering a way to level the playing field by loosening up the correlation between where you get CRA credit for making investments and where you have bank branches. In other words, a New York City bank now receives CRA credit only for investing in projects within the city limits. Under the proposed change, the bank would be able to get credit for investments in a broader geographic area, possibly as large as the entire state of New York.

Ditton is rooting for the regulators to implement such a change. "People would flood money into areas that are underserved now," he said. "That would bring a leveling to the current price disparities, which would be very positive for the tax credit program," he said.

The proposed change raises interesting political issues. In the wake of the mortgage market collapse, the American Enterprise Institute and other groups and politicians said

CRA forced lenders to make bad loans to meet low-income lending mandates.

But Ditton believes the proposed regulatory change would broaden political support for CRA. "If you pitched it correctly, what we're trying to do is make compliance with CRA easier and create more parity in benefits of CRA."

He said such a change would do away with "CRA oases and CRA deserts," which benefit projects in big cities but leave hundreds more starved for capital. Politically, eliminating disparities would mean broader support in Congress.

Finally, the change would improve underwriting and deal quality. Currently, Citi has to do all its tax credit lending and investing in only 62 CRA assessment areas where it has a retail presence. "It's hard to carry out investment activity prudently when you are jamming it all into such small areas."

With more consolidation of banks expected, the change will probably become more important in the future, Ditton concluded. ❧