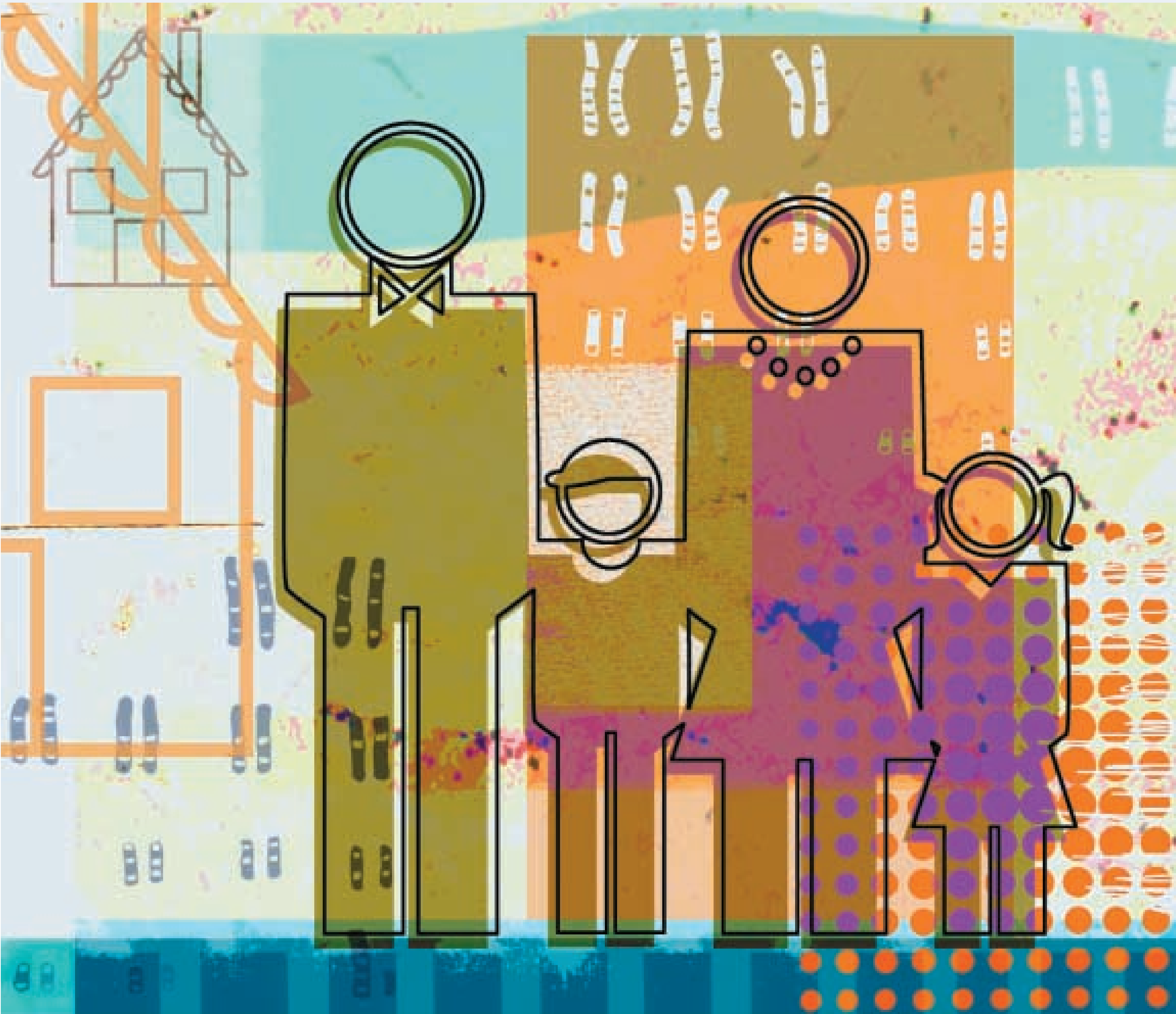
Taking Stock of CRA

By Julia Reade, Federal Reserve Bank of Boston

This spring, the Joint Center for Housing Studies of Harvard University released a report that reviewed the strengths and weaknesses of the Community Reinvestment Act over recent years. The authors have two main conclusions. First, the Community Reinvestment Act (CRA) does have its intended effect of expanding access to mortgage capital. Second, fewer and fewer mortgages are covered by CRA regulations, and this has eroded the impact of CRA. The Joint Center report stresses that CRA modernization is an important policy debate and offers broad suggestions for reform. (The full report, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System," is available at www.jchs.harvard.edu/crareport.html.)



CRA was enacted 25 years ago to increase access to capital for traditionally underserved populations. Concern existed that banks accepted deposits from households in low-income communities, but refused to subsequently grant adequate credit to those households. Under CRA, depository institutions are encouraged to have active lending in the areas where they operate.

CRA has been successful in opening up lending to underserved populations. Recent dramatic consolidation in the banking industry and a large rise in lending by nondepository institutions, such as independent mortgage companies, however, have many concerned that CRA is becoming less effective. The Joint Center report addresses these concerns by analyzing trends in Home Mortgage Disclosure Act data between 1993 and 2000, the period with the most recent and highest quality data. The analyses are complemented by extensive qualitative interviews.

Homeownership and Lending to Underserved Populations

During the 1990s, many individuals in historically underserved populations became homeowners. Likewise, the highest gains in mortgage lending were to these low-income households, low-income communities, and minorities.

Lending to lower-income people and communities grew an impressive 77 percent during the time period. Though this is a dramatic increase, lending to higher-income people in higher-income communities rose 43 percent. The share of home-purchase loans that went to lower-income people and communities rose to 36 percent. However, the bulk of loans (64 percent), still went to higher-income people in higher-income communities. (See Table 1 below for a detailed breakdown.) Lower-income communities also experienced higher levels of house price appreciation and housing turnover than higher-income communities. Both of these conditions are consistent with increased access to mortgage lending.

Minorities also experienced dramatic gains in lending. Home-purchase loans to Hispanics surged 140 percent; for blacks, the increase was 94 percent; and for other minorities, the gain was 92 percent. Meanwhile, lending to whites rose 27 percent. The minority share of home-purchase borrowers grew from 17 percent in 1993 to 25 percent in 2000.

Despite these gains, concern about disparities in lending to underserved populations is still warranted. In metropolitan areas, 35 percent of all households live in low-income neighborhoods, but these neighborhoods receive only 13 percent of mortgage loans originated. Disparities also exist by race and ethnicity. Homeownership rates in 2000 were nearly 75 percent for whites, but less than 50 percent for minorities.

The CRA Effect

As noted in the Joint Center report, CRA may have led to some of these lending gains. However, these increases may have also stemmed from a strong economic situation, new lending products, growth in the secondary mortgage industry, technological advances in mortgage lending, fair housing and lending enforcement, and a rising number of government-insured loans, among other things.

The report attempts to control for some of these influences to gauge CRA's effect. The authors' technique is to break loans into three types, described below, and to see if lending patterns differ across the groups. If the current economy dictated all the changes in lending patterns, then lending in each of the three groups would probably be affected similarly. If lending to lower-income households or areas is stronger for loans covered under CRA, it suggests that CRA is having an impact.

Table 1: More Lending to Low-Income People and Communities

Lower-income people and communities have seen the highest gains in originations of home-purchase loans. Despite the dramatic growth, these loans still make up a small share of the total number of loans.

POPULATION	PERCENT RISE IN HOME PURCHASE LOANS 1993 TO 2000	PERCENT OF TOTAL LOANS IN METROPOLITAN AREAS 2000
Lower-Income People in Lower-Income Communities	94	6
Higher-Income People in Lower-Income Communities	79	7
Lower-Income People in Higher-Income Communities	72	23
Higher-Income People in Higher-Income Communities	43	64

Source: Joint Center Enhanced HMDA Database. "Lower-income borrowers" are defined as families with less than 80 percent of the metropolitan area median income. "Lower-income communities" are defined as census tracts with median family income less than 80 percent of the metropolitan area median family income.

Less than one-third of mortgages are covered under CRA, and that share is shrinking. In some metropolitan areas, less than one-tenth of mortgages are covered.

The three groups of loans used to determine whether CRA has an effect come from both CRA-regulated lenders and nonregulated ones. CRA-regulated lenders include banks and savings associations with deposits insured by the Federal Deposit Insurance Corporation. Loans made by these institutions fall into two of the three groups: loans made inside assessment areas (these loans get detailed reviews by regulators), and loans made outside assessment areas (these loans get "scant" reviews by regulators). The third group of loans represent lenders not regulated by CRA. (As such, these loans are not reviewed.) Nonregulated lenders include independent mortgage companies, credit unions, consumer finance companies (such as credit card issuers), and mortgage company subsidiaries of insurance, financial services, and home building companies.

What Works

The Joint Center report states that CRA does expand access to mortgage capital. CRA-regulated institutions have measurably different lending patterns than they would have if CRA did not exist. One indication of this is that CRA-regulated institutions originate a higher proportion of loans to lower-income people and communities than they would if they were not under CRA. Another sign is that CRA-regulated institutions have lower denial rates for low-income people and low-income areas than other institutions. In qualitative interviews with lenders, CRA-regulated institutions said that CRA did not directly affect their business plans, but affected them "at the margin."

The researchers found important differences in CRA-regulated lending for different kinds of loans. As shown in Table 2, CRA-regulated institutions have a higher proportion of their prime conventional mortgage loans going to low-income people and low-income areas than other institutions do. CRA-regulated lending is particularly strong in providing prime conventional lending to disadvantaged minorities.

The report emphasizes that the loans deserving attention are prime conventional loans. It argues that government-backed loans do not provide a good measure of how banks lend in their assessment areas. Government-backed loans are considered "pass-through operations" which are immediately resold to the secondary market. In addition, these loans have "noticeably different" costs and associated fee structures. The authors summarize that "CRA-regulated entities continue to lead others in extending prime conventional loans to lower-income people and communities, an outcome that was envisioned in the enactment of CRA more than two decades ago."

Table 2: Regulation Has an Impact

This table shows the share of conventional prime loans that went to lower-income people and communities by race and ethnicity during 2000. Loans made to minorities within assessment areas (AAs) by CRA-regulated organizations are most likely to serve low-income people and communities.

POPULATION	CRA REGULATED ORGANIZATIONS		NON-CRA REGULATED ORGANIZATIONS
	Within AA	Outside AA	
Whites	29	26	26
Blacks	61	44	41
Hispanics	54	43	39
Other	26	23	23
All Races	31	26	26

Source: Joint Center Enhanced HMDA Database.

What Does Not Work

While CRA may benefit underserved populations, its relevance is decreasing. Less than one-third of mortgages are covered under CRA, and that share is shrinking. In some metropolitan areas, less than one-tenth of mortgages are covered. The authors also conclude that CRA currently has a "minimal" impact on lending in rural areas.

Surprisingly, CRA offers the least protection for populations it was created to serve. About 25 percent of refinance loans to lower-income borrowers and communities are covered, but for higher-income borrowers and communities, the coverage is nearly 35 percent. Coverage gaps disfavoring lower-income borrowers and communities also exist for home-purchase loans, but they are much smaller.

Minorities also have lower levels of CRA coverage. For home purchases, about 32 percent of loans to whites are covered under CRA; for Hispanics, only 26 percent are covered; for blacks, just 23 percent are covered. Gaps in coverage for refinancing are even larger: CRA covers 36 percent of loans to whites, 32 percent of refinance loans to Hispanics, and 21 percent of refinance loans to blacks.

Some of these gaps are due to CRA's differential coverage of loan types. For example, 25 percent of all refinance loans are subprime, but less than 5 percent of subprime refinance loans are covered by CRA. Because nearly one-half of refinance loans originated to blacks are subprime, blacks are disproportionately affected by CRA's low coverage of subprime lenders.

What Happened?

When CRA was passed, thrifts and local banks dominated lending, but their influence has been waning. In the past decade, independent mortgage companies and other lenders not regulated under CRA have grown rapidly. In addition, patterns of lending for CRA-regulated institutions have changed, which, in turn, affected the number of loans covered by CRA. The relaxation of interstate banking laws has allowed banks to greatly expand lending outside traditional local areas. This has led to CRA-regulated institutions making increasing numbers of loans that are not tightly reviewed under CRA. The report states that such outside assessment-area lending is currently the fastest-growing type of mortgage lending.

What Now?

CRA could be modified by two broad approaches. The Act could be extended to regulate a larger share of mortgage lending, a traditional focus of CRA. One way of doing this would be to expand coverage to include institutions that have not been covered before, such as independent mortgage companies. Another way would be to increase the breadth of CRA coverage for loans made by institutions that are already CRA-regulated; for instance, extending CRA coverage of loans made by institutions operating outside their local areas.

The other approach would be to modify CRA by building on the Act's branch-banking focus. Although mortgage lending today is far less linked to branch-based deposit-gathering institutions than in the past, local branches still play an important role in providing community development lending and financial services for lower-income people and communities. CRA could be adapted so that it more broadly emphasizes access to financial services to lower-income people and communities.

With such evidence that the power and relevance of CRA is weakening, the Joint Center authors believe that CRA should be updated to reflect today's realities. Numerous other stakeholders have voiced their opinions about CRA, and many have submitted comments to the federal regulatory agencies, who are assessing these comments. *Communities & Banking* will provide updates on CRA modernization as they occur.

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Community-Based Advocacy Adapts

In the past, many community-based advocates sought to help local communities by influencing the mortgage lending operations of local banks. However, with ties between lenders and communities weakening, advocacy groups are being forced to adapt their strategies. The increasingly complex structure of lending institutions, with spin-offs and subsidiaries, makes it difficult to determine the role of any particular lender in a community. Poor data on loan interest rates and prices cloud the issues even more.

The rise in nationwide lending has run parallel to an increase in nationwide advocacy groups. This has led to competition for limited funding between local and national organizations. Community groups used to rely heavily on local banks for funding. Nationwide banking institutions appear to have shifted much of their nonprofit funding from local to national advocacy groups. Some local organizations have tried to adapt by developing networks with other groups to span wider geographies. In Illinois, for example, community groups from all across the state are forming alliances to push antipredatory lending regulations through its legislature.

Many advocacy groups have broadened their focus from mortgage lending. They now cover more wide-ranging topics in access to financial services for lower-income people and communities, among other economic development strategies. Educational programs, such as homebuyer counseling and financial literacy, are becoming more important.