



**THE 25TH ANNIVERSARY
OF THE
COMMUNITY REINVESTMENT ACT:
ACCESS TO CAPITAL IN AN
EVOLVING FINANCIAL SERVICES SYSTEM**

March 2002

Prepared for the Ford Foundation

by



The Joint Center for Housing Studies
Harvard University

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The empirical work reported here extends previous Joint Center research done in cooperation with the U.S. Department of Treasury and The Brookings Institution (Belsky *et al.*, 2001, Litan *et al.*, 2000). The Joint Center acknowledges the significant contributions to this initial effort by former Treasury Department officials Michael Barr and Alan Berube.

At the Joint Center, William Apgar led the project study team. The team included Eric Belsky, Yi-Ru Chen, Mark Duda, Gary Fauth, Dawn Patric, Madeleine Pill, Nicolas Retsinas, and Alexander Von Hoffman. The study team gratefully acknowledges the many insights obtained during a series of in-depth interviews and discussion groups convened as part of the overall project. In the spring of 2000, the Joint Center held 11 discussion groups with over 100 experts in housing policy, housing finance, and community development. The Joint Center also conducted in-depth interviews with more than 100 individuals in the Baltimore, Birmingham, Chicago, and Los Angeles metropolitan areas, as well as in rural Colorado. These interviews and group discussions examined CRA in the context of the changing organization of the mortgage industry, the growth of affordable lending tools, and the resulting changes in the provision of credit to lower-income borrowers, and were invaluable to the success of the overall project.

Finally, we are indebted to an Advisory Committee established by the Joint Center that provided helpful comments at each stage of the project. The Advisory Committee included senior officials from bank regulatory agencies, as well as nationally recognized experts drawn from the housing and mortgage finance industries, and national and local non-profit community development and advocacy organizations. A list of Advisory Committee members is presented in an appendix to this report. The report also benefited from the advice and counsel of numerous outside technical experts, most particularly Robert Avery, Raphael Bostic and Glenn Canner of the Federal Reserve Board of Governors, Daniel Milkove and Samuel Calhoun of the USDA's Economic Research Service, Michael Schill of New York University School of Law, and Anthony Yezer of George Washington University.



EXECUTIVE SUMMARY

The United States Congress passed the Community Reinvestment Act (CRA) in 1977 to encourage depository institutions to meet the credit needs of lower-income communities. The Act responded to the contention that savings and loans associations and banks were ‘redlining’ or systematically denying credit to lower-income and minority neighborhoods. CRA advocates argued that by restricting credit access based on neighborhood characteristics as opposed to the credit-worthiness of individual loan applicants, the actions of depositories were exacerbating urban decline.

CRA was built on the simple proposition that depositories have an obligation to serve the credit needs of the communities where they maintain branches. The linkage between depositories and community credit access reflected the structure of the banking and mortgage industry at the time of enactment. Unlike today, 25 years ago banks and thrifts originated the vast majority of home purchase loans. Restrictions on branching and interstate banking limited the geographic scope of banking operations, making CRA’s focus on markets where CRA-regulated entities maintained branches a sensible one.

Along with the Home Mortgage Disclosure Act (HMDA) and closely related Fair Lending and Fair Housing legislation, CRA today continues to provide significant incentives for CRA-regulated institutions to expand access to credit to the lower-income and minority communities in which they maintain deposit-taking operations. Yet, in the quarter-century since its passage, dramatic changes have transformed the financial services landscape, especially home mortgage lending. Entirely new forms of mortgage lending provided by new lending entities have appeared and grown explosively, as global capital markets and institutional investors have replaced deposits as the source of funding for residential mortgages. As the link between mortgage lending and branch-based deposit gathering has eroded, however, so has the scope of CRA in the mortgage lending industry. Today, less than 30 percent of home purchase loans are subject to intensive review under CRA. In some metropolitan areas this share is below 10 percent.

With a substantial portion of home purchase lending no longer subject to detailed scrutiny under CRA, the issue of how best to modernize CRA has emerged as an important public policy challenge. Some argue that CRA’s costs exceed its benefits. Others advocate expanding regulatory oversight. Congress considered changes to CRA in the debate leading up to the passage of the 1999 Gramm-Leach-Bliley Financial Modernization Act (GLBA) but in the end did little to adapt CRA to the realities of the evolving financial services marketplace. Though CRA continues to provide significant benefits to lower-income households and communities, reform is needed for the Act to encourage financial services providers to meet the continuing needs of these groups.

In light of the changing mortgage lending landscape, reform of CRA could follow either one or both of two broad paths. One path builds on CRA’s traditional *mortgage lending focus* and calls for extending the Act to the entities that now conduct the bulk of mortgage lending - mortgage brokers, finance companies, and the affiliates of depository banking organizations operating outside of the areas where they maintain deposit-gathering operations. The other path builds on CRA’s traditional *branch banking focus* and proposes repositioning the Act to give greater emphasis to the provision of financial services to lower-income borrowers and communities. Unlike mortgage lending, many financial services including community development lending and the provision of low-cost checking and savings accounts are still closely linked to branch banking operations. Providing enhanced incentives for financial services organizations to expand these activities to better serve lower-income and/or minority communities could provide a new focus for a reformed and revitalized CRA.



PRINCIPAL FINDINGS

This report examines CRA in light of the transformed world of mortgage and financial services provision. Using the detailed data on home purchase and refinance loans for the period 1993-2000, the report compares the lending patterns of CRA-regulated entities with those of lenders outside of CRA's regulatory framework. The analysis divides lending by CRA-regulated entities into two components: the assessment area loans subject to the most detailed CRA review, and the 'out-of-area' loans that do not come under any, or at best scant CRA scrutiny because they are made outside of areas where they maintain deposit-gathering branches. In addition the report tracks the activity of independent mortgage companies and other non-bank lenders that are not covered by the Act. Principle findings include:

CRA Has Expanded Access to Mortgage Capital. Simple descriptive statistics and complex multivariate techniques document how CRA-regulated entities lead the primary market in the provision of prime conventional mortgage loans to lower-income people and neighborhoods. Here lower-income is defined as having an income that is less than 80 percent of area median income, CRA-regulated lenders refer to federally regulated banks and thrifts as well as their mortgage company and finance company affiliates, and CRA-eligible loans refer to loans made to lower-income households and/or to households living in lower-income areas.

- In both 1993 and 2000, CRA-regulated lenders operating in their assessment areas (areas where they maintain deposit taking operations) have shares of conventional, conforming prime home purchase loans to CRA-eligible borrowers that exceed the equivalent shares for out-of-area lenders or non-covered organizations.
- The CRA-eligible share of conventional prime lending to blacks is as much as 20 percentage points higher for CRA-regulated lenders operating in their assessment areas than for independent mortgage companies. For Hispanics, the equivalent gap is 16 percentage points.

CRA-Regulated Lenders Originate More Home Purchase Loans to Lower-Income People and Communities than They Would if CRA Did Not Exist. Multivariate statistical analyses isolating CRA's impact from that of other factors that have influenced residential lending trends confirm that CRA has had, and continues to have, an important impact on mortgage lending.

- CRA-regulated entities have gained market share in the provision of loans to lower-income people and communities, in effect crowding out lenders falling outside of CRA's regulatory reach.
- Lower-income neighborhoods targeted by CRA appear to have more rapid price increases and higher property sales rates than other neighborhoods, a finding consistent with the proposition that CRA has expanded access to mortgage capital in these neighborhoods.

Changing Mortgage Industry Structure Reduces CRA Impact. While the results confirm that 25 years after enactment, CRA still works to expand lending to lower-income borrowers, they also indicate that CRA's impact may be waning. The past decade has witnessed a dramatic restructuring of the mortgage industry, including the explosion of new forms of lending, the growing importance of mortgage brokers and mortgage banking operations, and the expansion of secondary mortgage markets. These changes have combined to weaken the link between mortgage lending and branch-based deposit-gathering on which CRA was based, and consequently may also be reducing CRA's effect on the mortgage market.

- In 2000, the 25 largest lenders made more than 25,000 home purchase loans each and accounted for 52 percent of all home purchase loans made that year. In contrast, only 14 organizations topped 25,000 loans in 1993, and they accounted for only 23.5 percent of all home purchase lending.
- Government-backed, subprime, and manufactured home loans account for a large share of lower-income and minority lending growth, and organizations that specialize in these loans often are not subject to detailed CRA evaluation.
- Banking organizations operating out of their CRA assessment areas have expanded rapidly and today constitute the fastest growing segment of the residential mortgage market. As a result, between 1993 and 2000, the number of home purchase loans made by CRA-regulated institutions in their assessment areas as a share of all home purchase loans fell from 36.1 percent to 29.5 percent.

CRA's Impact Varies from One Community to the Next. While the focus group discussions and in-depth interviews established some broad generalizations, it is important to remember that CRA's impact varies across diverse metro and non-metro areas, as well as from one community to the next within a particular area. This diversity reflects the fact that both the structure of the mortgage lending industry and the capacity and relative sophistication of not-for-profit organizations working on CRA-related issues in their communities varies significantly.

- Assessment area lending varies from one market area to the next. Of the 301 metropolitan areas examined in this study, assessment area share of lending varies from 6 percent in Denver, Colorado to 74 percent in Dubuque, Iowa.
- CRA's regulatory reach varies from one neighborhood to the next. In each of the four metropolitan areas examined in detail, lenders falling outside of CRA's regulatory reach are particularly active in neighborhoods with the greatest concentration of minority and/or lower-income households (although their concentrations are still higher relative to non-CRA lenders).
- Rural markets are distinct from urban markets (as well as from one another). Many rural counties lack a well-developed banking infrastructure and rural borrowers often pay more for mortgage credit than their urban counterparts. This may be changing, however, as larger regional and national banking organizations seek to serve the growth segments of the rural economy.

- CRA's impact on rural areas today is minimal. This results from the fact that many rural communities are served by smaller banks that are not subject to the same degree of CRA scrutiny as larger banks, and from the absence of well-developed networks of community-based advocacy organizations in many rural areas.

CRA Has Influenced Mortgage Lending Operations. The interviews conducted for this project confirm that CRA has a significant impact not only on the ways in which regulated entities structure their business operations, but also on how they relate to the communities they serve. In many instances CRA lenders interviewed for this study reported that compliance-oriented activities are profitable, productive of good will, or both. Others lenders pointed to what they felt was the high cost of CRA compliance, a complaint more often voiced by smaller lenders that had difficulty competing in the CRA-eligible market against more efficient larger lending organizations.

- CRA generally is not a driver of the business plans of regulated lenders but is a factor that influences the plans of most lenders at the margin.
- As the lower-income mortgage market has become demonstrably mainstream and more competitive over the last decade, many lenders tailored products for the CRA-eligible sub-market and deployed them as part of their standard business practices. Thus while their CRA lending is most intense in their assessment areas, introduction of new products to better serve these areas have likely had positive spillover effects on lending outside of assessment areas, as well as on the lending of non-CRA regulated competitors.

Changing Industry Structure Prompts Changes in CRA Advocacy. Historically, community-based advocacy organizations have worked to expand access to capital and financial services in lower-income communities. Along with the changing mortgage industry, the role of community-based advocacy organizations is changing, as is the relationship between these organizations and CRA-regulated banks and thrifts.

- The complexity of new mortgage products makes it increasingly difficult for community organizations to assess their impact on lower-income communities and borrowers, and consequently to provide feedback to lenders on the capacity of these products to meet community needs.
- Shifts in industry structure threaten the fundraising capacity of smaller, locally-based community groups, as larger banking organizations look to partner with fewer, larger and more sophisticated non-profit organizations.
- Community groups are responding to this changing environment in different ways and with differing degrees of success. Some advocates are forging new coalitions that have the capacity to engage with large scale banking organizations. Others seek to expand their advocacy beyond mortgage lending, and shift the focus of their activities to larger issues relating to expanding access to financial services more broadly.

CRA Fails to Keep Pace with Changing Industry Structure. The changing industry structure, along with the fact that over time CRA may have expanded the capacity of all industry players to serve lower income borrowers, has eroded CRA-regulated entities' lead in the conventional prime home purchase market. As noted earlier, when Congress modernized financial services through the Gramm-Leach-Bliley Act of 1999 (GLBA), it did little to bring CRA into conformance with the rapidly evolving financial services world. Reform could follow one or two both of two distinct pathways.

- Reform could build on CRA's traditional mortgage lending focus by extending assessment areas to cover a larger share of lending by banking organizations subject to CRA, and by extending CRA to include independent mortgage companies and other newly emerging non-bank lenders.
- Retail banking services arguably remain most closely linked to the branch banking mechanism through which CRA obligations are defined and implemented. Reform could therefore build on CRA's traditional branch banking focus and reposition CRA to give greater emphasis to the provision of financial services to lower-income people and communities.

METHODOLOGY

The work reported here utilizes the Joint Center Enhanced HMDA Database that combines loan-level data on borrower and loan characteristics with Federal Reserve Board (FRB) data on lender characteristics and branch locations. The FRB lender file contains information that facilitates aggregation of individual HMDA-reporters into commonly-owned or -controlled institutions that can be analyzed as integrated units. The FRB branch location data are the source of assessment area definitions used in the analyses presented here. As a reasonable approximation to true assessment areas, this report assumes that if a lending entity subject to CRA has a branch office in a particular county, then that county is part of that entity's assessment area. Loans made in counties where the lending entity does not have a branch are assumed to fall outside of that entity's assessment area.

In addition to quantitative analyses, this paper draws on qualitative information gathered during a series of discussion groups and in-depth interviews. In the spring of 2000, the Joint Center for Housing Studies held 11 discussion groups with over 100 experts in four cities, three each in Atlanta, New York, San Francisco, and two in New York (Belsky *et al.*, 2000). The Joint Center also conducted in-depth interviews with more than 100 individuals in the Baltimore, Birmingham, Chicago and Los Angeles metropolitan areas, as well as rural Colorado. These interviews examined CRA in the context of the changing organization of the mortgage industry, the growth of new affordable lending tools, and the resulting changes in the provision of credit to lower-income borrowers.

This paper utilizes HMDA data to illustrate trends in mortgage lending. HMDA data have been collected since 1977, but because they were not reported at the loan level by non-depository lenders until 1993, the discussion focuses on the 1993-2000 period. Even over this period, however, HMDA data have a number of limitations. Perhaps most critical is the fact that HMDA's coverage of the mortgage market changed over the 1993-2000 period. Consequently, HMDA data are likely to overstate somewhat actual lending growth for the 1993 to 2000 period. Potentially more serious is the fact that the change in reporting requirements may differ by lender type, based on the specialization of each type of lender. Therefore, some of the growth in lending to lower-

income households relative to that for higher-income households could simply reflect differential reporting if lenders specializing in lower-income lending increased the reliability of their reporting over the period.

Counterbalancing these limitations is the fact that HMDA is a large and fairly rich micro-level data source at the individual loan application level. No other data source affords the opportunity to analyze lending patterns and trends by borrower income, race/ethnicity or gender in such detail. Further, HMDA loans are geo-coded to census tracts, allowing a rich exploration of the impact of CRA on lending in lower-income, minority, or other historically underserved market areas. These strengths and limitations also suggest the importance of disaggregating the results by lender and borrower characteristics in an effort to control for reporting differentials across the various mortgage industry segments.



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GLOSSARY

ACORN	Association of Community Organizations for Reform Now
APR	Annual Percentage Rate
ATMs	Automatic Teller Machines
BISO	Bankers in Search Of (Los Angeles)
CDCs	Community Development Corporations
CDFIs	Community Development Financial Institutions
CRA	Community Reinvestment Act
CSW	Case Shiller Weiss
ECOA	Equal Credit Opportunity Act
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FICO	Credit Score
FIRREA	Financial Institutions Reform, Recovery and Enforcement Act
FMA	Financial Modernization Act
FRB	Federal Reserve Board
GLBA	Gramm-Leach-Bliley Financial Modernization Act
GSEs	Government Sponsored Enterprises – Fannie Mae and Freddie Mac
HIB	Higher-income borrowers (those earning at least 80% of area median income)
HIN	Higher-income neighborhoods (census tracts with median income at least 80% of the MSA median in 1990)
HMDA	Home Mortgage Disclosure Act
HUD	U.S. Department of Housing and Urban Development
JCHS	Joint Center for Housing Studies at Harvard University
LIB	Lower-income borrowers (those earning less than 80% of area median income)
LIN	Lower-income neighborhoods (census tracts with median income less than 80% of the MSA median in 1990)
LMI	Low and moderate income
LTV	Loan-to-Value
MIS	Management Information System
MSA	Metropolitan Statistical Area
NACA	Neighborhood Assistance Corporation of America
NAHB	National Association of Home Builders
NCRC	National Community Reinvestment Coalition
NORMAL	Neighborhood Ownership Recovery Mortgage Assistance Loan (Chicago)
OCC	Comptroller of the Currency
OTS	Office of Thrift Supervision
PMI	Private Mortgage Insurance
RHS	Rural Housing Service of the U.S. Department of Agriculture
SBA	Small Business Administration
VA	Department of Veterans' Affairs





SECTION 1

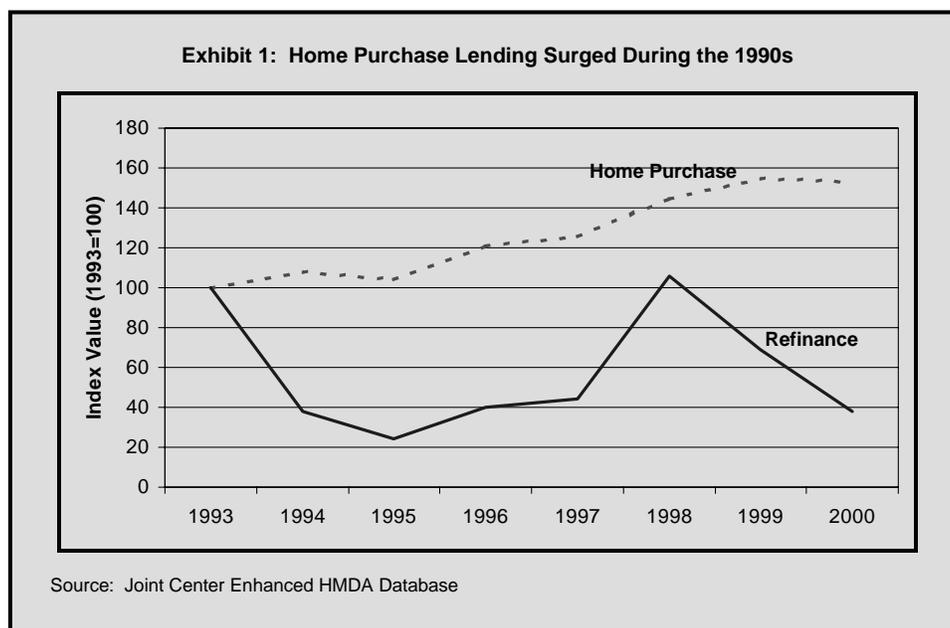
TRENDS IN RESIDENTIAL MORTGAGE LENDING IN THE 1990s

This study examines the impact of the Community Reinvestment Act (CRA) on mortgage lending for the period 1993 to 2000, the period for which the best data are available for the task (see Appendix 1). To establish the overall market context for the evaluation, this section documents - using data reported pursuant to the Home Mortgage Disclosure Act (HMDA) - the impressive rise in mortgage lending that was bolstered, if not led, by especially strong growth in the lower-income and minority segments of the market.

HMDA data has advantages and disadvantages for the purpose of examining trends in the mortgage lending industry over the 1990s. These characteristics of the data are evaluated in more detail in part D of this section, but it is important to note at the outset that as a result of improving HMDA coverage over the period, HMDA data may overstate actual growth in residential mortgage lending from 1993 to 2000. Despite these drawbacks, HMDA provides loan-level data on mortgage originations for the purchase or refinancing of homes geo-coded to the census tract level, and contains detailed information on borrower and lender characteristics. As such, HMDA represents the best data source available for investigating trends in mortgage lending over the study period.

MORTGAGE LENDING IN THE 1990s

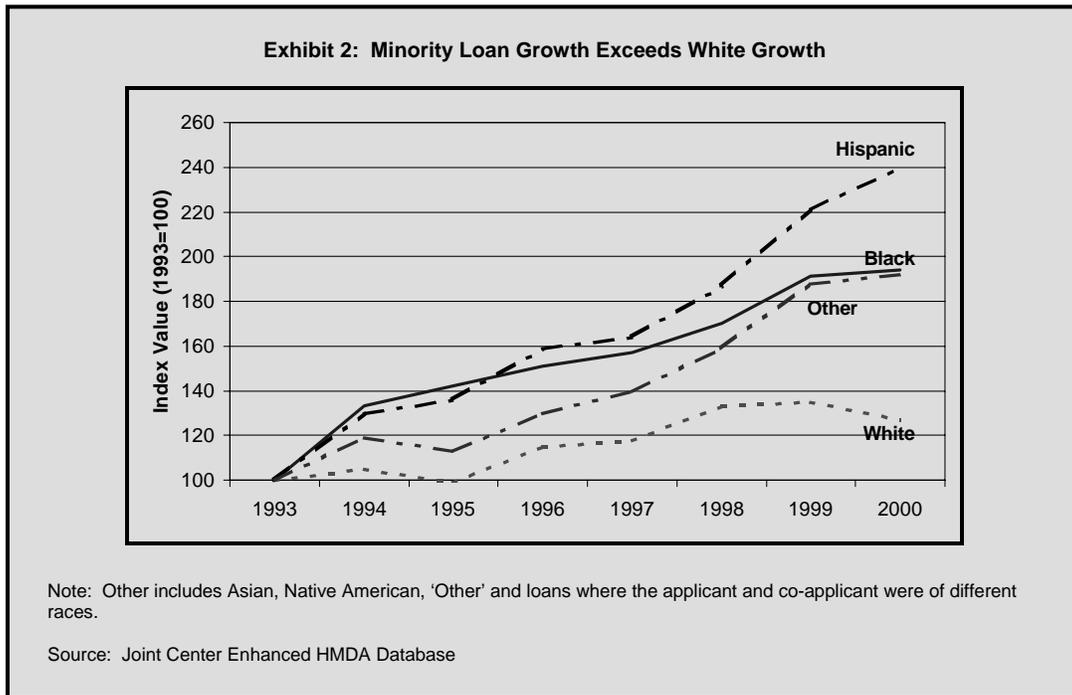
Buoyed by income and employment growth, modest mortgage interest rates, and innovative products for lower-income buyers, mortgage lending rose dramatically in the 1990s. As measured by HMDA, the number of loans for the purchase of one-to four family properties in metropolitan areas increased from 2.4 million in 1993 to 3.7 million in 2000, a gain of 53 percent (Exhibit 1). Interest rate sensitive home refinance lending exhibited a boom/bust pattern over the same period. Following a record-setting 1993, which saw 4.5 million refinancings, the sector eased through the mid-1990s before surging to new heights in 1998 (4.7 million refinancings). Refinancings re-



treated in 1999 (3.1 million loans) and 2000 (1.7 million loans) in the face of higher interest rates, though they rebounded sharply in 2001.

As noted, these trends relate to metropolitan area lending, defined here as counties that were part of a U.S. Census Bureau designated Metropolitan Statistical Area (or MSA) for the entire study period. As a result, the study excludes counties that either became MSAs or became parts of MSAs during the study period. Since reporting problems are more severe in newly added metropolitan counties and in non-metropolitan counties, this geographic standardization not only measures loan growth for a fixed set of counties, it also serves to minimize potential bias resulting from reporting requirements being extended to additional areas over time.

It should be noted that all figures refer to ‘originated loans,’ as opposed to ‘purchased loans.’ Under CRA, an individual lender may receive credit for purchasing an existing loan from another institution. As a result, a single loan may be reported in HMDA more than once. Including purchased loans in this analysis would distort the observed trends because apparent changes in lending could simply reflect the increased or diminished likelihood of a loan having multiple owners prior to lodging permanently in a lender’s portfolio, or being sold into the secondary market.



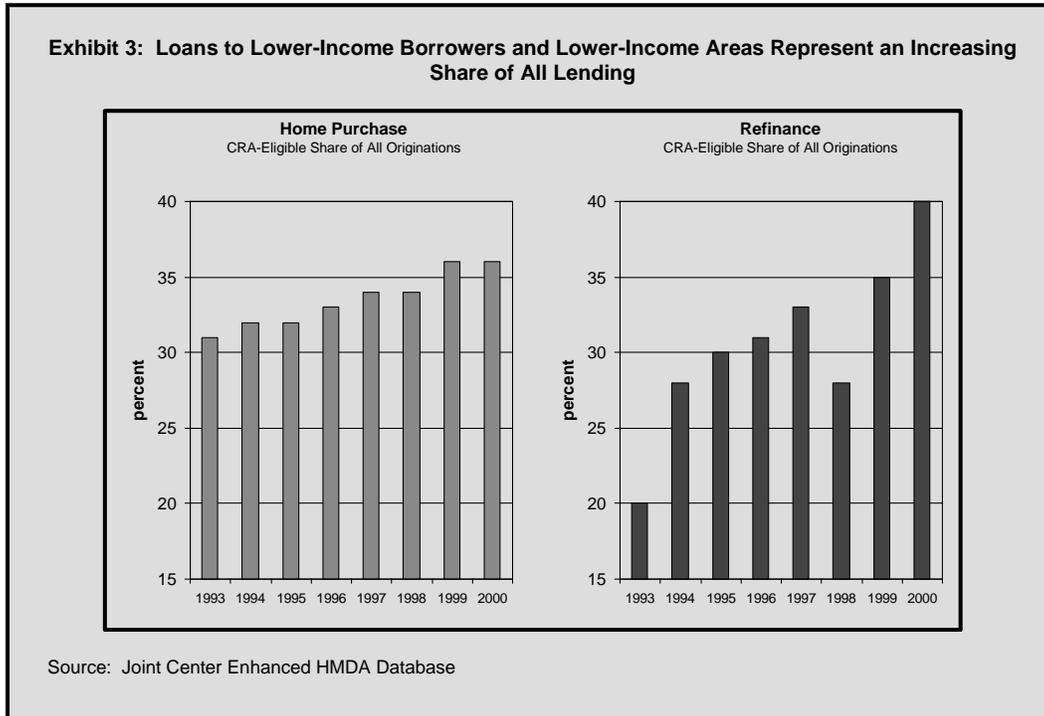
As measured by HMDA, mortgage lending gains were spread across all income, racial, and ethnic groups, with particularly strong advances recorded by minority borrowers. From 1993 to 2000, HMDA data indicate that the number of home purchase loans made to black borrowers increased by 94 percent, to Hispanic borrowers by 140 percent, and to other minority borrowers by 92 percent (Exhibit 2). Home purchase lending to white borrowers increased 27 percent over the same period. These changes corresponded to an increase in home purchase loans over the 1993 to 2000 period of 121,000 for blacks, 169,000 for Hispanics, 145,000 for other minorities, and 525,000 for whites. As a result of these trends, minority borrowers accounted for some 25 percent of total home purchase lending in 2000, up from 17 percent in 1993. Minorities also posted similarly strong gains in home refinancing, where their share climbed from 13 percent in 1993 to 23 percent in 2000.



As documented in Harvard's Joint Center for Housing Studies 2001 report, *The State of the Nation's Housing*, the surge in lending fueled an equally strong uptake in homeownership. The number of homeowners grew by 8.1 million from 1994 to 2000 – a record increase for a six-year period. By the end of the decade, the national homeownership rate also reached a record 67.4 percent, up from 64.3 percent in 1990. Increases were spread across all income, racial, and ethnic groups, with minorities capturing up to 40 percent of the increase in homeownership that occurred from 1994 to 2000. Even so, the homeownership gap had narrowed only slightly by 2000, with the white homeownership rate standing at 73.8 percent and the minority rate at 48.1 percent.

A. Growth in Lower-Income Lending

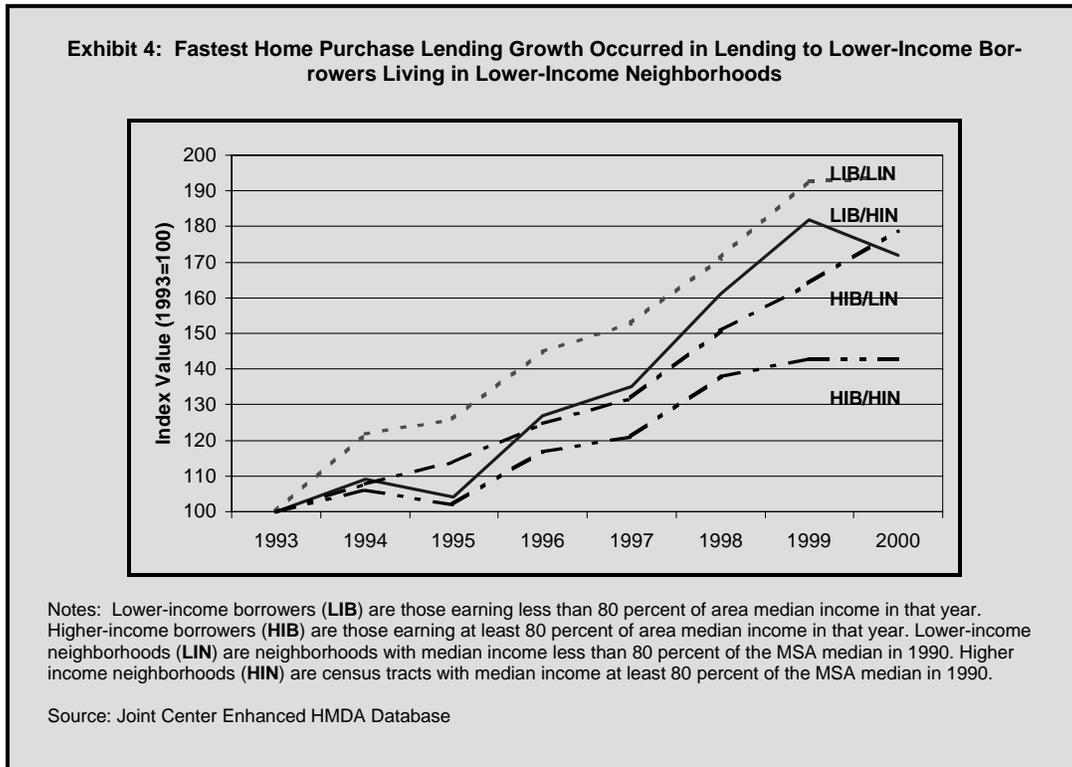
The 1990s surge in home lending was led by lower-income borrowers and communities. (Throughout this report lower-income borrowers are defined as having incomes less than 80 percent of metropolitan area median income, and lower-income communities are census tracts with 1990 median family income that was less than 80 percent of their metropolitan area median). HMDA data indicate that home purchase loans to lower-income borrowers and/or lower-income communities increased by 77 percent, or 571,000 loans, over the period 1993 to 2000. The growth in the lower-income market far exceeded the 53 percent overall growth in home purchase lending. As a result, loans to lower-income people and communities expanded to account for 36 percent of all home purchase lending, up from 31 percent in 1993 (Exhibit 3). Further, these borrowers accounted for 44 percent of the 1.3 million-loan increase in home purchase lending between 1993 and 2000.



Lending to lower-income people and communities was also an increasing share of the more volatile home refinance market, rising sharply from 1993 to 1997. In 1998, the share of home refinance loans going to lower-income people and communities fell off, as large numbers of higher-income borrowers entered the market to refinance their homes at historically low rates. Even so,

once the refinance boom began to subside, the share of refinance loans going to lower-income people and communities moved up sharply again, reaching a record high of 40 percent in 2000. These trends may reflect, among other things, the increasing tendency of lower-income borrowers to refinance their homes to repay credit card debt or other financial obligations, or to raise money to fund home repairs or other big-ticket purchases, as many higher-income borrowers have done. It also likely reflects increased marketing and outreach to lower-income borrowers and communities by mortgage lenders, including subprime specialists. Finally, an unknown portion of the increase is due to loans made using ‘predatory’ lending practices.

The growth in lending to lower-income people and communities was widespread. Since lower-income borrowers living in lower-income areas are generally considered the most difficult to reach and most likely to be underserved, Exhibit 4 disaggregates lower-income borrower/area growth into four borrower/area income categories. It shows that the fastest growth in home purchase lending was, in fact, for lower-income people living in lower-income communities. For this group, HMDA reported home purchase lending increased by 94 percent over the 1993-2000 period. Home purchase lending to lower-income people living in higher-income communities was also up by 72 percent over the decade, easily outstripping the 43 percent growth in home purchase lending for higher-income people living in higher-income areas.¹



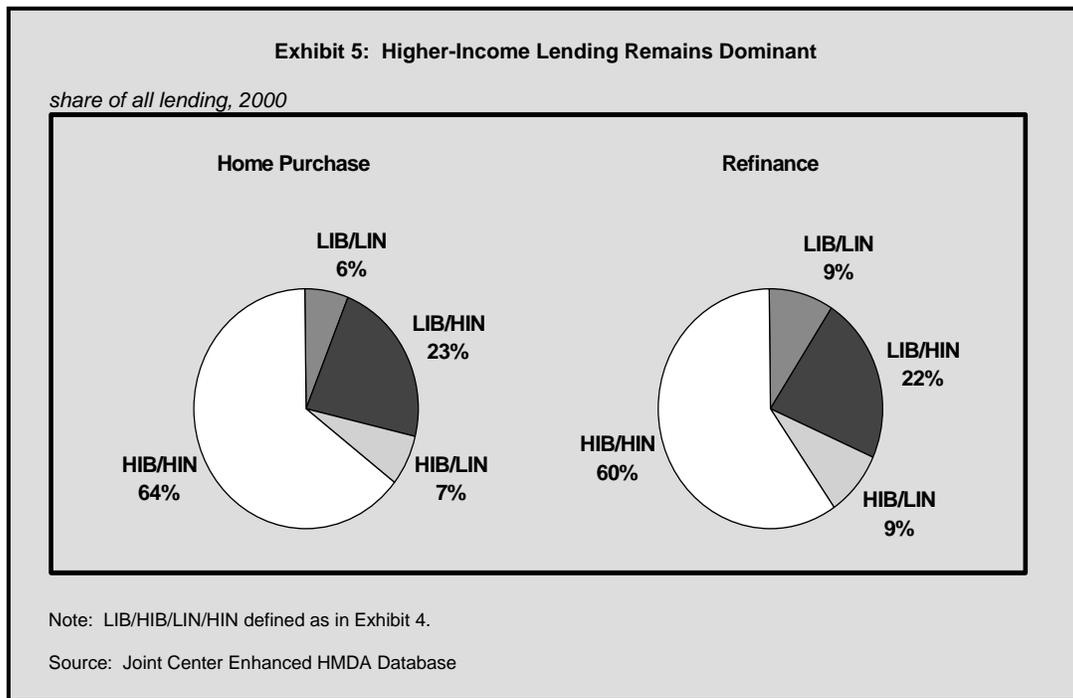
The steady and far-reaching growth in lending to lower-income people and communities, and especially minorities, represents one of the most important accomplishments of the 1990s. While the relative importance of specific factors is in dispute, these gains are generally considered to

¹ Lending to higher-income people in lower-income neighborhoods increased by 79 percent. The percentages represent the following increases in lending 1993-2000: lower-income borrowers in lower-income neighborhoods by 112,000 loans; lower-income borrowers in higher-income neighborhoods by 349,000; higher-income borrowers in lower-income neighborhoods by 110,000; higher-income borrowers in higher-income neighborhoods by 715,000.



have resulted from technological advances in mortgage lending, Fair Housing/Lending enforcement efforts, the increasing importance of government-backed lending, particularly the Federal Housing Administration (FHA), the increased liquidity provided by secondary market financing, and CRA. Responding both to market and policy signals, lenders have made concerted efforts to reach lower-income borrowers. According to a recent Federal Reserve Board survey of the nation's largest banks, three-quarters of respondents reported offering special products to make homeownership more accessible to lower-income borrowers (Federal Reserve Board, 2000). Outreach tools include fee waivers or reductions, homeownership counseling, lower downpayments, or higher debt-to-income ratios. Moreover, new technologies - particularly automated underwriting and credit scoring systems - have enabled lenders to better evaluate risk and in so doing extend mortgage credit to lower-income borrowers by offering mortgages with lower downpayment requirements to creditworthy but nevertheless lower-income or lower-wealth borrowers, or by making higher priced loans to potential borrowers with less than perfect credit histories.

As impressive as the shift toward lower-income market segments is, it is noteworthy that loans to lower-income people and communities still represent a fairly small share of the total. Exhibit 5 indicates that, according to HMDA data, home purchase loans to higher-income people living in higher-income neighborhoods still account for 64 percent (or 2,384,538 loans) of all home purchase and 60 percent (or 1,018,503 loans) of home refinance loans. In contrast, lending to lower-income people living in lower-income communities represented just 6 percent (or 231,852 loans) of all home purchase lending and 9 percent (or 160,056 loans) of home refinancings in 2000. Likewise, home purchase lending in lower-income neighborhoods (for households of all income levels) accounted for only 13 percent (or 480,819 loans) of total home purchase lending. For home refinancings, lower-income areas captured a slightly higher share of 18 percent (or 305,502 loans). This is in spite of the fact that within metropolitan areas, lower-income neighborhoods comprise approximately 35 percent of all households and 20 percent of all owner households.



Looking at all lower-income households (regardless of where they live) produces a similar picture. As indicated in Exhibit 5, fully 29 percent of all home purchase lending (or 1,066,358

loans), and 32 percent of home refinancing (or 537,952 loans), goes to lower-income households. Among these figures, lower-income families living in higher-income areas account for the largest share of all lower-income lending. Again, these figures represent notable progress over 1993, when lower-income households accounted for just 25 percent (or 605,175 loans) of total home purchase lending, and 14 percent (or 644,903 loans) of home refinancing. Even so, with lower-income households accounting for 37 percent of all households, and 32 percent of all owner families, the increases have not enabled lending to lower-income families to reach parity with lending to higher-income households.

B. Loan Type Varies by Income

Along with attractive mortgage interest rates and robust economic conditions resulting in low unemployment, the growth of innovative mortgage products helped to fuel lending increases across the board, with their impact often felt most strongly among lower-income borrowers and areas. These include new forms of subprime lending and manufactured home lending, as well as more extensive use of existing government-backed loan programs.

The emergence of subprime lending was one of the most significant events impacting mortgage market trends in the 1990s. According to one industry estimate, subprime loan originations increased from \$35 billion in 1994 to \$160 billion in 1999 (Mortgage Market Statistical Annual for 1999). As a percentage of all mortgage originations, the subprime market share increased from less than 5 percent in 1994 to almost 13 percent in 1999. By 1999, outstanding subprime mortgages amounted to 8 percent of the \$4.8 trillion in outstanding single-family mortgage debt.

Equally significant increases were recorded for government-backed lending, particularly for loans insured by the Federal Housing Administration (FHA). From 1993 to 1999, FHA-insured lending for home purchase surged from 563,000 to 919,000 loans, before falling back to 847,000 loans in 2000. FHA lending focuses on the lower-income segment of the market, including underserved minority communities. In 2000, minorities accounted for 40 percent of all home purchase mortgages insured by FHA, up from the 22 percent figure recorded in 1993 (U.S. Department of Housing and Urban Development, 2000).

Manufactured home loans also grew notably during the 1990s, as did sales of manufactured homes. From a low of 195,000 units in 1990, placements of manufactured homes grew to an all time record high of 369,000 units in 1998 before falling back at the end of the decade (Joint Center for Housing Studies, 2001). According to the Census Bureau, over the decade, manufactured housing accounted for between one-quarter and one-third of all production of single-family detached homes (U.S. Census Bureau, Construction Statistics, 2001), and was a particularly important component of housing production activity in the fast growth areas of the South and West.

Using available HMDA data it is possible to assess the trends in government-backed, subprime, and manufactured home lending by borrower and lender characteristics, as well as location. While HMDA does not label the loan type directly, HUD supplies a list of each lender's 'specialization' in prime, subprime, or manufactured home lending. Government-backed loans are directly identified in HMDA, and are defined here as loans made by prime lending specialists that are insured or guaranteed by FHA, the USDA's Rural Housing Service, or the Veterans Administration. Each of these three types of lending are considered 'alternatives' to conventional prime lending in that they typically entail different pricing and terms than conventional prime mortgages, which remain the standard.

By 2000, the share of refinance lending captured by firms specializing in subprime loans was fully 25 percent, up from only 2 percent in 1993. On the home purchase side, subprime represented 6 percent of all loans, up from 1 percent in 1993. Among lower-income borrowers, subprime represented 8 percent of home purchase loans in 2000 and 36 percent of refinancings. For lower-income people living in lower-income areas, the figures are even higher, at 13 percent for home purchases and 48 percent for refinancings.

Government-insured or guaranteed lending, particularly loans insured by the FHA, were also a significant source of lending over the period - again especially for low-income households (Bunce, 2000). In 2000, HMDA data suggest that government-insured or guaranteed loans accounted for 21 percent of overall home purchase lending. For home purchase loans to lower-income borrowers and in lower-income areas, government-backed loans comprised 32 and 28 percent of the total respectively, and fully 36 percent of home purchase lending to lower-income people living in lower-income neighborhoods. Government-backed loans are a decidedly smaller share of refinancings, capturing 2 percent for both higher- and lower-income borrowers. The government-backed share is lower for refinancings because many families 'graduate' out of government-backed loans, which often, but not always, have higher rates and fees than conventional loans.

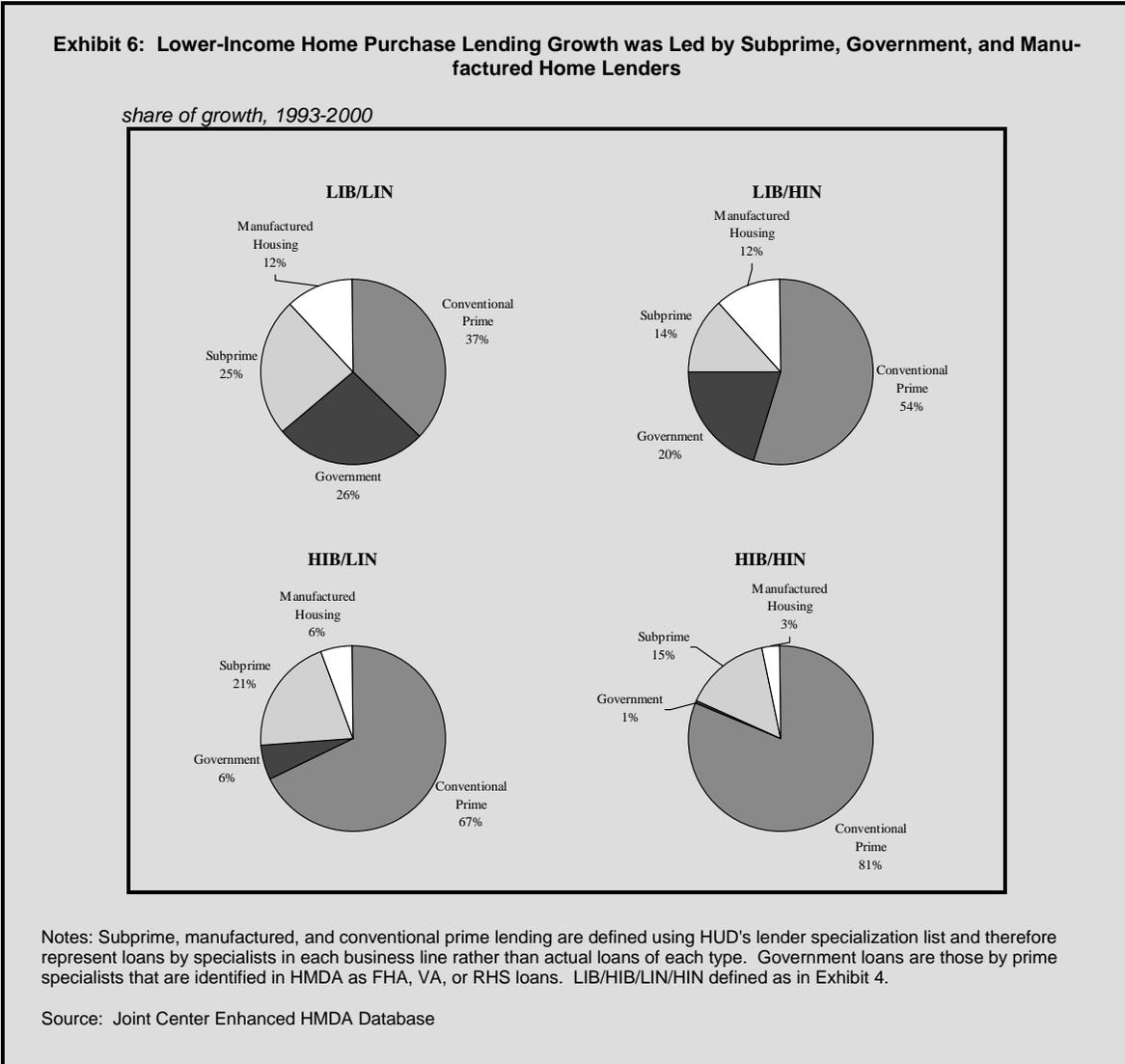
Equally significant was the growth of HMDA reported manufactured home lending. The number of loans made by firms specializing in manufactured home lending more than tripled between 1993 and 2000. By 2000, lending by manufactured home lending specialists accounted for 3 percent of overall home purchase lending and 7 percent of home purchase lending to lower-income people.²

Together, the emergence of these new loan types and new affordable housing options were a major contributor to the overall growth of home lending. Over the 1993 to 2000 period, government-backed, subprime, and manufactured home lending accounted for nearly one third of the 1.3 million overall increase in the number of home purchase loans. The role of these alternative financing types was particularly pronounced in lower-income market sectors (Exhibit 6). They are most prominent in lending to lower-income borrowers in lower-income markets, where HMDA reporting suggests that little more than a third of lending is in the form of conventional prime loans. A quarter of the growth in lending to this particular segment of the market came from subprime lending specialists and another 26 percent from government-backed, and fully 12 percent from manufactured housing. These numbers are in significant contrast to higher-income area and borrower lending, where conventional prime lending accounted for 81 percent of all 1993-2000 home purchase lending growth.

These figures illustrate how over the 1990s, lenders created new mortgage products or expanded use of government-backed loans to meet the mortgage credit needs of lower-income people and communities. Yet, all three of these alternative mortgage types have their critics. The relatively low share of conventional prime loans in lower-income segments of the market raises the issue of whether borrowers typically receive credit on the most favorable terms for which they might qualify. For example, subprime loans carry higher fees and interest rates, as they must in order to compensate lenders for assuming greater risk. A recent Department of Treasury and Department of Housing and Urban Development report used private industry data to estimate that more than half of all subprime loans originated from July through September 1999 had coupon rates in excess of 10.5 percent, well above the rate for prime conventional mortgages, which ranged from 7

² These shares were 4 percent overall and 9 percent for lower-income people in 1999 before the manufactured housing sector entered a deep recession.

to 8 percent over the same period (U.S. Department of Treasury and U.S. Department of Housing and Urban Development, 2000). Moreover, some fraction of subprime loans are predatory, with agents employing aggressive sales tactics or taking unfair advantage of the borrower's lack of understanding about loan terms. One contention is that mortgage brokers in search of higher fees may steer lower-income borrowers into higher cost subprime loans, even though the borrower would have qualified for a lower cost prime loan (U.S. Department of Treasury and U.S. Department of Housing and Urban Development, 2000).



Similarly, while government-backed loans can be an important source of credit for lower-income households, they have their critics (National Training and Information Center 1997; Bradford, 2000). Some advocates argue, for example, that as a result of the reduced risk and enhanced fee structure of FHA-insured loans, lenders may arbitrarily steer lower-income home seekers to FHA, even though the borrower would qualify for a conventional prime loan with lower interest rate and fees.

Manufactured housing raises other concerns, largely stemming from the fact that almost half of all manufactured homes are placed on rented land and financed with consumer, as opposed to real estate, loans. As a result, many manufactured homes are financed at rates that are from 2 to 5 percentage points higher than those on conventional prime real estate loans (Vermeer and Louie, 1996; Collins, Carliner, and Crowe, 2001).

C. Minorities Increasingly Depend on Government and Subprime Loans

The overall expansion of mortgage lending fueled dramatic growth in homeownership among minorities. Although representing less than one-fifth of all owners, minorities received 34 percent of the increase in home purchase lending from 1993 to 2000. Despite these gains, however, access to mortgage capital for minorities is not yet on a par with whites, as suggested by large and persistent gaps in the homeownership rates of whites and minorities. In 2000, the black homeownership rate stood at 47.6 percent, the Hispanic rate at 46.3 percent, and the rate for other minorities at 53.9 percent – all considerably below the 73.8 percent homeownership rate of whites. While a significant portion of these differentials reflect differences in household income, wealth, age and family composition among the various racial and ethnic groups, these differences do not account for all of the homeownership gap, and the most recent attempt to survey existing evidence suggests that discriminatory practices persist in the marketplace (Yinger, 1998).

Exhibit 7: Conventional Prime Loans Account for a Small Share of Minorities' Home Purchase Lending Growth

share of growth, 1993-2000

	Borrower Race/ Ethnicity			
	White	Black	Hispanic	Asian/ Other
	Lower-Income Neighborhoods			
Lower-Income Borrowers	51.2	20.0	35.3	49.0
Higher-Income Borrowers	85.2	45.7	37.2	72.6
All Borrowers	71.1	28.3	36.0	63.6
	Higher-Income Neighborhoods			
Lower-Income Borrowers	69.0	29.5	41.6	64.8
Higher-Income Borrowers	96.6	49.1	52.5	84.9
All Borrowers	87.0	39.0	47.7	80.7
	All Neighborhoods			
Lower-Income Borrowers	65.7	19.7	39.5	61.3
Higher-Income Borrowers	94.9	48.4	49.5	83.6
All Borrowers	84.5	32.3	44.6	78.4

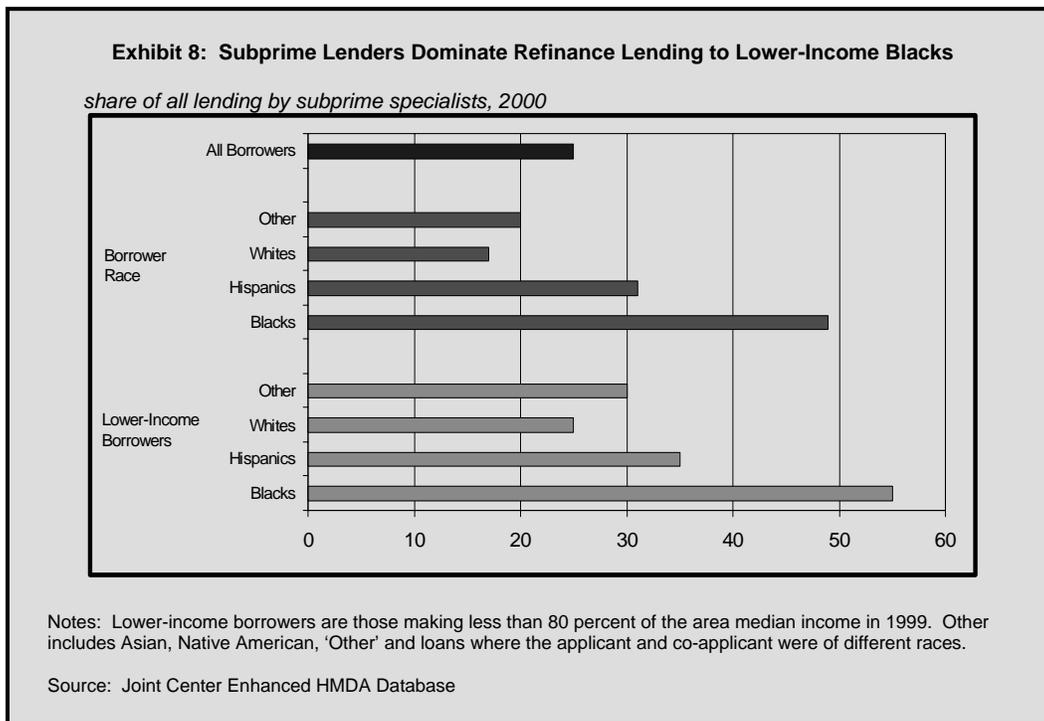
Source: Joint Center Enhanced HMDA Database

Exhibit 7 leaves little doubt that lending to whites and minorities displays fundamentally different patterns. Though it may be entirely the result of the differential risks borrowers of each group present to lenders, the disparity across race and ethnicity is substantial. Prime conventional lending (*i.e.* loans made at the most favorable rates and on the most favorable terms) accounted for fully 85 percent of growth in home purchase lending to whites in the period 1993 to 2000. In contrast, prime conventional lending accounted for 32 and 45 percent of home purchase loan growth for black and Hispanic households respectively.

Exhibit 7 also shows that differentials in the composition of home purchase loan growth persist after controlling for the income of the household applying for a loan and the location of the property. For example, HMDA data indicate that between 1993 and 2000 conventional prime lending accounted for 97 percent of total home purchase loan growth for higher-income white borrowers living in higher-income neighborhoods. In contrast, conventional prime loans accounted for 49 and 53 percent of loan growth for similarly situated black and Hispanic borrowers. Indeed, the prime conventional lending share of loan growth for Hispanics and blacks with higher-incomes living in higher-income areas, more closely approximates the 51 percent share recorded for lower-income whites in lower-income neighborhoods.

Not surprisingly given the dearth of conventional prime lending to minorities, government-backed lending accounted for a disproportionate share of growth in lending to blacks and Hispanics. Over the 1990s, government loans accounted for 37 and 46 percent of growth for lower-income black and Hispanic borrowers in lower-income areas. Meanwhile, only 9 percent of growth in lending to comparably situated whites was government-backed.

The contribution of subprime lending specialists to lending growth by race/ethnicity presents a less distinct picture, as these lenders captured increasing shares of lower-income lending regardless of race/ethnicity. The only notable difference is in lending to *higher-income* blacks, where subprime loans accounted for 29 percent of home purchase lending growth 1993-2000, against 18 percent for higher-income whites and Hispanics.



Differences by race are more apparent in the refinance market, where subprime loans are especially common among lower-income blacks (Exhibit 8). Moreover, 36 percent of higher-income minority-borrowers refinanced their mortgage with a subprime lending specialist against only 14 percent of higher-income white borrowers. In fact, only 25 percent of lower-income white owners that refinanced their mortgage in 2000 did so with a subprime lending specialist.



Differences in the shares of loans or composition of lending growth by race and income reported in HMDA cannot be taken as proof of discriminatory practices in mortgage markets. At minimum, the results here do not control for most of the characteristics that lenders use to determine for which mortgage products particular applicants qualify. Discrepancies such as these, however, do fuel advocates' claims that the rise of alternative mortgage products has resulted in a new, and subtler, form of differentiation based on race and ethnicity in mortgage markets.

D. Limited Scope of Available Data Hinders Assessment of Mortgage Trends

This report relies primarily on HMDA data to illustrate mortgage lending trends. HMDA data have been collected since 1977, but because they were not reported at the loan-level by both depository and non-depository lenders until 1993, the discussion focuses on the 1993-2000 period. Even over this period, however, HMDA data have a number of limitations that bear directly on the actual numbers reported, if not the broad conclusions of the report. This section discusses these limitations in detail.

The first and perhaps most critical issue is the fact that HMDA's coverage of the mortgage market changed over the 1993-2000 period. One source of this differential coverage is the fact that non-depository lenders were first required to report in 1993 but some subset either did not do so, or did so haphazardly for several years. Over time HMDA reporting improved as lenders modified their information technology systems to deal with the reporting requirements. Overall reporting also improved when non-depositories were acquired by depository institutions that reported more completely. The share of loans HMDA reported may also have changed over time as small non-reporters merged into institutions with reporting requirements. Consequently, HMDA data are likely to overstate somewhat actual loan growth for the 1993 to 2000 period.

Exhibit 9 illustrates the HMDA coverage differentials for several types of home purchase lending for the period 1993 to 1996. For lending, there is a steady increase in coverage over the period, though the total change is relatively small. For purchases by Government Sponsored Enterprises (GSEs), improved reporting appears to have stabilized as early as 1994, with that year's reporting only slightly lower than the share two years later. The fact that 1995 was significantly higher is, however, suggestive of a general fluctuation in annual coverage of purchases.

Exhibit 9: Small but Steady Increase in HMDA Coverage

percent of loans covered

Year	FHA	GSE
1993	87.8	75.3
1994	88.0	80.4
1995	89.5	85.7
1996	93.3	81.6

Source: HMDA, GSE, and FHA data (reprinted from Scheessele, 1998)

A potentially more serious issue for the present use of HMDA data is the fact that the change in reporting requirements may differ by lender type, and that this differential may be carried through to borrower types based on the specialization of each type of lender. For example, if non-depositories were less assiduous reporters initially, non-reporting may overstate growth of lending more at the lower-income end of the market where non-depository bankers are most active. Therefore, some of the growth in lending to lower-income households relative to that for higher-income households could simply reflect differential reporting.

Finally, regulations governing collection of HMDA data have not kept pace with the changing structure of the industry or the characteristics of new mortgage products. These limitations have taken on new significance as a result of the growth of subprime, manufactured housing, and government-backed lending, and the corresponding trend toward the increasing segmentation of the mortgage market by income, race and ethnicity. In particular, HMDA does not collect even the

most basic information on loan pricing and loan characteristics needed to assess the implications of the rapid growth of alternative mortgage products. HMDA data limitations are particularly significant in light of the fact that many firms who specialize in providing these alternative products (subprime lending specialists or consumer finance companies) are not CRA-regulated financial institutions, and hence are not subject to detailed lending reviews under CRA examinations. While care must be exercised to ensure that expanded HMDA data collection does not impinge on the privacy rights of borrowers or lenders, expansion of data collection to cover all segments of the mortgage market is needed to more clearly understand the full implications of the explosion of lower-income and minority lending that has occurred over the past decade.

Counterbalancing these limitations is the fact that HMDA is a large and fairly rich source of data at the level of the individual loan application. No other data source affords the opportunity to analyze lending patterns and trends by borrower income, race/ethnicity or gender. Further, HMDA loans are geo-coded to the census tract level, allowing a rich exploration of the impact of CRA on lending in lower-income, minority, or other historically underserved market areas.

Recognizing the limitations of current HMDA requirements, in January 2002 the Federal Reserve Board of Governors issued a Rule to expand the number of non-depository institutions subject to HMDA reporting requirements and to disclose pricing data on higher costs loans and to identify loans on manufactured homes. In particular, the new rule extends HMDA coverage by requiring all non-depository institutions with more than \$25 million in mortgage loans to report. Currently, non-depository lenders report for HMDA only if their residential lending (including home purchase and refinance loans) during the previous year equaled or exceeded ten percent of total loan originations. In addition, the new rule requires lenders to identify whether the loan is 'high cost' as defined by the Home Ownership and Equity Protection Act and to report the spread between the annual percentage rate (APR) and the yield on the comparable Treasury security when this spread exceeds 3 percent for first-lien loans and exceeds 5 percentage points for subordinate-lien loans. Finally, the new regulation requires lenders to report whether the loan involves a manufactured home.

Since these enhancements to HMDA data will not begin until 2003, it will be several years before researchers can assess their implications. As a result, using currently available HMDA data, it is important to focus on those trends that can be corroborated by other data sources. The strengths and limitations of currently available data also suggest that it is important to disaggregate the results by lender and borrower characteristics in an effort to control for reporting differentials across the various mortgage industry segments. And finally, they suggest the importance of focusing on the activities of larger lenders that have the best capacity to maintain accurate reporting systems. By proceeding cautiously, HMDA data can support a rich, and ultimately very insightful, empirical assessment of the trends in mortgage lending.

THE CHANGING INDUSTRY STRUCTURE

The 1990s witnessed dramatic changes in both the operation of mortgage lenders and the overall structure of the mortgage industry. Among the most important changes have been the explosion of new lending products, the ascendancy of large lending organizations, the expanding share of loans originated through mortgage brokers and mortgage banking operations, the migration of some bank and thrift mortgage lending to separately incorporated affiliates and the growth of secondary mortgage markets with its attendant reduction in the share of lending funded by bank deposits. This section summarizes these significant trends and assesses their implications for the evolution of mortgage markets.



A. The Growing Importance of Securitization and the Rise of Mortgage Banking

Historically, deposit-taking institutions (thrifts and commercial banks) dominated mortgage originations. As recently as 1980, nearly half of all one-to-four family home mortgages were originated by thrift institutions. An additional 22 percent were originated by commercial banks (U.S. Department of Housing and Urban Development, 1997). That same year, mortgage companies and other lenders accounted for the remaining 29 percent of all one-to-four family mortgage loans. That distribution reflected the fact that deposits, and hence deposit-taking institutions (particularly thrifts), were the main source of funds for mortgage debt. Depository lenders held the loans they originated in portfolio because underwriting standards and mortgage documents varied considerably and third party investors were reluctant to purchase mortgages that lacked adequate credit enhancements and standard features.

Over the subsequent two decades this system changed dramatically. While banks and thrifts continue to originate loans and hold some of them in portfolio, mortgage brokers and retail mortgage bankers now originate a majority of mortgage loans. In 1997 (the last year that the Department of Housing and Urban Development conducted its Survey of Mortgage Lending Activity), mortgage companies were the dominant (56 percent) originator of one-to-four family mortgage loans. Their rise came at the expense of thrifts, which captured only 18 percent of loans in 1997, while commercial banks were up slightly, to a 25 percent share of all originations. Further marking the change in industry structure, much of banks' and thrifts' 43 percent share of originations flowed through their mortgage banking subsidiaries.

The rise to dominance of non-depository lenders has been facilitated by the rise of secondary market institutions. The ability to package and sell loans in the secondary market reduces the need to hold deposits (or other sources of cash) to fund mortgage loans because investors in the mortgage-backed securities that the GSEs and private conduits issue replace deposits as the source of funds for these loans. By mandating the standardization of loan contracts, Fannie Mae and Freddie Mac have played a role in streamlining and rationalizing the mortgage market.

Recognizing the importance of promoting access to affordable housing and homeownership, in 1992 Congress established three affordable housing goals to encourage the GSEs to expand lending for lower-income families, particularly those living in historically underserved neighborhoods. Interim goals established by the legislation were replaced with somewhat higher goals in 1995, and again in 2000. One objective of these goals was to encourage Fannie Mae and Freddie Mac to lead the market by introducing new affordable lending programs that better serve the mortgage lending needs of lower-income families and others who have found it difficult to access credit in the conventional mortgage market (U.S. Department of Housing and Urban Development, 2000).

The GSE goals helped support the substantial growth in lending to lower-income people and lower-income neighborhoods by expanding their purchases in these areas, and by developing new approaches to promoting affordable homeownership. Since 1993, the mortgage industry in general, and Fannie Mae and Freddie Mac in particular, have introduced new affordable lending programs and allowed greater flexibility in underwriting lower-income loans. A recent Department of Housing and Urban Development study, however, suggests that the GSEs continue to trail other market players in affordable lending. For example, the study estimated that in 1999, together Fannie Mae and Freddie Mac purchased 41 percent of all home purchase loans in metropolitan areas, but purchased only 29 percent of all loans to low-income borrowers and only 20-22 percent of loans to African-American and Hispanic borrowers in MSAs (Bunce, 2000).

In addition to Ginnie Mae, an organization created to securitize the government-insured portions of the market, private market entities are also now active in the securitization business. While the largest share of conventional conforming loans (those made at standard terms for amounts below the federally-determined ceiling for GSE purchases) are typically sold to Fannie Mae and Freddie Mac, non-conforming mortgages (or ‘jumbos’) are also commonly pooled and sold as private-label securities, mostly by Wall Street investment banks. Individual loans underlying both GSE and private-label issues that are made at high loan-to-value ratios carry private mortgage insurance, but issuers of jumbo packages tend to provide additional credit enhancements beyond those of the conventional conforming GSE issues.

Securitization as discussed above has largely affected the market for prime mortgages – those made at the most favorable rates and terms to borrowers that present lenders and investors with small and manageable credit and collateral risks. Prior to the 1990s, subprime mortgages were chiefly extended by large finance companies, which financed them with secured and unsecured debt. Recently, however, securitization has also been aggressively extended into the subprime sector. Indeed, a recent joint report by the U.S. Department of Housing and Urban Development and the U.S. Department of Treasury noted that the securitization of subprime loans increased from \$11 billion in 1994 to \$83 billion in 1998, before easing back to \$60 billion in 1999 (U.S. Department of Treasury and U.S. Department of Housing and Urban Development, 2000). Issuers of subprime mortgage-backed securities have tended to be private firms, because, until recently, Fannie Mae and Freddie Mac purchased only prime loans.

B. The Rise of Large Banking Organizations

Paralleling the rise of mortgage brokers and the securitization of mortgage loans has been the rise of large banking organizations and their affiliated mortgage lending organizations. A study by the Federal Reserve Board noted that from 1975 to 1997, the number of banking institutions dropped by 40 percent, as a result of industry consolidation and a substantial number of bank failures (Avery, Bostic, Calem and Canner, 1999). Following the shake out in the late 1980s and early 1990s, the number of liquidations slowed, but stimulated by the globalization of financial services, and efforts to increase efficiency, reduce costs, or gain competitive advantages, the number of mergers and acquisitions continued to mount.

Regulatory changes also supported the consolidation of the financial services industry as the 1980s saw most state-level restrictions on intrastate banking removed or relaxed. At the federal level, interstate branching became a reality in the 1990s. This opened up opportunities for commercial banks to expand beyond boundaries that had been in place since the Depression, and enabled larger organizations to further enhance the scale and scope of their operations through merger and acquisition. Federal Reserve Board data indicate the scale of consolidation in the mid 1990s. From 1993 to 1997 alone, the number of banking institutions acquired in a merger or acquisition totaled 2,829, or 21 percent of the total. Over the same period, 431 new institutions were formed.

To understand the ongoing concentration in mortgage lending it is necessary to understand trends both within the mortgage sector and in the broader financial services industry (Avery, Bostic, Calem, and Canner, 1997). Among the various financial services provided by banks and related businesses, consumer and mortgage lending require extensive marketing, customer support, account management and servicing operations. Large-scale operations are able to spread the high fixed costs associated with these tasks across a larger customer base. In addition to these classic ‘scale economies,’ larger organizations benefit from ‘scope economies’ that enable them to use



data and information gathered from a large customer base to develop and cross-sell specialized, and potentially more profitable, consumer products to mortgage customers. Similarly, the organizations can reduce the average costs of mortgage originations by capturing the mortgage activity of their other customers.

Finally, major technological changes also spurred major changes in the structure of the mortgage industry. Since increasingly loan origination systems operated via telephone, fax, and now the Internet, the link between the location of the borrower and the location of the lender today is less important than even a decade ago. As a result, many banks have abandoned operating some or all of their residential mortgage lending operations out of 'sticks and bricks' branches, but instead have created or acquired large mortgage banking subsidiaries that utilize technology to operate from centralized locations that serve entire metropolitan areas or larger regions. Moreover, electronic loan processing and underwriting, including the growing use of automated credit scoring and automated appraisal and underwriting tools, reduced the costs of loan origination and loan servicing, and allowed lenders to reduce costs by better managing risk.

For the most part, the new technology requires high fixed investment by firms, but once installed operates at extremely low marginal costs. As a result, increased technological sophistication in mortgage lending tends to favor larger lending organizations and has helped to foster consolidation in the mortgage business. At the same time, these trends have also supported the growth of mortgage brokers, who working on a fee-for-service basis, handle the front end of the mortgage application process, a function that often still requires a presence in a local market area, and some face-to-face communication with a loan applicant. Here, scale economies are decidedly less significant, and relatively small organizations continue to thrive as mortgage brokers.

Exhibit 10: Mortgage Industry Consolidation Has Been Dramatic

Loans Per Year	Lenders	Loans	Share	Lenders	Loans	Share
	1993			2000		
More than 50,000	4	260,771	10.8%	12	1,444,121	39.0%
25,000 to 49,999	10	302,312	12.5%	13	470,955	12.7%
10,000 to 24,999	32	462,073	19.1%	27	414,508	11.2%
5,000 to 9,999	37	267,428	11.1%	41	287,787	7.8%
1,000 to 4,999	258	545,907	22.6%	249	541,066	14.6%
500 to 999	260	187,584	7.8%	259	179,401	4.9%
250 to 499	415	147,336	6.1%	363	125,962	3.4%
100 to 249	812	130,462	5.4%	746	119,448	3.2%
Less than 100	4,338	110,636	4.6%	4,327	116,283	3.1%
Total	6,166	2,414,509	100%	6,037	3,699,531	100%

Note: Share is percent distribution of home purchase loans.

In combination, these changes have promoted dramatic consolidation among mortgage lenders. In 2000, for example, only 12 lending organizations made more than 50,000 home purchase loans, but these 12 accounted for 39 percent of all home purchase loans made that year (Exhibit 10). Seven years earlier, in 1993, only 4 organizations topped 50,000 loans, and they accounted for only 11 percent of all home purchase lending. The number of lenders making between 25,000

and 50,000 loans per year also increased, though their share of the market was flat. Together, the top 25 home purchase lenders originated fully 52 percent of all home purchase loans in 2000. This group accounted for all but 102,000 of the nearly 1.3 million more home purchase loans originated in 2000 than in 1993.

Exhibit 10 also reveals, however, that there remain thousands of organizations that made fewer than 25,000 loans, including over 4,300 organizations that originated fewer than 100 loans in 1993 and 2000. Lenders in the 10,000-25,000 loan category saw an absolute decline in the number of loans, and saw their share of home purchase originations drop from 19 to 11 percent. The next group of lenders' (making 5,000-9,999 loans) share also declined, from 11 to 8 percent, even as they originated 20,000 more loans than seven years earlier. Lenders making between 100 and 5,000 loans saw both their share of home purchase originations and number of loans decline over the period. Interestingly, however, the number of loans originated by the smallest lenders, those making fewer than 100 loans, actually rose, though these lenders accounted for a smaller share of all originations.

Exhibit 11 divides the lending organizations into two categories: banking organizations (*i.e.* commercial banks and savings associations with their mortgage and finance company affiliates) and other organizations (independent mortgage and finance companies and credit unions). The exhibit indicates that banking organizations led the growth of large organizations. By 2000, home purchase lending for the ten largest banking organizations totaled over 1.1 million loans, and the top 20 combined for a total of 1.5 million loans. Between 1993 and 2000, the largest banking organizations were responsible for 85 percent of the increase in home purchase originations by large (more than 50,000 loans) lenders, and 78 percent of the total increase.

Exhibit 11: Large Banking Organizations Led Mortgage Lending Growth

Number of Loans	Banking Organization				Non-CRA-Regulated Organizations			
	Lenders		Loans		Lenders		Loans	
	1993	2000	1993	2000	1993	2000	1993	2000
More than 50,000	2	10	155,085	1,161,815	2	2	105,686	282,306
25,000 to 49,999	5	10	149,018	341,556	5	3	153,294	129,399
10,000 to 24,999	21	18	301,236	286,624	11	9	160,837	127,884
5,000 to 9,999	26	21	189,288	146,278	11	20	78,140	141,509
1,000 to 4,999	141	109	302,513	240,739	117	140	243,394	300,327
500 to 999	138	134	97,277	92,231	122	125	90,307	87,170
250 to 499	254	194	88,734	67,856	161	169	58,602	58,106
100 to 249	619	456	99,128	71,437	193	290	31,334	48,011
Less than 100	3,175	2,844	86,561	82,183	1,163	1,483	24,075	34,100
Total	4,381	3,796	1,468,840	2,490,719	1,785	2,241	945,669	1,208,812

Note: Banking organizations include all commercial banks, savings associations, and their mortgage and finance company affiliates. Non CRA-regulated organizations include mortgage companies and credit unions.

Source: Joint Center Enhanced HMDA Database

The emergence of large bank lending operations reflects, in large measure, forces that prompted dramatic consolidation of retail banking operations within and across individual metropolitan market areas. Within-market consolidations reflect the increasing economies of scale in retail banking, and the trend for larger, more efficient banking operations to acquire smaller banks or otherwise increase their presence in a particular market. Growth of regional and even national

banking operations also reflected the efforts of larger banks to capitalize on potential scale economies and name recognition, as well as reducing risk by diversifying geographically across numerous spatially distinct markets (Avery, Bostic, Calem and Canner, 1999).

At the same time, several large independent mortgage and finance companies competed head-to-head against banking organizations in mortgage markets across the country. These included the two largest, Countrywide Home Loans and Cendant Mortgage, that each made more than 50,000 home purchase loans in 2000. But many other independent mortgage banking operations either failed to grow over the period, or merged with or were acquired by a large banking operation. This latter category includes such large operators as North American Mortgage that was acquired by Dime Savings Bank, and Norwest Mortgage that merged with Wells Fargo and Company.

At the other end of the spectrum, the data confirm that the number of banking organizations originating less than 100 loans shrank by 10 percent between 1993 and 2000. This category of lender also made slightly fewer loans in 2000 than in 1993. In contrast, smaller independent mortgage companies and credit unions were on the rise. For example, over the period, the number of independent mortgage companies and credit unions making less than 100 home purchase loans rose 28 percent (from 1,163 to 1,483) and the number of home loans originated by these organizations rose 42 percent.

Consolidation among home refinance lenders was also strong as the impact of technological advances and related developments that have reduced the costs of home purchase lending had an equally strong impact on the costs of providing a refinance loan. For example, lending institutions making more than 10,000 refinance loans in 2000 accounted for 57 percent of all home refinance loans, compared with only 51 percent in 1993, with much of the growth again concentrated among large banking institutions.

It remains an open question whether the dominance of larger organizations helps or hinders the provision of affordable home loans. Many housing advocates argue that smaller, locally-based institutions have an enhanced capacity to better understand and to address the credit needs of the people and businesses they serve (Immergluck and Smith, 2001). Others argue that the efficiencies associated with large-scale operations, as well as the ability of larger organizations to offer a wider and more diverse product mix and to access low-cost funds on the world capital market, are advantages that more than neutralize these disadvantages. In any case, there seems to be little doubt that the trends of consolidation of the mortgage industry and the declining importance of deposits as a source of mortgage capital have yet to run their course.

Continued technological change should serve to further enhance the competitive advantage of larger players. New automated systems require substantial initial investments and smaller companies unable to afford such investments are finding it increasingly difficult to remain competitive in the mortgage lending arena. At the same time, since these technologies operate at low marginal or incremental costs, they foster fierce competition among those firms continuing to operate in the market. Going forward, the result will likely be both continued consolidation of mortgage lending activities, a growing reliance on mortgage brokers to take loan applications, as well as continued evolution of better products, services and pricing, as large firms seek to identify and exploit competitive advantage in their pursuit of customers in an increasingly competitive marketplace.

C. The Effect of Changing Industry Structure on Small Business and Multi-Family Lending

The changing structure of the banking industry is also having a noticeable impact on multi-family lending, and is just now beginning to influence small business lending as well. As was true in the single-family mortgage market, the past two decades have seen shifts in the financing of multi-family apartments. Until the mid-1980s, local thrifts and savings banks were the largest providers of multi-family mortgages, followed by insurance companies and commercial banks. Since that time, secondary market entities, including the GSEs, have played an increasingly prominent role, as the standardization of multi-family underwriting criteria and the application of new pricing and risk management technologies have helped the multi-family sector access funding from the broader capital markets. Today, nearly as large a share of multi-family mortgages (58 percent) as single-family mortgages (61 percent) are securitized (U.S. Department of Housing and Urban Development, 2000).

In contrast to the declining role of thrifts, the market share of commercial banks has risen in the 1990s, accounting for 30 percent of the net overall growth of mortgage debt for multi-family apartment buildings in the second half of the decade (Schnare, 2001). Smaller banks and thrifts still participate in multi-family mortgage lending, but increasingly their role is confined to specific market niches, such as 5 to 50 unit apartment buildings. The relatively high costs of underwriting mortgages on small multi-family properties has to some extent kept larger institutions out of this niche but improving data quality and availability on project characteristics and loan performance is enabling larger institutions to enter these markets as well (Herbert, 2000).

Smaller banking institutions continue to be relatively more active in small business lending than larger institutions. In 1996, banks with less than \$100 million in assets made loans worth 9 percent of their assets to small business, while banks with over \$5 billion in assets lent only 3.4 percent of their assets to these businesses (Strahan and Weston, 1998, as reported in Immergluck and Smith, 2001). Safety and soundness regulations limiting the share of total assets that a bank can commit to a single borrower keep smaller banks focused on the small business market. In addition, a small bank may lack the capacity to meet the diverse needs of larger business customers. Yet by capitalizing on their local market knowledge and by working to cultivate relationships with small business owners, small business lending continues as an important niche market for smaller banks, even as larger banks are coming to dominate residential mortgage lending.

SUMMARY

Growth of lower-income and minority mortgage lending is one of the most notable banking stories of the past decade. Decoupling of the mortgage banking and deposit-taking activities of financial services organizations, combined with technologically-driven reductions in the cost of originating mortgage loans, have helped to support the rise of large mortgage banking operations. Enhanced capacity to evaluate risk has expanded the diversity of available loan products and fostered the growth of subprime lending operations. Each of these forces has worked to expand lending to lower-income and minority households. Yet, the dramatic restructuring of the mortgage industry presents new challenges, as well as opportunities, for lower-income and minority lending in the future. This concern stems, for example, from observations such as the apparent decline in the importance of prime conventional lending in meeting the credit needs of traditionally underserved groups that were highlighted earlier. These concerns are heightened by the fact that the information necessary to accurately assess the extent to which non-standard lending products serve the interests of lower-income and minority borrowers is not currently available.



SECTION 2

THE REGULATORY ENVIRONMENT

This section examines issues associated with CRA and related legislation. It begins by discussing the early history and rationale of the Act, and then discusses the evolution of CRA and related legislation in the 1980s and 1990s. Despite numerous changes throughout its 25-year history, CRA continues to focus on the presumed spatially-determined link between deposit-gathering activities and a depository institution's obligations to meet community credit needs.

CRA AND RELATED LEGISLATION: EVOLUTION AND BACKGROUND

A. Early History and Rationale

The Community Reinvestment Act of 1977 directed federally insured depository institutions³ to help meet the credit needs of the communities in which they operate. Despite these lofty pronouncements, the Act provided little guidance as to how bank regulators should evaluate bank performance in this regard, and how often these examinations should take place. Moreover, the Act granted the regulators little direct enforcement authority, other than stipulating that a bank's CRA record can be used as a basis to deny the bank's application to expand operations.

CRA was built on several earlier pieces of local and federal legislation. The Act complemented the Home Mortgage Disclosure Act (HMDA) of 1975, which required depository institutions with assets over \$10 million to report mortgage lending totals in metropolitan areas aggregated by census tract. HMDA in turn was based on a Chicago City ordinance passed in 1974 that was intended to highlight and expose 'redlining,' or the systematic denial of mortgage credit by depository institutions to specific neighborhoods, particularly lower-income central city areas, based on the racial or ethnic characteristics of the population. In an effort to place a spotlight on unfair lending practices, the Chicago ordinance mandated that any savings and loan association or bank (depository institution) applying to hold deposits from the city disclose information about the zip code and census tract of each residential mortgage loan that they originated.

Like the Chicago City ordinance, CRA specifically responded to the perception that savings and loan associations and banks were 'redlining' lower-income and minority areas, and proponents of CRA cited the dearth of conventional mortgage lending, particularly in inner cities, as an important cause of neighborhood deterioration and urban decline plaguing the nation at that time. The Act sought to affect lenders' behavior through a system based on periodic 'CRA exams' that allowed regulators to hold up or prevent proposed mergers and branch openings for banks that failed to attain minimal levels of satisfactory performance.

Depository institutions' obligation to serve the credit needs of their communities as highlighted in CRA grew also out of their depository charters, which require banks and thrifts to serve the 'convenience and needs' of the communities in which they operate. The Act's targeting of depository institutions reflected the fact that, at a time when intra- and interstate branching was largely proscribed, depositories were responsible for the majority of home mortgage and small business lending in communities across the country. CRA directed bank regulators⁴ to evaluate depository

³Insured depository institutions include any bank or savings association, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC). CRA does not cover credit unions and independent mortgage companies.

⁴ The federal banking regulators responsible for administering the statute are the Comptroller of the Currency (OCC)



lenders' effectiveness in meeting the credit needs of their communities, including those of lower-income borrowers and neighborhoods, consistent with safe and sound banking operations. It also required depository institutions to post in their offices a CRA notice, and to maintain and make available upon request a public file that included specified information about the institution's CRA performance. Two of the Act's provisions that later proved most important required regulators to allow public comment on the institution's community lending record, and, as noted above, to include an institution's CRA performance in evaluating consolidation and expansion applications.

Between 1977 and 1989 CRA assessment was built around twelve factors grouped into the following five categories: 1) ascertainment of community credit needs; 2) marketing and type of credit extended; 3) geographic distribution of and record of opening and closing branches; 4) discriminatory and other illegal credit practices; and 5) community development.

After a decade, there was a growing sense among community advocates, and ultimately in the United States Congress, that the performance assessments and ratings specified in the initial legislation had done little to turn lenders' attention to underserved markets. In 1988 Senator William Proxmire, Chair of the Senate Banking Committee, held a highly visible public hearing where he challenged the regulatory agencies to be more aggressive in their efforts to encourage banks to expand access to credit to low and moderate income borrowers. Despite the apparent rigor of the criteria, fully 97 percent of institutions examined over the period received one of the two highest ratings (on a five point scale) (Swidler, 1994). Indeed, testimony revealed that in some years in the 1980s, certain regulators conducted no CRA exams at all (Matasar and Pavelka, 1998, as reported by Zinman, 2001).

This is not to say that CRA had no impact in the early years. Armed with a legislative mandate that a bank serve the "the credit needs of its entire community, including low- and moderate-income (LMI) neighborhoods," community activists confronted banks and demanded that they expand lending in their communities (Bradford and Cincotta, 1992). Not all banks responded, but some did engage with community groups and began to experiment with new loan underwriting criteria and to develop new mortgage products designed to expand access to credit in many underserved communities. Arrangements between community groups and lenders often were codified into formal commitments or 'CRA agreements,' where banks pledged to meet specific lending or service delivery targets. An emerging set of national organizations, including the Center for Community Change, the National Community Reinvestment Coalition, and the Neighborhood Reinvestment Corporation, worked to disseminate information about emerging trends in mortgage lending as community leaders and bankers alike began to discover that it was in fact possible to find 'bankable' loans in lower-income areas.

Despite this progress, there could be little doubt that more needed to be done to expand access to credit to lower-income communities. This awareness was heightened by the publication in 1988 of the *Atlanta Journal and Constitution's* Pulitzer Prize-winning 'Color of Money' (Dedman, 1988) series documenting the widespread disparities in mortgage lending between blacks and whites in Atlanta. This not only stimulated discussion of the failure of banks to serve 'community needs,' but also linked CRA and Fair Lending in the public debate. The Fair Lending Act of 1968 prohibited discrimination in mortgage lending, a prohibition that was enhanced with the

for national banks; the Board of Governors of the Federal Reserve System for State-chartered banks that are members of the Federal Reserve System and bank holding companies; the Federal Deposit Insurance Corporation (FDIC) for state-chartered banks and savings banks that are not members of the Federal Reserve System and the deposits of which are insured by the FDIC; and the Office of Thrift Supervision (OTS) for savings associations with deposits insured by the FDIC, and savings association holding companies.



passage of the Equal Credit Opportunity Act of 1974, and the Community Reinvestment Act of 1977.⁵ Stimulated in part by the continuing community activism around racial disparities in lending, twenty years after the passage of the initial legislation, Congress enacted the Fair Housing Amendments Act of 1988, a law that significantly expanded the scope of the initial legislation and strengthened its enforcement mechanism (Schill and Friedman, 1999).

B. Changes in the late 1980s and FIRREA

The failure of CRA to have a more pronounced effect on mortgage lending to lower-income people and communities lay largely in its failure to provide regulators with tools to punish poor performance or reward successful behavior. CRA's strongest provision, the ability of regulators to condition or deny a merger, had little weight in an era of limited banking consolidation, and was in any case never implemented in the first decade following the Act's passage. Further, both lenders and advocates perceived the examination process as capricious. Lenders' accountability was limited because they were evaluated on the strength of their *plans* to serve low-income areas rather than the outcome of these plans on improving conditions in low-income markets. Additionally, any reputational risk and public scrutiny faced by lenders for poor performance was minimal since examiners' ratings were not made public. This was to change, as the combination of additional regulations and changing market conditions gave new bite to CRA in the late 1980s and early 1990s.

In 1989, Congress strengthened both HMDA and CRA in several key ways through the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). FIRREA enhanced HMDA disclosure requirements to include the race, ethnicity, gender, and income of mortgage loan applicants, and disposition of mortgage loan applications. This additional data, particularly when correlated with census data on the racial composition, median family income, and central city, suburban, or rural location of the loan property census tract, provided a greatly enhanced statistical basis for analyzing the geographic and demographic distribution of home mortgage loans. FIRREA also mandated public disclosure of each institution's CRA rating and performance evaluation, established a four-tiered descriptive rating system⁶ to replace the prior numeric scale, and required the banking regulators to prepare a detailed written evaluation of the institution's CRA record.

Finally, in creating the Federal Home Loan Bank Affordable Housing Program (AHP) and the Community Investment Program (CIP), FIRREA also provided expanded resources to support community lending. In combination, the AHP and CIP programs, working in conjunction with the enhanced focus on CRA, spurred a new wave of innovative lending and investment programs designed to better serve lower-income communities.

Heightened Congressional concern about the effectiveness of CRA oversight also coincided with the more aggressive use of existing authorities on the part of bank regulators. In 1989, the Federal Reserve denied an application by the Continental Bank Corporation to acquire Grand Canyon Bank of Scottsdale on CRA grounds. The Federal Reserve ruled that in light of inaccurate filings, and lack of significant efforts to ascertain the credit needs of its community or advertise its products, with no compensating activities, the Bank's commitments to improve CRA performance did not absolve it for a weak CRA record. In an equally significant move, the same day that it announced its decision regarding the Continental Bank Corporation, the Federal Reserve also re-

⁵ For an excellent collection of essays on the cause and extent of mortgage lending discrimination see Goering and Wienk, 1996.

⁶ Outstanding, satisfactory, needs to improve, and substantial noncompliance.

leased a policy statement outlining a more aggressive stance concerning CRA. This included a checklist of items that regulators should consider in deciding whether to permit an application to merge to go forward, and a statement acknowledging the importance of public hearings and community input in the decision-making process.

The combination of the new policy statement, and the fact that the Continental case marked the first time a merger was rejected on CRA grounds, sent shock waves through the banking community. Among other things, these events served to focus senior banking executives on the role of CRA compliance in an organization's competitive position, particularly in the consolidation-oriented environment surrounding the demise of many savings and loans at that time. It also awakened community advocates to the potential gains from focusing protests on consolidating institutions. The fact that CRA performance is a meaningful criterion in approvals of consolidation and expansion activity became even more important later in the decade, as the pace of such activity accelerated following passage of the Riegle-Neal Interstate Branching and Efficiency Act of 1994.

Finally, the passage of the Fair Housing Amendments Act of 1988 generated a significant increase in Fair Lending enforcement (Schill and Friedman, 1999). The legislation provided that persons who felt that they had been discriminated against could file a complaint with the Department of Housing and Urban Development, and HUD would simultaneously seek to achieve conciliation and investigate the complaint. Cases where HUD found reasonable cause to proceed ended up in front of administrative law judges, or even in federal courts, where the possibility of punitive damages loomed. The 1988 legislation also extended anti-discrimination legislation to property appraisers and secondary market purchasers.

The growing Congressional concern about lending discrimination also prompted the Department of Justice to expand its Fair Lending enforcement activity (Galster, 1999). In a case brought against the Decatur Federal Savings and Loan Association (Atlanta), the DOJ accused Decatur of redefining its market area to exclude African-Americans, and of rarely advertising its products in African-American communities. The DOJ also sued the Shawmut Mortgage Company (Boston) in 1993, alleging discriminatory treatment in loan approval. In 1994, DOJ accused Chevy Chase Federal Savings Bank (Washington, DC) of violating Fair Lending laws by failing to extend services to predominantly African-American neighborhoods. DOJ prevailed in each of these high visibility actions. Settlements ranged from requiring banks to provide specific relief to aggrieved borrowers, to requirements that the lenders in question expand lending in minority communities and to minority borrowers by expanding outreach and marketing, altering underwriting procedures, and creating special mortgage loan packages for low-income minority applicants.

C. 1995 Changes to CRA Regulations

The changes in CRA examinations continued as the banking industry and community advocates complained that CRA evaluations still relied too heavily on the *efforts* depository institutions made to meet the needs of their communities rather than on results. In 1995, Federal banking regulators refined CRA enforcement procedures to focus explicitly on covered depository institutions' success in meeting their obligations under CRA by examining actual performance in their assessment areas - the geographic areas where the institution has its main office, branches, deposit-taking ATMs - and neighboring areas in which the institution has originated or purchased substantial portions of its loans.

The 1995 regulations provided for specific tests for three different lender types, sizes and businesses (large retail, small retail, and wholesale/limited purpose institutions – details of each test



are discussed in the next section). The test procedure is inherently subjective as examiners are directed to apply the relevant test in the context of the particular institution and the market in which it operates. This ‘performance context’ is defined so as to include information about the economic and demographic characteristics of the institution’s assessment area; lending, investment, and service opportunities in that area; the institution’s product offerings and business strategy; its capacity and constraints; its past performance and the performance of similarly situated lenders; information and public commentary contained in the institution’s public CRA file; and any other information the regulator deems relevant. The new rules also attempted to reduce both paperwork and subjectivity. For all types of institutions, public comment is encouraged by requiring that each banking regulator publish a list of banks that are scheduled for CRA examinations in the upcoming quarter.

In a nod to the changing structure of the banking industry, the 1995 regulations also recognized that many banking organizations included both depository institutions and affiliated mortgage companies or subsidiaries. For example, the 1995 changes gave each institution the discretion to include or exclude the activities of affiliated companies in the CRA exam for specific assessment areas. Recognizing that some mortgage company affiliates specialize in serving lower-income markets, while others serve a broader market, this feature arguably weakened CRA’s inducement to expand lower-income lending by enabling institutions to select the combination of reporting that will produce the most favorable lending record.

Interestingly, the lending test, which gives lenders credit for certain mortgage loans regardless of the characteristics of the areas in which the loans are made, represented a movement away from the initial spatial focus of CRA. In fact, mortgage loans to lower-income borrowers in higher-income areas have accounted for 66 percent of the growth in CRA-eligible home purchase lending between 1995 and 2000. Similarly, small business lending is evaluated primarily on the size of the loan and the applicant’s business rather than on the income characteristics of the neighborhood. At the same time, the regulations continued to focus on assessment area residential mortgage lending, as well as the spatial distribution of the provision of banking services to assessment area neighborhoods. As a result, more than two decades after enactment, CRA still maintains a clear focus on the presumed spatially-determined link between retail deposit-gathering activities and a depository institution’s obligation to meet community credit needs.

D. Gramm-Leach-Bliley Financial Modernization Act

The most recent changes to CRA occurred in the Gramm-Leach-Bliley Financial Modernization Act (GLBA) of 1999. GLBA mandates that depository institutions must have satisfactory CRA ratings before the institution, or its holding company, affiliates or subsidiaries, can engage in any of the expanded financial activities permitted under the law. GLBA’s ‘sunshine’ provision requires that agreements entered into by depository institutions and community organizations or other entities in fulfillment of CRA obligations must be publicly disclosed. The Act also changed the frequency of small banks’ exams to once every five years for institutions with an outstanding rating; every four years for those with a satisfactory rating; and as deemed necessary for institutions whose last rating was less than satisfactory. These small banks, however, also remain subject to CRA review at the time of any application for merger, to open or close a branch, or at the discretion of the regulators for reasonable cause at any time. Finally, GLBA also raised important concerns and limitations on the privacy of borrowers, including the use of credit history reports for purposes other than credit scoring.

THE CRA EXAM

As noted above, since 1995 regulations have provided for different tests for lending institutions of different sizes and in different lines of business. This section enumerates the key characteristics of current exams for each institution type.

A. Small Depository Institutions

Since 1995 banks and thrifts that have assets under \$250 million and that are not part of a bank holding company with assets in excess of \$1 billion have been evaluated under a simple quantitative test that focuses on loan-to-deposit ratios and lending inside versus outside of the institution's assessment area, the geographic distribution of loans in the assessment area, and the distribution of lending by borrower income and business or farm size. The bank's record of taking action, if warranted, in response to written complaints about its CRA performance is also considered. Investment and service activities, which together account for half of the large bank test, may be considered at the small institution's request. Qualified investments and services that enhance credit availability in the assessment area may be used to improve a rating from satisfactory to outstanding but may not be used by regulators to lower a small institution's rating.

B. Large Depository Institutions

The 1995 regulations went furthest toward standardizing, quantifying and objectifying performance criteria for large retail depositories.⁷ Since these regulatory changes have been in place, these institutions have had to collect and report annually on the number and dollar amount of mortgage applications outside of metropolitan areas, as well as small business and small farm loans, track the aggregate volume of community development lending, and maintain information on investments and services provided to communities in their assessment areas. Based on an institution's performance in the test areas, with particular attention to activities benefiting low- and moderate-income individuals and areas, regulators assign one of five possible ratings for lending, investment and service activities (Exhibit 12). These are then aggregated based on point values to generate one of four overall ratings as follows. Since regulators have the authority to deny merger applications based on CRA performance, ratings less than satisfactory or outstanding can have significant adverse consequences for bank operation. Grades of 'needs to improve' or 'substantial noncompliance,' which are rare, may also subject the institution to pressure from community groups, with attendant risk to the institution's reputation. Practices that are considered 'innovative' are necessary to earn 'outstanding' points on all three of the tests.

The lending test evaluates an institution's record of helping to meet the credit needs of its assessment area through home mortgage, small business/small farm, and community development lending, through both originated and purchased loans. Additionally, if consumer lending constitutes a substantial majority of an institution's business, it will be evaluated using criteria similar to those used for mortgage lending. Lending is the most heavily weighted component in the overall rating equation. Regardless of point values no institution can receive a composite rating of 'satisfactory' unless it receives a minimum rating of 'low-satisfactory' on the lending test, and an institution rated 'outstanding' on the lending test is assured an overall 'satisfactory' rating, even if it receives substantial noncompliance on the other two components.

In addition to formal CRA examinations, public access to detailed mortgage loan data under HMDA enables community organizations to monitor the activities of lenders. Provisions of CRA

⁷ Those with \$250 million or more in assets or belonging to a holding company with \$1 billion or more in assets.



require large lenders to file HMDA records on a wider variety of loans than that mandated under HMDA itself. For example, while HMDA requires reporting only of loans within MSAs, lenders that are considered ‘large’ under CRA must additionally file non-metropolitan loan applications so that CRA regulators can assess their performance wherever they operate. CRA regulations also call for an examination of the number and amount of loans within, versus outside, assessment areas, and the distribution of these loans across area and borrower income categories, as well as a determination of the extent to which the lender’s activities appropriately reflect the income mix of borrowers and sub-areas within their assessment areas. A given lender’s results should be evaluated based on peer comparisons with others involved in similar business lines and operating in the same or similar markets. Innovativeness is assessed based on the extent to which mortgage product offerings serve lower-income borrowers in new ways, and reach previously unserved but creditworthy borrowers.

Exhibit 12: Regulators Assign One of Five Possible Ratings for Lending, Investment and Service Activities

Rating	CRA Exam Component			Overall
	Lending	Investment	Service	
Outstanding	12	6	6	20+
High Satisfactory	9	4	4	11-19
Low Satisfactory	6	3	3	
Needs to Improve	3	1	1	5-10
Substantial Non-Compliance	0	0	0	0-4

Source: Federal Reserve Bank of Dallas, *A Banker's Guide to CRA*

Small business and small farm lending is included in CRA exams because market impediments affecting lower-income and minority access to residential mortgage credit also can hurt small firms. CRA treats all loans to businesses and farms with annual revenues below \$1 million, and loans less than \$1 million⁸, as ‘small business’ or ‘small farm’ loans. CRA performance evaluations also include an analysis of the distribution of small business lending across census tracts, grouped into four categories by neighborhood income. Though regulations have always taken note of the extent to which covered depository institutions have provided loans to small businesses within their assessment areas, only since the 1995 regulations changes have data on such lending been compiled and released publicly. Even so, monitoring small business lending poses difficult issues. For example, a single small business may have multiple locations or addresses, including the small business owner’s home. As a result, identifying the characteristics of the neighborhood that benefits from a small business loan is a much more difficult task than is the case with regard to home mortgage loans.

Activities promoting community development have also received increased emphasis since the 1995 revisions. As defined in the current regulations, ‘community development’ refers to affordable housing, including multi-family rental housing, for lower-income individuals; community services targeted to lower-income individuals; activities that promote economic development by financing small businesses or small farms; and activities that stabilize lower-income neighborhoods. Lenders are rated on the number and amount of these loans, as well as their ‘innovativeness’ and ‘complexity,’ and the extent to which they are a leader at making these loans. Community development loans are not tracked by census tract or other geographic identifier.

⁸ Broken into three categories: <=\$100,000; \$100,001-\$250,000; and \$250,001-\$999,999.

The investment test evaluates an institution's record of helping to meet the credit needs of its assessment area through 'qualified investments' that benefit the assessment area or a broader state-wide or regional area that includes the assessment area. A qualified investment is one that has community development as its primary purpose, and may include an investment, deposit, membership share, or grant in or to a variety of financial intermediaries or organizations.⁹ An institution's investment activity is evaluated on the basis of the dollar amount of qualified investments; the innovation reflected in its qualified investments; the responsiveness of qualified investments to credit and community development needs; and the degree to which the qualified investments are not routinely provided by private investors.

The service test evaluates a bank's record of helping to meet the credit needs of its assessment area through retail banking and community development services. Regulations require that retail banking services should be assessed according to the distribution of the institution's branches among low-, moderate-, middle- and upper-income areas; the institution's record of opening and closing branches (particularly those located in low-income areas or primarily serving low-income individuals). In addition, the regulations state that examiners should also consider the availability and effectiveness of alternate systems for delivering retail banking services in low-income areas and to lower-income individuals; the range of services provided to low-, moderate-, middle-, and upper-income geographies; the degree to which the services are tailored to meet the needs of those areas; as well as to consider alternative systems for delivering retail banking services, to the extent that they are effective alternatives in providing needed services to lower-income areas and individuals. Alternate systems for delivering retail banking services may include ATMs, banking by telephone or by computer, loan production offices, and bank-at-work or bank-by-mail programs. Although CRA exams typically include a discussion of the spatial distribution of branches and ATM machines, there is little evidence to support the notion that regulators commonly examine or evaluate efforts to create new or innovative ways to expand access to banking services (Stegman, 2001).

Community development services are defined as services that have community development as their primary purpose, are related to the provision of financial services, and have not been considered in the evaluation of the institution's retail banking services. These services might include the provision of technical expertise for organizations serving lower-income areas' housing needs or economic revitalization, credit counseling to promote community development and affordable housing, school savings programs, or low-cost bank accounts or free government check cashing. Services are assessed according to their extent, innovativeness, and responsiveness. In practice, service test compliance often involves participation in community organizations by employees of financial institutions.

C. Wholesale and Limited Purpose Banks

Wholesale banks (which are not in the business of making home mortgage, small business/small farm, or consumer loans to retail customers) and limited purpose institutions (such as credit card banks) are evaluated under a community development test, which does not consider direct residential or small business lending activities. Financial institutions must be designated as limited purpose or wholesale by their primary regulator prior to being examined under the community

⁹ These include CDFIs, CDCs, organizations engaged in affordable housing rehabilitation or construction, small business investment companies, facilities that promote community development, projects eligible for low-income housing tax credits, certain state and municipal obligations, or nonprofits serving community development needs (such as homeownership counseling and other financial services education).



development test. The community development test looks at the institution's record of helping to meet the credit needs of its assessment area through community development lending, qualified investments, or community development services. Performance criteria for these institutions are the number and amount of community development loans, qualified investments, or community development services; the innovativeness and complexity of qualified investments, community development loans, or services; the extent to which qualified investments are not routinely provided by private investors; and the bank's responsiveness to credit and community development needs.

D. Strategic Plan Option

All financial institutions may also be evaluated under a 'strategic plan' that has been approved by their regulator. Plans can last for a maximum of five years, and must have been in effect for at least one year in order to form the basis of an examination. They must be submitted for informal public comment during development and formal public comment through a specific process prior to regulatory approval. Written comments on the plan must be submitted to regulators at the time the institution seeks formal regulatory approval. The plan must contain measurable goals for helping to meet the credit needs of each assessment area covered by the plan, particularly the needs of low-income areas and individuals, through lending, investments, and services. These goals are specific targets that define satisfactory performance. Measurable goals that constitute outstanding performance may also be specified.

Strategic plans have appeal for lenders because they minimize regulator discretion during exams. They have the compensating disadvantage of being open to scrutiny from community groups and general public comment prior to approval by regulators, a process that can ratchet up numeric targets and generally expose lenders taking this route to criticism that they would have often avoided in undergoing a standard exam. Strategic plans also tend to be unappealing to lenders with business strategies involving consolidation, since the plans must be revised when the institution merges with another or expands operations.

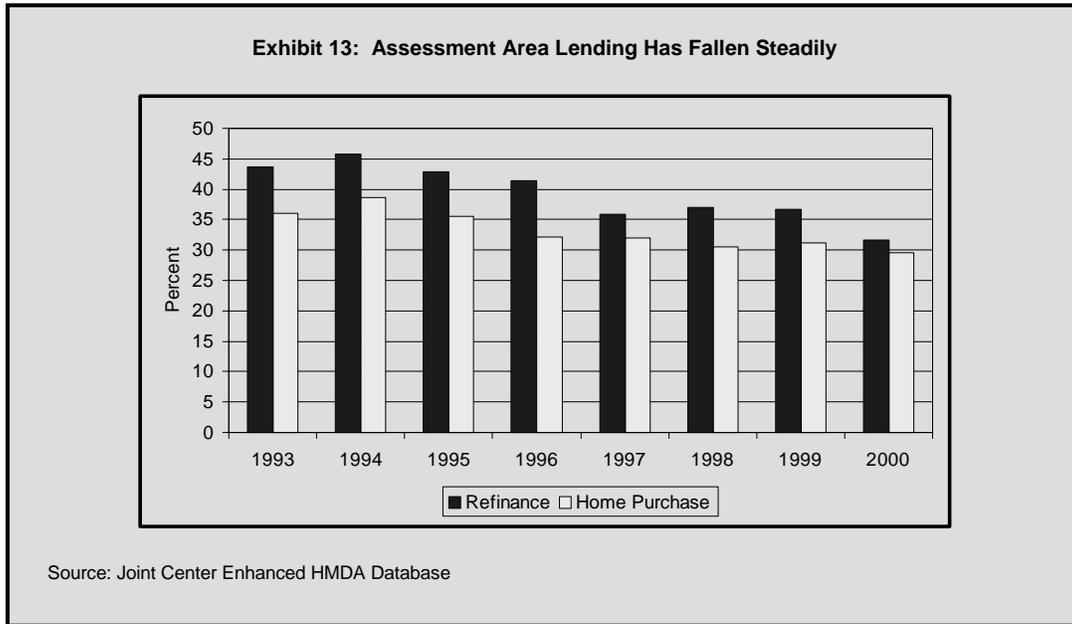
CURRENT CRA REGULATORY ISSUES

The Gramm-Leach-Bliley Act (GLBA) focused on financial services modernization, but interestingly did little to bring CRA into conformance with the new structure of the financial services world that the Act authorized. Opponents sought to scale back CRA, and called for, among other things, the creation of a 'safe harbor' that would limit CRA challenges for banks with a satisfactory or better CRA rating. Advocates pushed to expand CRA by extending its reach to all segments of the financial services industry, including non-banks that were involved in the provision of financial services. However, in the end the legislation left CRA more or less where it has been for the past several decades, although discussion continues about whether and how best to 'modernize CRA' (Goldberg, 2000).

A. CRA and Changing Industry Structure

The increasing share of loans made by the mortgage banking subsidiaries or affiliates of bank holding companies and by independent mortgage companies has brought a concomitant decline in the share of mortgage loans originated by deposit-taking institutions in the areas where they maintain branch banking operations. Since CRA mandates the most extensive review of lending in 'assessment areas' - those where banks have deposit-taking branches - an increasing share of all loans are not subject to detailed CRA review. Between 1993 and 2000 the number of home

purchase loans made by CRA-regulated institutions in their assessment areas as a share of all home purchase loans fell from 36.1 percent to 29.5 percent (Exhibit 13).



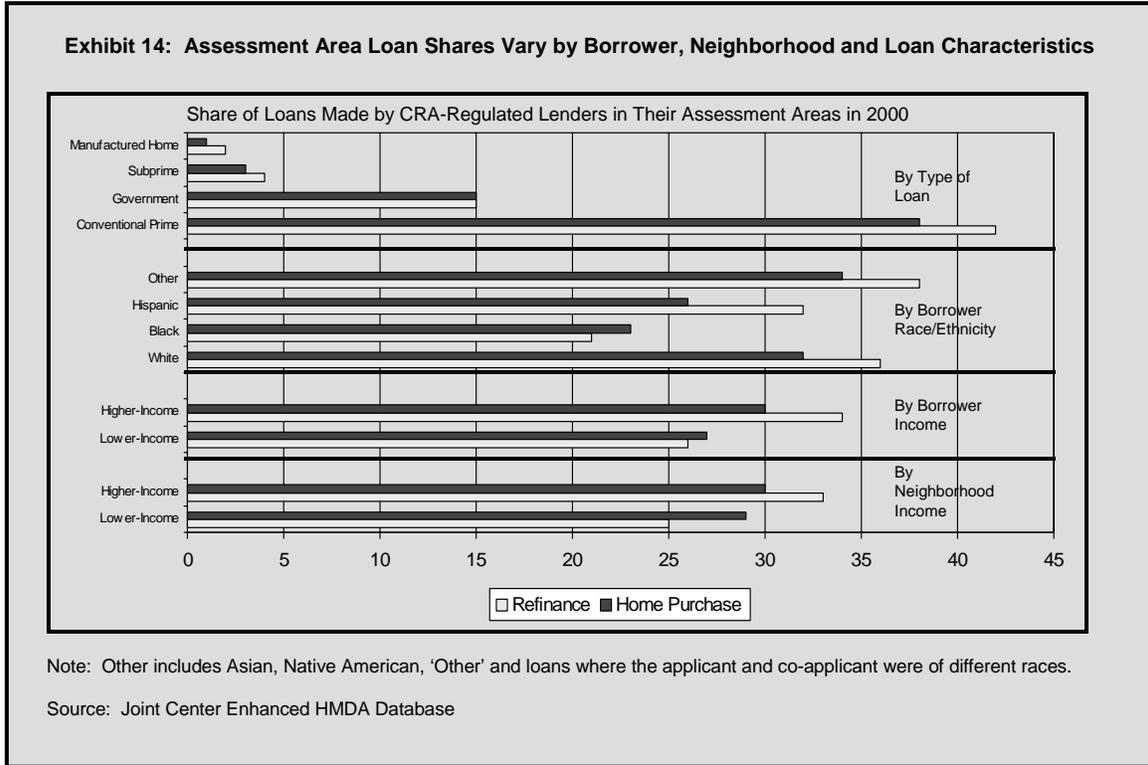
The fact that loans made by CRA-regulated institutions in their designated assessment areas as a percent of all loans (or assessment area share) has declined has several implications. For example, a large and growing share of the mortgage lending industry (independent mortgage companies, finance companies, and credit unions) fall entirely outside of CRA’s regulatory reach. In addition, even among CRA-regulated institutions, the fastest growth has been in out of area lending, or lending that takes place outside of the markets where these organizations maintain deposit-gathering branches, and hence is not subject to the most stringent aspects of the CRA examination process.

Equally noteworthy is the fact that each of these broad types of lending (In Assessment Area by CRA-Regulated Lenders; Out of Assessment Area by CRA-Regulated Lenders; and Non-Covered Lenders) differs in terms of its product mix and market orientation. As a result, the extent of detailed CRA examination of loans varies significantly by loan type, borrower type, and location. For example, in 2000 fully 38 percent of all prime, conventional home purchase loans were made by CRA-regulated depository institutions and affiliates in their assessment areas. In contrast, in the rapidly growing subprime segment, only 3 percent of all loans were made by CRA-regulated entities within their assessment areas (Exhibit 14). In addition, the vast majority of HMDA reported manufactured home lending was not subject to CRA assessment area review.

Significant differences also appear in the home refinancing market, where assessment area lending by CRA-regulated institutions captured 32 percent of all lending in 2000, and 42 percent of all conventional prime lending (indicating that depositories’ branch networks remain advantageous in this market). Even so, the vast majority (96 percent) of all subprime refinance loans are done by independent mortgage companies and out of area lenders, and as a result fall largely outside of CRA’s regulatory reach.



The relative importance of assessment area lending by depository institutions covered by CRA also varies by borrower and neighborhood income. For example, CRA’s regulatory reach is lowest for the nation’s historically disadvantaged minority groups. In 2000, within assessment area lending accounted for only 23 percent of all home purchase loans to black households and 26 percent of all home purchase loans to Hispanic households, as opposed to 32 percent for whites. For home refinancing, assessment area shares for blacks stands at 21 percent. For Hispanics, the home refinancing figure is higher (32 percent), but still trails the share of assessment area lending for whites (36 percent).



Against these general trends stand the rich and varied stories of the rise of individual organizations. The 25 largest home purchase lenders depicted in Exhibit 15 illustrate this substantial diversity. These are the organizations that made 52 percent (1.9 million loans) of all home purchase loans in 2000. With respect to mortgage lending, these organizations share strikingly few similarities.

Among large independent mortgage companies, Countrywide Home Loans operates nationally, largely electronically, and focuses on lending to lower-income first-time homebuyers. In contrast, Candant Mortgage serves customers with slightly higher incomes through a unique marketing approach that yields a mixture of applicants, while Consecro Finance specializes in funding subprime and manufactured home loans for lower-income borrowers. These different business models and plans translate into substantially different specializations. For instance, of independent mortgage companies in Exhibit 15, refinancing’s share of total lending ranges from 6 to 36 percent.

The banking organizations in Exhibit 15 are equally diverse. Overall, the banking organizations in the top 25 originate about a quarter of their loans inside their CRA assessment areas. For refinancings, the share is 33 percent. In contrast, Bank of America, which has a nationwide network of branches, originated over 80 percent of its over 240,000 home purchase and refinance loans in

its CRA assessment areas. At the other end of the spectrum, JP Morgan Chase and Company, which originated nearly as many total loans, did so primarily through its mortgage banking subsidiary in counties where the company did not operate branches. Only 13 percent of Chase's home purchase loans and 10 percent of refinancings took place in the bank's CRA assessment areas.

Exhibit 15: Assessment Area Lending Varies Significantly Among the Top Mortgage Lenders in 2000

Organization Name	Total Home Purchase Loans	Total Home Refinance Loans	Assessment Area Shares		CRA-Eligible Loan Shares	
			Home Purchase	Home Refinance	Home Purchase	Home Refinance
Wells Fargo and Co.	219,623	74,118	19.1%	52.0%	27.8%	30.4%
JP Morgan Chase and Co.	184,102	39,788	12.9%	10.1%	33.4%	39.5%
Countrywide Home Loans	173,531	53,578	0.0%	0.0%	32.7%	45.4%
Bank of America Corp.	152,810	91,053	83.0%	80.6%	40.6%	41.7%
National City Corp.	147,146	42,920	11.7%	17.9%	40.7%	39.9%
Cendant Mortgage	108,775	6,989	0.0%	0.0%	30.6%	32.6%
Washington Mutual Bank FA	91,843	43,680	63.6%	64.6%	24.6%	24.5%
Standard Federal Bank	89,670	41,051	32.8%	32.4%	32.8%	38.0%
Dime Savings Bank of NY FSB	76,579	25,396	4.5%	4.6%	34.6%	35.8%
World Savings Bank FSB	75,927	28,679	71.7%	77.1%	20.2%	25.9%
Citigroup Inc.	72,015	88,671	15.9%	6.6%	49.2%	56.2%
Suntrust Banks Inc.	52,100	13,398	57.0%	48.7%	29.7%	34.9%
GMAC Mortgage	49,650	28,097	0.0%	0.0%	32.3%	33.5%
First Union Corp.	45,862	48,118	64.6%	46.6%	42.5%	46.2%
Greenpoint Financial Corp.	42,217	18,055	1.0%	2.2%	46.1%	25.2%
Old Kent Financial Corp.	41,886	18,094	15.9%	45.2%	39.4%	37.7%
Conseco Finance Servicing Corp.	40,573	15,641	0.0%	0.0%	68.0%	44.9%
CTX Mortgage Co.	39,176	12,376	0.0%	0.0%	39.5%	64.2%
Flagstar Bank FSB	34,036	21,512	18.9%	16.3%	35.7%	43.8%
FleetBoston Financial Corp.	33,798	21,941	33.9%	51.6%	39.0%	33.2%
PNC Financial Services Group	32,918	22,624	38.0%	65.5%	30.4%	25.0%
Ohio Savings Bank	29,633	11,005	14.5%	8.5%	27.7%	30.0%
Bank One Corp.	28,775	102,462	10.0%	19.2%	33.9%	37.6%
California Federal Bank	27,147	9,800	70.4%	71.7%	22.0%	24.4%
Irwin Financial Corp.	25,284	7,051	7.2%	2.8%	50.4%	36.8%
TOTAL FOR TOP LENDERS	1,915,076	886,097	25.7%	32.6%	34.8%	38.9%

Note: Top lenders are the 25 organizations that made at least 25,000 home purchase loans in 2000 based on activity in MSAs included in this study. Lenders are aggregated at the holding company level. CRA-eligible loan shares include loans to borrowers earning less than 80 percent of area median income and/or loans made on properties in census tracts with incomes less than 80 percent of the MSA median as of 1990.

Source: Joint Center Enhanced HMDA Database



The top banking organizations also have significantly different home purchase and refinance lending shares. Chase is again extreme, with 18 percent of loans being for refinance, compared to an average of 67 percent for banking organizations in the top 25. In contrast, Citigroup (55 percent) and Bank One Corporation (78 percent) did well over half of their originations through refinance lending, even in 2000's relatively high interest rate environment.

These comparisons illustrate just some of the distinct blends of mortgage banking and retail banking operations. While physical location – ‘sticks and bricks’ - within a particular community can boost a mortgage lending operation, it is not an essential ingredient. As a result, many mortgage companies have emerged over the past several decades that operate electronically through a network of brokers with limited physical presence in a given market area. IndyMac, a lender that made more than 10,000 loans in 2000, is an interesting example of these trends. Once an independent mortgage company, IndyMac recently purchased a small thrift in the Los Angeles area, and now operates with an organizational structure best described as an ‘inverted’ mortgage company. Such a structure enables IndyMac to tap the secondary market, while also diversifying its funding by raising deposits in Los Angeles, but more importantly in the national capital market through the Internet and other electronic channels.

Also contributing to the growing diversity of mortgage lending operations are subsidiaries of organizations of ‘non-banks,’ including mortgage companies that operate as subsidiaries of large insurance companies and financial services companies. Similarly, included in the top tier of mortgage lenders in the growth regions of the country are the mortgage banking subsidiaries of major home builders and manufactured home producers (Kaufman and Broad Mortgage, NVR Mortgage Finance, Oakwood Acceptance Corp, and the Pulte Mortgage Company).

The growth of large and diverse lending organizations poses regulatory challenges to CRA. In their Advanced Notice of Proposed Rulemaking (ANPR) issued in 2001, federal regulators requested comment on how best to improve the efficacy of the current regulations. One central issue is how best to define ‘assessment area,’ or otherwise determine which loans should be subject to detailed CRA review. At present, assessments are defined in terms of where a CRA-regulated entity maintains deposit-taking operations. These rules reflect the original CRA philosophy that financial institutions had an obligation to meet the mortgage credit needs of those areas where they gather deposits. At the time CRA was enacted, this focus made sense, since locally based depository institutions dominated mortgage lending. Today, the assessment area concept results in an unevenness of application of CRA oversight with detailed CRA review being conducted on virtually all the loans made by some smaller depository institutions operating in a single area, but scant review being applied to the fastest growing segment of home purchase lending, namely those loans made outside of areas where organizations maintain deposit taking operations, and no review of loans made by the independent mortgage companies not covered by the Act from the beginning. As noted earlier, under current rules CRA oversight has declined steadily over time, and varies significantly from one market area to the next.

The diversity of mortgage lending operations, and the decline in the share of all loans that are made by CRA-regulated lenders in CRA assessment areas, have spawned numerous proposals to alter the CRA focus on traditional deposit-taking entities operating from a network of branch locations. Some argue that the current definition of assessment areas makes little sense in a world of electronic banking and national-scale mortgage lending operations (Thomas, 1998). The ANPR stimulated numerous proposals for expanding assessment areas for CRA-regulated institutions to include both markets where regulated entities maintain deposit-gathering operations as

well as all places where they conduct mortgage lending operations. For example, the National Association of Homebuilders (NAHB, 2001) advocated that assessment areas be defined as areas where CRA-regulated entities deliver retail banking services, whether or not that they have physical deposit-gathering branches or ATMs in that locale. In a similar fashion, the National Community Reinvestment Coalition (NCRC, 2001) proposed expanding assessment areas to include those metropolitan areas where a lending institution accounts for at least one-half of one percent of all home purchase and/or refinance loans.

Other proposals call for the extension of CRA to all financial services organizations, including non-depositories. One commonly suggested approach is to extend CRA obligations to independent mortgage companies and consumer finance companies that currently fall entirely out of the regulatory reach of CRA (Campen, 2001). These comments suggest that despite the multi-year Congressional debate on how best to ‘modernize’ the financial services industry, the need to rethink critical aspects of CRA remains, including CRA’s original focus on assessment areas linked to deposit-gathering activities.

B. One Size Doesn’t Fit All

Much of the CRA examination process continues as if the exam is being applied to activity in a single neighborhood or community where a bank or thrift has branch activity. In this context, lending, investment, or service activity can reasonably be compared with the activity of others operating in the same area.

The growth of large and diverse lending organizations poses regulatory challenges to CRA. Despite these differences in the scale of operations, current CRA regulations attempt to apply a relatively simple set of rules to a diverse set of depository institutions. While the distinction between ‘small’ and ‘large’ banking organizations represents a nod toward developing separate rules for organizations of differing scale, the asset threshold (greater than \$250 million) used to define ‘large banks’ lumps together ‘small large banks,’ often making fewer than 1,000 loans in a single assessment area, with national- scale financial institutions making as many as 200,000 home purchase loans in assessment areas scattered across the country.

Faced with the challenge of evaluating entities with many distinct assessment areas, regulators have adopted a number of sampling concepts that select just a subset of areas for ‘full scope review.’ Since selection criteria appear to be weighted toward more densely populated assessment areas, these rules focus limited attention on smaller market areas, including rural areas. Moreover, for lenders with multiple assessment areas, current CRA practices ‘roll up’ individual assessment area scores into an overall average for operations in a given state. As a result, the current system permits an entity to obtain an overall satisfactory rating, even when the organization’s performance in a particular assessment area was rated as ‘needs to improve.’

Proposed modifications include addition of criteria that would mandate ‘full scope reviews’ in rural areas or assessment areas generally deemed to be ‘underserved.’ The National Training and Information Center (NTIC, 2001) called for ‘localized CRA ratings,’ so that CRA-regulated institutions have an incentive to perform consistently well in all locations. Another approach would be to develop a multi-stage sampling procedure that first reviews HMDA and other readily available data to obtain an initial series of indicators of a given institution’s performance in each assessment area, and then to conduct ‘full scope reviews’ in all areas where these initial indicators suggest that the lender’s performance may fall in the low range of satisfactory or below, while continuing to target for review a sample of other areas as well. Whatever method of selection is



developed, other proposals call for specific penalties if a lender fails to obtain a rating of satisfactory or higher in any single assessment area that is reviewed.

C. Service Test

During the GLBA debate, numerous proposals surfaced about how to alter the CRA service test to account for the dramatic shifts in the provision of financial services (Goldberg, 2000). By most accounts the service test component of the exam is the least well developed of the three. Review of the CRA examinations for the banks interviewed for this study suggests that regulators in general spend little time on this element of the exam. In a typical CRA exam report, the service test gets a fraction of the space devoted to the lending test, and focuses largely on the hours of operation and equality of access to branches in lower- as compared to higher-income areas where the bank operates branches, and the pattern of branch openings and closings by neighborhood income, since the previous exam.

Lenders clearly perceive the community development services portion as onerous to document, if not to comply with. For example, lenders are responsible for undertaking the highly subjective task of documenting the charitable activities of their employees as evidence of their service to the community, as well as the somewhat tedious task of describing the location of ATM machines and documenting decisions concerning bank branch closings. Yet beyond possibly constraining their ability to close branches in lower-income markets, the service test appears to have little impact on the provision of financial services to lower-income individuals.

Despite the apparent weakness of the service test, of all the exam's components, retail banking services are arguably the most closely linked to the branch banking mechanism through which CRA obligations are defined and operated. In contrast, mortgage lending is almost entirely decoupled from branch locations as underwriting decisions on the vast majority of loans are made by automated systems that can be and are located just about anywhere, and loan officers situated in many branches are actually correspondents for mortgage companies.

Meanwhile, many people in lower-income areas frequent check cashing businesses, buy money orders at the post office, and get above-market rate used car loans from unscrupulous finance companies. Reacting to this situation, some have suggested that CRA may provide an opportunity to encourage banks to meet the financial service needs of lower-income people and areas, who today are underserved with respect to many other financial services to a greater degree than they are with respect to mortgage lending (Stegman, 2000).

D. Small Business Lending

Prior to the 1995 regulations changes, limited data existed for tracking small business lending. While assessments of banks' mortgage lending benefited from relatively detailed information reported under HMDA, assessment of small business lending was subject to a lower level of scrutiny. Since 1996, small business data reporting and public dissemination requirements for CRA lenders have improved the ability to track and evaluate lending patterns for this component of the exam, though small business data remain less detailed and comprehensive than HMDA filings. In addition, the small business data collected and distributed pursuant to CRA include limited information on business characteristics, failing in particular to report the race and gender of business owners. These factors combine to limit the effectiveness of CRA's oversight of small business lending and limit its impact.

Among the weaknesses of current regulations is the fact that only institutions with assets greater than \$250 million (those subject to the large bank exam) report small business data. A greater proportion of mortgage lenders file HMDA reports because the asset threshold stands at a much lower \$31 million. In addition, HMDA mandates reporting by most non-depository residential mortgage lenders but only depository lenders file small business data. Also unlike HMDA, lenders report only on originated small business loans, not ones that they reject. In addition, the ‘location’ of a small business is ambiguous and could potentially be the owner’s residence, mailing address, or location of management offices or other of the firm’s facilities. This ambiguity may enable potential borrowers to ‘game the system’ by using an address on their loan application that is located in a CRA-eligible area in an effort to improve the chances that their loan is approved.

E. Regulatory Toughness

Focus on the effectiveness of the implementation of the small business lending or the service test portions of the CRA are part of a larger set of issues relating to the uniformity of enforcement of CRA by the four regulatory agencies. The regulatory agencies do coordinate their activities through the Federal Financial Institutions Examination Council (FFIEC), but in practice there is wide variation in how CRA is enforced. In 1995, a General Accounting Office (GAO) study reviewed 40 CRA evaluations and found general evidence of inconsistent grading from one examiner to another (GAO, 1995). Similarly, Thomas (1998) reviewed 1,407 CRA exams and found significant variation both between and within regulatory agencies. Using data from the Thomas study, Zinman found not only that there was clear evidence of differing degrees of ‘regulator toughness’ from one regulator to the next, but also from one geographical region to the next. Moreover, Zinman concluded that this variation in the degree of toughness mattered, in that banks with tougher regulators were more likely to expand provision of small business loans (Zinman, 2001).

Findings such as these continue to fuel the ongoing debate as to how best to implement CRA provisions in the evolving world of financial services. Absent further regulatory reform, many bankers will continue to push for legislative relief arguing that CRA is ‘unfairly’ administered. At the same time, housing advocates will counter by noting that when ‘properly implemented’ CRA does produce clear benefits, and that there is significant room to extend the reach of CRA beyond the world of residential mortgage lending. In short, the debate about how to effectively implement CRA is likely to continue into the foreseeable future.

F. HMDA Data Collection

Closely related to ongoing discussion about CRA enforcement is the discussion about HMDA data collection. The structure of the large bank CRA exam formally makes the lending test as important as the investment and service tests combined. Anecdotal evidence suggests that of the three lending test components, mortgage lending carries the most weight. To the extent that this is true, it is a reflection of the fact that analysis of mortgage lending is supported by HMDA data, which, while imperfect, are more widely accessible, comprehensive, and available over a longer duration, than data for small business or community development lending. It also reflects the large share of all lending in lower-income market sectors that is devoted to housing.

HMDA data have also been the primary empirical tool used to complement street-level activism by community advocates. These groups have used HMDA to evaluate and in some instances lodge protests with regulators about the performance of lenders in their communities. Despite its important role in the struggles of the 1980s and first half of the 1990s, however, HMDA’s usefulness waned as reporting requirements failed to keep pace with the rapid restructuring of the mort-



gage lending industry. Among the key changes are the growth of subprime lending, the increased prominence of manufactured housing as a tenure choice for lower-income people, and the growth of loans by consumer lending organizations.

The area where current HMDA data perhaps lagged the market most was in its failure to collect data that would allow loans to be distinguished as being for manufactured housing or made at terms below the 'A' rate. Current practice by many analysts supplements public HMDA data with a lender 'specialization' list available from HUD that makes it possible to classify loans as being made by an institution that focuses on prime, subprime, or manufactured housing lending. Given the diversity of products offered by large and even relatively small lenders, this constitutes a coarse method of sorting loans. Many subprime lending specialists also make prime loans, just as banks and mortgage lenders may make subprime or manufactured home loans, though the bulk of their business may be in conventional prime lending.

Analysis of lending patterns for manufactured housing is hampered by a lack of information on property characteristics, making it impossible to determine whether a loan by a manufactured housing specialist involved the acquisition of a unit placed on rented land, or the purchase of a manufactured home and associated land. Because the potential financial outcome of the transaction for the typical owner of manufactured housing rests in large part on whether or not they own the land, knowing the property characteristics would allow regulators to differentially assess bank's lending of each type during the exam. Although this information is known to the lender at the time the loan is made, many bankers argue that including this information in HMDA would be prohibitively costly.

Subprime lending raises even thornier issues for regulators attempting to assess an institution's lower-income mortgage lending performance. Currently, regulators can obtain information about the terms and pricing of mortgage contracts that goes beyond what appears in HMDA reports. But review of CRA evaluations suggests that most CRA exams do not take advantage of this potential. As a result, most exams merge all loans to lower-income people and communities together to produce an aggregate lending total. This results, for example, in equal credit being awarded in exams for loans to lower-income people and areas made at the 'A' rate and the 'B' or 'C' rate, or for loans that do and do not reflect practices, such as inclusion of single-premium credit insurance, that are widely considered predatory. Meanwhile, the rise of new players in the home mortgage market, including independent consumer finance companies engaged in mortgage lending, has served to limit the share of all home lending covered by HMDA reporting.

Given the importance of more fully understanding the implications of the rapid expansion of mortgage product offerings, particularly as they relate to lower-income households and communities, in January, 2002 the Federal Reserve issued a Rule to expand the number of non-depository institutions subject to HMDA reporting requirements and to disclose pricing data on higher cost loans and to identify loans on manufactured homes. In particular the new rule extends HMDA coverage to non-depository institutions making more than \$25 million in mortgage loans. Currently, non-depository lenders report for HMDA only if their residential mortgage lending (including home purchase and refinance loans) during the previous year equaled or exceeded ten percent of their total loan originations. In addition, the new rule requires lenders to identify whether the loan is 'high cost' as defined by the Home Ownership and Equity Protection Act and to report the spread between the annual percentage rate (APR) and the yield on the comparable Treasury security when this spread exceeds 3 percent for first-lien loans and exceeds 5 percentage points for subordinate-lien loans. Finally, the new regulation requires lenders to report whether the loan involves a manufactured home.

SUMMARY

Since the 1970s, Congress, as well as the Federal regulators, have worked to ensure that CRA kept pace with dramatic shifts in mortgage lending and the financial services industry. Yet despite the shifting landscape, CRA remains controversial. Having finished work on the Gramm-Leach-Bliley Financial Modernization Act, Congress must continue to work with housing advocates, industry representatives, and regulators to craft some consensus on ‘CRA modernization,’ and how best to address the ongoing needs of lower-income communities for improved access to credit and financial services.

SECTION 3

THE EFFECT OF CRA ON MORTGAGE LENDING: A LITERATURE REVIEW

Despite the twenty-five year history of CRA, only a few studies have attempted to evaluate the impact of the Act on lending and the provision of financial services to lower-income people and areas. Many of these studies faltered because of limited data, while the usefulness of others was constrained by the fact that they were unable to properly control for the many factors - other than CRA - that influence mortgage lending patterns. This section briefly reviews existing research on CRA as well as closely related studies that evaluate changes in the pattern of mortgage lending to minorities and lower-income borrowers.

PREVIOUS STUDIES OF THE IMPACT OF CRA ON RESIDENTIAL MORTGAGE LENDING

Research on CRA-motivated lending faces the daunting challenge of disentangling CRA's effects from the other market and regulatory forces that influence capital flows and the provision of financial services. Most efforts to date have focused on mortgage lending since HMDA data are the most complete and widely available, and because the initial legislation and advocacy were concerned primarily with access to home mortgage credit.¹⁰ Because HMDA data initially lacked borrower information on income and racial characteristics, early studies attempted to assess variations in the supply of mortgage credit across *areas* defined by income and race, to the extent possible controlling for anticipated variations in mortgage demand. Evanoff and Segal (1996) review a handful of studies that modeled these flows at the census tract level (Ahlbrant, 1977; Hutchinson, Ostas and Reed, 1977; Avery and Buynak, 1981; Bradbury, Case and Dunham, 1989; Shlay, 1988; Shlay, 1989; Holmes and Horvitz, 1994; Perle, Lynch, and Horner 1993).¹¹

Most census tract level studies focused on a single metropolitan area. In these studies, the most common dependent variable is the level of mortgage lending, expressed as the number or dollar volume of loans, and in some cases standardized by the number of owner-occupied homes in the tract or metropolitan area to control for variations in the level of mortgage demand. The independent variables focus on economic (median household income), demographic (shares of population or households classified by race, family type, age of household head, and median household size), housing demand/supply (the number of building permits issued, vacancy rates, and the share of owner-occupiers), and mortgage supply (number of branch offices and total amount of deposits) indicators. These studies consistently found that each class of control variables influenced mortgage credit flows, and hence should be included in any models attempting to identify an independent CRA influence on these flows. This research did not produce conclusive results about CRA's impact on credit flows, however, with some studies finding negative disparities in credit flows to areas with lower median incomes and higher minority concentrations, and others indicating that there was insufficient evidence to support such a claim (Evanoff and Segal, 1996).

Beginning with the release of loan-level data on individual mortgage applicants' income and race in 1990, research on lending patterns shifted to studies of mortgage rejection rates, most often by

¹⁰ An exception is Benston and Horsky's (1992) survey of unsuccessful home sellers in central cities of three MSAs. Respondents reported that their inability to sell their homes was not the result of potential buyers being unable to secure financing.

¹¹ Megbolugbe and Cho (1993) conducted a study into mortgage credit flows at the metropolitan level.

race. In the so-called ‘Boston Fed study’ (Munnell *et al.*, 1992; Munnell, *et al.*, 1996), researchers used enhanced HMDA data to assess the extent to which mortgage rejection rates reflected discriminatory lending practices. The Boston Fed’s researchers examined thousands of loan application files from the Boston area and concluded that race did indeed play an important, independent role in causing rejection rates for black applicants to be higher than for white applicants, even after controlling for the risk characteristics of the individual applicant. They argued that the likely mechanism for this effect was somewhat subtle, and grounded in a presumption of credit-worthiness enjoyed by white applicants but not by blacks and Hispanics. The researchers speculated that this discrepancy surfaced in the context of borderline minority loan applicants, whose credit files could in many cases have been repaired if lending officers had informed minority applicants of the corrective action needed as often as they did for whites.

The initial Boston Fed results were subject to heated debate and critique, with some subsequent studies on the same data set purporting to reverse its findings (cf. Horne, 1997) and others upholding the initial result (cf. Carr and Megbolugbe, 1993). Several papers (Phillips and Yezer, 1996; Phillips, Trost, and Yezer, 1994; Rachlis and Yezer, 1993) critique the Boston Fed study at a fundamental methodological level, stating that rejection rate models cannot generate valid results that bear on the presence or absence of discrimination. They state that this is because property value, loan amount, loan-to-value ratio, term, downpayment, and use of cosigners, are endogenous in the sense that they are routinely the object of negotiation among the applicant, realtor, and lender in the process of determining the acceptability of the final mortgage application. Tootel (1996) dug deeper to investigate whether lending patterns in Boston resulted from discriminatory practices based on borrower or neighborhood characteristics (*i.e.*, ‘redlining’). He found that lenders were “reluctant to make loans to minorities wherever they apply, and [the discrimination] is not reflective of a reluctance to extend credit in poor areas that happen to be minority” (1996:1078). Lacker (1995) summarized the debate by noting that: “A skeptic with a strong prior belief in the ability of market forces to restrain unprofitable discrimination could easily remain unconvinced by the Boston Fed Study. On the other hand, critics with a strong prior belief in the prevalence of discrimination will find striking confirmation in the Boston Fed study. Between these extremes lies a range of reasonable assessments.”

From the perspective of CRA-related research, the Boston Fed study’s primary legacy was to spark a debate over the appropriateness of using mortgage rejection models to assess lender behavior with respect to both income and race. The inability to resolve this debate stimulated research on other aspects of lending such as the behavior of lenders and the flow of credit into lower-income areas and to lower-income people. As noted in the Joint Center’s previous study on CRA (completed in cooperation with The Brookings Institution for the U.S. Treasury Department), recent CRA-related research has generally steered clear of comparisons of rejection rates and instead attempted to detect a CRA influence on credit flows - particularly on flows of mortgage credit - by either: 1) comparing lending patterns for CRA-regulated and un-regulated lenders; 2) examining the performance of consolidating institutions; or 3) assessing the impact of CRA agreements (Belsky *et al.*, 2001).

A. Comparing Portfolio/Market Shares of CRA-Covered Lenders with Others

The logic behind attempts to detect the influence of CRA by examining mortgage lending patterns is that if CRA is having an effect on the practices of covered lenders, CRA-eligible mortgage lending performance by these institutions should exceed that by non-covered lenders, assuming that it is possible to control for other factors influencing lending to lower-income areas and borrowers, and for product mix. Because of the methodological challenges of operationaliz-

ing appropriate controls, studies have generally drawn tentative conclusions about the impact of CRA, without controlling for all relevant factors.

Evanoff and Segal (1996) obtained mixed results when they conducted this comparison with mortgage lending data over the 1990-95 period. They found CRA-eligible loans were an increasing share of originations made by CRA-covered institutions and their affiliates in the first half of the 1990s. The authors also found that CRA-regulated institutions and their affiliates had much greater shares of their originations in CRA loans in the 1990s compared with the 1980s. The authors did not control, however, for the fact that during the 1990s banks and thrifts were required to report on the activities of affiliates even in areas where they did not have branch offices, whereas they did not have to report on these activities during the 1980s. Additionally, Evanoff and Segal found that white-black differences in denial rates and applications narrowed both for lenders covered and not covered by CRA, suggesting that forces beyond CRA were influencing mortgage credit flows over the period.

In a more recent study, Gunther and his colleagues (1999) examined CRA-covered and non-covered lenders' loans for the purchase of one-to-four family homes. They found that financial institutions not covered by CRA increased their portfolio share of lower-income neighborhood originations from 11 percent in 1993 to 14 percent in 1997. Meanwhile, CRA lenders' portfolio share of such loans opened and closed the period at about 11.5 percent. Gunther and colleagues also compared loans to lower-income borrowers across the two lender types, finding that non-CRA lenders' portfolio share of loans to these borrowers rose from 25 percent in 1993 to 32 percent in 1997, while CRA lenders' portfolio share fell from 26 to 25 percent. The authors use these findings to argue that deregulation and technological advances in the financial services industry were more likely than CRA to have been responsible for the increased access to credit that lower-income borrowers and neighborhoods now enjoy (Gunther *et al.*, 1999). This argument was challenged by Immergluck (1999), however, who raised a number of methodological objections that undermine several of the study's findings.

B. Mortgage Performance of Institutions Active in Mergers and Acquisitions

Another way to assess the impact of CRA is to analyze the mortgage activity of institutions that have been especially active in acquisitions and mergers. The theory behind such analyses is that since regulators review a financial institution's record under CRA in evaluating merger and acquisition applications, consolidating institutions should be especially attentive to CRA-eligible activities in order to smooth the way for regulatory approval.

Avery and his colleagues (1999) found that the proportion of CRA home purchase originations by consolidating organizations and their affiliates typically increased in the counties in which they had branch offices. Moreover, CRA-eligible loans as a share of total home purchase originations increased more among consolidating banking organizations than among organizations that did not engage in merger activity in the same counties. The authors also found, however, that consolidating banking organizations lost market share over the period to independent mortgage and finance companies and credit unions. In balancing the study's empirical results, the authors summarize their findings as consistent "with the view that CRA has been effective in encouraging bank organizations, particularly those involved in consolidation, to serve LMI and minority borrowers and neighborhoods."

C. Impacts of CRA Agreements

A third way to detect the impact of CRA is to compare mortgage lending in areas covered by CRA agreements with those that are not, and to compare lending by lenders that have signed CRA agreements with those that have not. Shlay (1999) examined lending data for six metropolitan areas, testing the hypothesis that metropolitan areas where CRA organizing activity is highest should have better records of lending to underserved areas and borrowers. She found that lending increased to low-income and minority borrowers and neighborhoods in all cities examined, suggesting that the extent of CRA organizing in a particular city is not necessarily predictive of the increases in lending to underserved markets. Though not supported by the data in her study, she notes that ‘regulation from below,’ in the form of CRA-organizing, may have created the impetus for strengthened CRA enforcement at the federal level that was felt across all markets, and feels that the combined efforts of community reinvestment groups and federal regulators were partially responsible for the increases in lending to lower-income and minority borrowers and neighborhoods in the 1990s.

Schwartz (1998) also looked at the effect of CRA agreements on lender behavior. He compared mortgage and home improvement lending in 1994 by banks with and without CRA agreements. His results indicated that the presence of an agreement appeared to make a positive impact on bank lending to low-income and minority households and neighborhoods, with the most dramatic difference being on lending to black households. Schwartz also found that those institutions with agreements had higher approval rates for low-income and minority borrowers than institutions that had not entered into such agreements. He did not look, however, at lending behavior before and after signing agreements, and he did not control for other factors that may have generated the patterns he observed. For example, it is possible that the decision to sign an agreement is endogenous – that is, lenders with a greater capacity or willingness to meet CRA obligations sign agreements, in effect taking credit for actions they would have undertaken anyway.

A recent paper by Bostic (2001) looks for an effect of signing an agreement on overall lending in the counties in which the participating lender operates branches. Using a specially constructed panel of counties that includes information on CRA agreements provided by the National Community Reinvestment Coalition, Bostic finds that the number of newly-initiated CRA agreements in a county is significantly associated with 3-year changes in conventional mortgage lending, particularly in lending to lower-income and minority borrowers, and to lower-income neighborhoods. He also found, however, that these effects do not persist over time, waning almost completely after 3 years. Bostic concludes that the effectiveness of CRA agreements in increasing lending activity is ultimately determined by the persistence and sophistication of community groups in monitoring compliance with CRA agreements.

Taken together, the results of existing studies are mixed, largely because each has methodological limitations that limit their broad generalization. Nevertheless, the studies consistently find suggestions of a CRA effect, but one that their authors cannot definitively document, meaning that the debate on CRA’s usefulness continues to simmer. The next section examines critiques of the Act, largely built around theoretical as opposed to empirical arguments, that constitute the case for eliminating CRA.

THE IMPACT OF CRA ON ACCESS TO FINANCIAL SERVICES AND SMALL BUSINESS LENDING

Although CRA relates to the provision of a wide range of financial services and mortgage credit to lower-income communities, most of the empirical work done to date focuses on residential mortgage lending. In part this reflects the fact that until recently, the data available (HMDA) also focused on residential lending, as did much of the legislative debate concerning proposed modifications to CRA. In recent years, this focus has shifted. Using newly-available CRA small business data, there is an emerging body of empirical literature on the impact of CRA on small business lending. In addition, the growing policy debate about how best to expand access to financial services by lower-income people has spurred additional research on CRA's impact on the provision of banking services. This section briefly reviews some of the recent literature in each of these areas.

A. CRA and the Provision of Financial Services

As noted earlier, CRA-regulated entities are evaluated in terms of the extent to which they provide financial services to lower-income neighborhoods. Yet in light of the historical focus on residential mortgage lending, the service test appears to receive little attention in the CRA exam process. Recent research by Stegman and colleagues (2001) based on an analysis of nearly 2,000 CRA exams conducted between 1996 and 2001, concludes that the service test provides only minimal incentives for lenders to extend financial services to currently 'unbanked' individuals or others in need of less costly banking services. Specifically, Stegman and colleagues (2001) argue that regulations do not encourage banks to provide banking products and services such as low-cost checking, check cashing programs, savings clubs, and individual development accounts that would benefit lower-income clients. Further, they note that there is no quality control related to community development services. The effect of programs for which banks do receive credit, such as financial literacy training and homeownership counseling, are therefore not only highly variable, but have unknown impacts on the ability of lower-income people to manage their finances and prepare for homeownership. One of the more spectacular findings of Stegman and colleagues' research is the revelation that over the last five years only eleven banks have received ratings below satisfactory on the service test.¹²

Adding weight to their discussions of gaps in the community development and retail banking components of the service test, Stegman and his colleagues modeled the relationship between scores on the service, investment, and lending test components of the CRA exam. They found lenders' scores in one area were good predictors of their scores in other areas, with one exception. When lenders achieved so few points from the lending and investment test that they were in danger of achieving an overall grade below satisfactory, their service test scores were unusually high. This discrepancy was often just sufficient to get the lender's aggregate score to the 'satisfactory' threshold.

Overall, the research conducted for this report and the recent research by Stegman and colleagues (2001) casts suspicion on the usefulness of the service test as it is currently implemented as a tool for ensuring access to and delivery of financial services for lower-income people and areas. CRA's branch-based focus, derived from its initial intention to counteract mortgage credit redlining at a time when mortgage lending largely took place through small branch-oriented commercial banks and thrifts, is largely unrelated to several of the requirements of the Act in its current

¹² It is worth noting that one line of argument suggests that this is cause not for concern, but for celebration. If lenders do take CRA seriously and make good faith efforts in their service activities, there should be relatively few failures.

version, particularly to mortgage lending. Yet, the one area - retail banking services - where this linkage still holds most directly and where there appears to be an opportunity to aid lower-income people, seems to subject lenders to the weakest level of oversight of the three CRA exam components.

B. CRA and Small Business Lending

The 1995 CRA regulations mandated reporting on small business lending on the part of CRA-regulated lenders, and spurred new interest in the impact of CRA on small business lending. Immergluck and Smith (2001), noting the discrepancy in the growth rate of small business lending between higher- and lower-income areas, suggest that CRA is not forcing banks to take as active an interest in the small business market in lower-income areas as they do in mortgage lending in these areas. They find that fewer loans per firm are made in lower- than in higher-income areas and that this disparity worsened over the late 1990s. This observation is consistent with exam guidelines instructing regulators to focus on the revenues of the business applying for the loan and the size of the loan itself, rather than on the characteristics of the neighborhood in which CRA-eligible small business lending takes place. Immergluck and Smith also cite evidence (Cavalluzo *et al.*, 1999) that minority-owned small businesses, particularly those owned by blacks, are denied loans at higher rates than whites, even after controlling for a variety of firm characteristics, including credit history.

Zinman (2001), in contrast, posits that CRA is having a more significant effect on small business lending outcomes, especially when care is taken to control for the differential ‘toughness’ across regions and across regulators of CRA enforcement. In particular, Zinman presents econometric evidence that CRA does work to expand small business lending by regulated entities by twelve to fifteen percent. Furthermore, Zinman argues that the observed changes in small business lending appear to generate real benefits to communities in the form of expanded payrolls and reduced incidence of business bankruptcy, without undermining bank profitability. While these results imply that CRA serves to improve the efficiency of small business lending, Zinman is not able to identify the specific mechanism that generates these results, nor to match the results to a specific theory of market failure that CRA may work to eliminate.

CRITIQUES OF THE CONTINUING NEED FOR CRA OVERSIGHT

As noted in the U.S. Treasury CRA Report (Belsky *et al.*, 2001), there are three broad arguments challenging the continuing need for CRA oversight of banking organizations. The first claims that current credit markets are too competitive to allow discrimination to flourish and choke off credit to lower-income minority communities (Hylton and Rougeau, 1996). The second argues that CRA is an improper remedy for discriminatory practices directed toward specific borrowers and areas and is not the most efficient method for achieving its intended goals (Bentson 1999; Gruben *et al.*, 1990; Lacker, 1995). The third contends that whatever past market failures may have existed in credit markets, they have since been corrected (Gunther *et al.*, 1999).

A. Discrimination in Mortgage Lending

The first challenge to the continuing need for government intervention in mortgage markets rests on the claim that these markets are too competitive to permit market failures based on prejudice (so-called ‘taste-based’ discrimination). According to this argument, lenders who deny access to credit-worthy borrowers because of their race or ethnic background (and hence to lower-income borrowers and areas because of the correlation between income and race) will lose out to others

whose business practices are not based on prejudice, because the latter will be more profitable by exploiting the market opportunities that discriminators create. This line of argument states that given sufficiently competitive markets, discrimination cannot materially alter credit flows to lower-income areas (Hylton and Rougeau, 1996).

Discrimination in mortgage markets may also be ‘statistical.’ Statistical discrimination occurs when a lender finds it cheaper to use the characteristics of an applicant’s group to estimate his/her creditworthiness rather than the applicant’s own credit background (Ladd, 1998). As noted in the Boston Fed study, at least some of the observed differences between the treatment afforded white and minority applicants was the fact that loan officers appeared more ready to provide assistance to white applicants than minority applicants (Munnell *et al.*, 1996; 1992). One possible reason suggested was that the loan officer may have concluded that there was a greater likelihood that a negative credit report was more likely to be in error or otherwise more easily resolved in the case of a white applicant, and hence may have felt that it would be more time consuming and costly to work on ‘credit repair’ with minority applicants. Unlike taste-based discrimination, statistical discrimination is not inconsistent with profit-maximizing behavior by individual lenders.

Although the attempt to create ‘race blind’ electronic underwriting systems may work to reduce discriminatory mortgage lending, the growing use of these tools does not entirely eliminate the potential for discrimination in mortgage lending. For example, many loans continue to be manually underwritten and involve face-to-face contact between the loan officer and potential borrower. Even a share of those loans processed initially with automated electronic underwriting systems are ‘referred’ back to the lender for manual underwriting. Again, the potential exists to deny ‘referred loans,’ not on the basis of objective criteria, but as a result of some form of statistical or taste-based discrimination. In any event, engaging in the practice of differentiating among applicants on the basis of their membership in a racial or ethnic group is illegal. In essence, the law requires that lenders make decisions about mortgage loans as if they had no information about the applicant’s race, regardless of whether race is or is not a good proxy for risk factors not easily observed by the lender (Ladd, 1998).

Though in theory it is possible to test for the presence of both statistical and taste-based discrimination, it is difficult in practice. In one of the few studies to empirically assess the issue, Tootell (1996) essentially rules out the possibility that statistical discrimination was likely to have been the cause of the differing denial rate patterns by race that he observed in data for Boston. In general, studies relating to these issues (cf. Board of Governors of the Federal Reserve System, 1993; Canner and Passmore, 1995; Canner and Passmore, 1997) have not been conclusive (Lacour-Little, 1999). Reviews of the most recent literature and audit studies conclude, however, that whatever motivates market participants, market forces have not yet been sufficient to eradicate mortgage lending discrimination (Yinger, 1998; Urban Institute, 1999). Moreover, these academic findings are too often supported in the statistical evidence presented in court cases that document that despite substantial progress, various forms of discriminatory practices still persist in mortgage and housing markets.¹³

B. CRA as a Remedy

A second argument made against CRA asserts that even if some lenders are improperly discriminating, the proper solution is to apply and enforce existing laws prohibiting this sort of behavior.

¹³ For a collection of essays on the current state of Fair Housing and Fair Lending see *Cityscape*, 1999, “Commemorating the 30th Anniversary of the Fair Housing Act”.

Bentson (1999) has argued that the laws prohibiting both taste-based and statistical discrimination, and their enforcement by the banking regulators and the Department of Justice, are sufficient to address whatever discrimination may be occurring. Moreover, he notes that, based on the disposition of lending discrimination complaints, there is little evidence of widespread discrimination. For example, of the more than 2,000 Fair Lending complaints received by the Department of Housing and Urban Department under the Fair Housing Act and other civil rights laws from 1989 through 1995, in only one percent of the cases (23 cases) did HUD find lenders guilty, and HUD referred only nine to the Justice Department for prosecution. Benston does not, however, address the possibility that victims of statistical discrimination would be unlikely to know of their predicament, or that some victims may believe that the authorities would be unable to help them even if they did register a complaint. Relatively low numbers of prosecutions from Fair Lending complaints cannot, therefore, provide conclusive evidence of the presence or absence of discrimination.

In another critique of CRA as a remedy, Lacker (1995) claims that CRA is actually a means for redistributing wealth, but is an inefficient vehicle for doing so. He argues that providing direct subsidies for loans to lower-income borrowers through specialized financial institutions rather than through banks would be a more efficient way to deliver subsidies to lower-income borrowers and areas.¹⁴ This argument rests on the premise that CRA is intentionally redistributive. Yet, competing justifications for the Act state that, rather, CRA is a mechanism for addressing informational externalities and entry delay by lenders that serve to diminish credit flows in lower-income markets. From this perspective, CRA is a method for enforcing an enhanced degree of market efficiency (rather than a redistributive policy). In short, the persuasiveness of arguments against CRA as an inefficient redistributive policy or tax rest on a conception of the Act that is not clear in the initial legislation and subject to dispute among current observers. As such, these arguments provide useful insight but, like others, cannot offer conclusive statements about the need for CRA.

C. Market Forces

A final criticism states that changes in the mortgage lending industry since the 1970s have obviated the need for CRA. Gunther and his colleagues (1999) contend that competition for lower-income lending has increased as federal restrictions on the geographic scope of banks' activities have been relaxed, and as mortgage companies have increasingly met the needs of CRA-eligible borrowers, even as depositories' role in mortgage lending wanes. A complementary argument states that advances in information technology make it easy for out of market lenders to assess borrower creditworthiness and property values in distant areas, leading to greater competition everywhere. These arguments in turn imply that the positive effects of increased competition and lower information costs have reduced or eliminated the coordination problems in lower-income markets that CRA was in part intended to address. In fact, the factors cited by Gunther and his colleagues indeed have helped reduce market failures. It does not necessarily follow, however, that imperfections have been eliminated, that with changes in the marketplace such failures could not recur in the absence of CRA, or that lending patterns evidenced during the economic boom of the 1990s will persist in a less robust economic climate. Consequently, the impact of advances in information technology on the continuing need for CRA remains unresolved.

Lacker (1995) takes issue with the idea that market failures exist at all. He observes that while recent technological advancements may or may not have improved market information, no one

¹⁴ Similar claims that CRA is effectively a tax on financial institutions also imply that it is better to pursue redistributive goals with direct subsidies.



has ever provided proof that information-based market failure occurred in the first place. In particular, he notes that to the extent that information problems existed in the past, they would have affected lending in both affluent and lower-income areas. This argument dismisses CRA's (and HMDA's) widely accepted role in increasing market information and enhancing transparency of market activities. Yet, CRA's beneficial impact via market information and transparency, independent of any specific benefits for lower-income borrowers or lower-income communities, is one of the few aspects of the Act that faces few theoretical or empirical challenges in the research and policy community.

SUMMARY

The strong economy of the 1990s, along with the dramatic restructuring of the mortgage industry, have had profound effects on the pattern of mortgage lending, particularly the rapid growth of lending to lower-income and minority borrowers. In the face of these important trends, assessments of CRA face the difficult prospect of isolating CRA's influence on mortgage lending patterns. Debate continues over whether CRA actually works to overcome the failures of market participants to appropriately seek out and fund profitable lending opportunities, or simply reflects a government-mandated income transfer program that pressures lenders into uneconomic lending so as to avoid regulatory sanctions or adverse publicity. Some scholars question the need for CRA at all, particularly in its current mortgage-focused incarnation. While the existing literature broadly supports the view that CRA legislation has expanded the flow of mortgage capital into lower-income areas and extended homebuying opportunities for minority families, it is hardly definitive. In an effort to better understand the effect of CRA on mortgage lending, the report next presents a series of benchmark assessments, or comparisons of trends in the lending patterns of CRA-regulated organizations with those of an alternative (or benchmark) group of lending organizations not subject to CRA regulations.



SECTION 4

THE IMPACT OF CRA ON MORTGAGE LENDING: A BENCHMARKING ASSESSMENT

As previous CRA studies have suggested, one way to understand the effect of CRA on residential mortgage lending is to compare the performance of CRA-regulated organizations and their affiliates to organizations not subject to the Act, including independent mortgage companies and credit unions. These 'non-CRA covered' lenders together accounted for about one-third of all lending to lower-income people and/or lower-income communities over the study period. Using these lenders as a comparison group, or a benchmark against which to examine the behavior of regulated entities loosely controls for a variety of factors that might also explain the expansion in overall CRA lending during the 1990s. Since both groups were influenced by general market-place factors but only regulated institutions would have been influenced by CRA, the comparison has the potential to highlight the Act's independent impact on lending patterns.

Unfortunately, both conceptual and data issues make simple comparison between CRA-regulated lenders and other lenders difficult to develop and interpret. Before turning to the benchmark analysis, this section discusses these conceptual issues. It then describes the Joint Center's Enhanced HMDA Database that merges information on mortgage loan and borrower characteristics with data on the organization making the loan and the census tract and metropolitan area characteristics of the neighborhood where the loan was made. The benchmarking analysis points to the importance of employing such detailed data in any assessment of CRA's role in expanding credit access for lower-income and minority borrowers. At the same time, the benchmarking approach suggests that by controlling for loan product mix, it is possible to measure the extent to which CRA-regulated entities lead the market in the provision of mortgage capital to lower-income people and neighborhoods, particularly as it relates to prime lending and outreach to lower-income and minority borrowers.

THE DIFFICULTY OF THE BENCHMARKING APPROACH

Any effort to isolate the impact of CRA on mortgage lending to lower-income people and communities must account for the significant changes in the structure of the mortgage industry over time. As noted throughout this report, CRA was designed at a time when depository institutions dominated mortgage lending activities. In that era, deposits were the single most important source of mortgage capital and prime lenders (as opposed to subprime or manufactured housing lenders) conducted virtually all home purchase and refinance lending. The growth of independent mortgage companies, the rise of secondary market funding, and the advent of a whole new array of mortgage products (some of which are originated electronically) have dramatically changed the mortgage landscape. So have the rise of 'non-bank' financial services industry players, including insurance companies, investment houses and others, who have extended their business lines to include traditional banking and mortgage lending activities. Moreover, detailed HMDA data on the characteristics of loans and lenders were not available until 1993. As a result, for most of CRA's history, it was impossible to conduct any detailed comparisons of the lending patterns of CRA-regulated entities and others operating in market.

Several observations flow from these comments. The first relates to the dramatic rise in subprime and manufactured home lending, and to the equally significant differences in loan product mix between CRA lenders and their affiliates, and non-covered institutions. Because independent mortgage companies accounted for most of the growth in subprime and manufactured home lend-



ing, comparisons of the level of growth of lower-income lending between CRA-regulated entities and others should carefully control for the differing product mix. Said another way, absent a careful accounting for the differing mix of loans made by regulated and non-regulated lenders, comparisons of CRA-eligible lending by each group will not be ‘apples to apples,’ and in fact will count subprime and manufactured home loans (with their generally higher interest rates and fees) as the same as conventional prime loans.

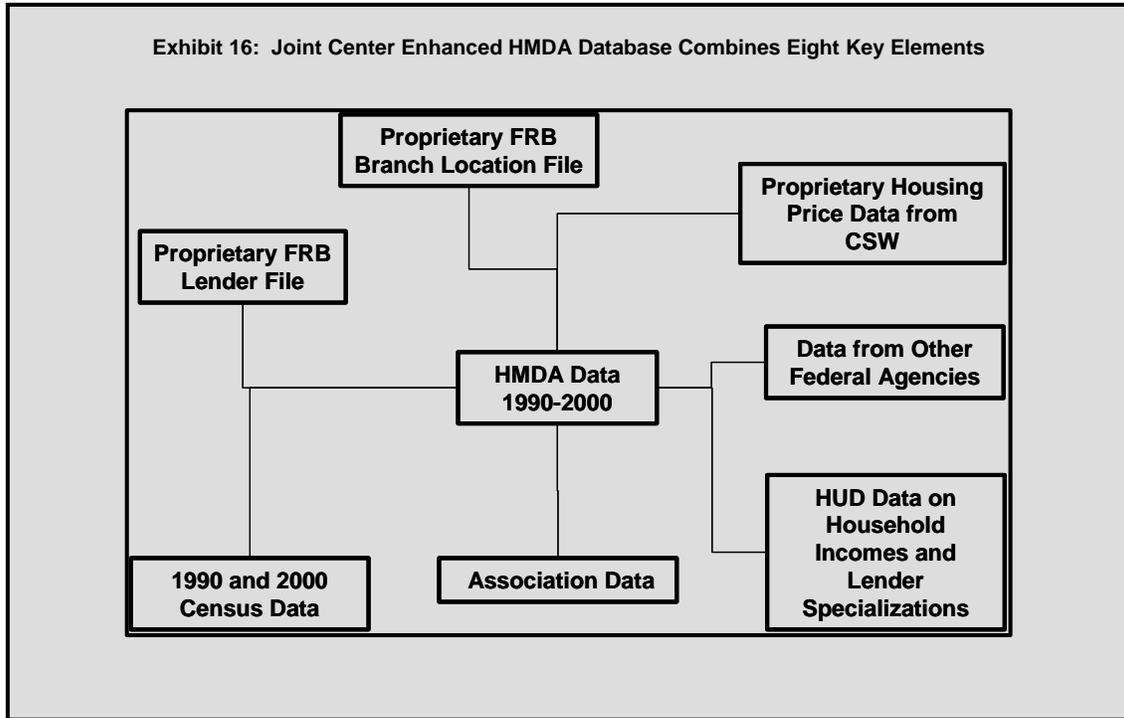
The second observation relates to the rise of out of assessment area lending by mortgage company affiliates or subsidiaries of CRA-regulated institutions. By the 1990s most of the larger, CRA-regulated entities formed and/or acquired mortgage banking subsidiaries or affiliates capable of operating outside of their CRA-designated assessment areas (defined here as the county, or counties, where a CRA-regulated entity operated *deposit-taking* branches). Today less than half of all mortgage lending by banking organizations (and less than a third of mortgage loans made by any entity) occurs within the assessment area of a CRA-regulated entity. This issue is important because bank and thrift regulators examine all lending as part of their safety and soundness and Fair Lending oversight, but only assessment area loans are subject to the further, detailed review mandated by CRA. In assessing the impact of CRA on residential mortgage lending it is therefore important to identify three different sets of loans: loans made by CRA-regulated entities within their CRA assessment area (‘Assessment Area Lending’), loans made by CRA-regulated entities outside of their CRA assessment areas (‘Out of Area Lending’), and loans made by entities not regulated by CRA (‘Non-CRA Regulated Lending’).

Next, it is important to understand that some of CRA’s impact on mortgage lending may have occurred prior to 1993, the date when detailed HMDA data are first available. Moreover, legislative and regulatory changes, along with equally important increases in the enforcement of Fair Lending legislation, combined in the 1980s to increase the incentives of CRA-regulated entities to seek out ways to serve lower-income and minority communities. As a result, the gains achieved in the 1980s as CRA-regulated entities searched out ‘new market’ opportunities may have carried over to the current period to the benefit of CRA-regulated entities and other market participants alike, and contributed to the surge in lower-income lending that occurred in the 1993 to 2000 period.

Whether CRA (along with expanded Fair Housing enforcement) worked to overcome barriers relating to discrimination and/or information barriers linked to lower-income borrowers or communities may be less important than its role in promoting the explosion of borrower and loan performance information that has occurred over the past quarter century. Although some of the most detailed information about borrowers and loan performance remains proprietary, much has seeped into the general marketplace to the benefit of all market participants. This represents a marked contrast to the paucity of borrower and loan performance information that was available when CRA was enacted in 1977. In short, beyond any direct effect CRA may have had on the lending of CRA-regulated entities, it is likely also to have had an indirect impact on the lending patterns of non-covered lenders, as ‘lessons learned’ by CRA-regulated entities were absorbed by other market participants.

THE DATA FOUNDATION FOR THE ANALYSES

The database used in the analyses in this report combines data from eight sources. This section briefly describes this database (Exhibit 16), which is built around loan application level information released pursuant to the Home Mortgage Disclosure Act.



A. Home Mortgage Disclosure Act Data

The core database used to complete the statistical tests and to support important parts of the analysis in other sections of this report builds on information submitted by financial institutions under HMDA. As currently amended, HMDA requires most mortgage lenders to report for all loan applications the race and income of the applicant, the state, county, and census tract of the property included in the application, the type of loan applied for and the disposition of the application.

Exhibit 17 describes in greater detail the creation of the loan-level data used in this study. For the period 1993 to 2000, approximately 120 million records of loan applications and transactions are included in the HMDA data. HMDA data include information on both ‘originated loans,’ and ‘purchased loans,’ where ‘purchased loans’ are loans that are originated by one entity and sold to another HMDA reporting institution, either to hold in portfolio or to sell again into the secondary market. To avoid double-counting of any particular loan, all ‘purchased loans’ are eliminated from the sample, a step that reduces the initial count of HMDA data records by half.

The analysis also looks only at the 734 metropolitan area counties for which HMDA filers have been required to report in all years between 1993-2000. This geographic focus eliminates 20 percent of the remaining records, which are either in non-metropolitan counties, or in counties that were added to or dropped from the list of metropolitan counties during the study period. This geographic standardization is enforced to ensure that the additional data do not confound interpretation of trends in either the benchmarking or multivariate statistical analyses.

Note also that this study focuses on only HMDA reported loans originated to purchase or refinance a one-to-four family home. As a result, the study does not cover multi-family and other loans contained in the initial HMDA database. Exhibit 17 also indicates several other filters used to eliminate incomplete or inconsistent loan records from the final database. These incremental

filters bring the final count of HMDA records used to 24.4 million home purchase records and 20.8 million refinancing records.

Exhibit 17: Filtering of Raw HMDA Data Creates Usable Records

	1993	1994	1995	1996	1997	1998	1999	2000	All Years
Home Purchase Records (Millions)									
All HMDA Records	5.3	6.1	6.4	7.5	8.0	9.5	10.1	9.9	62.9
Filter for Originated Loans Only	3.2	3.5	3.5	3.8	4.0	4.5	4.8	4.8	32.2
Added Filter for Valid MSA Locations	2.6	2.8	2.7	3.1	3.2	3.7	4.0	3.9	26.1
Added Filter for Valid Tract Data	2.5	2.7	2.7	3.1	3.2	3.7	4.0	3.9	25.9
Added Filter for Valid Borrower Income	2.5	2.7	2.6	3.0	3.1	3.6	3.9	3.8	25.3
Added Filter for Valid Loan Amount	2.4	2.6	2.6	2.9	3.1	3.6	3.8	3.7	24.8
Added Filter for Valid Lender Assets	2.4	2.6	2.5	2.9	3.0	3.5	3.7	3.7	24.4
Refinancing Records (Millions)									
All HMDA Records	8.6	4.3	3.0	5.1	6.1	13.0	10.7	7.2	58.1
Filter for Originated Loans Only	6.1	2.5	1.6	2.6	2.8	6.7	4.4	2.4	29.1
Added Filter for Valid MSA Locations	5.2	2.0	1.3	2.1	2.2	5.6	3.5	1.9	23.8
Added Filter for Valid Tract Data	5.1	2.0	1.2	2.1	2.2	5.5	3.5	1.9	23.6
Added Filter for Valid Borrower Income	4.6	1.8	1.2	1.9	2.1	4.9	3.2	1.8	21.5
Added Filter for Valid Loan Amount	4.5	1.7	1.1	1.8	2.0	4.8	3.1	1.7	20.8
Added Filter for Valid Lender Assets	4.5	1.7	1.1	1.8	2.0	4.7	3.1	1.7	20.5

Source: Joint Center Enhanced HMDA Database

B. Federal Reserve Board Lender and Branch Location Files

The Federal Reserve Board (FRB) maintains two research databases that were also used in this study. The FRB lender file contains information that facilitates sorting lenders based on whether or not they are subject to CRA. It also allows individual HMDA filers to be aggregated based on common ownership. Finally, the FRB lender file contains information on the assets of HMDA reporters, which is necessary to establish a consistent minimum size limit for reporters because the asset threshold for HMDA reporting changed several times during the study period.

The FRB branch location data are also the source of our assessment area definitions. This report assumes that CRA-regulated lenders' performance is assessed in (and throughout) all counties in which the lender operates a deposit-taking branch office, hence defining a lender's assessment area as being all counties in which it has deposit-taking branches. While this may differ from lenders' actual assessment areas, which are in some cases comprised of portions of counties, counties are generally the level at which assessment areas are defined by lenders and regulators, and using county-based assessment area definitions produces a reasonable approximation of actual assessment areas (Avery *et al.*, 1999).



C. HUD Data on MSA Median Household Incomes and Lender Specializations

This report classifies loans by both the income of the loan applicant and the income of the census tract where the property is located, relative to the overall median income for the Metropolitan Statistical Area or MSA. The Department of Housing and Urban Development prepares annual estimates of MSA median household income, which were appended to the HMDA records used in this analysis. In addition, HUD prepares an annual listing of particular HMDA reporters that specialize in subprime or manufactured home lending. The HUD lender specializations were also appended to the core HMDA records in the database.

D. Data on Census Tract and Metropolitan Area Characteristics

The statistical analysis in this report exploited certain data from the 1990 Census (such as the age of the housing stock) as control variables, and combined 1990 and 2000 Census data on census tract population to produce growth indicators for each of the 45,000 census tracts included in the analyses. The report also used data from other federal agencies, including the Bureau of Labor Statistics. These included, for example, metropolitan area unemployment rates, that were linked to the database and used to define control variables for the statistical analysis.

E. House Price and Affordability Price Data

Case Schiller Weiss, Inc. (CSW) maintains zip code level housing price indices for major metropolitan areas. CSW provided zip code level house price changes for Los Angeles, Chicago, and Boston. Since zip codes typically include two or more census tracts, the assumption made in this study was that house price changes are the same for each census tract in a zip code. In addition, the report also utilized the National Association of Home Builder (NAHB) estimates of the share of homes that are affordable to a median income household in each MSA.

F. National Community Reinvestment Coalition CRA Agreement Database

Finally, the National Community Reinvestment Coalition (NCRC) provided data on the year, amount and location of CRA agreements between community groups and lenders. These data were joined to the database at the MSA level.

BENCHMARK COMPARISONS

This section lays out a series of benchmark comparisons intended to understand the effect of CRA on regulated lenders by comparing their home purchase lending record against that of non-CRA covered lenders. Since both groups were influenced by the same changes in the marketplace but non-CRA covered lenders (independent mortgage companies and credit unions) were not subject to CRA regulations, the comparison has the potential to highlight the independent effects of CRA on lending patterns. Using the Joint Center's Enhanced HMDA database to carefully control for loan product mix, this analysis demonstrates how CRA-regulated entities continue to lead the market in the provision of prime conventional conforming residential mortgage loans to lower-income people and neighborhoods, particularly in terms of their greater outreach to African-American and Hispanic borrowers.

Exhibit 18 presents information on the CRA-eligible share of prime lending, where 'CRA-eligible' refers to loans made to lower-income households and/or to households living in lower-income areas. The exhibit makes two important points. First, in 1993 among CRA-regulated

lenders operating in their assessment areas the share of all prime home purchase lending made to CRA-eligible borrowers exceeded the equivalent share for ‘out of area lenders’ and non-covered entities (including independent mortgage companies). In that year, CRA-regulated entities operating in their assessment areas made 31.9 percent of their prime home purchase loans to CRA-eligible borrowers, against 30.5 percent for out of area lenders, and 28.6 percent for non-CRA lenders.

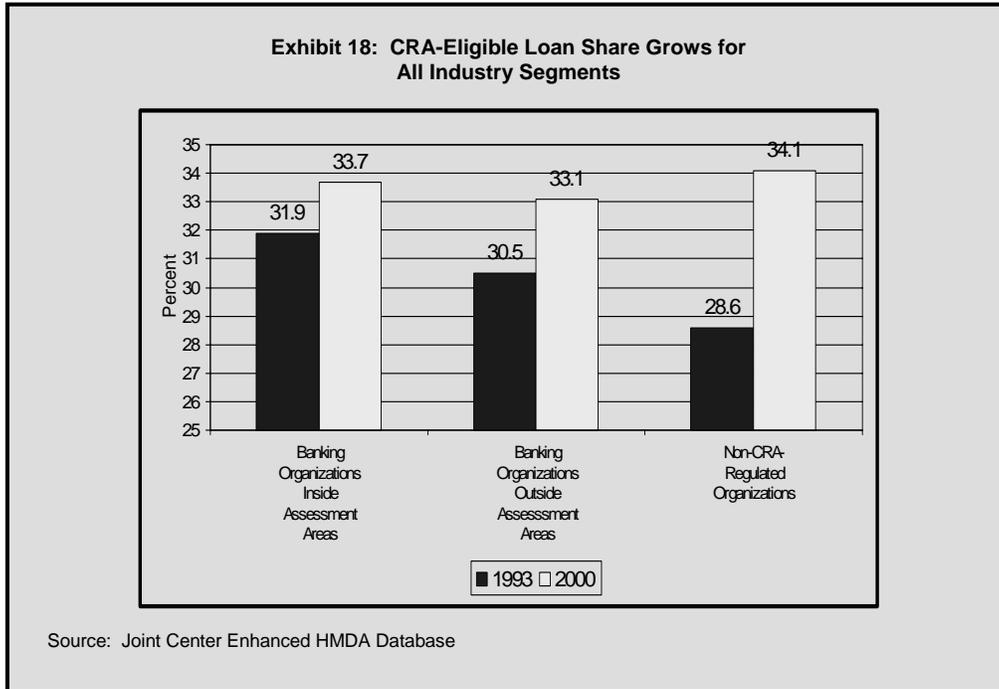


Exhibit 18 also demonstrates that over the 1993-2000 period, the CRA-eligible share of prime home purchase lending advanced broadly among all lender types. The strong economy, technological advances, and increased competition surely played a role in this general advance of CRA-eligible prime lending. Indeed, by the end of the period, the CRA-eligible share of prime loans made by independent mortgage companies eclipsed that of banking organizations. In the presence of CRA, which applies only to regulated lenders operating in their assessment areas, the more rapid growth of CRA lending by independent mortgage companies merits further attention. In particular, critics of CRA have cited similar findings to argue that CRA is unnecessary. They argue that if entities that fall outside of CRA’s reach are as likely to make prime loans to lower-income borrowers as regulated entities, competitive pressures must be insuring that markets for lower-income lending remain active and viable, and there is little need for CRA.

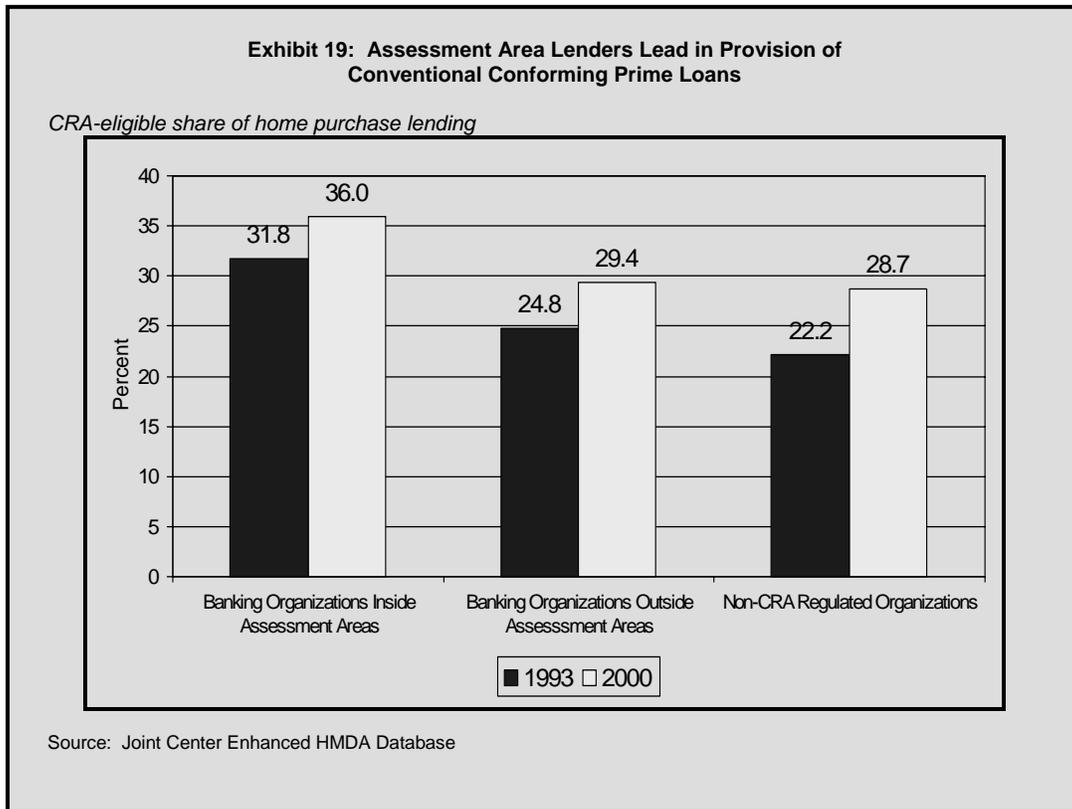
The standard rebuttal to such a challenge is that CRA itself established and helps maintain the conditions that enable independent mortgage companies to succeed in their efforts to reach lower-income borrowers and communities. The Act accomplished this first by demonstrating that market opportunities existed in serving previously neglected borrowers and areas, and second by enforcing ongoing credit access in lower-income places ensuring that housing markets in these areas remain viable.

This line of argument further suggests that the gains in credit access that lower-income borrowers and areas enjoyed over the 1990s amid unprecedented national economic growth will not endure without regulatory oversight during less favorable economic times. Some observers of this debate argue simply that the slight advantage independent mortgage companies now hold in the



CRA-eligible share of prime lending is too small and too new to imply any firm conclusions. And some note that simply looking at prime lending is not sufficient to determine whether or not CRA has an important ongoing influence on credit flows because it lumps together conventional prime lending with government-backed loans, loan types that have noticeably different costs and associated fee structures and fails to exclude ‘jumbo’ lending, little of which flows to lower-income borrowers.

To examine this issue, Exhibit 19 looks only at *conventional conforming* prime loans for the three lender types. Removing government-backed loans make sense, as this lending is mostly a pass-through operation, with loans largely originated by mortgage brokers and sold quickly into the secondary market via Ginnie Mae mortgage-backed securities. Limiting this assessment to conforming loans does not give undue weight to those lenders operating chiefly in the jumbo market. The exhibit shows the share of all conventional prime loans that each type of lender makes to CRA-eligible borrowers and areas. It indicates that CRA-regulated institutions operating in their assessment areas make a notably higher share of these loans to CRA-eligible clientele than do either CRA lenders outside of assessment areas or non-CRA lenders. Exhibit 19 again shows the gap across lender types is closing, potentially in response to enhanced understanding of how to profitably lend to these borrowers and markets stemming from experience acquired by CRA-regulated lenders in response to CRA obligations.



In recognition of the fact that CRA’s initial impetus along with the push for Fair Lending legislation came from activism and municipal regulations that responded to ‘redlining’ and other elements of racial/ethnic discrimination in mortgage markets, Exhibit 20 extends the benchmarking analysis to examine racial and ethnic variations in lending patterns. The exhibit highlights the fact that loans to African-Americans and Hispanics are much more likely to be CRA-eligible,

presumably because these groups have lower average incomes and are more likely to live in lower-income census tracts than whites.

At the same time, it is important to note that in 2000 the CRA-eligible share of conventional prime lending to blacks and Hispanics by CRA-regulated entities operating in their assessment areas is noticeably higher than the share of lending to blacks and Hispanics done by regulated entities operating outside of assessment areas, as well as the lending done by non-CRA lenders. For whites, the difference is minimal, but for blacks, assessment area lenders have CRA-eligible shares that are 17 percentage points (38 percent) higher than for outside assessment area lenders, and 20 percentage points (48 percent) higher than for non-CRA lenders. For Hispanics, the CRA-eligible share for in assessment area lenders is 13 percentage points (28 percent) higher than for outside assessment area lenders and 16 percentage points (39 percent) higher than for non-CRA lenders.

Exhibit 20: CRA-Eligible Share Varies by Race, Loan and Lender Type

	Banking Organizations				Non-CRA Regulated Organizations	
	In Assessment Area		Out of Assessment Area			
	1993	2000	1993	2000	1993	2000
	All Prime Lending					
Whites	29.6	30.9	28.3	30.4	26.7	31.2
Blacks	58.6	62.6	52.1	56.9	48.0	53.6
Hispanic	52.5	56.7	49.5	54.0	44.4	52.1
Other	29.1	27.2	27.8	27.6	24.6	28.1
All Races	31.9	33.7	30.5	33.1	28.6	34.1
	Conventional Prime Lending					
Whites	27.4	28.9	22.0	25.5	19.3	25.6
Blacks	59.2	60.6	42.4	43.7	29.4	40.9
Hispanic	51.1	54.4	38.9	42.6	31.6	38.8
Other	27.4	25.9	22.9	23.4	19.4	23.0
All Races	29.7	31.4	23.1	26.4	20.0	26.3
	Government					
Whites	43.3	50.1	41.5	48.8	41.1	45.4
Blacks	57.2	67.5	57.4	66.9	55.8	60.3
Hispanic	60.2	68.5	58.2	65.5	54.0	60.1
Other	40.7	45.0	39.0	44.8	36.7	40.7
All Races	45.4	54.2	44.2	53.9	43.6	49.5

Note: Other includes Asian, Native American, 'Other' and loans where the applicant and co-applicant were of different races.

Source: Joint Center Enhanced HMDA Database

These figures are consistent with the observation that CRA continues to encourage CRA-regulated entities to extend conventional prime lending to these historically underserved segments of the market. Other lenders, and indeed CRA-regulated entities themselves, are increasingly using other loan products, including government-backed loans and subprime loans, to manage the risks inherent in serving these markets. But in addition to their growing use of alternative lending products, 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.



Finally, of course, it is possible that the growth of CRA-eligible lending simply results from the fact that CRA-regulated entities have acquired mortgage companies, including subprime lending specialists, that concentrate in lending to lower-income households. Previous Joint Center analysis on this issue suggests, however, that the impact of mergers and acquisitions on benchmarking comparisons is modest, especially when care is taken to account for differences in loan product mix by focusing on prime conventional loans (Belsky *et al.* 2001).

SUMMARY

These simple benchmark comparisons demonstrate the value of examining lending patterns across lender types. Disaggregating prime loans into government-backed and conventional components reveals that banks operating in their assessment areas do a larger share of lending to CRA-eligible people and communities than either these same institutions operating where they are not examined for CRA purposes or institutions that fall wholly outside the scope of the Act (primarily independent mortgage companies and credit unions). The differences across lender type are especially large for the share of lending to blacks and Hispanics that is CRA-eligible. The benchmark comparisons also hint at the variety of factors that must be controlled for in order to understand the independent influence of CRA on lending patterns. To better examine CRA's impact in such a complex setting, the next section of this report presents a series of multivariate models that seek to isolate the effect of CRA while controlling for the influence of a suite of other factors such as economic and housing conditions, borrowers' demographic traits, and lender characteristics.



SECTION 5

ECONOMETRIC ANALYSIS OF CRA IMPACTS

The simple descriptive analyses presented in the previous section demonstrate that the assessment area lending of CRA-regulated depository institutions is more focused on lower-income people and communities than is lending by non-regulated entities. The analysis revealed, however, that changes in industry structure, the emergence of new types of affordable loan products, and the strong economy also had significant impacts on lending to lower-income people and communities. Disentangling these overlapping influences on mortgage lending levels is a challenging task. This section addresses this task through a series of multivariate models that seek to isolate the independent role of each of these factors, including CRA, on the behavior of CRA-regulated institutions and the residential mortgage market.

The Community Reinvestment Act of 1977 encourages banks, thrifts and their affiliates¹⁵ to expand home purchase lending to borrowers in lower-income neighborhoods and to lower-income borrowers throughout metropolitan areas.¹⁶ To accomplish this expansion in lending, CRA-regulated institutions must alter the supply of mortgage credit in ways that favor lower-income borrowers. This could occur in any of the following ways. CRA could induce lenders to directly lower the out-of-pocket costs faced by CRA-eligible borrowers by lowering interest rates (or other costs) on mortgage loans. CRA could also increase the supply of mortgage credit by prompting lenders to ease approval standards, effectively deepening the pool of qualified mortgage loan applicants. Finally, CRA could spur lenders to do additional marketing, outreach and counseling, thereby lowering the pre-qualification costs borne by prospective mortgage borrowers. Importantly, all three of these factors could be the source of observed independent CRA effects discussed in this section.

If CRA-regulated lenders are behaving in any or all of these ways, it should be possible to observe the effects of these actions either directly or indirectly. The section reports on three classes of tests, each of which use linear regression models to search for CRA's potential independent influence. The section begins with a non-technical overview of the findings, then describes the analytical framework behind each class of test, and finally discusses the results for each group of tests in detail.

OVERVIEW OF FINDINGS

This section presents and describes statistical models based on 1993-2000 residential mortgage lending data. The models are designed to identify CRA's impact on the volume of home purchase lending flowing to lower-income borrowers and neighborhoods. The section presents the results of complex econometric models, and the discussion is therefore somewhat technical in nature. It is useful, therefore to begin with a non-technical overview of the findings, to help introduce the material presented in the rest of the section.

The econometric models divide logically into three broad groups. The first set of models look at how CRA may have directly influenced CRA lender behavior. The second and third types of

¹⁵ Banks, thrifts and their affiliates are sometimes referred to as CRA lenders in this section. Similarly, credit unions and independent mortgage banks are sometimes referred to as non-CRA lenders.

¹⁶ Loans to lower-income borrowers and borrowers in lower-income areas are sometimes referred to as CRA-eligible loans in this section. Loans that are not classified as CRA-eligible loans are considered to be higher-income loans.



models look for *consequences* of changed CRA lender behavior, in terms of their overall share of the CRA-eligible lending market, and in terms of changes in housing markets in CRA-eligible neighborhoods.

The analysis reports the following three key findings, which are consistent with the notion that CRA has had a positive impact on CRA-eligible lending:

- CRA lenders have changed their behavior. CRA lenders originate a higher proportion of CRA-eligible loans than they would if CRA did not exist, and they seem to reject fewer CRA-eligible loan applications than they would if CRA did not exist.
- CRA lenders appear to have captured a higher share of the CRA-eligible lending market than they would have if CRA were not in place.
- CRA-eligible neighborhoods seem to have more rapid house price increases and higher turnover rates than other neighborhoods, which is consistent with an expansion of credit in those areas.

The findings are reasonably robust, in that changing the structure and design of the statistical models does not affect the basic findings, except where explicitly identified in the text. And, while there is always a range of options in structuring statistical models, the results presented here do not depend, in large measure, on using the particular specification presented.

The statistical testing presented in this section goes beyond qualitative effects to quantify to what extent CRA lender behavior has changed, to estimate how much their CRA-eligible market share has expanded, and to measure the size of the house price increase and turnover rate differentials between CRA-eligible neighborhoods and other neighborhoods. These magnitudes are much more difficult to interpret, however. Differences in how the models are structured can have important impacts on the estimates of the magnitude of the effects presented in this section. Thus, while different model specifications do not produce qualitatively different answers, they do produce different quantitative ones. It would be inappropriate to conclude that the models have revealed with precision the exact magnitude of the impact of CRA on mortgage lending or housing market prices and turnover rates.

With these very important caveats in mind, Exhibit 21 presents the quantitative results of the statistical models. The technical discussion in the remainder of this section reveals specifically how these estimates were developed. The findings in Exhibit 21 suggest that CRA has had a number of small but measurable effects. For perspective in reading the table, in 2000 there were 1.3 million CRA-eligible home purchase loans (those made to lower-income borrowers or in lower-income communities) originated in the metropolitan areas included in this analysis.

The statistical analysis shows that CRA may have increased the CRA-eligible loan origination share by 7 percent, from 30.3 percent to 32.4 percent over the 1993 to 2000 time period. This change, in absolute terms, is consistent with a shift to CRA-eligible lending from non-CRA eligible lending of 42,000 originations. Compared to the 864,000 CRA-eligible loans that CRA lenders originated in 2000, the shift represents a small but significant effect. Different specifications of the statistical tests are almost certain to produce alternative estimates of this quantitative impact. The key conclusion that should be drawn is only that CRA can be reasonably demonstrated to have a small but measurable impact.

Exhibit 21: CRA Has Had a Small but Significant Effect on CRA-Eligible Lending

Impact Area	Expectation	Results over the 1993-2000 Time Period, Expressed in Three Equivalent but Different Ways		
Behavior of CRA Lenders	CRA should increase the proportion of originated home purchase loans that are CRA-eligible	Proportion found to be 7% higher than it would have been without CRA	Average CRA-eligible loan origination share would have been 30.3% instead of 32.4%	In an average year, CRA lenders originated 42,000 more CRA-eligible loans than would have been originated without CRA
	CRA should increase the proportion of CRA-eligible home purchase loans originated in higher income areas, and this effect should be stronger after 1995 than before 1995	Proportion found to be 13% higher than it would have been without CRA No differential effect identified before and after 1995	CRA-eligible loan origination share would have been 21.0% instead of 23.7%	In an average year, CRA lenders originated 29,000 more CRA-eligible loans in higher-income areas than would have been originated without CRA
	CRA should reduce the proportion of all CRA-eligible home purchase loans applications that are rejected	Rejection rate found to be 24% lower than it would have been without CRA	Rejection rate would have been 25.3% instead of 20.8%	In an average year, CRA lenders accepted 39,000 more CRA-eligible loan applications than they would have without CRA
CRA-Eligible Market Share of CRA Lenders	The ratio of higher- to lower-income lending for non-CRA prime lenders should be declining over time, and should be higher in areas where CRA has stronger impact	Ratio found to be 4% higher than it would have been without CRA No significant effect over time identified	Ratio would have been 3.70 instead of 3.87 (for selected set of prime non-CRA lenders)	On average, about 53,000 prime loans per year shifted to CRA lenders from non-CRA lenders
	The share of all CRA-eligible lending accounted for by CRA lenders should be higher in areas where CRA has stronger impacts	Share found to be 2% higher than it would have been without CRA	CRA market share would have been 61.3% instead of 62.3% over the time period	On average, about 13,000 net lower-income loans were originated by CRA lenders instead of non-CRA lenders
Price Changes and Turnover Rate Changes in LMI Neighborhoods	CRA should increase price change in lower-income neighborhoods	Price changes found to be 1% higher than they would have been without CRA	On average price inflation would have been 4.6% per year instead of 4.7% per year	Prices for properties in lower-income neighborhoods were perhaps \$500 higher with CRA than they would have been without CRA
	CRA should increase turnover rates in lower-income neighborhoods	Turnover rates were 1% higher than they would have been without CRA	On average turnover rates would have been 6.21% per year instead of 6.24% per year	For an average tract, there would have been .5 less sales per tract in an average year

The statistical modeling discussion that follows controls for significant changes in the economy over time and for economic and demographic differences across the 301 MSAs studied. For further perspective in interpreting the model results, it appears generally true that economic changes had more impact on CRA-eligible lending than did the CRA itself. For example, a 1.3 percentage point decrease in the unemployment rate (which is less than half of the total reduction in unemployment over the 1993 to 2000 time period) had the same impact in increasing the share of CRA-eligible originations as did a loan application being for a property located inside, rather than outside, a CRA lender's assessment area.

The remainder of this section is more technical in nature, describing the analytical framework, the data, and the specific tests in more detail.

ANALYSIS FRAMEWORK

For CRA to have expanded the level of credit available to lower-income people and communities the Act must have, in economic terms, shifted the mortgage credit supply curve. In order for the amount of mortgage credit available to increase as a result of CRA, the price of mortgage credit faced by these borrowers and areas must decrease.

It is important to understand that this price decrease may come through a variety of methods, and not just through lower loan interest costs. For any given borrower, the cost of securing a mortgage includes time spent searching for a lender. As a result, CRA-induced outreach and marketing efforts directed toward CRA-eligible clientele may raise costs for lenders while at the same time lowering search costs for potential borrowers. Similarly, products that allow lower down-payments, higher debt-to-income ratios, or broader scope for demonstrating creditworthiness also lower the cost to borrowers of getting a mortgage. The same is true anytime lenders relax underwriting criteria in order to expand the pool of acceptable borrowers. Thus, new borrowers may pay the same interest rate as others, but still be facing lower costs than they would in a world without CRA. This additional cost is absorbed by lenders through expenses associated with non-standard underwriting, additional loss mitigation efforts or more directly through higher default and delinquency rates. To the extent that lenders require credit enhancements such as mortgage insurance, however, they are able to shift a portion of these costs back to borrowers.

It is important to understand, however, that the costs to lenders of achieving this downward shift in the supply curve may be temporary. In cases where the supply of mortgage credit to lower-income borrowers and communities had been constrained due to market failures (as was hypothesized to be the case by many of CRA's original proponents), after an initial demonstration period, the costs of supplying credit decline so that the additional, or marginal credit provided by CRA lenders may be no more costly to provide than that which they were already providing. The fact that many large independent mortgage companies (*i.e.*, mortgage lenders not subject to CRA) have been stunningly successful at serving the lower-income market is highly suggestive that this dynamic has indeed played out and that a reasonable portion of the CRA-eligible market is now being served economically.

Behavior by CRA lenders is consistent with the notion that they have taken steps to adjust to a world in which CRA exists and to minimize or eliminate the additional costs of compliance. Homebuyer counseling is one prominent way lenders have attempted to improve the loan worthiness of the CRA-eligible pool by partnering with non-profits that they hope will develop 'loan-ready' borrowers and screen out lower-income households not yet ready for homeownership.

CRA's impact should be observable from three different perspectives. CRA's effects should translate into a more concentrated focus on CRA-eligible lending by CRA lenders. This greater concentration should result most directly in more CRA-eligible loans being originated by CRA lenders. This higher level of CRA-eligible loan originations on the part of CRA lenders should generate two other kinds of impacts. First the CRA-eligible market share for independent mortgage banks and credit unions (non-CRA lenders) should fall as CRA lenders capture customers that would otherwise turn to independent mortgage banks for service. Second, insofar as higher levels of CRA-eligible loan originations represent an expansion of the overall CRA-eligible segment of the housing market, there should be relatively more demand for housing in CRA-eligible lower-income neighborhoods, and these neighborhoods should exhibit more housing turnover and greater price increases than would otherwise occur.



The models presented in this section utilize four distinct variable categories: MSA characteristics, census tract characteristics, loan characteristics, and borrower characteristics. Exhibit 22 lists the specific variables within each of these groupings, and the dataset from which each is drawn. The strength of the analysis here derives in large part from combining data from different sources to control in an effective way for determinants of lending behavior besides CRA.

At the heart of the statistical analysis that follows are two variables constructed to represent the impact of CRA: a lending-agreement-in-place indicator variable, and a variable that indicates whether or not a CRA-eligible loan is originated by a CRA-regulated lender operating inside its CRA assessment area. These indicator variables are discussed in more detail below.

Exhibit 22: Statistical Modeling Uses Data On MSA, Census Tract, Loan, and Borrower Characteristics

Variable Category	Statistical Analysis Variable	Source of Data Underlying Variable
Metro	Indicator Of Existence Of Metro Area Lending Agreement	Developed by Joint Center for Housing Studies from NCRC report
Metro	Index Of Housing Affordability (% Of Households Than Can Afford Median Priced Home)	NAHB
Metro	Metro Median Household Income	HUD Income Database
Metro	Metro Unemployment Rate	Bureau of Labor Statistics
Metro	Metro Home Ownership Rate In 1990	1990 Census
Tract	% Of Tract Housing Built Before 1960	1990 Census
Tract	% Change In Tract Housing Prices	Proprietary Data from CSW
Tract	1990 Tract Minority Population As % Of Total Tract Population	HMDA
Tract	Tract Income As % MSA Income	HMDA
Tract	1990-2000 Tract Population Growth Rate	1990 and 2000 Censuses, and Proprietary Joint Center Estimation
Loan	Loan Amount	HMDA
Loan	Conventional Or Government (FHA, VA, Fmha) Loan Indicator	HMDA
Loan	Indicator Of Whether Or Not Loan Is Resold To Fannie Mae Or Freddie Mac In Year Of Origination	HMDA
Loan	For All CRA Lenders, Code Indicating Assessment Area Or Non-Assessment Area Loan	FRB Proprietary Lender Database
Loan	Lender Type (Prime, Subprime, Or Manufactured Home)	HUD Lender Specialization Database
Loan	Lender Parent Organization's Overall Level Of Home Purchase Lending	FRB Proprietary Lender Database
Loan	Lender Assets	FRB Proprietary Lender Database
Loan	Lender Regulatory Status (CRA Lender Or Non-CRA Lender)	FRB Proprietary Lender Database
Loan	County Location Of Loan Property	HMDA
Loan	Tract Location Of Loan Property	HMDA
Borrower	Borrower Income	HMDA
Borrower	Borrower Race	HMDA

A. Assessment Area Indicator for CRA Lender Loan Originations

The most important CRA variable employed in the models is a dummy variable indicating whether or not each loan was made by a CRA-regulated lender or one of its affiliates operating in its assessment area. The variable takes a value of 1 if the loan is an assessment area loan, and 0 otherwise. ‘CRA-regulated lenders’ are defined at the holding company or bank organization level so that all activities of the organization that take place in a county in which the organization



maintains a deposit-taking branch are considered ‘in assessment area’ lending. To reiterate an important point made earlier in the report, all lending by an organization in a county where the organization has a branch is considered to be in assessment area lending even if it is made by the organization’s mortgage company affiliate, whether or not the organization chose to include the affiliate’s activity in its CRA exam.

Affiliate activity is included for several reasons. First, lenders effectively have discretion to shift and book activity between their depository and mortgage company affiliates. Second, in many, though by no means all cases, affiliate activity is actually included in the exam at the lenders’ behest. Therefore, looking only at the depository’s activity will miss some activities upon which lenders intend to be examined. In fact, due to the ability of lenders to book different types of mortgage business in different parts of the organization, the alternative approach could give an unrealistically positive picture of the impact of CRA. Our approach is intentionally conservative in this regard.

Lending inside and outside assessment areas represents a ‘natural experiment’ testing for the effect of CRA. After controlling for economic and demographic differences, CRA’s additional impact can be quantified by examining the differential levels of CRA-eligible lending inside and outside assessment areas. As a result, the assessment area indicator is a robust measure of CRA’s impact on the supply of mortgage capital by CRA-regulated entities.

B. Lending Agreement Indicator for MSAs

The lending agreement variable is also a dummy variable defined at the MSA level. An MSA is considered to have an agreement in place for every year or not at all. Insofar as CRA has led to the establishment of these agreements, and insofar as the agreements led to more CRA lending, the variable can be used to quantify the impact of CRA. In simplest terms, after controlling for as many factors that impact CRA-eligible lending as possible, the lending agreement variable is used to set up a ‘natural experiment’ which looks to see if CRA-eligible lending is higher in areas with agreements than areas without agreements.

The determination of which MSAs have agreements in place is based on the National Community Reinvestment Coalition’s list of CRA commitments (National Community Reinvestment Coalition, 2001). Because these agreements generally last for five to ten years, any metropolitan area that had any agreement made in 1988 or later was assumed to have had an agreement in place for the duration of the study period. In addition, where lenders signed state-level agreements all MSAs that were assessment areas for the signatories were also assumed to have had agreements in place. In all, 123 of the 301 MSAs included in the analysis are flagged as having lending agreements in place.

Meeting the goals of the agreements, whose existence is due in part to the CRA, pushes lenders to target and reach the CRA-eligible market to a greater extent than they would otherwise. Therefore, if areas with lending agreements exhibit increased CRA-eligible lending relative to areas without agreements, this is taken as evidence that the existence of CRA agreements results in higher levels of mortgage credit being supplied to CRA-eligible borrowers and areas.

It is important to point out, however, that the presence of agreements might also be linked to elevated CRA-eligible lending levels in more subtle ways. For instance, interaction between banks and community-based organizations that begins around a CRA agreement may lead to collaboration in development of products that serve the needs of the CRA-eligible market. These products, by allowing more substantial penetration of lower-income markets in these MSAs, may then

boost CRA-eligible loan volume. Alternatively, since community reinvestment oriented non-profits often conduct homebuyer counseling, agreements may signal more extensive counseling efforts that result in a larger pool of loan-ready borrowers over time.

Finally, it is necessary to note that lenders may be particularly willing to enter into agreements in MSAs where the opportunities for success in the CRA-eligible market are highest. In such a case the correlation between agreements and CRA-eligible lending levels would also be positive, but largely not as a result of CRA. As a result, care must be exercised in interpreting the coefficients on this variable as solely representing the impact of CRA on mortgage lending patterns.

TESTS OF CRA IMPACT ON CRA LENDER BEHAVIOR

This set of three tests examines the extent to which CRA might be affecting the lending patterns of regulated lenders in observable ways. All of the models examine changes in home purchase lending (as opposed to refinance or home equity lending) that are originated (as opposed to purchased) by CRA-regulated lenders. The tests all work through the two CRA variables discussed above, which reveal the extent to which CRA had an independent effect on lending patterns. In each case, the effects of other factors that would be expected to influence lending patterns with or without CRA are controlled for by including independent variables that capture the effect of demography, economics, housing market characteristics, and industry structure.

A. CRA Lenders' CRA-Eligible Portfolio Share

The first test examines whether the CRA variables appear to influence the proportion of CRA-regulated lenders' loans that are CRA-eligible (*i.e.*, CRA lenders' 'CRA-eligible origination share'¹⁷). As throughout the report, CRA-eligible loans are defined here as those going to lower-income people and/or lower-income areas. The hypotheses for these tests can be stated as follows: 1) CRA-regulated lenders are expected to have portfolios that consist of larger shares of CRA-eligible loans when they are operating in their assessment area than when they are not, and, similarly, 2) CRA-regulated lenders are expected to have portfolios that consist of larger shares of CRA-eligible loans when they are operating in markets that have CRA agreements in place than when they are operating outside such markets.

Exhibit 23 presents the results for a linear regression model that uses individual loans originated by CRA lenders as the underlying observations. Over the 1993 to 2000 time period there were approximately 13,000,000 such loans to consider. The dependent variable in the model summarized in Exhibit 23 takes a value of 1 if the loan is a CRA-eligible loan, and a value of 0 if the loan is not a CRA-eligible loan.

The linear regression specification is only one possible approach: non-linear logit and probit specifications are also possible. Linear models are used here for several reasons. First, linear specifications facilitate interpretation of the effects of the independent variables. In addition, since the average of the dependent variable is not located near the extreme 0 or 1 values, the linear specification doesn't inappropriately misrepresent the underlying functional form.

¹⁷ CRA-eligible origination share is a more concise way of saying 'the share of all lending that is CRA-eligible lending.'

Exhibit 23: Loan-Level Model of CRA-Eligible Origination Share Identifies a CRA Effect

Coefficient Category	Coefficient Description	Coefficient Value	t-value	Mean Value
	Intercept	(0.376)	(203.7)	1.0
CRA	Lending Agreement Dummy	0.022	76.3	.730
CRA	Loan Inside Assessment Area	0.027	101.9	.499
Metro	MSA Housing Affordability Index	0.003	284.9	66.32
Metro	MSA Med Household Income	0.002	103.1	50.49
Metro	MSA Unemployment Rate	(2.04)	(239.2)	.045
Metro	Metro Home Ownership Rate in 1990	0.594	287.4	.625
Tract	90-00 growth -8-0%	(0.025)	(49.6)	.198
Tract	90-00 growth 0-10%	(0.040)	(81.2)	.274
Tract	90-00 growth 10-20%	(0.039)	(73.4)	.156
Tract	90-00 growth >20%	(0.063)	(128.8)	.292
Tract	1990 Tract Minority Percentage	0.644	878.9	.166
Loan	Loan resold to FNMA/GNMA	(0.011)	(38.3)	.269
Loan	FHA Loan	0.194	523.4	.145
Loan	Large Lender Dummy	(0.012)	(41.9)	.602
Borrower	Black Applicant	0.059	109.6	.064
Borrower	Hispanic Applicant	0.117	213.6	.061
Year	1994 Year Dummy	0.003	5.5	.103
Year	1995 Year Dummy	0.003	4.8	.106
Year	1996 Year Dummy	(0.009)	(16.7)	.124
Year	1997 Year Dummy	(0.022)	(40.4)	.130
Year	1998 Year Dummy	(0.032)	(57.3)	.140
Year	1999 Year Dummy	(0.021)	(38.0)	.151.
Year	2000 Year Dummy	(0.010)	(17.1)	.150
	Observations	13,000,000		
	Adjusted R-Sq	0.13		
	Model	LMI_L2		

The coefficient for the lending agreement dummy variable indicates that CRA-eligible loans are 2.2 percent more likely in MSAs with lending agreements than in MSAs without such agreements. Similarly, the coefficient on the assessment area variable indicates that CRA-eligible lending is 2.7 percent more likely if the loan property is located inside rather than outside the lender's assessment area. Since the likelihood in the overall sample of a loan being a CRA-eligible loan is 32.4 percent, the results indicate that CRA has had a small but statistically significant positive impact in raising the proportion of loans originated that are CRA-eligible.

The other independent variables in the statistical regression model presented in Exhibit 23 work as expected to control for economic, housing market, industry structure, and demographic differences that also impact lending inside and outside assessment areas or inside and outside MSAs with lending agreements in place. For example, every increase of 1 percentage point in the unemployment rate reduces the likelihood of a loan being a CRA-eligible loan by 2 percent. Thus, the overall positive effect CRA appears to have had in increasing the likelihood of a loan made



inside the lender's assessment area being CRA-eligible is roughly equivalent to the impact of a 1.3 percentage point reduction in unemployment.

Similarly, other independent variables are significant indicating that, in addition to CRA and employment conditions; demographics, economics, housing market characteristics, and industry structure all play an important role in determining the CRA-eligible shares of CRA-regulated lenders' mortgage lending portfolios. Because both CRA impact variables are statistically significant the model indicates that CRA also matters in determining CRA lenders' CRA-eligible origination shares.

Exhibit 24 presents models of CRA lender origination share that are estimated at the metro and tract level, and presents again the loan-level model in Exhibit 23 for comparison purposes. Repeating the analysis at higher levels of geographic aggregation is useful, because it can produce different outcomes as a result of using a restricted set of control variables, or because doing so implicitly weights individual loans differently.

Using aggregated data involves some transformation of the independent variables. For example, in the loan-level equation, the assessment area variable is a dummy variable taking on the value of 1 if the loan is an assessment area loan, and taking on the value of 0 otherwise. In a tract or metro area level model, however, the dummy variable must be modified to represent the proportion of all loans in the tract or MSA that are originated by CRA lenders operating in their assessment area. Similarly, while the loan-level model uses an indicator for the race/ethnicity of the applicant, the aggregate models employ the proportion of all borrowers in the tract or metro area that are black or Hispanic. Additionally, since the black and Hispanic share is a fraction between zero and one, the models can include this share directly, and also as higher-order terms (*e.g.*, the share squared or cubed) to reflect differential effects as the share becomes higher or lower.

Exhibit 24 demonstrates that statistical tests based at MSA or tract level also indicate a positive effect for CRA that generally falls in the range of being statistically significant (as a useful rule of thumb, most analysts accept a coefficient as statistically significant if the t-value exceeds 2.0). The different levels of aggregation produce a range of coefficient estimates and levels of statistical significance, but the collective modeling results are generally consistent. For example, the coefficient on the MSA lending agreement variable ranges from .004 to .04, with the loan-level estimate from Exhibit 23 squarely in the middle of the range. The coefficient on the assessment area variable ranges from .027 to .082, with the loan-level estimate at the lower end of this range.

Some analysts argue that HMDA data, which are the foundation data for the statistical analyses reported here, vary in their coverage consistency over the 1993 to 2000 time period. In addition, it is possible that CRA-regulated entities' tendency to originate higher shares of loans to CRA-eligible borrowers simply reflects the fact that over time CRA-regulated entities have acquired affiliates that specialize in lower-income lending. To explore these issues, and to understand how the statistical effects identified may vary from year to year, we developed separate loan-level models for each year of the 1993 to 2000 time period. Exhibit 25 presents the coefficients for each of the CRA variables included in the models. For comparison, it also includes the coefficients from the model estimated over all years of data first presented in Exhibit 23. Exhibit 25 shows that the CRA variables are statistically significant in each year of the time period, with the impact declining over time. For example, the assessment area dummy variable indicates that in 1993, loans located inside the lenders' assessment areas were 3.9 percent more likely to be CRA-eligible loans, while in 2000 loans located inside assessment areas were 2.1 percent more likely to be CRA-eligible loans. This finding is consistent with the observation that CRA's regulatory reach has declined over time.

Exhibit 24: CRA-Eligible Origination Share Models Are Broadly Consistent Across Different Units of Analysis

Coefficient Category	Coefficient Description	Loan-Level Model		Metro Level Model		Tract Level Model	
		Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
	Intercept	(0.376)	(203.7)	(0.110)	(6.0)	(0.160)	(20.6)
CRA	Lending Agreement Dummy	0.022	76.3	0.004	1.5	0.040	31.1
CRA	Share of Loans inside Assessment Area	0.027	101.9	0.027	3.0	0.082	32.3
Metro	MSA Housing Affordability Index	0.003	284.9	0.002	17.4	0.004	68.7
Metro	MSA Med Household Income	0.002	103.1	0.003	16.7	0.000	1.4
Metro	MSA Unemployment Rate	(0.020)	(239.2)	(0.003)	(5.1)	(0.025)	(73.3)
Metro	Home Ownership Rate in 1990	0.594	287.4	0.135	6.4	0.511	67.0
Tract	90-00 growth -8-0%	(0.025)	(49.6)			(0.036)	(19.0)
Tract	90-00 growth 0-10%	(0.040)	(81.2)			(0.055)	(29.9)
Tract	90-00 growth 10-20%	(0.039)	(73.4)			(0.048)	(23.0)
Tract	90-00 growth >20%	(0.063)	(128.8)			(0.057)	(29.3)
Tract	1990 Tract Minority Percentage	0.644	878.9			0.672	227.0
Loan	FNMA & GNMA Resell Rate	(0.011)	(38.3)	0.106	6.6	(0.183)	(52.3)
Loan	Share of Loans which are FHA	0.194	523.4	0.225	13.8	0.369	108.4
Loan	Share of Loans Orig by Big Lenders	(0.012)	(41.9)	0.008	1.0	(0.090)	(34.6)
Borrower	% Loan Orig to Blacks			(0.257)	(3.7)	0.099	11.9
Borrower	% Loan Orig to Hispanics			(0.147)	(4.6)	0.387	43.7
Borrower	% Loan Orig to Blacks Squared			1.512	4.2	(0.210)	(23.6)
Borrower	% Loan Orig to Hispanics Squared			0.382	8.8	(0.309)	(29.6)
Borrower	Black Applicant	0.059	109.6				
Borrower	Hispanic Applicant	0.117	213.6				
Year	1994 Year Dummy	0.003	5.5	0.024	5.3	(0.011)	(5.0)
Year	1995 Year Dummy	0.003	4.8	0.026	5.6	(0.002)	(1.1)
Year	1996 Year Dummy	(0.009)	(16.7)	0.013	2.7	(0.007)	(3.2)
Year	1997 Year Dummy	(0.022)	(40.4)	(0.000)	(0.1)	(0.016)	(7.0)
Year	1998 Year Dummy	(0.032)	(57.3)	(0.006)	(1.4)	(0.016)	(7.1)
Year	1999 Year Dummy	(0.021)	(38.0)	0.015	3.0	(0.015)	(6.2)
Year	2000 Year Dummy	(0.010)	(17.1)	0.028	5.2	0.014	5.6
	Observations	13,000,000		1,437		293,119	
	Adjusted R-Sq	0.13		0.57		0.43	

The measure of CRA impact is computed taking into account both the effect of MSA agreements and the effects of location inside or outside assessment areas. Without CRA, the assessment area dummy would always be 0, and the associated coefficient multiplied by 0 would equal 0. With CRA, the assessment area dummy takes on the value of 1 in some observations, so the effect with CRA is the mean value of this dummy variable multiplied by the coefficient associated with the variable. The difference with and without CRA is thus the average value of the assessment area dummy variable multiplied by the associated model coefficient. The computation of the impact of MSA agreements is similar, except there may be multiple drivers behind putting lending agreements in place, of which CRA is only one. For example, many agreements focus on lending to minority communities, and are as likely to represent concerns about Fair Lending issues as concerns about lending to lower-income borrowers and neighborhoods. To be conservative, the



impact calculation takes 50 percent of the total MSA agreement effect, to recognize these other drivers behind lending agreements. Thus, the total CRA effect is the sum of the assessment area effect and 50 percent of the lending agreement effect.

Exhibit 25: CRA-Origination Share Models Developed for Individual Years Demonstrate Declining CRA Impact

Year	MSA Agreement Dummy		Assessment Area Dummy		CRA Impact
	Coefficient	t-value	Coefficient	t-value	
1993	.041	43.2	.039	45.8	0.037
1994	.027	29.1	.044	53.5	0.036
1995	.019	22.6	.028	34.6	0.022
1996	.016	19.7	.020	27.0	0.015
1997	.021	27.1	.023	31.6	0.019
1998	.021	27.9	.025	36.2	0.020
1999	.018	23.6	.024	36.2	0.018
2000	.019	24.1	.021	31.1	0.016
93-00	.022	76.3	.027	101.9	0.021

Note: CRA impact is the sum of the product of the assessment area coefficient times the mean value of the assessment area variable, and one-half the product of the MSA agreement coefficient times the mean value of the MSA agreement variable.

The analysis of CRA-eligible origination share also tested alternative specifications of the loan-level model, to better understand how the inclusion or omission of control variables impacts the results. For example, the 1990 percentage of minority residents in the census tract performs as an important control variable in the loan-level model in Exhibit 23. Leaving this variable out of the model presented in Exhibit 23 slightly reduces the coefficients on the CRA variables but they remain positive and statistically significant. Similarly, omitting the indicator for whether or not the loan originator is a large lender with more than 5,000 home purchase loans overall in the year of origination does not change the signs or the statistical significance of the coefficients.

The indicator of whether or not the loan is an assessment area loan is obviously the key variable in driving the ‘natural experiment’ of comparing lending inside and outside assessment areas. To test whether or not some other unspecified loan characteristic might be correlated with assessment area lending, and driving the results, an alternative specification of the model presented in Exhibit 23 was constructed that included both a binary indicator of each loan’s assessment area status, and also a measure of the aggregate proportion of loans within each loan’s geographic census tract which were assessment area loans. Including the aggregate tract assessment share variable did reduce the magnitude of the coefficient on the assessment area binary indicator, but the coefficient remained positive and statistically significant.

To test whether changes in the mix of lenders over time might be driving the result that the coefficients on the CRA variables are positive and significant, an alternative specification of the model presented in Exhibit 23 was constructed that included dummy variables for each of the largest 100 lenders. This alternative specification did not change the result that the coefficients on the CRA variables are positive and statistically significant.

Finally, a logit specification of the model in Exhibit 23 was tested, to see if a non-linear structure would change the result.¹⁸ The CRA effects identified in the linear specification also were pre-

¹⁸ The (non-linear) logit specification recognizes that as the values of the independent variables drive the predicted dependent variable close to the extreme values of 0 or 1, unit changes in the dependent variables have a diminished

sent in the logit specification tested as a variant of the model presented in Exhibit 23. The coefficients on the MSA agreement indicator and the assessment area indicator were positive and statistically significant and the CRA effect computed from the logit model was very similar to the CRA effect computed from the regression model.

B. CRA Lenders' CRA-Eligible Portfolio Share Outside CRA-Eligible Neighborhoods

Tests in Part B are similar to those in Part A, except for the fact that they concentrate exclusively on higher-income areas – those where only lending to lower-income borrowers counts for CRA credit. The first test considers whether the CRA effect that appears significant overall is also operating for lending outside CRA-eligible neighborhoods. The second test explores whether or not CRA had a greater impact after than before 1995, in response to the belief that the refocusing of CRA in the 1995 regulations changes placed more emphasis on CRA-eligible lending outside CRA-eligible neighborhoods.

Exhibit 26 presents the outcome of the testing, presenting the results of two models explaining CRA-eligible loan origination share outside CRA-eligible neighborhoods. The first model is parallel in structure to the overall origination share model presented in Exhibit 23. It demonstrates smaller, but still significant, impacts of CRA on lending outside CRA-eligible neighborhoods. The coefficient on the lending agreement variable is .016 rather than .022, and the coefficient on the assessment area variable is .022 rather than .027. The smaller coefficient on the lending agreement variable is consistent with the fact that CRA agreements have historically focused on lower-income, and hence CRA-eligible, neighborhoods. The smaller coefficient on assessment area is consistent with less focus by CRA-regulated lenders on loans outside CRA-eligible neighborhoods earlier in the 1993 to 2000 time period.

To explore the timing issue more explicitly, the second model in Exhibit 26 includes interactions of each CRA impact variable with the specific year dummy variables. If CRA had more of an impact on lending outside CRA-eligible neighborhoods in the early years, this should be reflected by larger (positive) coefficients on the interaction term variables in the later years than in the earlier years. The results indicate no such pattern, however. The analysis, therefore, does not support the proposition that CRA-eligible lending outside CRA-eligible neighborhoods became more important in the later years of the time period.

C. CRA Lenders' Rejection Rates on CRA-Eligible Loan Applications

Tests in this section are based on the notion that, insofar as CRA pushes CRA-regulated lenders to expand their CRA-eligible lending, rejection rates on CRA-eligible home purchase loan applications should decline. Many analysts accept this general proposition but avoid studying rejection rates because credit score information is unavailable. In addition, HMDA-measured rejection rates may be a poor measure of true rejection rates because HMDA does not capture applications that are never filed when loan officers discourage applicants most likely to be rejected. To the extent that this activity takes place, the observed rejection rate will be different than the measured rejection rate. Alternatively, lenders actively reach out and otherwise market their loans to prospective applicants that can meet their eligibility criteria, and these further increase the probability that an applicant will be accepted.

effect on changes in the dependent variable. A linear specification assumes, in contrast, that unit changes in the independent variables have the same effect on the dependent variable irrespective of whether the predicted dependent variable is close to 0 or 1 or centered somewhere between those two values.



Exhibit 26: Loan-Level Model of CRA-Eligible Origination Share Outside CRA-Eligible Neighborhoods Identifies CRA Effect

Coefficient Category	Coefficient Description	Coefficient Value	t-value	Coefficient Value	t-value	Mean Value
	Intercept	(0.312)	(168.2)	(0.328)	(165.6)	1.0
CRA	Lending Agreement Dummy	0.016	54.3	0.037	41.5	.729
CRA	Loan Inside Assessment Area	0.022	83.0	0.027	33.4	.494
Metro	MSA Housing Affordability Index	0.003	277.1	0.003	275.5	66.45
Metro	MSA Med Household Income	0.002	149.1	0.002	148.2	50.43
Metro	MSA Unemployment Rate	(1.074)	(124.6)	(1.087)	(125.9)	.045
Metro	Home Ownership Rate in 1990	0.306	147.9	0.305	147.4	.625
Tract	90-00 growth -8-0%	(0.008)	(15.2)	(0.008)	(15.2)	.196
Tract	90-00 growth 0-10%	(0.018)	(34.5)	(0.018)	(34.5)	.276
Tract	90-00 growth 10-20%	(0.019)	(35.5)	(0.019)	(35.5)	.155
Tract	90-00 growth >20%	(0.028)	(54.8)	(0.028)	(54.8)	.301
Tract	1990 Tract Minority Percentage	0.154	165.0	0.154	165.2	.135
Loan	Loan Resold to FNMA/GNMA	0.001	3.2	0.001	3.2	.279
Loan	FHA Loan	0.210	553.4	0.211	553.8	.135
Loan	Large Lender Dummy	(0.000)	(1.0)	(0.000)	(1.1)	.604
Borrower	Black Applicant	0.115	196.6	0.114	196.3	.051
Borrower	Hispanic Applicant	0.131	221.4	0.131	221.3	.049
Year	1994 Year Dummy	0.010	17.9	0.015	12.6	.102
Year	1995 Year Dummy	0.009	16.5	0.030	25.9	.106
Year	1996 Year Dummy	0.001	1.2	0.025	22.4	.125
Year	1997 Year Dummy	(0.010)	(18.1)	0.009	7.8	.130
Year	1998 Year Dummy	(0.015)	(27.2)	0.003	3.0	.141
Year	1999 Year Dummy	(0.006)	(10.0)	0.016	14.5	.150
Year	2000 Year Dummy	0.001	1.9	0.023	20.6	.148
CRA*Year	Inside Assmnt Area * Year 1994			0.006	5.8	.060
CRA*Year	Inside Assmnt Area * Year 1995			(0.008)	(7.8)	.055
CRA*Year	Inside Assmnt Area * Year 1996			(0.011)	(10.1)	.058
CRA*Year	Inside Assmnt Area * Year 1997			(0.008)	(7.4)	.061
CRA*Year	Inside Assmnt Area * Year 1998			(0.003)	(3.2)	.067
CRA*Year	Inside Assmnt Area * Year 1999			(0.006)	(6.0)	.070
CRA*Year	Inside Assmnt Area * Year 2000			(0.008)	(7.7)	.065
CRA*Year	MSA Lending Agmnt * Year 1994			(0.013)	(10.8)	.076
CRA*Year	MSA Lending Agmnt * Year 1995			(0.023)	(19.3)	.075
CRA*Year	MSA Lending Agmnt * Year 1996			(0.027)	(23.2)	.088
CRA*Year	MSA Lending Agmnt * Year 1997			(0.021)	(18.1)	.094
CRA*Year	MSA Lending Agmnt * Year 1998			(0.023)	(20.5)	.102
CRA*Year	MSA Lending Agmnt * Year 1999			(0.026)	(23.0)	.112
CRA*Year	MSA Lending Agmnt * Year 2000			(0.025)	(22.3)	.112
	Observations	11,500,000		11,500,000		
	Adjusted R-Sq	0.07		0.07		
	Model	LMIBMHNH_L4		LMIBMHNH_L4A		

For the purposes of capturing CRA’s impact, the difference between observed and true rejection rates may not be critical, however. As long as the behavior that leads to the discrepancy between true and observed rejection rates is not different inside and outside assessment areas or inside and outside of MSAs where lending agreements are in place, then the CRA impact can still, in principle, be identified.

The loan-level model presented in Exhibit 27 suggests that CRA has a very important effect on rejection rates. It indicates that rejection rates on CRA-eligible applications are lower in MSAs where lending agreements exist, and lower inside CRA lender assessment areas. The coefficients on these variables are negative and statistically significant in Exhibit 27. All other things being equal, the model suggests that rejection rates are 8 percentage points lower inside assessment areas than outside assessment areas, and the rejection rates are 3 percentage points lower in MSAs where lending agreements exist than in others.

Exhibit 27: Loan-Level Model of CRA-Eligible Loan Application Rejection Rates Demonstrates CRA Effect

Coefficient Category	Coefficient Description	Coefficient Value	t-value	Mean Value
	Intercept	0.725	302.9	1.0
CRA	Lending Agreement Dummy	(0.029)	(71.5)	.710
CRA	Loan Inside Assessment Area	(0.081)	(221.6)	.479
Metro	Housing Affordability Index	(0.002)	(108.5)	67.7
Metro	Med Household Income	(0.004)	(185.8)	50.7
Metro	Unemployment Rate	0.173	13.7	.043
Tract	90-00 growth -8-0%	(0.005)	(8.3)	.206
Tract	90-00 growth 0-10%	0.001	0.9	.264
Tract	90-00 growth 10-20%	0.002	2.4	.155
Tract	90-00 growth >20%	0.005	8.1	.268
Tract	% Tract Housing Built pre1960	(0.074)	(112.2)	.395
Tract	1990 Tract Minority Percentage	0.017	19.0	.248
Tract	Ratio of Tract to MSA Household Income	(0.056)	(74.5)	.931
Loan	Large Lender Dummy	(0.053)	(138.6)	.594
Loan	Loan Amount / Applicant Income	(0.042)	(212.5)	2.19
Borrower	Black Applicant	0.097	167.0	.127
Borrower	Hispanic Applicant	0.046	75.9	.109
Year	1994 Year Dummy	(0.010)	(12.7)	.096
Year	1995 Year Dummy	(0.009)	(11.1)	.100
Year	1996 Year Dummy	0.023	28.6	.119
Year	1997 Year Dummy	0.041	50.9	.126
Year	1998 Year Dummy	0.037	45.4	.135
Year	1999 Year Dummy	0.078	96.5	.163
Year	2000 Year Dummy	0.096	114.4	.169
	Observations	5,320,000		
	Adjusted R-Sq	0.050		
	Model	RR_L2		



The control variables in Exhibit 27 generally behave as expected, with the notable exception of the loan-to-income ratio. The expectation would be that, all other things equal, a higher loan-to-income ratio would lead to higher rejection rates. However, the model coefficient indicates that the reverse is true. This may be a result of the inability to observe actual rejection rates. Alternatively, it may be that metropolitan differences in loan-to-income ratios are significant and there is a correlation across MSAs that is obscuring the true positive relationship between loan-to-income ratios and rejection rates that might be expected.

The three groups of tests in this section collectively indicate a role for CRA in influencing the level and pattern of mortgage credit access. The first group indicated that location in the lender's assessment area or in an MSA with a CRA lending agreement in place has a positive effect on the proportion of CRA-regulated lenders' loans that are CRA-eligible. The second group indicated that CRA's effect persists in higher-income neighborhoods, though it is weaker, and suggested that CRA impact in these areas has not measurably increased since 1995. The third set of tests showed that CRA-regulated lenders' rejection rates are also responsive to the provisions of the Act, being lower in MSAs with lending agreements in place and for applications for loans inside lenders' assessment areas.

TESTS OF CRA IMPACT ON CRA LENDER SHARE OF THE CRA-ELIGIBLE LOAN MARKET

Since the mortgage market is served both by organizations subject to CRA and those that are not, it is possible to examine the factors that influence the share of the market that is served by different types of lenders. The tests in this section examine the shares of the CRA-eligible market captured by CRA-regulated and non-regulated lenders. The tests are built on the premise that because of CRA, covered lenders have an extra incentive to seek out and originate CRA-eligible loans, and should consequently claim a larger share of the lower-income borrower and area markets.

A. CRA Lenders' Share of the CRA-Eligible Market

The first test in this section examines whether CRA lenders tend to capture a larger share of the lower-income borrower and/or area market for mortgage loans when they are operating in MSAs with CRA agreements in place. The assessment area dummy variable is not included here because it has no meaning in a model that includes non-CRA lenders. If the variable was included, it would always be zero for non-CRA lenders, and by definition, an assessment area loan would be a CRA lender loan. Because of this identity, the variable would perform well in indicating which loans were CRA loans, but that performance would be based on a truism built into the model rather than on changes in behavior caused by CRA.

The hypothesis investigated here is that CRA lenders' market share will be higher in MSAs with an agreement in effect. At the loan-level, we expect that a loan is more likely to be made by a CRA lender than a non-CRA lender if it is made in an MSA with a CRA agreement in place. Exhibit 28 presents the model developed to test the hypothesis. It shows that CRA lenders have a market share that is 3.5 percentage points higher in MSAs with lending agreements in place than in other MSAs.

As in the previous section, the influence of the control variables was generally significant and as expected. Interestingly, dummy variables for the year loans were made that were included in this model indicate that, holding all other influences constant, CRA lenders' share of lower-income

lending slipped as the decade wore on through 1999. This effect is at least partially based on the big expansion in subprime lending that took place, for the most part, among non-CRA lenders. The effect is seen in many of the other variables as well, with CRA lenders having bigger market shares in areas with a stronger economy, and in neighborhoods with fewer minority residents – that is, in places where subprime lenders are less prominent.

Exhibit 28: Loan-Level Model of the CRA Lender Share of the CRA-Eligible Market Demonstrates CRA Effect

Coefficient Category	Coefficient Description	Coefficient Value	t-value	Mean Value
	Intercept	0.413	170.4	1
CRA	Lending Agreement Dummy	0.035	82.7	.714
MSA	MSA Housing Affordability Index	0.002	91.6	67.5
MSA	MSA Unemployment Rate	(0.014)	(116.6)	4.46
MSA	Home Ownership Rate in 1990	0.097	28.4	.630
Tract	90-00 growth –8-0%	(0.001)	(1.3)	.202
Tract	90-00 growth 0-10%	(0.002)	(2.4)	.262
Tract	90-00 growth 10-20%	(0.011)	(13.9)	.157
Tract	90-00 growth >20%	(0.026)	(36.6)	.277
Loan	Loan resold to FNMA/GNMA	0.044	94.2	.206
Loan	Large Lender Dummy	0.094	244.4	.564
Borrower	Borrower:MSA Income	0.005	35.4	.769
Borrower	Black Applicant	(0.057)	(98.6)	.122
Borrower	Hispanic Applicant	(0.064)	(106.3)	.117
Year	1994 Year Dummy	0.012	14.2	.100
Year	1995 Year Dummy	0.015	17.7	.101
Year	1996 Year Dummy	(0.005)	(6.3)	.120
Year	1997 Year Dummy	(0.018)	(21.1)	.127
Year	1998 Year Dummy	(0.054)	(65.3)	.145
Year	1999 Year Dummy	(0.022)	(26.0)	.160
Year	2000 Year Dummy	0.024	27.6	.151
Tract	% Tract Housing Built pre-1960	0.101	156.1	.387
	Observations	6,700,000		
	Adjusted R-Sq	0.030		
	Model	LMIC_L		

The model presented in Exhibit 28 shows a noticeable positive effect on CRA lender market share in 2000. That is, the coefficient on the year 2000 dummy variable is positive and statistically significant. The year 2000 effect is so different from the effects measured in other years that it is possibly the result of one or more acquisitions of major independent mortgage companies by CRA lenders, shifting the activity done by this or these formerly unregulated lenders into the CRA-regulated category.



B. Non-CRA Prime Lenders' Ratio of Non-CRA Eligible Loans to CRA-Eligible Loans

If, as the previous models suggest, CRA-regulated lenders are making extra efforts to originate loans that count for CRA credit, they should be squeezing non-CRA lenders out of this portion of the market. By originating fewer lower-income loans, non-CRA lenders should therefore have higher proportions of higher-income loans. Thus, examining non-CRA lenders' ratio of loans in higher-income areas to loans in lower-income areas highlights a potential indirect effect of CRA. One specific hypothesis is tested: that non-CRA lenders' ratio of higher-income area loans to lower-income area loans should be higher in counties where CRA agreements are in effect.¹⁹

Exhibit 29 summarizes a model designed to test this hypothesis. The observations used in the model are ratios of non-CRA-eligible lending to CRA-eligible lending for particular lenders in particular counties in particular years. The model includes observations for all lenders who originated at least 50 loans each in a county for each year of the time period. The minimum loan requirement is used to stabilize the ratio computation, and the requirement that each lender have at least 50 loans in the county for each year of the time period is intended to generate consistent lending histories so the confounding effects of lenders coming into and leaving counties is avoided.

Exhibit 29: Model of Non-CRA Lender Ratios of Non-CRA-Eligible Loans to CRA-Eligible Loans Demonstrates CRA Effect

Coefficient Description	Coefficient Value	t-Value	Mean Value
Intercept	562.517	11.7	1.0
Year	(.280)	(11.6)	1996.8
MSA Lending Agreement Dummy	.511	2.2	.669
County Dummies			
Observations	12,081		
Adjusted R-Sq	.17		
Model	NH3_2		

The coefficient on the MSA lending agreement dummy is positive, indicating that non-CRA prime lenders systematically have lower ratios of non-CRA eligible lending to CRA-eligible lending in those places. The effect is not large, however, and when lender dummies as well as county dummies were included in the equation, the effect disappears.

Tests in this section presented results on the market share impacts of CRA, both directly and indirectly. The first set of results indicates that CRA lenders have larger shares of the CRA-eligible lending market in MSAs where lending agreements are in place. The second test showed that CRA-regulated lenders' competitors do proportionately more higher-income lending (*i.e.*, lending that is not CRA-eligible) in places where CRA agreements are in place – suggesting that they are crowded out of the CRA-eligible market by their regulated competitors.

¹⁹ All counties in MSAs with agreements in place are assumed to be 'counties where CRA agreements are in effect.'

TESTS OF CRA IMPACT ON HOUSING PRICE AND TURNOVER

This section is built around another set of indirect tests for CRA's influence in the marketplace. In this case, the relationship between CRA's geographic focus on lower-income areas and housing market characteristics in these areas is examined. Specifically, the tests consider whether rates of house price change and housing stock turnover in lower-income areas are measurably different than they are in higher-income places. Both tests are conducted at the tract level. The first group of tests employs data on house price appreciation and housing transaction frequency in Boston, Los Angeles, and Chicago.²⁰ The second uses tract-level data from all 301 MSAs in the database used for most of the analyses in this report.

A. House Price Changes in CRA-Eligible Neighborhoods

It seems reasonable to expect that if CRA stimulates credit flows to lower-income neighborhoods in particular, then house prices in those neighborhoods should be increasing faster (or declining more slowly) than prices in other neighborhoods. This should occur because the extra focus of CRA lenders on lower-income areas ought to result in higher levels of effective demand in these areas as relatively larger numbers of lower-income borrowers are eligible to purchase homes there. Based on this line of reasoning, the following hypothesis is tested: house prices will rise more rapidly (or decline more slowly) in census tracts that are CRA-eligible than in other neighborhoods, even holding other relevant influences on house price changes constant.

Exhibit 30: Models of House Price Changes Demonstrate CRA Effects

Description	Specification 1		Specification 2		Specification 3		Specification 4		Mean Value
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	
Intercept	(28.718)	(43.9)	(28.718)	(43.9)	(19.188)	(7.5)	(19.187)	(7.5)	1.00
Los Angeles Dummy	(0.032)	(13.8)	(0.032)	(13.8)	(0.032)	(14.0)	(0.032)	(14.0)	.316
Chicago Dummy	(0.010)	(4.9)	(0.010)	(4.9)	(0.010)	(4.9)	(0.010)	(4.9)	.181
LMI Neighborhood Dummy	0.006	2.3	0.006	2.3	(1.730)	(0.7)	(1.730)	(0.7)	.104
Year	0.014	43.9	0.014	43.9	0.010	7.5	0.010	7.5	1996
% Minority in Tract	(0.008)	(1.8)	(0.008)	(1.8)	(23.948)	(8.8)	(23.947)	(8.8)	.218
Tract:MSA Income	0.008	3.7	0.008	3.7	(3.563)	(1.8)	(3.564)	(1.8)	1.15
90-00 tract growth			0.001	0.3			0.001	0.3	.092
Year * LMI Tract					0.001	0.7	0.001	0.7	209.2
Year * % Minority Population					0.012	8.8	0.012	8.8	435.3
Year * Tract:MSA Income					0.002	1.8	0.002	1.8	2,308.5
Observations	3,243		3,243		3,243		3,243		
Adjusted R-SQ	.43		.43		.45		.45		
Model	PE_6		PE_6a		PE_6c		Pe_6b		

The test for a CRA effect in this model is conducted through a dummy variable that determines whether or not loans in each tract are CRA-eligible in each year or not. The model results in Ex-

²⁰ Transaction data are those that underlie the Case Schiller Weiss house price index.



hibit 30 indicate that house prices in CRA-eligible areas increase more rapidly and resist declines better than in higher-income neighborhoods, as indicated by the positive coefficients on the dummy variable for lower-income neighborhood. This result is consistent with the hypothesis.²¹

B. Turnover Rates in CRA-Eligible Neighborhoods

If CRA induces regulated lenders to expand their CRA-eligible lending, it is reasonable to expect that turnover rates in lower-income neighborhoods will be higher, all other things being equal, than turnover rates in higher-income neighborhoods. CRA-eligible neighborhoods should be more attractive to both lower- and higher-income borrowers because the costs of home purchase loans there are less than they would be without CRA, so prospective buyers will have heightened interest in owning properties there. To test this proposition, a model that looks at the turnover rate in lower- and higher-income tracts is used, where ‘turnover’ is defined as the total number of home purchase loans in the tract in a particular year divided by the number of owner-occupied housing units in the tract in 1990. The hypothesis here is that, holding other relevant factors constant, turnover will be more rapid in CRA-eligible tracts than in non-eligible tracts.

Exhibit 31: Models of Turnover Rates Demonstrate CRA Effects

Description	Specification 1		Specification 2		Specification 3		Specification 4		Mean Value
	Coefficient	t-value	Coefficient t	t-value	Coefficient	t-value	Coefficient	t-value	
Intercept	(7.353)	(131.4)	(7.35400)	(131.4)	(7.7830)	(33.0)	(7.78000)	(33.0)	1.0
LMI Neighborhood Dummy	0.001	6.0	0.00121	6.0	(0.4020)	(2.3)	(0.40241)	(2.3)	.284
Year	0.004	132.7	0.00372	132.7	0.0039	33.2	0.00393	33.2	1996.5
% Minority in Tract	(0.025)	(78.7)	(0.02529)	(78.7)	(0.6728)	(3.0)	(0.67316)	(3.0)	.271
Tract:MSA Income	0.010	44.4	0.00992	44.3	0.7238	3.9	0.72077	3.9	1.00
90-00 tract growth			0.00004	8.7			0.00004	8.7	.305
Year * LMI Tract					0.0002	2.3	0.00020	2.3	568.6
Year * % Minority Population					0.0003	2.9	0.00032	2.9	541.6
Year * Tract:MSA Income					(0.0004)	(3.9)	(0.00036)	(3.9)	2013.5
Observations	334,671		334,671		334,671		334,671		
Adjusted R-SQ	0.21		0.21		0.21		0.21		
Model	TO_8a		TO_8b		TO_8d		TO_8c		

The model results confirm the existence of higher turnover rates in CRA-eligible neighborhoods, as indicated by the positive coefficients on the dummy variable for lower-income neighborhood in Exhibit 31, or the combined positive effect of the lower-income dummy variable and interaction effects. The models of turnover rate are structured to be parallel to the housing price change models. The other variables in the model behave in identical fashion, as would be expected.

²¹ A number of different specifications of the housing price change model were tested, producing consistent results whether or not indicators of tract growth over the 1990 to 2000 time period were included and whether or not interaction effects between different years and the explanatory variables were included or excluded.

Overall then, the results from this section offer additional support for a CRA effect in housing markets. Results presented here are consistent with the notion that in areas where lenders receive CRA credit for their activities, house prices are more robust and homes are sold more frequently. Both of these results suggest that CRA's mandate to increase accessibility to mortgage capital works by increasing effective demand in specific types of areas

SUMMARY

Statistical analysis of 30 million home purchase loan originations and loan applications over the 1993 to 2000 time period produces evidence consistent with the following propositions about CRA:

- CRA lenders originated a higher proportion of CRA-eligible home purchase loans than they would have if CRA were not in place.
- CRA lenders rejected a smaller proportion of CRA-eligible home purchase loan applications than they would have if CRA were not in place.
- CRA lenders captured a larger share of the CRA-eligible home purchase market than they would have if CRA were not in place.
- Housing price increases and turnover rates were higher in CRA-eligible neighborhoods than they would have been if CRA were not in place.

These conclusions are based on finding positive and statistically significant correlations between variables that capture CRA's differential influence on the volume of specific types of lending across market segments and geography.

To the extent that these findings have weight, it is the result of these correlations, and not on the precise magnitude of the changes that CRA may appear in the analysis to have generated. Because there are many credible alternative specifications of the statistical tests used, each of which would produce different estimates of the magnitude of CRA's impact, it is inappropriate to rely on the specific quantitative estimates of the effects of CRA presented in this report. Rather, the specific quantitative effects of CRA that are summarized in Exhibit 21 are meant to provide order of magnitude indications of CRA's likely impacts over the 1993 to 2000 time period.

In the statistical testing presented in this section, a serious and diligent effort was undertaken to build control variables based on metro area, local neighborhood, lender, loan, and borrower characteristics. Based on the specific approach reported here, CRA's quantitative impact has been small but significant. Other specifications and research efforts could produce different specific results, but it is unlikely that such efforts would indicate either that CRA has had no effect or that CRA has had a very major impact on the levels of CRA-eligible lending that took place over the time period.

SECTION 6

CRA IN METROPOLITAN AREAS

Mortgage lending patterns will differ from one market area to the next. These differences emerge, in part, from historical variation in the spatial pattern of housing and economic development in particular areas, as well as the history of state and local legislation and regulations governing this development. While regulation of mortgage lending is largely a federal matter, state and local government intervention into mortgage and housing markets has also been important. This is particularly true of historical variation in the laws relating to bank branching and to mergers and acquisitions. Local laws governing housing construction and land use have similarly been important.

Recognizing the diversity of experiences across markets, this study conducted group discussions and in-depth interviews with lenders, community advocates, government officials and housing market experts around the U.S. This section begins reporting the findings of this more qualitative portion of the study by documenting metropolitan- and tract-level variation in housing and mortgage markets. It then explores variation in the impact of CRA in the four metropolitan areas selected for detailed review and assessment and presents spatial analysis of lending data at the census tract level. The next section examines trends in lending from a rural perspective. The final two sections focus on CRA issues, first from the perspective of lenders in each of these metropolitan areas, and then from the perspective of community-based organizations operating there.

MSA LEVEL CHARACTERISTICS OF HOUSING AND MORTGAGE MARKETS

Reflecting a key difference between housing markets, several California lenders interviewed for this study noted that some Metropolitan Statistical Areas (MSAs) simply do not have housing stock that is affordable to well qualified, credit- and homeownership-counseled, lower-income prospective borrowers. Accompanying this housing market variability is similarly significant variation in metropolitan area financial services markets. These differences are a result of the long-term economic performance of the area, the strength and national ambitions of locally-based lenders, demand for mortgage credit, and state-level banking regulations, among other factors.

From a CRA perspective, there are two important implications of metropolitan area variation in housing and financial services markets. First, CRA-eligible lending is significantly more challenging for lenders in some MSAs than others. Second, vastly different shares of lending pass through the CRA regulatory apparatus in some places than others. Consequently, CRA's effect from one MSA to the next varies substantially based on MSA characteristics and the MSA-specific structure of the mortgage industry there.

A. Variation Across Metropolitan Areas

The demand for mortgage credit depends in part on the relationship between home prices and incomes in a given area. In areas where housing costs are high relative to income, there may be little opportunity to lend to lower-income families. At the same time, because larger metropolitan areas tend to have a more diverse income mix, they may present lenders with greater opportunities to serve CRA-eligible borrowers. Conversely, smaller MSAs with more tightly bunched income distributions may have more CRA-eligible lending, because CRA-eligible borrowers in these places have incomes that are, in absolute terms, relatively close to the average, presenting lenders in these places with lower risk profiles.



Exhibit 32 sheds some light on this issue by examining the distribution of CRA-eligible lending and assessment area lending by MSA size. It shows a weak negative relationship between CRA-eligible share and MSA size for all but the very largest MSAs (those with populations exceeding four million). The assessment area share results decline steadily from 36 percent for the smallest MSA to 26 percent in those metropolitan areas whose population is between two and four million, before settling up near the average for the largest MSAs.

Exhibit 32: CRA-Eligible and Assessment Area Shares of Home Purchase Lending Vary by MSA Size

MSA Size (thousands)	Number of MSAs	CRA-eligible share	Assessment area share	Total Loans	Total Population (2000)
<200	106	37.4	36.4	209,401	14,372,239
200-500	96	35.5	33.7	508,866	31,304,645
500-1,000	39	36.1	30.2	421,624	26,990,344
1,000-2,000	34	35.8	28.7	873,126	46,981,346
2,000-4,000	18	34.5	26.3	938,369	47,921,370
>4,000	8	35.9	29.3	748,477	51,314,239
Total	301	35.6	29.5	3,699,863	218,884,183

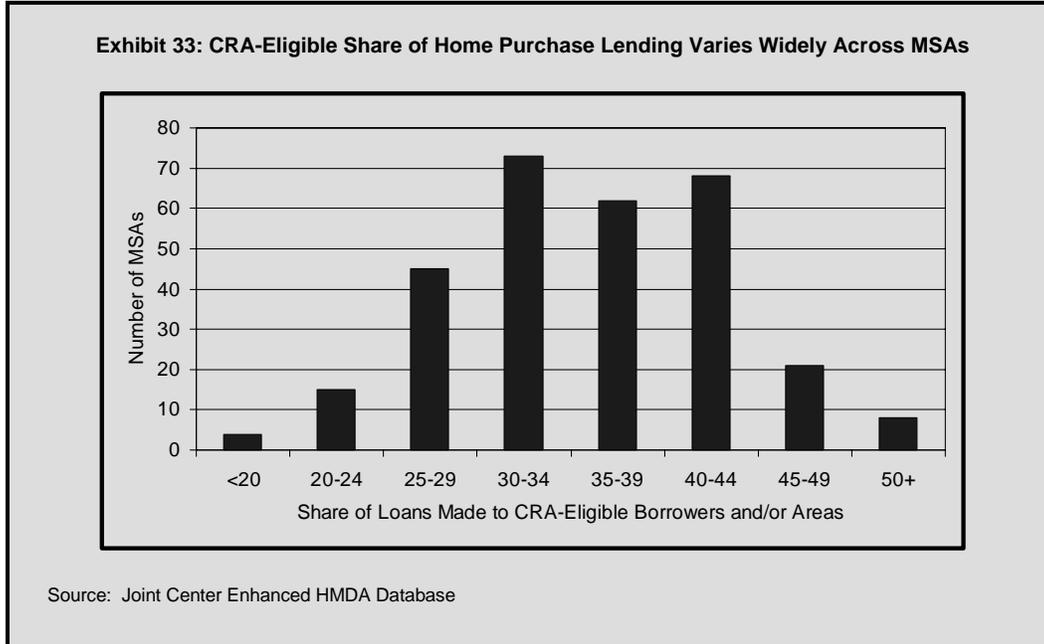
Source: Joint Center Enhanced HMDA Database

Keeping in mind the structure of the mortgage lending industry is helpful in trying to make sense of these figures. Larger markets offer economies of scale to participants, making them attractive to independent mortgage companies and affiliates of depositories looking to expand their activities. These places are therefore likely to be more competitive, and to draw the most successful players in the mortgage lending industry, the activities of which are often not covered by CRA. In light of the growth of out of area activities of CRA-regulated institutions noted throughout the report, it seems likely that their presence is the factor pushing CRA-regulated share down in these larger markets. Smaller markets offer limited economies of scale and are consequently more likely to be left to indigenous depository lenders.

Exploring the notion of cross-MSA variability further, Exhibit 33 looks at the share of lending that goes either to lower-income borrowers or areas ('CRA-eligible share') in all 301 MSAs examined in this study. The exhibit indicates that lower-income lending can account for as little as one-in-five or as much as half of all home purchase loans originated in individual MSAs. CRA-eligible share, in fact, ranges from 19 percent in New York City, to 55 percent in Decatur, Alabama, with a median value of 36 percent (in Tulsa, Oklahoma). These figures appear to fit loosely with the typology described above, where small MSAs have larger shares of lower-income lending and large ones have smaller shares.

Pursuing MSA-level variability at a finer grain, however, indicates that places with few lower-income loans are not particularly homogeneous with respect to population (Exhibit 34). Instead, lower-income share is more directly related to income and housing costs, as CRA-eligible lending shares tend to be lowest in higher cost MSAs in California and in the New York metropolitan area. In contrast, most of the ten MSAs with the highest shares of lower-income borrower and area lending are located in affordable areas in the Midwest. Interestingly, many of the MSAs with the largest CRA-eligible shares are smaller lending markets, and overall the relationship between market size and lower-income borrower/area share is indistinct.





The ‘Selected Others’ column of Exhibit 34 presents results from ten large MSAs, including the four case study sites for this research. It shows that the nation’s larger MSAs have shares of lower-income lending that range almost as widely as the overall distribution. Comparing, for example, Los Angeles and Washington DC, which have nearly identical levels of total home purchase lending, indicates the impact of variability in lower-income lending: in Los Angeles 27,764 loans were CRA-eligible, against 51,638 in Washington, DC.

Exhibit 34: Top and Bottom MSAs for CRA-Eligible Home Purchase Lending, 2000

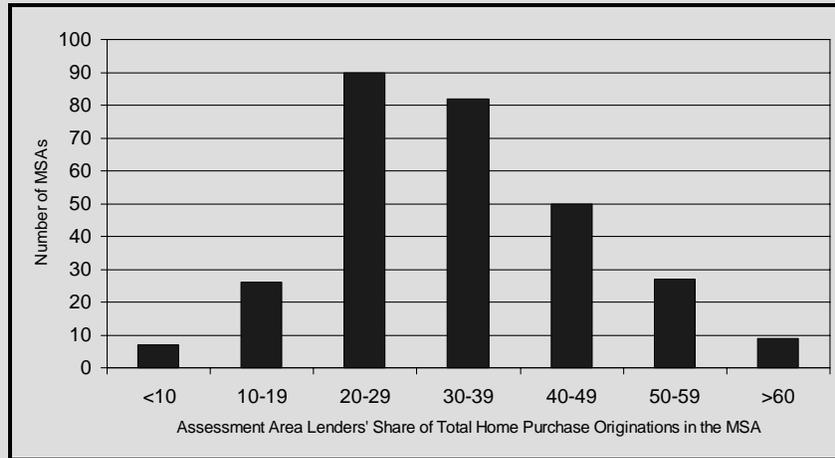
Lowest Shares	CRA-Eligible Share	Total Loans	Highest Shares	CRA-Eligible Share	Total Loans	Selected Others	CRA-Eligible Share	Total Loans
New York, NY	19.1	59,118	Topeka, KS	48.6	2,675	San Diego, CA	22.3	54,357
Vallejo, CA PMSA	19.5	10,340	Kokomo, IN	48.7	1,797	Los Angeles, CA	24.3	114,254
Salinas, CA	19.8	5,080	Elkhart, IN	50.2	2,957	Las Vegas, NV	26.2	37,035
Santa Rosa, CA	19.9	8,690	Springfield, IL	50.8	3,560	Miami, FL	27.7	38,875
Merced, CA	20.2	2,947	Terre Haute, IN	51.0	1,997	Boston, MA	32.5	87,888
Johnstown, PA	20.8	1,849	Wilmington, DE	51.7	10,651	Philadelphia, PA	37.1	71,725
San Francisco, CA	20.9	22,228	Rochester, MN	52.0	3,233	Birmingham, AL	39.8	14,861
Santa Cruz, CA	21.0	4,199	Bloomington, IL	52.0	2,942	Baltimore, MD	40.4	44,343
Olympia, WA	21.3	3,724	South Bend, IN	52.5	4,345	Chicago, IL	42.5	146,434
Jersey City, NJ	21.8	5,068	Decatur, AL	55.8	2,339	Washington, DC	45.4	113,740

Source: Joint Center Enhanced HMDA Database

Because the size of the lower-income borrower and area market to some extent suggests the relative ‘fertility’ of each market with respect to its ability to generate CRA-eligible loans, it is not surprising that the share of loans in each place originated by CRA-regulated lenders and their af-

filiates inside assessment areas also varies substantially. As Exhibit 35 shows, in some MSAs only a handful of loans are originated in CRA assessment areas, while in others well over half are. In fact, the difference in assessment area share between the MSA with the lowest assessment area share (Denver: 6 percent) and the highest (Dubuque: 74 percent), at nearly 70 percentage points, is even wider than that between the MSAs with the lowest and highest CRA-eligible loan shares.

Exhibit 35: Assessment Area Share of Home Purchase Originations Also Varies Widely



Source: Joint Center Enhanced HMDA Database

Exhibit 36 repeats the top and bottom ten breakdown for assessment area lending shares. Both groups contain at least one large MSA, and a complement of medium and smaller-sized ones. San Francisco's 60 percent share is some ten times higher than Denver's share. Similarly, Brazoria, Texas, one of the bottom ten, had a much smaller share of assessment area lending than Lincoln, Nebraska in the top ten, though they had nearly identical numbers of home purchase originations in 2000.

Exhibit 36: Top and Bottom MSAs for Assessment Area Home Purchase Lending Originations, 2000

Lowest Shares	Assessment Area Share	Total Loans	Highest Shares	Assessment Area Share	Total Loans	Selected Others	Assessment Area Share	Total Loans
Denver, CO	5.9	63,755	San Francisco, CA	59.6	22,228	Las Vegas, NV	14.4	37,035
Greeley, CO	7.1	5,735	Grand Forks, ND	60.1	639	Atlanta, GA	16.6	94,537
Boulder, CO	7.9	9,306	Williamsport, PA	60.2	1,250	Baltimore, MD	20.3	44,343
El Paso, TX	8.2	7,244	Pittsfield, MA	60.4	1,563	Washington, DC	24.5	113,740
Col. Spr., CO	8.6	12,699	Wheeling, WV	60.5	1,379	Birmingham, AL	25.8	14,861
Tucson, AZ	9.0	17,244	Decatur, IL	64.7	1,748	Chicago, IL	30.4	146,434
Lawton, OK	9.8	1,208	Bloomington, IL	69.7	2,942	San Diego, CA	32.6	54,357
Brazoria, TX	10.2	4,276	Lincoln, NE	70.6	4,278	Los Angeles, CA	36.7	114,254
Anchorage, AK	10.5	5,022	Enid, OK	71.0	801	New York, NY	45.7	59,118
Pueblo, CO	11.9	2,212	Dubuque, IA	73.9	1,063	San Jose, CA	54.8	27,565



This metropolitan area variation in assessment area share and CRA-eligible share results from far more than simply size or fertility with respect to CRA-eligible lending. For instance, Denver, where only 6 percent of loans are made in assessment areas, has a relatively high CRA-eligible lending share of 40 percent. Conversely, San Francisco, where 60 percent of loans are made inside assessment areas, has the seventh lowest CRA-eligible share, at just 21 percent.²² These two markets in fact present almost completely opposite characteristics with respect to their shares of lending that are CRA-eligible, and the shares that are actually originated by a CRA-regulated entity.

In short, the determinants of assessment area lending are more than a simple reflection of the opportunities presented to CRA-regulated lenders. Exhibit 36 suggests the role played by state-level banking regulations and the idiosyncratic characteristics of the individual markets. All six of Colorado's MSAs are among the eleven MSAs with the lowest assessment area shares in the country. Note that Colorado was one of the last states to deregulate its banking industry, putting branch-based mortgage operators at a disadvantage relative to independent and affiliated mortgage companies. Moreover, Denver went through a wrenching regional recession in the 1980s that led to the collapse of large segments of its banking and thrift industry. During this period, national players were less eager to purchase Denver-based banking operations and instead expanded their operations elsewhere. Today, Denver and other metropolitan areas in Colorado are experiencing explosive growth, but growth is largely being served by national mortgage companies - both bank affiliates and independent mortgage companies.

Overall, there is substantial diversity in MSAs' mortgage markets. Despite a mild relationship between population growth and assessment area share, and to a lesser extent CRA-eligible share, the overriding sense is of the diversity of these places, as large, medium, and smaller MSAs are placed near the top and bottom of the distribution by both assessment area share and CRA-eligible share of all mortgage loans.

B. Variation Within Selected Metropolitan Areas

Another way to examine nationwide variability in lending markets is to look for patterns at the tract level. Doing so involves summing across all U.S. tracts by key sources of variation. This section considers home purchase loan originations by tract level race, income, and population growth characteristics.

Exhibit 37 looks at the CRA-eligible lending share by tract population growth rate and tract minority percentage. The population growth panel reproduces the finding of increased CRA-eligible lending shares noted earlier in the report. It also shows that declining tracts had much larger shares of lower-income lending than tracts that grew rapidly. In addition, the exhibit indicates that while CRA-eligible share grew across all population growth categories, it grew fastest in tracts that lost the most population, and grew most slowly in tracts that gained population most quickly. This results in part from the fact that many declining areas lost higher-income households, and that the growth in CRA-eligible share reflects this relative loss of lending opportunities to higher-income borrowers as much as it reflects the increase in lending to lower-income people.

²² The shares for Oakland and San Jose are 25 and 28 percent, respectively.

The tract minority percentage panel also shows the CRA-eligible share of lending rising across all categories from 1993 to 2000. The panel also demonstrates an extremely strong, positive relationship between tract minority percentage and the share of loans that are CRA-eligible. While only 30 percent of loans in mostly white tracts are CRA-eligible, the comparable figure for tracts with more than three-quarters minority inhabitants is 77 percent. CRA-eligible share also rose more rapidly between 1993 and 2000 in high minority areas than anywhere else.

Exhibit 37: CRA-Eligible Share Varies by Tract Population Growth Rate and Minority Share

Tract Population Growth Rate	CRA-Eligible Share		
	1993	2000	Change
Decline >8%	39.1	45.4	6.3
Decline 0-8%	33.0	38.3	5.3
Growth 0-10%	30.0	34.9	5.0
Growth 10-20%	30.4	35.5	5.1
Growth >=20%	27.5	31.9	4.4
Total	30.7	35.5	4.9
Tract Minority Percentage			
<10%	25.7	29.9	4.2
<20%	27.0	30.3	3.4
<50%	36.8	40.3	3.5
<75%	54.2	58.7	4.4
>=75%	70.8	76.9	6.0
Total	30.7	35.5	4.9

Source: Joint Center Enhanced HMDA Database

The rapid growth in lower-income borrower and area lending reported in Exhibit 37 raises the question of what kinds of lending were responsible for the increases in the different types of tracts. Exhibit 38 examines the share of lending done by lenders specializing in conventional prime mortgages by the same tract characteristics as the previous exhibit, and also by tract income.²³ It indicates that conventional prime lenders' share was remarkably consistent, hovering near 70 percent for all categories and decreasing only minutely on average over the 1993-2000 period.

This cross-tract equivalence and stability stands in contrast to the results by tract racial and ethnic characteristics. In 1993, 77 percent of home purchase loans in mostly white tracts were originated by conventional prime lending specialists, compared to 58 percent in tracts that were at least three-quarters minority. By 2000, this 19 percentage point gap had widened to 27 percentage points, as conventional prime lenders originated 76 percent of loans in mostly white tracts and less than half (49 percent) of all loans originated in predominantly minority areas. The decrease in prime lending was made up by subprime lending specialists, who gained market share at the expense of specialists in both government-backed and conventional prime lending.

²³ The preceding exhibit did not look at tract income because all lower-income area lending is CRA-eligible by definition.



The final panel shows that conventional prime lenders also lost market share in lower-income areas, falling from 59 to 56 percent, while holding steady in higher-income tracts. As in high minority tracts, subprime lending specialists gained market share at the expense of prime (both government-backed and conventional) lenders, gaining 10 percentage points of market share between 1993 and 2000, to land at 12 percent.

Exhibit 38: Share of Conventional Prime Lending Also Varies by Census Tract Characteristics

	Conventional Prime Share		
	1993	2000	Change
Tract Population Growth Rate			
Decline >8%	67.3	65.4	-1.9
Decline 0-8%	71.7	70.0	-1.8
Growth 0-10%	72.7	71.5	-1.2
Growth 10-20%	71.0	69.8	-1.2
Growth >=20%	68.0	69.4	1.4
Total	70.4	69.8	-0.6
Tract Minority Percentage %			
<10%	76.6	75.6	-0.9
<20%	67.1	69.9	2.8
<50%	59.2	62.4	3.2
<75%	60.0	58.3	-1.7
>=75%	57.7	49.2	-8.5
Total	70.2	69.8	-0.4
Tract Income			
Lower Income	59.3	55.8	-3.5
Higher Income	71.8	71.9	0.1
Grand Total	70.4	69.8	-0.6

Source: Joint Center Enhanced HMDA Database

Because CRA-regulated lenders tend not to specialize in subprime lending, the results from Exhibits 37 and 38 suggest that there may be some trend to the share of loans in each tract type that are provided by CRA-regulated lenders operating inside their assessment areas. Exhibit 39 investigates this issue, keeping the same tract groupings and looking at the share of home purchase originations made by CRA-regulated lenders inside and outside their assessment areas, and by non-CRA lenders.

The exhibit shows the rapid growth of out of area lending across tracts of all incomes, minority shares, and population growth rates. In the tracts that lost population over the 1990s, this growth came primarily at the expense of in-area lenders, while in rapidly growing tracts it was more likely to come from non-CRA lenders. Similarly, in lower-income tracts, out of area lenders grew heavily at the expense of in-area lenders, and hit non-CRA lenders harder in higher-income places.

Results for tract minority percentage are somewhat more complicated, as in-area lenders lost significant share to out of area lenders in tracts with the most and least minorities, but held there own in places where minorities comprise between 10 and 75 percent of the population. Interest-

ingly, these are precisely the places where out of area lenders gained most heavily at the expense of non-CRA lenders.

Exhibit 39: Assessment Area Lending Declines in All Tract Types

	1993			2000			Change		
	In Area	Out of Area	Non-CRA	In Area	Out of Area	Non-CRA	In Area	Out of Area	Non-CRA
Tract Population Growth Rate									
<8	41.6	24.0	34.3	31.4	37.2	31.4	-10.2	13.2	-2.9
8-0	39.9	24.1	36.0	31.4	37.7	30.9	-8.4	13.6	-5.1
0-10	37.7	24.5	37.8	31.6	37.5	31.0	-6.1	13.0	-6.9
10-20	35.5	25.3	39.3	29.8	37.6	32.6	-5.6	12.3	-6.7
20+	32.1	25.5	42.5	27.5	37.7	34.7	-4.5	12.3	-7.7
Tract Minority Percentage									
<10%	40.8	25.0	34.2	30.8	39.8	29.4	-10.0	14.8	-4.8
<20%	30.5	26.0	43.5	28.5	37.2	34.4	-2.0	11.2	-9.2
<50%	29.3	24.7	46.0	27.9	35.5	36.7	-1.5	10.8	-9.4
<75%	32.7	21.1	46.3	29.8	33.8	36.4	-2.9	12.7	-9.9
75+	36.5	18.1	45.4	27.5	34.4	38.0	-8.9	16.3	-7.4
Tract Income									
LI area	40.1	21.2	38.6	29.1	37.1	33.8	-11.0	15.9	-4.9
HI area	35.6	25.2	39.2	29.6	37.9	32.5	-6.1	12.8	-6.7

Source: Joint Center Enhanced HMDA Database

In summary, while metropolitan areas share some common features, they vary significantly from one another. Aggregating across tract characteristics nationally showed glimpses of somewhat more systematic variation, such as the tendency for conventional prime lending specialists to relinquish market share in areas that had lower-incomes, less population growth, or higher shares of minorities. Because these patterns hint at spatial relationships between lender types and specializations and market characteristics, the next section examines in greater detail spatial variation in lending patterns in four selected metropolitan areas.

DETAILED ASSESSMENT OF FOUR METROPOLITAN AREAS

The four MSAs selected for more intensive analysis reflect the considerable diversity of U.S. metropolitan areas detailed throughout this section and the report. The section begins by briefly characterizing the variation across these MSAs and then examines the spatial pattern of mortgage lending in these places in greater detail using a series of maps.

A. Overview of Selected Metropolitan Areas

Exhibit 40 summarizes HMDA data on key characteristics of home purchase lending markets in four selected metropolitan areas. The exhibit highlights the diversity among the places. Indeed on most measures no two of the selected metropolitan areas are similar to one another. Among the



more interesting differences is the discrepancy between the share of home purchase loan originations in Los Angeles and Birmingham made by the 12 largest lending organizations in the country. While this share Birmingham is just 22 percent, in Los Angeles it nearly reaches 50 percent. These differences reflect the nature of the local mortgage market, as Birmingham has several strong regional-scale players that have managed to resist incursions by national players to a greater extent than virtually any other relatively large MSA. Meanwhile, Los Angeles is served by several of the top 12 lenders operating as depositories, but is also the home base for several top independent mortgage companies, and has attracted the attention of large out of area lenders as well. Compared to the national average of 39 percent, Baltimore also has a high share of loans made by the very largest lenders, while Chicago presents a more typical picture.

Though a large share of Baltimore's loans came from large national players, it had the lowest share of home purchase loans originated by CRA-regulated lenders and their affiliates inside their assessment areas, at just 20 percent. The national average share is a full ten percentage points higher at 30 percent. Birmingham also fell below the national average, while Los Angeles, at 37 percent, was highest in the group.

Los Angeles is also at the extreme in the share of home purchase originations made by subprime specialists. Though the national average share in 2000 was 6 percent, fully 11 percent of Los Angeles's home purchase loans were originated by subprime specialists. All of the other MSAs are below the national average share (both Birmingham and Baltimore are under 5 percent).

Low-subprime shares do not translate into high conventional prime shares, as illustrated by Baltimore's 61 percent conventional prime share, a level well below the national average of 70 percent, and far short of Chicago's 77 percent. Baltimore's dearth of conventional prime loans is offset by government-backed lending, which accounts for 34 percent of home purchase loans there, compared to the national 21 percent level, and under 20 percent in Chicago and Los Angeles. Interestingly, Birmingham, which also falls below the national average in conventional prime lending, has an extremely strong manufactured housing lending share. Fully 11 percent of its originations, or more than three times the national average, were for manufactured housing in 2000. None of the other case study MSAs had a share of even one percent.

B. Mapping Spatial Variation in Home Purchase Lending Originations

The final portion of Section 6 uses maps to present the spatial distribution of four key CRA-related variables in the case study MSAs. The maps first show neighborhoods with incomes less than 50 percent of the MSA median and those that are at least 50 percent minority. The third map identifies neighborhoods in which subprime lending specialists conducted a disproportionate share of all lending. The final map highlights census tracts where CRA lenders operating in their assessment areas were most active. Collectively, these maps indicate a mismatch between the areas on which CRA is ostensibly focused (*i.e.*, lower-income and minority neighborhoods) and the places where assessment area lending is concentrated. Additionally, a disproportionate share of activity in the lower-income and minority neighborhoods is conducted by subprime lending specialists. This latter observation reflects the finding presented earlier in the report that the mortgage finance system differentiates between lower-income areas and others. The maps imply, but do not offer definitive proof, that as part of this dual system, CRA-regulated lenders help borrowers of all income classes receive loans in higher-income areas, but are less central to efforts directing mortgage capital to lower-income communities. The remainder of this section discusses the pattern of residence and lending in each MSA.

Exhibit 40: Distribution of Home Purchase Lending Varies Across Case Study Areas

	U.S.	Baltimore	Birmingham	Chicago	Los Angeles
By Lender Size					
50,000 or more	39.0	46.1	21.5	36.8	49.4
25,000 to 49,999	12.7	6.6	14.3	15.3	12.8
10,000 to 24,999	11.2	8.6	15.8	11.7	9.4
Less than 10,000	37.0	38.7	48.4	36.2	28.4
All Lender Sizes	100.0	100.0	100.0	100.0	100.0
By Loan Type					
Conventional Prime	69.8	60.5	65.1	76.6	69.7
Government	20.6	34.2	20.1	17.5	18.9
Subprime	6.4	4.6	4.3	5.6	10.6
Manufactured Housing	3.2	0.8	10.5	0.3	0.8
All Loan Types	100.0	100.0	100.0	100.0	100.0
By Lender Type					
Banking Organization within Assessment Area	29.5	20.3	25.8	30.4	36.7
Banking Organization outside Assessment Area	37.8	53.2	41.3	44.7	27.3
All Banking Organizations	67.3	73.5	67.1	75.1	64.0
Other Organizations	32.7	26.5	32.9	24.9	36.0
All Organizations	100.0	100.0	100.0	100.0	100.0
By Borrower and Neighborhood Income					
LI Borrower/LI Neighborhood	6.3	7.4	6.6	6.5	3.8
LI Borrower/HI Neighborhood	22.6	28.0	29.2	28.0	8.1
HI Borrower/LI Neighborhood	6.7	5.0	4.0	7.9	12.4
HI/Borrower/HI Neighborhood	64.4	59.6	60.2	57.5	75.7
All Borrowers and Neighborhoods	100.0	100.0	100.0	100.0	100.0
By Borrower Race					
White	74.6	74.6	80.6	69.0	48.5
Black	7.5	17.7	15.8	9.1	6.4
Hispanic	8.7	1.4	1.1	12.0	25.8
Other	9.2	6.3	2.5	9.8	19.3
All Races	100.0	100.0	100.0	100.0	100.0

Source: Joint Center Enhanced HMDA Database

As is well known, much of Chicago's lower-income and minority population is concentrated in a band that runs through the South Side of the city and continues through the southern suburbs, as depicted in the first two Chicago maps. These maps also indicate that few predominantly minority or lower-income neighborhoods exist to the north and west of the city. The third map, depicting concentrations of subprime lending, lines up with the lower-income/ predominantly minority neighborhood band stretching southward through the city. The final map is distinctive for being



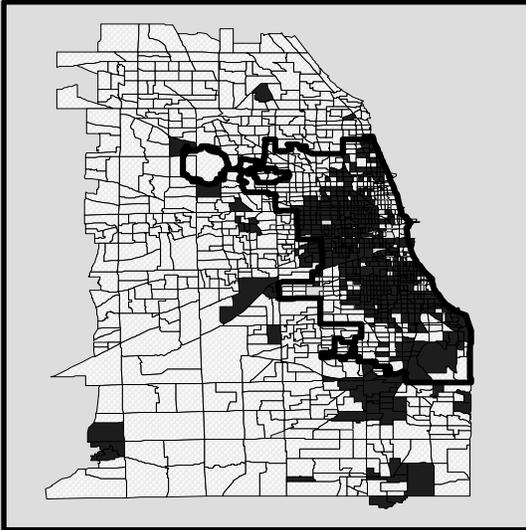
nearly the mirror image of the first three. Tracts where assessment area lending is at least 30 percent of the total are rare in southern Chicago and its suburbs. Conversely, CRA lenders conduct much of the lending in most tracts to the north and west of the city.

The trend is similar, if slightly less distinct, in Los Angeles. Lower-income neighborhoods are concentrated in the center and to the east of the City of Los Angeles. Tracts with high minority populations are also located in these places, though they include additional areas with incomes greater than 50 percent of the area median to the south and east of the City, and a similar pocket to the north. Neighborhoods receiving a disproportionate share of subprime lending are scattered across the MSA, avoiding only the high-cost coastal areas and upper-income areas such as Bel Air, Brentwood and Beverly Hills north of downtown Los Angeles. The final map shows that assessment area lending dominates in these higher-income areas. Assessment area lending is also at least 30 percent of the total in some of the predominantly minority areas to the east of the city. Assessment area lending is weakest, however, in lower-income areas the populations of which are at least half minority.

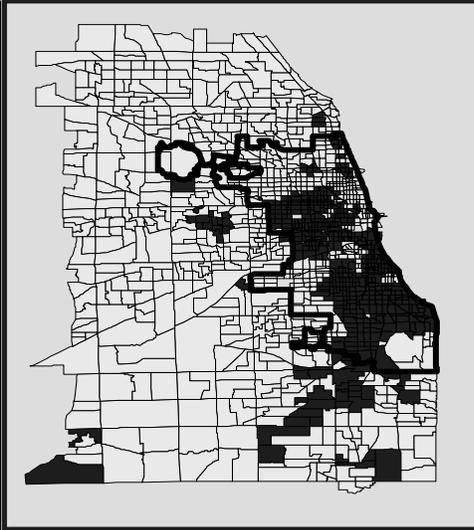
Both Birmingham and Baltimore also ascribe to the pattern outlined for Chicago and Los Angeles. In each MSA lower-income and predominantly minority neighborhoods are concentrated in or near the central city. Subprime lenders are disproportionately active in these tracts. Meanwhile, CRA lenders operating in their assessment areas are more active in the suburbs. Suburban tracts in Birmingham where CRA assessment area lending is below 30 percent and subprime lending below 15 percent are likely have a substantial manufactured home lending presence, as well as out of area lenders and independent mortgage companies. In Baltimore, with a relatively limited branch-banking presence, lending in the suburbs is dominated by independent mortgage companies and out of area lenders.

Exhibit 41: Lending Patterns in Chicago

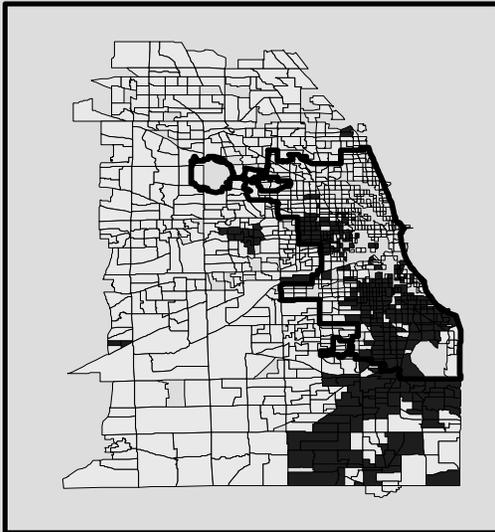
Lower-Income Neighborhoods



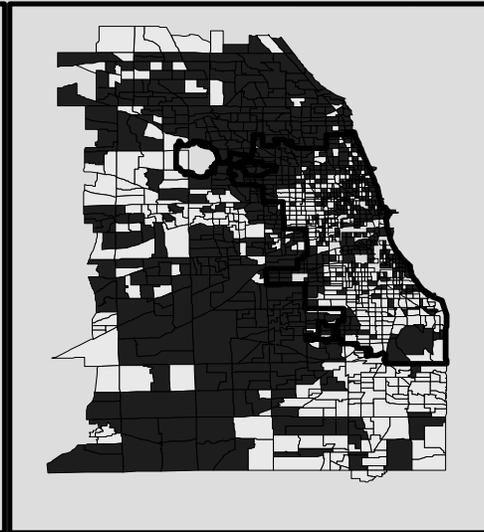
Minority Population >50 percent



Subprime Lending Share >15 percent



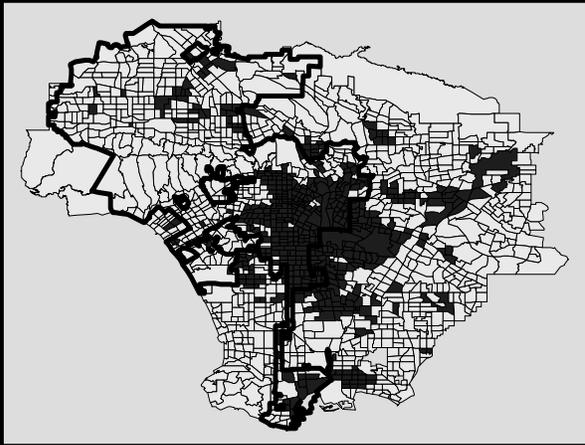
Assessment Area Lending Share >30 percent



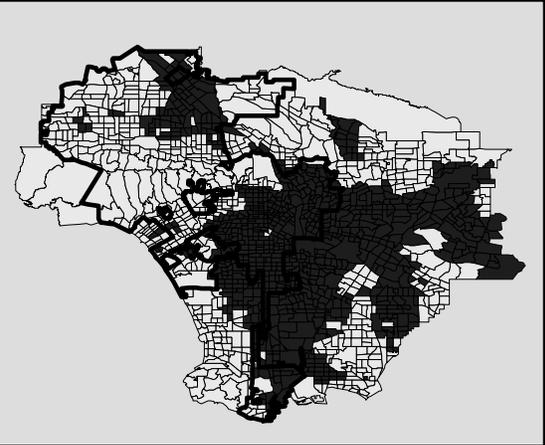
Note: Map focuses on central part of MSA

Exhibit 42: Lending Patterns in Los Angeles

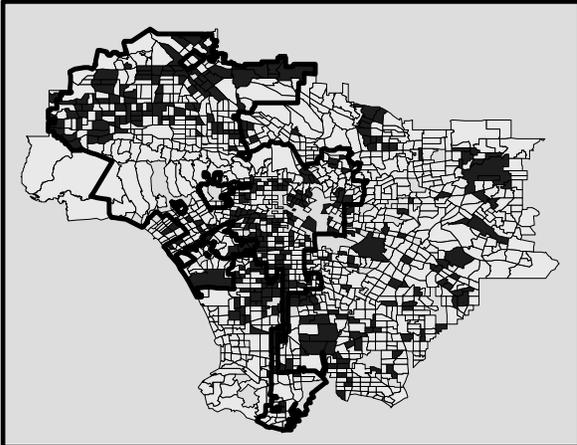
Lower-Income Neighborhoods



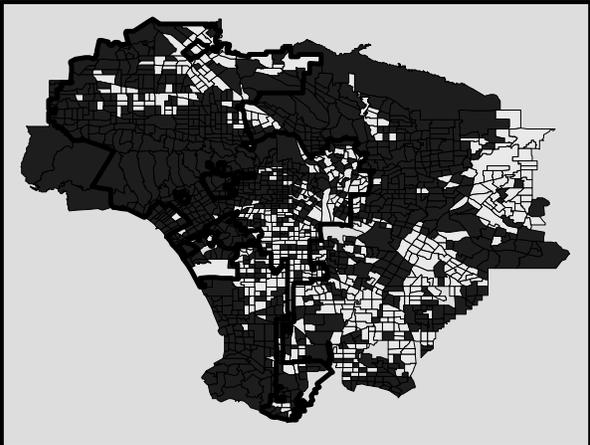
1990 Minority Population >50 percent



Subprime Lending Share >15 percent



Assessment Area Lending Share >30 percent



Note: Map focuses on central part of MSA

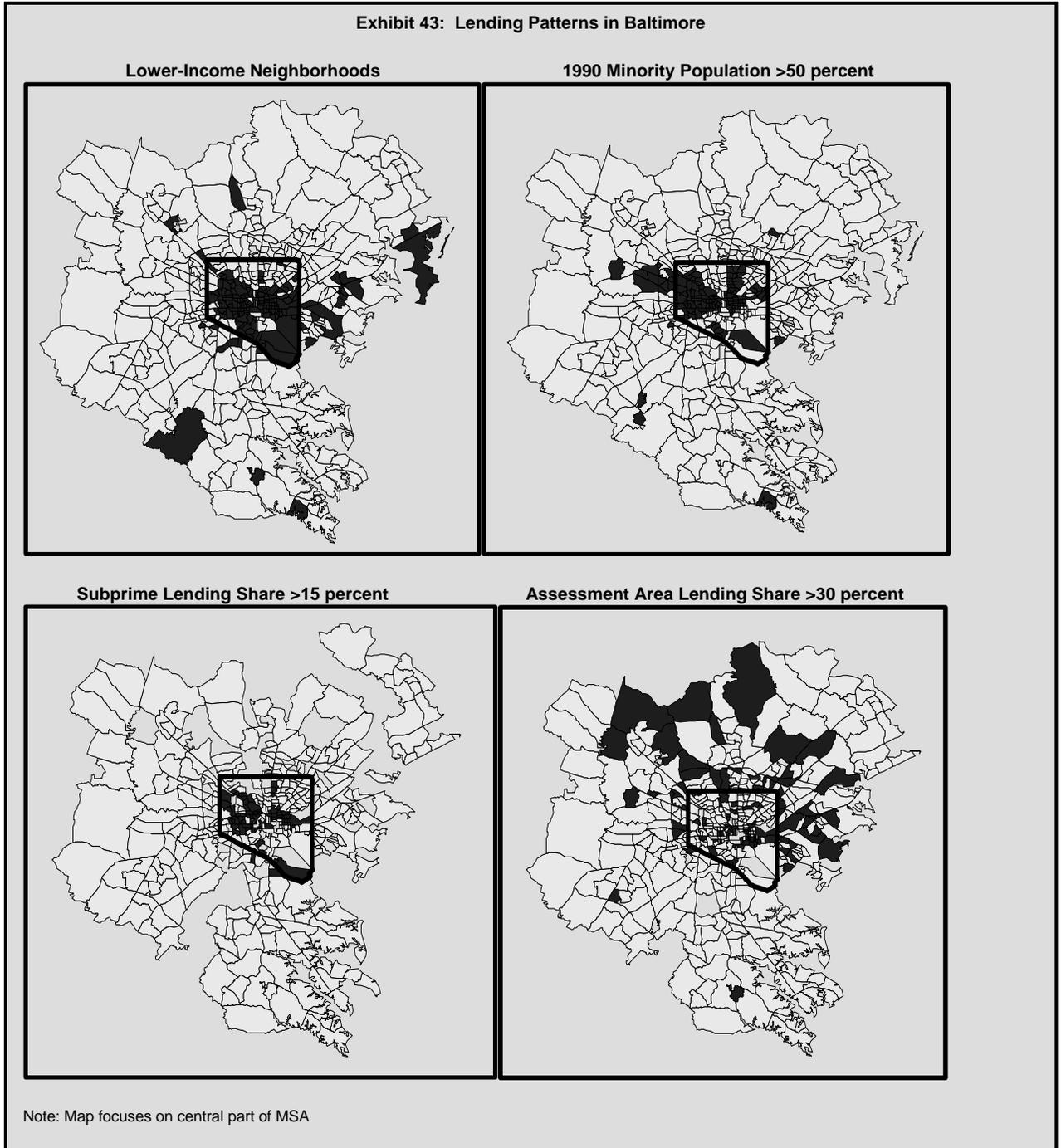
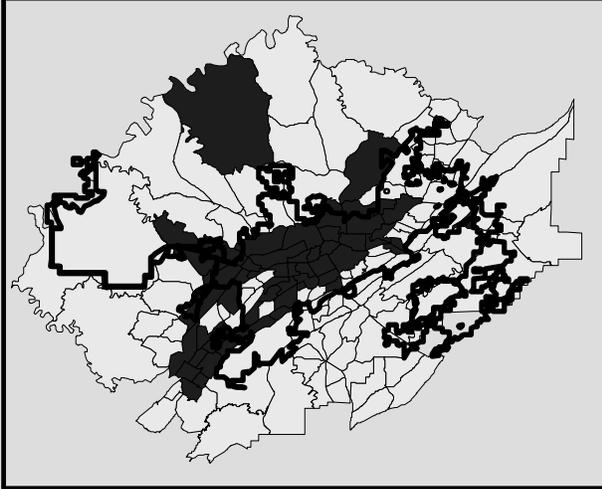
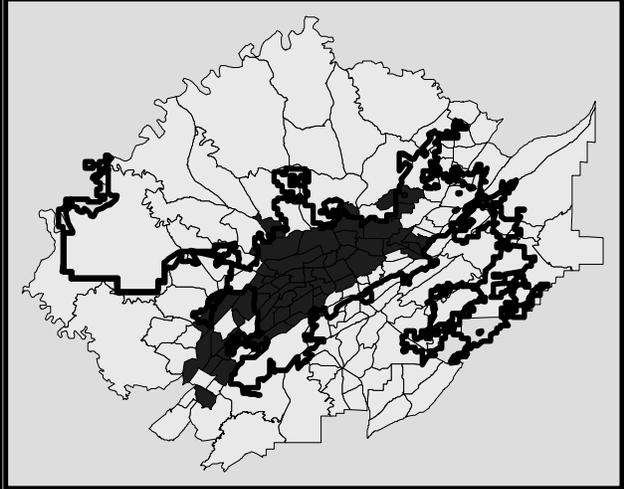


Exhibit 44: Lending Patterns in Birmingham

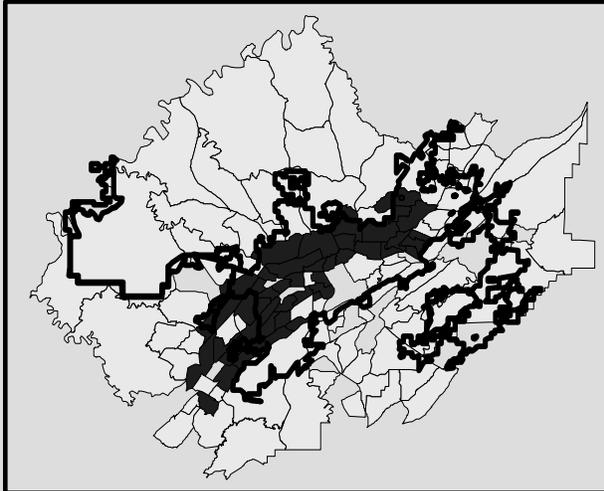
Lower-Income Neighborhoods



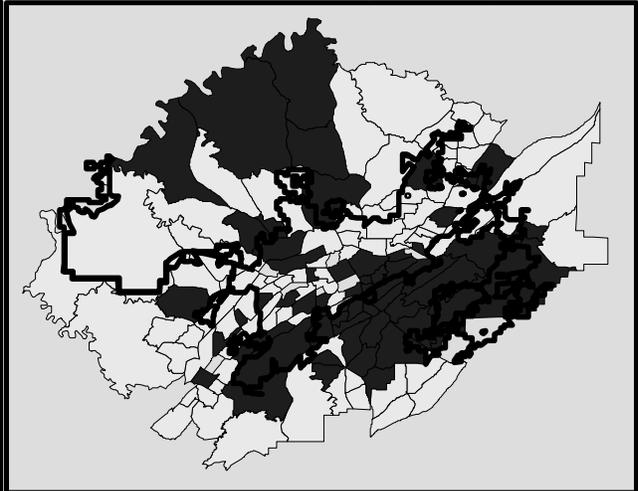
1990 Minority Population >50 percent



Subprime Lending Share >15 percent



Assessment Area Lending Share >30 percent



Note: Map focuses on central part of MSA

SUMMARY

Complex variations in the spatial distribution of affordable housing stock, and especially complex variation in the structure of the mortgage and banking industries in specific metropolitan area markets, make it difficult to generalize about spatial variation in the effect of CRA on mortgage lending. Clearly the racial composition of particular neighborhoods plays a role, as does the overall growth of these neighborhoods. The information in this section suggests, however, that while there are some regularities, much of the structure and functioning of metro-level mortgage markets is the result of idiosyncratic variation from one place to the next. The next three sections continue to illustrate this variation, first, by examining changes in rural banking markets, and then by reporting results from interviews with lenders and community groups in each case study site, in order to capture more of the rich context in which lending decisions and CRA compliance activities are conducted in each place.

SECTION 7

FINANCING NON-METROPOLITAN AMERICA

Non-metropolitan America, including rural areas, and smaller cities and towns, presents a special set of challenges to the financial industry. Its demographic characteristics and property markets are markedly different from those of metropolitan areas. Key attributes include remoteness, lower population density, high poverty rates, lack of housing opportunities and limited economic diversity. Historically, these factors have combined in different non-metropolitan areas to result in generally thin markets for financial products and services whose providers are subject to uneven levels of regulatory oversight. However, non-metropolitan areas have begun to experience the national trend towards consolidation. The decline in community-based small banks and the increasing presence of larger regional and national players herald change in the provision of financial services to rural communities, and suggest the need to rethink the role of CRA regulations in non-metropolitan America.

BACKGROUND

Non-metropolitan areas are those lying outside of federally-defined Metropolitan Statistical Areas. In 1993 the U.S. had 2,276 non-metropolitan counties, accounting for 83 percent of the nation's land area and 21 percent of its population (USDA, 1997). Households and housing stock in these counties are different than those in MSAs. Though home prices are often low, affordability can be a problem because incomes are also low, and poverty rates are high (45 percent of rural households are low-income, 19 percent are below the poverty level). Even though rural areas contain 22 percent of all occupied housing units in the U.S. and tend to have higher homeownership rates (at 75 percent) than urban areas, more than one in five rural households are cost-burdened (Housing Assistance Council, 2000). This translates into 5 million households spending more than 30 percent of their monthly income on housing (National Rural Housing Coalition, 2000). Poor quality housing is also more common in non-metropolitan areas where eight percent of units are moderately or severely inadequate (Housing Assistance Council, 2000). Meanwhile, rural households tend to be older and less racially diverse than in the rest of the country. The nature of rural property also differentiates rural from urban markets. Site-built housing units often do not meet standard mortgage underwriting criteria due to their tendency to be larger and built on non-conforming sites, located in sparsely developed areas, contain numerous out-buildings, combine business and residential uses, include sub-standard buildings, and be served by under-developed infrastructure (Strauss, 1999).

Manufactured housing constitutes a significant share of the overall housing inventory in non-metropolitan areas. In fact, half of the 6.8 million occupied manufactured housing units in the U.S. are located outside MSAs, where they comprise 15 percent of occupied housing units, up from 13 percent in 1993. The prevalence of manufactured housing reflects not only the challenges of site-built construction in rural areas and rural residents' lower incomes, but also the relative difficulty of finding financing for conventional homes. Part of manufactured housing's appeal lies in the ease of placing a unit on a lot, which can be important in areas lacking well-developed construction and trade sectors. There is also limited scope for multi-family rental development, the tenure alternative for lower-income clientele. These factors combine with the relatively low cost of land to make manufactured housing an attractive option for lower-income rural residents.



Special rural population groups, such as migrant and seasonal farmworkers, marginal farm owners, and Native Americans, also present challenges to conventional lending in rural markets. A variety of conditions, including high mobility, extreme poverty, seasonal employment, land trust issues, title problems, and limited downpayment availability, serve as barriers to these prospective borrowers' qualification for conventional mortgages/financing. Migrant and seasonal farmworkers do not fit conventional mortgage markets due to their mobility and seasonal employment patterns. The Housing Assistance Council (1997) found that there are an estimated 670,000 such workers in the U.S., most subsisting below the poverty line. These workers suffer from the paucity of private rental housing in rural communities, compounded by the lack of rural access to housing subsidy programs. Non-profits are constrained in developing farmworker housing given the difficulty of packaging financially viable deals given the low incomes and short occupancy periods of workers. There are some subsidy programs that operate in rural areas, including those housing subsidy programs operated by USDA's Rural Housing Service (RHS), but at current funding levels, available housing assistance falls far short of addressing rural housing needs.

Despite sharing many characteristics, rural areas are heterogeneous. This is illustrated by the county typology of the USDA's Economic Research Service, which differentiates between eleven types of non-metropolitan counties according to their primary economic activity and other policy-relevant characteristics. Counties are classified into one of six distinct economic types – those that are dependent on: farming; mining; manufacturing; government; or services; and a final category of 'non-specialized counties' with economies that do not fit into one of the economic specializations. Counties are also classified into five overlapping policy types: retirement destinations; federal lands; commuting counties; persistent poverty counties; and transfers-dependent counties.

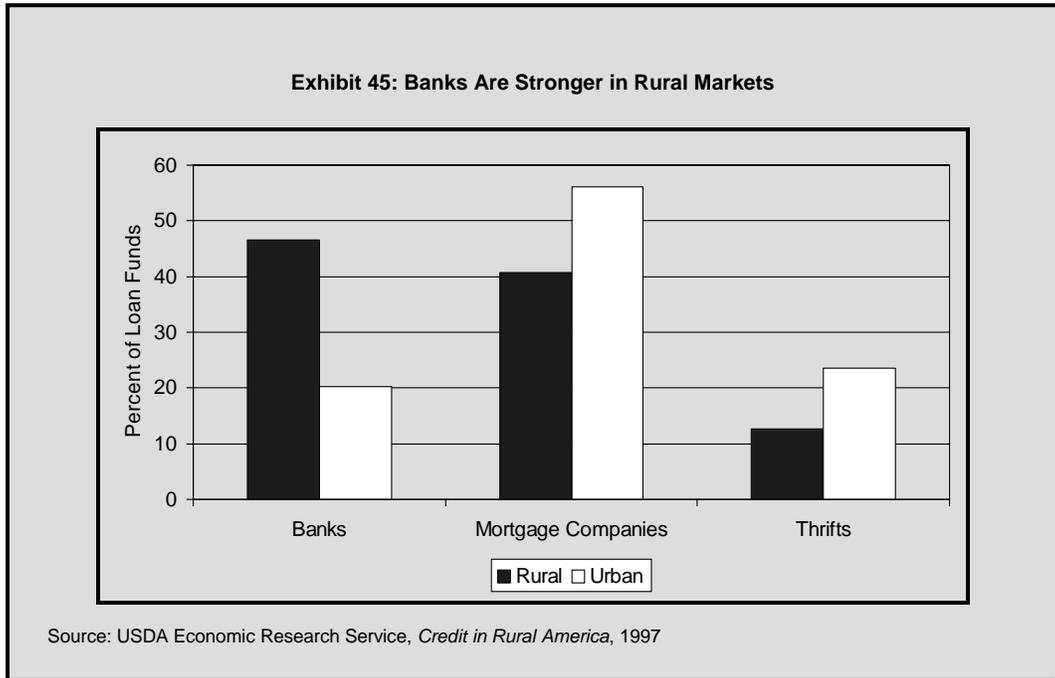
An analysis of population growth using this typology by McArdle (1999) illustrates the differing fortunes of non-metropolitan areas. All economic types experienced faster population growth over the 1990s than the 1980s, illustrating the national trend of population decentralization. Even so, the growth rates of farming and mining-dependent counties lagged considerably behind those of counties that are services- or government-dependent. Similarly, within the policy typology, retirement destination counties had the strongest growth, followed by counties in which federally-owned lands make up more than 30 percent of the land area. However, those counties classified as 'persistent poverty' or 'transfers-dependent' had dramatically slower growth rates than other types, illustrating the varying growth trajectories of differentially-endowed rural areas.

In combination, the characteristics of rural areas make designing suitable financial products and services a challenge. Non-conforming properties can make product development difficult. Cash-strapped workers with variable employment records present higher risks to lenders that can close off access to secondary markets. Serving such markets can pressure lenders toward uneconomic product proliferation or costly manual underwriting and case-by-case analysis.

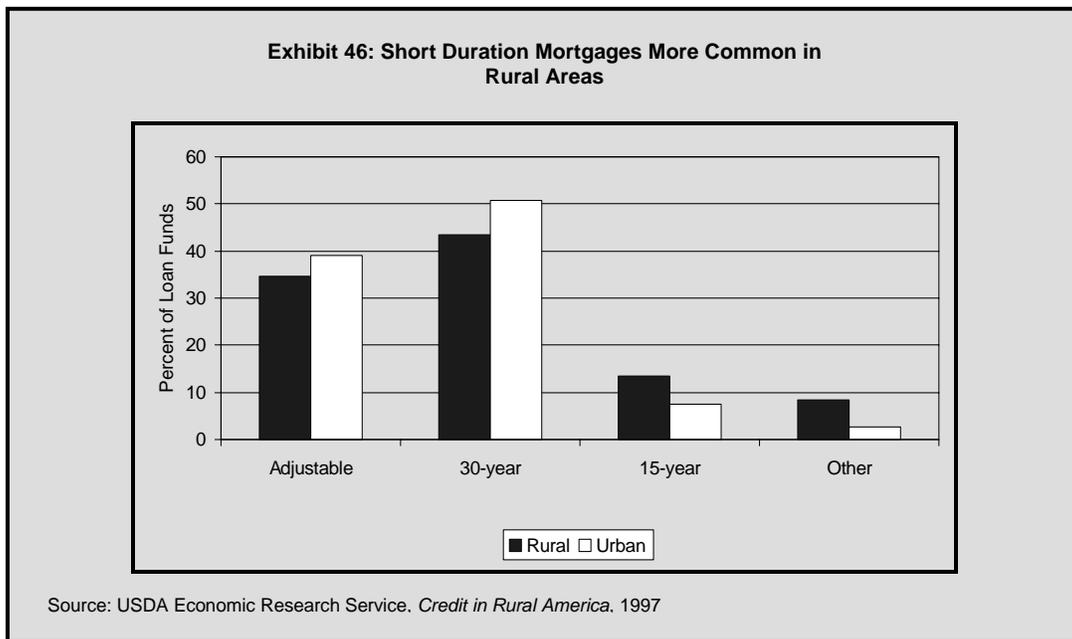
INDUSTRY STRUCTURE AND MARKET CHARACTERISTICS

In non-metropolitan areas commercial banks are a much more important source of mortgage credit than in metropolitan areas (Exhibit 45). In 1995, banks originated over 46 percent of rural housing loans, greatly in excess of their 20 percent share of urban mortgage originations.





The terms on rural and urban mortgage products differ, with rural mortgages more likely to have shorter maturities. Thirty-year fixed and adjustable-rate mortgages constituted 80 percent of all rural mortgage lending, compared to 90 percent of the urban total (Exhibit 46). Other mortgage loans had fixed rates and a term usually less than 30 years.



Rural interest rates are also on average higher than those in urban areas (Exhibit 47). Overall, fixed interest rate home mortgage loans were 17 basis points higher in rural than in urban areas in 1995. That same year mortgage company 30-year loans were 9 basis points higher in rural areas, and the rate on commercial bank 15-year loans was 27 basis points higher (USDA, 1997).

Less favorable loan terms for rural than urban borrowers, as reflected in higher credit costs and loans of shorter duration, have been linked to the lack of effective competition in rural financial markets because of small market sizes, barriers to entry and market segmentation. An assessment of rural financial markets found that the range of institutions involved is likely to be narrower than that serving urban communities, and competition for rural loans less keen, with the small size of rural communities and rural borrowers limiting the number of lenders that can profitably compete for rural loans (USDA, 1997).

Exhibit 47: Mortgage Interest Rates Higher in Non-Metropolitan Areas

Lender Type	Loan Term					
	15 Year		30 Year		All Loans	
	Urban	Rural	Urban	Rural	Urban	Rural
Thrifts	7.90	8.02	8.14	8.28	8.10	8.23
Mortgage companies	7.82	7.82	8.19	8.28	8.13	8.17
Commercial banks	8.06	8.33	8.26	8.20	8.24	8.50
All Lenders	7.89	8.08	8.19	8.25	8.15	8.32

Source: USDA Economic Research Service, *Credit in Rural America*, 1997

Most non-metropolitan areas do indeed have a limited range of financial institutions relative to metropolitan areas. Exhibit 48 presents data on the number of banking institutions in each of the nation's 813 urban counties and 2,276 rural counties. In 2000 some 533 (23 percent) non-metropolitan counties were served by 2 or fewer banks, compared to 25 (3 percent) metropolitan counties.

Exhibit 48: Rural Banking Markets Becoming More Competitive

Number of Banking Firms	Urban			Rural		
	Number of counties			Number of counties		
	1994	2000	Change	1994	2000	Change
None	0	0	0	20	23	2
1-2	34	25	-9	601	510	-91
3-5	178	108	-70	1,097	1,022	-75
6-9	280	254	-26	478	599	121
10 or more	321	426	105	80	123	43
Total counties	813	813		2,276	2,276	

Note: A banking firm is an independent bank or a bank holding company. All of the bank offices and affiliates of a bank or holding company constitute one banking firm. Thus, a banking firm may own many banks in a county, which are treated as a single competitor.

Source: USDA Economic Research Service tabulations of June 30, 2000 Summary of Deposits file of the FDIC, and June 30, 2000 Report of Condition and Report of Income of the Board of Governors of the Federal Reserve System



It is important to note, however, that the banking industry is in a state of flux in non-metropolitan areas. Exhibit 48 shows an increase in the number of rural counties with three or more banking firms between 1994 and 2000, with over three-quarters of rural counties now in this category.

Exhibit 49 offers further evidence of the impact on rural counties of the national trends of consolidation in the banking industry detailed previously. The 1994-2000 period saw the decline of small, local banks in rural areas. Only 73 (3 percent) of rural counties are now served exclusively by local banking organizations (down from 204 or 9 percent in 1994), and 394 (or 17 percent) are served solely by small banking firms (compared to 726 or 32 percent in 1994). This decline was accompanied by a dramatic increase in the presence of large, out of area lenders. The share of counties served solely by non-local banking organizations is now approaching 50 percent, up from 32 percent just six years ago. Now 1,580 (or 69 percent) of non-metropolitan counties have at least one large banking firm compared to 1,320 (or 58 percent) in 1994.

Exhibit 49: Large Banks Are Expanding Into Rural Markets

Counties served by:	Urban			Rural		
	Number of counties			Number of counties		
	1994	2000	Change	1994	2000	Change
Only local banking firms	9	1	-8	204	73	-131
Only 'non-local' banking firms	173	264	91	729	1,057	328
Both local and non-local firms	631	548	-83	1,343	1,146	-197
Only small banking firms	34	7	-27	726	394	-332
At least one large banking firm	761	791	30	1,320	1,580	260
Total counties	813			2,276		

Notes: A local banking firm has all of its offices and affiliates in one county; all others are considered non-local, even if the banking firm includes a locally headquartered affiliate. A small bank or banking firm has assets of under \$250 million; a large bank or banking firm has assets over \$1 billion.

Source: USDA Economic Research Service tabulations of June 30, 2000 Summary of Deposits file of the FDIC, and June 30, 2000 Report of Condition and Report of Income of the Board of Governors of the Federal Reserve System

In summary, the structure of non-metropolitan financial markets is changing. Larger players are developing strategies to penetrate rural markets given the opportunities provided by the diversity of rural areas. Some are developing agricultural lending strategies, some are targeting smaller-tier but growing markets, and others are focusing on resort/retirement communities.

Though there are still some counties with limited competition, together these changes in the number and type of players in rural financial markets signal increased competition. There may be some concern regarding the diminished presence of local banks in rural markets, given the perceived greater responsiveness of community banks to local needs. However, the increase in the average number of banking firms per rural county bodes well. Larger lenders may benefit rural consumers via reduced prices as a result of enhanced technical capacity, greater access to capital

markets, greater economies of scale, access to secondary markets, and ability to diversify risk geographically.

REGULATORY CHALLENGES

It remains to be seen if some rural markets are too idiosyncratic and relationship-oriented to make larger networks successful. Characteristics of existing rural lenders such as conservatism with respect to (lower) loan-to-deposit ratios and (higher) capital-asset ratios relative to metropolitan lenders may in part be reactions to the riskier rural lending environment rather than a failure to employ the latest risk management techniques. Similarly, limited use of secondary markets by rural lenders may reflect the fact that a higher proportion of rural properties do not conform to secondary market criteria, making it difficult for lenders operating in these areas to reach the minimum scale to deal with Fannie Mae and Freddie Mac, rather than lenders' unwillingness to engage in these more 'sophisticated' financing arrangements.

Although much FHA lending is accomplished by mortgage lenders, rural banks' less frequent use of FHA programs can be seen to be a function of the fact that many rural banks have too little capital to be approved as FHA lenders, and the low volume of mortgage loans in some rural areas combined with the low FHA loan fees make the program unfeasible for some banks (Strauss, 1999). Indeed, rural households access government insurance programs at half the rates of their counterparts inside MSAs (National Rural Housing Coalition, 2000).

Government assistance specifically targeted to improve rural housing opportunities is provided by the Rural Housing Service (RHS), an agency of the USDA. The RHS provides a range of assistance, and is intended as a lender of last resort. Programs encompass multi-family funds, including farm labor and rural rental housing loans, and single-family funds such as direct rural housing loans. The RHS' emphasis has more recently shifted to guaranteeing mortgage loans made by private lenders. CRA requirements can be said to be helping to expand use of such programs because these loans help banks meet CRA requirements (Wilson and Carr, 1999). However, the share of rural home mortgages guaranteed by the RHS is still smaller than the rural market share insured by the FHA or the VA (USDA, 1997).

A further challenge is the lessened regulatory reach in non-metropolitan areas. This relates to the huge geographical scale and diversity of the areas under assessment, and the lessened scrutiny of lending patterns as CRA and HMDA are less potent in these areas. In an assessment of HMDA coverage of the mortgage market, Scheessele (1998) found that HMDA does not adequately measure mortgage market activity in non-metropolitan areas. Small lenders that do not originate loans in metropolitan areas are not even required to report to HMDA. Loans for properties located outside MSAs are reported if originated by a lender with substantial metropolitan activity, however, reporting outside of MSAs is subject to limits on the geographic detail of the information that is reported.

CRA's provision for less frequent performance evaluations for small banks means that regulatory pressure to meet borrowers' needs is less rigorous in rural areas. Case study interviews indicated that rural counties are also less likely to be included in a full scope CRA exam. This sampling bias is attributed to the need to assess large multi-state MSAs and other more populous areas where lending activity is greater. In addition, CRA allows small banks to be evaluated under less strenuous performance standards than large banks. Small banks are only evaluated on the proportion of loans within their assessment area, borrowers' profile and loan-to-deposit ratio. This makes the Act's impact weaker in those rural areas served disproportionately by small institu-

tions, and constrains rural community groups' ability to analyze lending in these areas, hampering the leveraging of banks through advocacy. Overall, the CRA-related challenge in markets attracting attention from larger lenders is how to encourage banks to serve the entire rural population as they capitalize on growth opportunities in specific areas.

RURAL ISSUES IN COLORADO

Colorado illustrates many of the issues related to non-metropolitan areas. The case study focused on two areas: the San Luis Valley in the south (Alamosa, Conejos, Costilla, Mineral, Rio Grande and Saguache counties); and the central part of the Western Slope (Eagle, Garfield, Mesa, Pitkin and Rio Blanco counties). The San Luis Valley is an agriculturally-based area characterized by persistent poverty. In contrast, the Western Slope has tight property and second home markets, and the lack of affordable rental housing for seasonal and low-wage workers is a key local problem that is most extreme in Eagle and Pitkin counties (home to the resorts of Vail and Aspen). Indeed, Lipman and colleagues (2001) talk of an 'Aspen effect' that includes high property values, lack of affordable housing, a population influx, and the creation of primarily low-wage jobs. Colorado contains several other types of rural areas including developing regional economic centers (such as Grand Junction), and depopulating Eastern Plains communities with a waning agricultural base.

This cross-rural area diversity and attendant variability in market opportunities is reflected in the strategies of Colorado's rural financial industry operators. Some banks are building strategies around penetrating rural markets and bringing new products and services to these areas. Bank of the Rockies and Alpine Bank have established themselves in resort counties, in direct competition with larger national lenders for the business generated by strong housing markets and a wealthy customer base. Vectra Bank is taking a different route, covering the state from the high-growth Front Range communities to the remote towns in the San Luis Valley, and has expanded its rural reach by purchasing sound community banks. Because it serves metropolitan markets in Colorado and because it is owned by Zions Bancorporation, a large regional lender, it can bring resources and deploy products in rural areas that its community lending predecessors could not.

However, small, local community banks remain important in Colorado's agricultural areas given the value of relationship banking in this sector. This is due to the variability associated with the cyclical nature of agricultural prices. To a farmer who may lose money on each harvest for several years running before making enough back to pay back loans in one banner year, relationship banking is paramount. Several lenders in the San Luis Valley mentioned the impact on their balance sheets of a potato blight and several consecutive years of low international prices. It is difficult for out of area lenders to develop the kind of relationships, trust, and expertise to operate in such markets. They may not be inclined to do so because the agricultural environment is inherently risky. These factors in combination tend to act as a barrier to banking consolidation in such areas. The continued presence of small, community banks also highlights the fact that larger players tend not to expand outward from bases in growth markets to serve lower-income rural areas.

CRA is not on the radar screens of many rural Colorado banks. One lender pointed out that pressure to perform in many rural areas is limited by the fact that all activity in many areas is CRA-eligible because it is entirely classified as 'low-income.' Further, its rural operations are less likely to be evaluated. Thus the bank focused its CRA efforts within its MSA assessment areas. Confusion about CRA was also evident, with one lender for example pointing out the struggle to obtain CRA credit for doing the construction loan for a manufactured housing development under

the affordable housing component of the community development lending test. Such uncertainty acts as a disincentive for emphasis on CRA and the development of innovative products and services.

Comparison of the main home purchase lenders operating in the two case study regions (Exhibit 50) also illustrates the varying regulatory reach of CRA. The top ten home purchase lenders in the counties of the San Luis Valley include out of area lenders and independent mortgage companies. In contrast, recognition of the market opportunities presented by the Western Slope counties is evidenced by the presence of major national banks, such as Wells Fargo and Bank of America, and sophisticated smaller players, such as Alpine Bank, which are operating branches within the counties and are subject to CRA regulation.

Exhibit 50: Top 10 Home Purchase Lenders in Rural Case Study Counties, 1999

San Luis Valley (6 counties)	Loans	Western Slope (5 counties)	Loans
Mountain West Financial Inc.	51	Wells Fargo and Co.	1,213
Conseco Finance Servicing Corp.	38	Countrywide Home Loans	531
Dime Savings Bank of NY, FSB	36	Unifirst Mortgage Corp.	426
Associates Financial Services	18	Bank of America Corp.	405
Countrywide Home Loans	17	Fidelity Mortgage Co.	340
Cendant Mortgage	13	Alpine Banks of Colorado	328
Firstmerit Corp.	12	Chase Manhattan Corp.	276
Irwin Financial Corp.	7	Universal Lending Corp.	274
Oakwood Acceptance Corp.	3	Mortgage Portfolio Service Inc.	266
Old Kent Financial Corp.	6	Conseco Finance Servicing Corp.	243
Total for Top 10 lenders	201	Total for Top 10 lenders	4,302
Total for Other lenders	120	Total for Other lenders	2,147
TOTAL	321	TOTAL	6,449

Source: Joint Center Enhanced HMDA database

Just as there is diversity among communities and in financial markets in non-metropolitan areas, there is also diversity in the range and quality of advocacy networks. Advocacy may be focused on such issues as protecting agricultural or recreational lands, promoting economic development in declining areas, or enhancing housing opportunity for farmworkers.

Especially impressive in Colorado were the activities and advocacy related to housing provision for farmworkers and their families. An example is provided by the development at Center in the San Luis Valley of a 216-bed dormitory for single male workers that is managed by the Tierra Nueva Farmworker Housing Corporation. This project was supported by the Colorado Rural Housing Development Agency, which provides technical assistance to local governments and non-profits seeking RHS funds to construct farmworker housing. However, the realm of farmworker housing provision illustrates that while Colorado has many excellent non-profit organizations serving rural communities, many unmet needs remain. There is a strong need for sources of development finance other than limited RHS funds for farmworker housing in the state. While banks do enter partnerships for such developments, the limited range of banking organizations operating in the area, makes it difficult to use CRA to leverage funding for a large number of rural projects.



SUMMARY

Rural markets present special challenges to the financial industry due to their demographic characteristics, property markets and heterogeneity. Rural areas are more remote, have lower population densities, higher poverty rates and limited economic diversity. Further, housing alternatives for those with lower incomes are typically limited. These factors have historically limited the opportunities and raised the risks of providing financial products and services in these places. Recently, however, the national trend toward consolidation in the financial services industry has begun to penetrate non-metropolitan America. The decline of community-based banks and the increasing presence of larger regional and national players will offer new opportunities to customers in rural communities. At the same time, these changes suggest the need to rethink the role of CRA outside MSAs, with the key challenge being to encourage larger lenders to serve the entire rural population as they capitalize on growth opportunities in specific areas.



SECTION 8

THE EFFECT OF CRA ON MORTGAGE LENDING OPERATIONS

This section presents a qualitative assessment of the impact of CRA on the operation of mortgage lenders, and thus serves as a complement to the earlier discussion of the impact of CRA on mortgage lending patterns. Material for the section comes primarily from interviews with CRA-regulated, and in some cases non-regulated, lenders in our five case study sites. Some of the material also comes from interviews with other interested observers of the community reinvestment process in these areas (and is noted as such) and some is drawn from discussion groups conducted with regulators, lenders, and advocates as part of this project (Belsky *et al.*, 2000). The lenders interviewed spanned all sizes, from institutions with national reach to those with only a handful of branches operating in a single market. Specific personnel interviewed were generally at the CEO/senior management level for small banks. At larger lenders, interviewees were typically the person or persons responsible for CRA compliance activities. Responses here are consensus views unless otherwise noted and represent an effort to distill reactions and opinions on a range of issues related to the past, present and future of CRA, compliance activities, community reinvestment more broadly, mortgage lending, and banking in general.

CRA AND BUSINESS STRATEGY

While obviously a component of the competitive environment in which both CRA-regulated and unregulated lenders operate, CRA generally surfaces as a second-tier consideration in the business plans of regulated lenders. Said another way, CRA compliance strategies are typically formulated taking business strategy as a given. For example, one regulator in the San Francisco focus groups pointed out that in lender decision-making regarding merger or expansion activities, CRA considerations are swamped by tax-related concerns. At the margin, however, CRA can influence some business decisions. And, some activities, such as operating an affiliated mortgage company or pursuing a strategy of cross-selling mortgage and small business products through branch networks, are more compatible with CRA obligations than others.

A. Reputational Risk and Impact on Services and Product Lines

Over the past 15 years CRA has entered the strategic considerations of lending industry decision-makers in ways linked both to opportunities for new business lines and to potential reputational and regulatory concerns. Along with HMDA, CRA's impact on transparency and data quality clearly helped lower-income area and borrower markets develop into their current robust condition. The effect of CRA and HMDA in combination with enhanced technology and industry competition since the late 1980s has been to demonstrate the viability of these markets, and open up this lending as standard lines of business. The transformation of lending to parts of the lower-income area and borrower markets has been so complete that it is currently difficult to apportion motivation for depositories' ongoing lending to some lower-income borrowers and areas between CRA obligations and standard business considerations.

CRA and related concerns may also influence business activities on the positive side when combined with a leadership role in the community. One large lender in Chicago that has expanded in part by purchasing several smaller depositories, reported fierce loyalty among the clients of one of the acquired institutions that was widely perceived as being a champion of the interests of lower-income, particularly immigrant, customers. While it would seem possible for a lender to market itself based on its success at reaching underserved borrowers and areas (as evidenced by a



grade of outstanding on a CRA exam) no one interviewed for this study reported doing so. Several lenders did, however, mention using the value of being known as a concerned corporate citizen more generally. The chairman of one bank, in a letter to the *Chicago Tribune*, denounced predatory lending at a time when doing so constituted breaking ranks with many in the lending community. He did so on the theory that, in addition to ethical considerations, predatory lending can harm legitimate lenders in targeted neighborhoods by weakening markets there. Weeding out those engaging in predatory lending is therefore good for legitimate lenders.²⁴

Small lenders may experience the link between performance that is commendable on CRA grounds and business strategy most viscerally because they are situated in relatively few areas, with limited options for expansion, and consequently dependent on the viability of these areas for their own survival. Particularly in lower-income areas, CRA-eligible activities help keep markets sufficiently liquid and communities sufficiently robust to prevent the deterioration of assets held by lenders in these areas. A medium sized lender in Chicago expressed this point, saying “leaving CRA aside, the [bank’s] board feels that the community has to do well for the bank to do well.” A small lender in the same market referred to itself as “located in and invested in low- and moderate-income areas” to the extent that absent CRA they would have little choice but to continue serving lower-income markets. And, in an extreme example of this kind of commitment, a small commercial lender in Birmingham considers the bank, while intended to be a profitable concern, as “an extension of the other empowerment activities” of its founders.

To the extent that it is possible to isolate a CRA effect on business decisions today, however, it is in some cases easier to find it in the practices and business lines that regulated lenders avoid on account of CRA rather than in the markets they are serving because of it. Several lenders mentioned that specific practices and lines of business are associated with negative attention from regulators and advocates during exams and with undesirable effects on their community reputation. Two areas of particular concern were methods of reaching the unbanked population and mortgage lending practices that could be construed as predatory. One small lender in Baltimore, for example, reported getting out of the check cashing business, despite its profitability, in response to concerns from community advocates. Similarly, CitiGroup and Household Finance Corporation recently made unilateral commitments to drop mortgage products that include single premium credit insurance (a practice many consider predatory), again in spite of their profitability.

Several national lenders interviewed for this study reported specific interventions designed to ensure that their pricing does not enter realms that may be considered predatory and hence attract negative attention from advocates and regulators. Such efforts are in large measure a belated response to the uproar about loan packages securitized by the GSEs and Wall Street that were revealed to contain loans made using predatory practices and through which lower-income people were defrauded out of home equity and/or cheated into losing their homes altogether by being tricked into securing a loan they were unable to repay. Some lenders’ self-police using absolute point caps, independent of risk, for all of their ‘B’ and ‘C’ market activities. One reported monitoring pricing differentials by race/ethnicity and gender on both its retail and wholesale operations, a move that may reflect lenders’ particular sensitivity to Fair Lending legislation. A third national lender has taken advantage of technological advances to insulate itself from decisions by its brokers that might reflect poorly on the institution, by designing an automated underwriting system that automatically gives the client the best pricing for which he/she qualifies. Further in-

²⁴ Any benefits of this kind of action must be weighed against the negative impact it has on a bank’s relationship with mortgage brokers, who are wary that legislative efforts intended to ameliorate “predatory lending” may affect their livelihoods in unintended ways by proscribing classes of activities.



dicating the attention paid to ethically questionable practices, this lender takes the additional step of running background checks on brokers and approving them to originate some product lines and not others, based on the results of this check.

These steps reflect the intersection between CRA and related legislation, including the Fair Housing Act and the Equal Credit Opportunity Act (ECOA) and the reputational risk considerations that lenders face. Lenders are extremely concerned with reputational risk because the impression that a lender's practices are unfair with respect to income and race can be extremely costly and difficult to overcome, and may be widely publicized. In California, for example, the Greenlining Institute compiles and distributes a 'watch list' of lenders whose practices it considers suspect, that is monitored by advocates, consumers, and potentially by regulators.

Regulators clearly pay attention to community groups with clout. One lender in Chicago reported facing a particularly tough exam because of a campaign against the bank by ACORN that coincided with its CRA exam. And in a prominent early example of the importance of reputational risk, Decatur Federal Savings and Loan Association (Atlanta) not only paid a \$1 million settlement to 48 African-American families that had been turned down for mortgage loans, it also agreed to expand its CRA assessment area, target minorities in its marketing, modify its commission structure to reward loan officers for making loans to African-Americans, open a branch in South Fulton County, and hire minority loan officers, all to appease the Department of Justice for violations of ECOA and the Fair Housing Act associated with its mortgage lending practices (Schill unpubl).

B. Consolidation and Branch Banking

Another area where CRA interfaces with depositors' business strategies is in decisions about consolidation, and expansion or contraction of branch networks. Though contained in the initial legislation, CRA's provision that an institution's CRA performance be considered when regulators consider its application for mergers and branch openings was ineffectual until 1989, when the Federal Reserve denied the Continental Bank Corporation's attempt to take over Grand Canyon Bank of Scottsdale on the basis of Continental's poor CRA record. This made it clear that lenders must have their CRA house in order if proposed consolidation activities are going to meet regulatory approval. To this end, actively and potentially consolidating banks seek to maintain ratings no less than 'satisfactory' to ease their ability to consolidate, an ability that is increasingly important in the current highly competitive banking industry. To this end, mergers can be the occasion for reinvigorating and publicizing community reinvestment activities, as was the case in the Chase-Chemical merger of 1996, which resulted in a public \$18 billion small business and mortgage lending commitment to lower-income and minority borrowers and areas.

Branching activities also attract regulatory attention during the service test portion of the exam, in which examiners scrutinize the pattern of opening and closing branches to ensure that lower-income areas are not disproportionately targeted for closings. This has, in practice, made it extremely difficult to close branches. One lender described a process of closing a small rural branch that included commissioning and funding a study of the impact of the branch closing, and funding a CDFI to serve the area in place of the closed branch. Several bankers noted that it is nearly impossible to close a branch because of the negative publicity and the leverage that community advocates have in the exam process. Another lender described a meticulous process by which his bank investigated the demographic characteristics of areas in and around locations that they consider for new branch placements in order to "improve their perceived impact" in the CRA exam. At the same time, branch openings can also pave the way for regulatory approval of merger activities and may to some extent be *quid pro quo* for this approval. In Los Angeles, U.S.

Bancorp, at the time it acquired Firststar, agreed to open two branches in the predominantly Latino East Los Angeles and the predominantly African-American South Central neighborhood. The latter branch was the first opened in the area for 20 years.

Overall, the relationship between CRA and business strategy, while operating at the margins, nevertheless exists. In addition to the examples catalogued above, it may enter business considerations in less direct ways. One representative of a mortgage company operating outside of the assessment area of its parent bank, noted that mortgage product development first occurs in bank assessment areas, and is then deployed in other markets served by the mortgage company. Another lender noted that CRA and business strategy are not really at odds when it comes to mortgage lending. Since the homeownership rates of lower-income people and minorities, whom current CRA and related legislation is designed to benefit, are far lower than those of higher-income people and whites, the CRA-eligible market is the growth market going forward, thus aligning business interests and CRA.

INTERNAL ORGANIZATION OF CRA COMPLIANCE

Most covered institutions have responded to CRA by initiating processes and developing personnel to ensure that their activities result in defensible records of community-oriented lending, investments, and other activities. These people and/or departments may track lending patterns, anticipate peer comparisons, engage in and document community outreach, as well as a number of other activities intended to demonstrate that their performance is satisfactory or better when the examiners arrive. While some CRA-relevant activities are undertaken by lenders of all sizes, others are a function of the amount of resources that the institution can devote to compliance-related activities, and hence differ between large and small lenders. This section looks at these activities noting the differences in compliance paths chosen by larger and small institutions.

A. Goal Setting

Many institutions begin structuring a compliance plan by establishing a target for the desired exam score. This decision is typically made by senior management, and is then communicated to compliance staff. Since achieving an outstanding rating is more costly, the expenses incurred must be weighed against the potential benefits of a higher ranking. And, as noted earlier, a grade of outstanding does not necessarily generate leverage or create business in the community. Indeed, the head of compliance at one ‘outstanding’ organization said that the rating “does us no good internally or externally.” Yet focus group and case study participants agreed that a subset of lenders would do what it takes to achieve an outstanding rating.

Institutions that aim for the outstanding rating typically cite indirect reasons for committing the expenditures involved in reaching this goal. In some cases, their motivation derives from an organizational culture where ‘being the best’ is deeply ingrained. One compliance officer mentioned that the “message from the top [is that] we will always be outstanding.” Another lender that aimed for outstanding cited the problem of sustaining employee morale if it sends a mixed message that the institution’s goal is to be the best at everything, except for CRA. Interestingly, the link between organizational goals and strong lower-income lending performance was confirmed by a large non-CRA lender that has a division focused on lending that would be CRA-eligible if it were a depository, and has made public commitments led by senior management to hit lower-income and minority lending goals.



Other lenders, while recognizing the need to maintain satisfactory performance, do not actively aim for outstanding. Often this is a reaction to the perceived uncertainty of the regulatory environment. One executive at the holding company level pointed out that his institution noticed variation between regulatory agencies reviewing different parts of the organization.²⁵ As evidence of this variation, one lender mentioned struggling to obtain CRA credit for doing the construction loan for a manufactured housing development under the affordable housing component of the community development lending test, while another lender noted that regulators had “found” such a loan on their books and counted it toward meeting their CRA goals, though the bank had initially not intended to include it in their lending summary. Another CRA compliance officer for a bank that had been rated ‘needs to improve’ after a series of satisfactory ratings, subsequently examined 200 exam reports from comparable institutions and said that the bank’s own performance was not discernibly different from that of its peers, all of whom were rated satisfactory. Comments such as “our goal is not outstanding but to make a difference” and “we want to do outstanding work, which may or may not get us an ‘outstanding’ grade”, all reflect a lack of clarity about the process on the part of some well-intentioned lenders. One lender summarized his bank’s approach as “putting up numbers that are high satisfactory and [possibly] letting regulator discretion take us to outstanding.”

Uncertainty about the relationship between a certain level of performance and the attendant CRA rating is often located in the subjectivity of the law and regulations, despite the push to quantify the exam since 1995. Two key areas are the provisions to evaluate the bank’s activities given the ‘performance context’ in which it operates, and the ‘peers’ to which the institution’s performance is compared. In focus groups, lenders mentioned these as key areas of uncertainty. They also noted that regulators continually raise the bar for what constitutes acceptable lending levels and ‘innovativeness’ in investment, service, and community development lending activities.

Lenders also suggest that ratings fluctuate because regulators fail to understand the nature and complexity of the products and business lines they are involved in, and consequently do not give them sufficient credit for some activities or demand unfair levels of achievement for others. One reported being pressured to reach unrealistically high mortgage lending goals, though their business consists of very little mortgage lending. Lenders also cite the role played in the exam process by community groups as a source of uncertainty because regulators tighten standards when they know that advocates have identified a lender as one whose performance should be monitored closely. One lender even reported being told by regulators that they could not receive credit for a particular loan because it would not pass the scrutiny of a specific community group.

Beyond the cost and uncertainty of moving between satisfactory and outstanding, some lenders note that an outstanding rating “sets you up to fail.” It raises the bar with regulators, to some extent casting ‘outstanding’ lenders as institutions that are expected to continue to lead and innovate. It also brings increased attention from community advocates. One lender specifically mentioned the desirability of the “lower public profile” that comes with a satisfactory rating. Lenders believe that both regulators and advocates will perceive the organization’s performance as deteriorating if they move from outstanding to high satisfactory, a change that many believe is well within the margin of regulator discretion/variability.

B. Structure and Staffing of Compliance

Subsequent to goal setting, institutions must devise an internal structure to address, staff, and track compliance activities. Larger lenders typically have entire departments managing compli-

²⁵ Thomas (1998) has documented fluctuation in the intensity of regulatory scrutiny across regulators and regions.

ance activities that in some cases reach across the disparate corporate entities housed within a holding company. In the most straightforward structure, ‘CRA Compliance’ departments assume responsibility for generating and tracking CRA-eligible activity. In other cases, depending in part on the strengths and focus of the institution, ‘Community Development’ or ‘Affordable Lending’ departments bear primary responsibility for CRA-related activities. In some instances these are standard business units that happen to generate CRA-eligible activity. In others, they are targeted more specifically at achieving compliance-oriented goals.

In an example of a hybrid structure, one large lender had a ‘Community Investment’ division housed in the risk management department. Despite the institution’s size, the division consisted of a single person who coordinates all community development activities and who brings CRA-eligible projects to lending officers in the appropriate section of the bank. This approach was similar in some ways to that pursued by several smaller institutions (including some with asset levels low enough to qualify under the small bank exam rules) that had an individual whose primary responsibility was to manage compliance issues. In one case, a small lender hired an individual to a position created specifically to turn the bank’s CRA performance around following a disappointing review from regulators.

Lenders’ response to the letter and in some cases the spirit of the Act is also evident in the way they go about staffing compliance activities. Several lenders have, in fact, hired community advocates to head up their compliance effort. Hiring someone from ‘the other side’ can be both a signal to regulators that the institution is serious about CRA, and an effort to use the advocate’s skills and knowledge to gain a competitive edge in lending to lower-income borrowers and areas. It can also be a way of capturing advocates’ knowledge of which community-based organizations are likely to be effective partners, information that is increasingly important as institutions seek to coordinate their charitable giving with their CRA business strategy. Sending the right messenger to meet potential community partners may help banks secure a relationship with one that has sufficiently effective leadership and institutional capacity to be a useful partner. Some lenders have chosen to hire heads of compliance out of their mortgage lending operations, presumably reflecting the perception that mortgage lending carries disproportionate weight during the exam. A key benefit of this strategy is that it houses CRA-eligible mortgage product development in the same department as compliance.

Following selection of a compliance chief, the bank must structure its internal operations in such a way that they meet CRA compliance obligations. This typically follows one of three approaches: employing specialized teams that do CRA-eligible lines of business; providing incentives or requiring regular business units to do certain shares of CRA-eligible lending; and hybrid approaches. In each of these, a key issue is compensation, because CRA-oriented activities and deals are widely seen as more time-consuming to consummate and hence dilutive of loan officer productivity. Lenders following the ‘specialized department’ approach often pay higher rates of commission on CRA-eligible business. Alternatively, some community development loan officers are paid a salary rather than commission, reflecting the fact that CRA business often is viewed as being distinct from mainstream business.

Several lenders without special CRA lending teams pay higher commissions on some or all loans that qualify for CRA credit. One bases commissions on the number of loans, rather than dollar volume, to work around the fact that CRA-eligible loans are, on average, smaller than others. Another lender initially paid higher commissions on CRA mortgage products to loan officers but was later able to abandon these special incentives; once the origination team had gained experience and become convinced of the viability of this segment of the market, they would originate these loans anyway as part of their standard, volume-based commission structure. Other lenders



have more complicated commission structures that reward officers for both the number and dollar volume of loans.

As further evidence of the special practices organizations undertake to generate CRA-eligible loan volume, one Birmingham-based lender employs community lending specialists while also setting goals and providing incentives for regular loan officers to do CRA-eligible business. The company also pays loan processors more on community development loans because they are more challenging to process as well as underwrite. Another lender has chosen to start a department that handles more challenging deals, but also pays regular loan officers more when they do a community development deal.

A key aspect of the compliance strategies of both large and small lenders appears to be periodic meetings to track CRA goals. One large California-based lender reported meeting bi-monthly to track community development lending, and a medium-sized lender in Chicago reviews its overall progress on CRA-eligible lending in a quarterly self-exam. Another lender's compliance committee - comprised of the compliance officer plus senior management, including the CEO - meets annually to assess and discuss performance in between exams.

All of these adaptations to the CRA environment are aided by management information systems (MIS). MIS allow formal, CRA-oriented sub-goals to be allocated to departments and tracked at periodic meetings. More technologically oriented lenders integrate the systems that track overall business activities and the subset that are CRA-oriented. These systems have allowed some lenders to define and specifically track profitability goals for CRA-oriented lending.

In sum, the amount of energy devoted to structuring, staffing, and tracking CRA performance leaves little doubt about the fact that lenders expend resources in adapting to the regulatory environment. In today's competitive banking and mortgage lending marketplace the challenge of CRA is to integrate compliance obligations as seamlessly and as profitably as possible into existing business operations.

PRODUCT DEVELOPMENT

Because the lending test portion of the CRA exam is weighted most heavily, product development for the CRA-eligible segment of the market is a key component of lenders' response to the regulatory environment. As the lower-income mortgage market has become demonstrably mainstream and competitive over the last decade, virtually all mortgage lenders now tailor products to this sub-market as part of their standard business practice. Because of market conditions, regulatory or competitive pressure, or good corporate citizenship, lenders in some cases will go further and innovate products that reach deeper than standard lower-income targeted products intended for sale on the secondary market.

Spurred on by CRA activism, the process of mortgage innovation was well established in the 1980s. In part a response to community pressure, in part an effort to develop new market niches, banks in Chicago and elsewhere began to work with community groups in forging new community lending partnerships. Many of these early efforts, codified in the form of CRA agreements, led to a range of new loan products and a new focus on modifying underwriting standards to better serve lower-income borrowers living in historically underserved communities. The role played by individual banks to create new loan products was complemented in the late 1980s and early 1990s by parallel efforts on the part of Fannie Mae and Freddie Mac. Responding to Congressional pressure that led ultimately in 1992 to the legislation that mandated the creation of

specific ‘GSE goals,’ Fannie Mae and Freddie Mac joined in the effort to develop new products that would better meet the needs of lower-income and otherwise traditionally underserved borrowers.²⁶

Recognizing the growing array of affordable lending products on the market, many lender participants in the focus groups and case studies noted that they began their efforts to reach lower-income market segments by entering into partnering arrangements that minimize or eliminate their risk exposure. To the extent that these are available, most lenders are willing to try them. On the mortgage side, many reported working with the GSEs’ 97 and 100 percent loan-to-value products. Further, a substantial share of lending that counts for CRA credit comes through FHA and VA. In the economic development arena, many mentioned using Small Business Administration products to serve small business customers.

Several lenders also mentioned working with existing city, county, and state programs - one large lender designs products specifically to complement existing city programs. Another lender considers it part of its competitive advantage in being a client service leader to try harder than competitors to find and facilitate layered financing of their products with available government and non-profit programs to the extent possible. Other tactics include working on product design with community groups, and with their own loan officers, in order to learn why lower-income clients are being rejected and what it takes to get them above the bar.

In some cases, market conditions drive product development. For example, southern California lenders frequently discussed challenges relating to the lack of affordable homeownership opportunities in the region, as well as the difficulty of serving non-native speakers of English. Lenders that are part of national organizations often commented on the additional difficulty of communicating these challenges to headquarters located outside the state. The pervasiveness of affordability and linguistic issues in a large and competitive market like California makes hitting lower-income lending goals particularly challenging and, in many cases, does rely on the development of innovative products, or at a minimum offering products and marketing materials in languages besides English. One lender cited the “need to be realistic” about borrowers’ economic situations in discussing a new mortgage product that allows up to 15 percent of the primary borrower’s income to come from undocumented sources, a response to the nature of employment among many immigrants in the Los Angeles market. Others mentioned having the language skills on staff to originate a mortgage loan in nine different languages, and having printed materials available in three languages.

Though in many cases their focus on achieving scale economies limits the participation of larger lenders in truly niche areas, large lenders nevertheless have a range of product development options that are not available to smaller entities. One lender reports having a product that is “more competitive than FHA” via a lower interest rate and no private mortgage insurance requirements. Another refuses to buy loans to meet CRA lending goals, designing products with whatever specifications are necessary to meet CRA goals if its lower-income lending is falling short of targets. In particularly challenging markets, another national lender deploys a 95 percent loan-to-value product that is combined with a 5 percent unsecured loan. These loans are seasoned for two years and then sold to the GSEs. A complementary approach is to target mortgage products to the housing stock lower-income borrowers typically occupy. To this end, one lender designed a product for use on small multi-family properties.

²⁶ For an overview of these trends see: Listokin and Wyly (2000); Lea (1996); and Guttentag, (1992).



Many smaller lenders also develop products that allow them to pursue idiosyncratic market niches. Several devise and deploy these niche products as part of their general business/survival strategies that are based in many cases on accessing market segments that large organizations overlook or find difficult to serve. In the competitive Chicago market, one mid-sized lender developed a product around ‘2x4’ and ‘2x6’ combined commercial and residential properties.²⁷ The non-standard architecture makes this a non-standard product, but one that is common enough in many Chicago neighborhoods to make it viable for a lender that is not looking for national reach with its products. Another lender has a product, including a \$12,000 grant, designed specifically for physically handicapped borrowers.

COPING STRATEGIES

Beyond developing internal compliance structures and developing CRA-oriented products, lenders subject to CRA have developed a variety of other ‘coping mechanisms’ intended to ensure their activities are judged compliant amid the uncertainty inherent in the regulatory process. The diversity of these tactics is impressive, and provides clear evidence that lenders continue to respond to CRA. In many cases these efforts are self-evidently outside the scope of the bank’s normal activities. In others they complement these activities.

Managing the Exam Process. Most lenders have developed an approach to managing the exam process itself that is designed to minimize uncertainty and control the impression that they present to regulators. Several mentioned trying to make regulators aware of their compliance-oriented activities on an ongoing basis, not merely at the time of the exam. This includes asking regulators for advice on community needs, questioning them about which community groups might be effective partners, and probing for suggestions about activities that might be considered ‘innovative.’ One lender expressed this as an effort to develop a “non-confrontational relationship with the regulators.” Regulators may also be invited to internal intra-exam compliance meetings, presumably to demonstrate the nature of and challenges to the lender’s compliance effort. In focus groups, regulators confirmed that lenders were increasingly attempting to work with them on community reinvestment issues and activities.

Managing the exam process also involves making sure the institution puts its best foot forward. This can take the form of policies that limit which employees can speak to the regulators and under what circumstances. One lender that had “done a bad job of telling [its] story” during one exam went as far as to design a procedure, detailing which employees were allowed to interact with regulators, into its protocol for subsequent exams. Other lenders attempt to manage the exam through negotiations with regulators over the coverage and characteristics of assessment areas. One small lender successfully reduced the effective size of its assessment area using detailed maps to convince regulators that a substantial portion of the area that had been labeled a ‘lower-income neighborhood,’ actually was comprised mostly of hospitals, parks, and cemeteries.

Working with Community Groups. As noted throughout the report, CRA often brings lenders into working relationships with community groups or state and local agencies. In previous years these often took the form of codified ‘CRA agreements’ between the lender and a community group, and may have specified lending and service goals for the banks, and complementary activities for advocates as well. These two-way agreements are less common in the current environment where automated underwriting and approval systems often diminish the importance of community groups’ specialized knowledge of applicants and neighborhoods. Unilateral lender

²⁷ These properties have two commercial spaces on the ground floor and four or six residential units above.

pledges to meet certain underserved borrower and area goals across multiple markets are more common today, with one compliance officer noting that “to some extent the agreement era is over.”

In the present, intensely competitive environment, cooperation between lenders and community-based organizations often works best when community groups provide services that help lenders lower the cost of reaching qualified lower-income borrowers.²⁸ One common approach, for example, is the effort of many community groups to provide credit and homeownership counseling to buyers, doing outreach to market segments that would be difficult for lenders to access, and generally helping make marginal applicants ‘loan-ready’ and bringing them to the lender. Since counseling programs are often funded by government or foundation grants, they may generate ‘loan-ready borrowers’ at little or no cost to the lender. Whether or not partnerships between banks and community groups represent a substantial benefit to a bank’s bottom line, of course, will depend on whether any savings the lender realizes in marketing and outreach are offset by lender contributions to support or subsidize other community-based activities.

Illustrating the complex and diverse characteristics of lender relations with community organizations, one smaller lender reported partnering with a local group on business plan writing, with the goal of improving the quality of small business loan applications and increasing approval rates for these loans. Community groups may also help lenders identify the appropriate depth of targeting on mortgage products as several reported asking for community groups’ input on the appropriate lower thresholds for credit scores.²⁹

The advantages resulting from these cooperative relationships flow in both directions as lenders provide a variety of services to community-based organizations. According to both lenders and advocates, bankers play a key role when they sit on community group boards. One lender noted, however, that as local corporate control recedes in many markets, community groups “are making a lot of bad decisions” in areas such as finance, because they no longer have bankers on their boards. Similarly, in many places bankers are the only corporate leaders sitting on these boards as other businesses have either left lower-income areas for the suburbs or abdicated responsibility for advising local groups, aware that bankers must maintain their involvement because of CRA.³⁰ Reflecting on this situation generally, one banker lamented that community groups “don’t do a good job of finding other partners besides banks.”

Beyond sitting on boards, lenders play a variety of other roles in their relationships with community groups. Despite many larger lenders reporting the desirability of working with large-scale advocacy organizations, they were often engaged in efforts to build capacity and enhance sustainability in smaller ones. Such efforts include activities seemingly well removed from banks’ core activities, such as helping community groups develop press strategies. One lender helped twelve community groups coordinate their real estate acquisitions and development efforts in a distressed part of the city. The groups had previously not realized the extent of each other’s holdings, and the bank’s involvement helped the groups identify key parcels for acquisition and avoid bidding against each other. Another lender provided seed money for community groups to use in getting

²⁸ One lender noted that in a particular market, collaboration was made difficult by the fact that community groups there are “just advocates.”

²⁹ Interestingly, one lender reported a community group urging them not to go below 600 FICO scores for fear that borrowers below this level are not ready for loans and that neighborhood deterioration could result from geographically-concentrated defaults.

³⁰ One Chicago lender noted that insurance company executives participate to a greater extent than other business people (attributing these efforts at least in part as a component of insurance companies’ strategy of avoiding having CRA extended to them). In Birmingham, lenders mentioned hospitals as the only other engaged sector.



community development projects started, with the hope that the money would improve the quality of the projects at the time when the groups applied to the bank's community development lending department for formal financing.

Realtors. Working with real estate agents can also help lenders bolster CRA performance, since many buyers follow their broker's advice about where to seek a mortgage loan. Several lenders emphasized this channel for generating CRA-eligible volume, including efforts to educate realtors about the special provisions of their products that are targeted to lower-income borrowers. One Birmingham lender extends this practice to community development lending, with specialists in this area cultivating relationships with realtors as part of the department's general business development activity. In California, the competitiveness of the market and the fact that realtors can also be mortgage brokers has led one lender to devise a program intended to increase realtor loyalty to its products and capture CRA-eligible loans. Under this scheme, the lender pre-approves potential borrowers and sends them to a realtor/broker who helps them find a home. Acting as a broker as well, the realtor then originates the loan using one of the lenders' products. Though this program is currently unique, the lender expects it to be copied by others in due course given the highly competitive nature of the market and the realtors' ongoing centrality to the mortgage process.

Large Lenders. While many of the coping strategies mentioned thus far are available to all lenders, large lenders can engage in some activities that smaller ones cannot. Large players can, for example, test products in one or a few markets and then deploy successful ones nationally. They can also develop and offer a diverse range of products that makes them competitive in virtually all types of markets and sub-markets. These lenders can also use their portfolios as a safety net to season aggressive CRA-eligible loans that do not initially meet secondary market criteria. And they can also afford to break even or lose money on some CRA-oriented products and deals. Though none of the lenders interviewed for this study reported doing so themselves, several commented that other lenders write off many CRA loans the day they buy or originate them.

Perhaps the greatest advantage enjoyed by some large lenders, however, is their affiliated mortgage company. Because the CRA legislation allows lenders to include the activity of their mortgage company affiliates operating in their CRA assessment areas in their lending totals, organizations with mortgage company affiliates typically take advantage of this option and have little difficulty meeting mortgage lending goals. One compliance officer, who had moved to an institution with a mortgage company from one without, commented that a healthy mortgage company makes the job of a compliance officer easier, allowing him/her to focus on more complex compliance activities associated with community development lending, and the investment and service tests. Because mortgage companies, both independent and affiliated, are often the most cost-effective mortgage originators in their market areas, not having an affiliate basically offers lenders two relatively expensive compliance options for the lending test: operate your own lower-income origination business or buy loans.

One lender reported hitting lower-income mortgage lending goals exclusively by buying loans. While this is rare and results from the lender's business focus outside of mortgage lending, buying loans to reach CRA targets is not. One lender reported selling every loan its mortgage company originates in another lender's assessment area to that lender. Another official at an independent mortgage company reported selling a high share of its low-income loans to depositories aiming to achieve lending goals. This practice, by which the loans pass through the hands of an additional owner on their way to the secondary market, is clearly uneconomic. Lenders appear to treat it as a cost of doing business and one that is preferable to risking a rating below satisfactory that hurts their competitive standing. While common, the practice is not universal. One lender

“never buys loans” to reach CRA targets, preferring to develop products with a deeper subsidy that transfers the lender’s additional expenditure to the borrower.

Large lenders may also enjoy an advantage in being able to absorb the costs of producing marketing materials in languages beside English. Because immigrants have relatively low homeownership rates and disproportionately lower incomes, the immigrant market can be a fertile territory for CRA-eligible loans for lenders that can reach it effectively. Outreach includes marketing in non-English language publications and radio and television programs and producing materials in other languages (though this is complicated by regional variation and dialects within a single language). Further compounding the expense of such efforts, non-English marketing channels are highly fragmented. One lender reported doing lots of small-scale activities and “waiting for the message to trickle through.” Large lenders are more likely to engage in these efforts because of the scale necessary to recoup the expenses, though some smaller institutions clearly specialize in serving a particular ethnic group. One large lender has a Hispanic marketing department that, in addition to leading the institution’s strategy in reaching the Hispanic market, will translate materials from other departments into Spanish. Another prints materials in both Chinese and Spanish and has loan officers that speak a variety of other languages including Vietnamese, Thai, and Lao.

Smaller Lenders. Smaller lenders’ lack of resources principally affects their lending test performance. These lenders are generally less competitive in conventional conforming lending and have a limited menu of product offerings. At the same time, they are generally not able to commit reserves to meet goals by buying loans. In order to produce mortgage lending volume they are employing a range of strategies.

Some intend to compete with the lower prices and/or more sophisticated marketing of their competitors by offering superior service. Others have simply ceased originating loans, opting instead to have their own branch-based loan officers serve as correspondents for other mortgage lenders. Such an approach is intended to retain existing customers by offering a full product range and to open opportunities to cross-sell bank products to mortgage clients. Some banks continue to offer mortgages as a loss leader that helps create and maintain ‘customers for life.’ And one particular lender reported offering unprofitable mortgage products in order to meet goals because they prefer that their expenditures subsidize lower-income borrowers rather than be used to pay the cost of fighting over their exam score in court.

Small lenders also hunt out niches that are profitable and in many cases CRA-eligible that have been overlooked by larger lenders in the consolidation-oriented environment of the previous decade. These efforts often concentrate on small business lending, which is not yet as commodified as the prime mortgage market. One lender reported a highly profitable niche in making business loans under \$2,500, a level well below what many larger institutions will handle. Another has a Korean banking unit that generates lots of small business activity. A Los Angeles lender noted that many Asian immigrant groups are, in fact, more eager for small business than mortgage loans, with current immigration patterns suggesting that this should be a good business going forward. Another smaller lender was fortunate that the niche left open by consolidation among larger players is small multifamily construction finance, which can in some cases be counted under the lending test’s affordable housing provisions.

In addition to exploiting CRA-eligible niches, smaller lenders often strategically collaborate in meeting CRA obligations in order to share risk, overcome loan limits, and minimize the cost of compliance.³¹ These efforts most often occur in activities related to the investment test and

³¹ Under some circumstances larger lenders will also collaborate, an example being among Chicago lenders working on



community development lending test portions of the exam. One medium-sized lender in Chicago reported advising smaller lenders on CRA-eligible investments. In Los Angeles, smaller lenders have formed an organization called Bankers In Search Of (BISO). BISO members discuss compliance issues and invest together in community development projects presented to the group at monthly meetings during which community-based organizations are invited to present prospective projects to the group. Each of BISO's roughly 20 member banks takes a turn at hosting the meeting and the host invites a community group to present a proposal for funding. Banks that want to participate in the project can offer any level of funding, while others may choose not to participate at all. All participating lenders are listed as funders, regardless of the level of the contribution (though actual dollar amounts are reported to regulators for CRA purposes). This approach ensures that these smaller lenders have a variety of investment activities well beyond what they could achieve individually.

Investment Test. One specific area of adjustment to the regulatory environment concerns actions taken to fulfill the investment test requirements. Guidelines for the investment test generally require CRA-regulated lenders to engage in significant levels of qualified community development investments and grants - preferably in a leadership role - and to be innovative in responding to credit and community development needs in their assessment areas.

An area for further review is the definition of 'innovative.' Some lenders contend that regulators are slow to consider activities 'innovative' that are actually challenging to accomplish. As an example, one lender purchased state housing finance agency bonds backed by mortgages to lower-income borrowers and is unsure whether this purchase arrangement will be considered innovative. Another large lender counts a 25 percent equity position in a small bank operating in a very low-income area of the metropolitan area for investment test credit.³² Large lenders also have the advantage of being able to make grants that are of sufficient size as to be self-evidently capable of making a positive community impact.

The backbone of investment test compliance for lenders of all sizes, however, is tax credit and mortgage-backed security deals. Just as having an affiliated mortgage company is a compliance advantage on the lending test, some lenders have departments that do financing on tax credit deals, and consequently larger investment portfolios, while others seek investment credits in other areas. However, large lenders who are generally better equipped to evaluate complex deals sometimes take a lead role and then bring smaller lenders on board. This cooperation is not uncommon, as Chicago lenders collaborate on investment test deals to keep costs down because of the potential for bidding wars over these projects. There was suggestion, however, that tax credit deals allow some lenders to comply with minimal effort by 'creaming' the most attractive tax credit deals.

Providing support to CDFIs is another popular strategy. One large lender mentioned dividing \$8 million among three CDFIs in the assessment area surrounding its headquarters and another had recently given \$10 million to a local CDFI. CDFIs are also a potential area of collaboration among lenders, as the development of Birmingham's Region 2020 CDFI illustrates. Region

investment deals. Another example mentioned by one large lender was a collaborative approach to warding off negative criticism from an advocacy group. In some cases large and small lenders also work together, as in the Alabama Multifamily Housing Consortium and the Birmingham Business Resource Council, which do multifamily finance and 'micro-lending' respectively. In some cases, however, small players are unwilling and/or suspicious of larger lenders and one large lender reported that such partnerships do not work for them because smaller players believe the bank will "railroad and trample their interests."

³² The bank's other (non-CRA) regulators force the large institution to take a hands-off approach and they are not allowed to help the institution grow or even purchase mortgages from it.

2020, a non-profit group serving northern Alabama, is currently developing a CDFI with contributions (that it hopes will total \$100 million) from large and small lending institutions in the area. Lenders interviewed for the study were willing participants, with prospective individual contributions as high as \$10 million. Lenders' supportive attitudes toward the project reflect the dilemma CRA presents to large lenders who often have trouble finding viable investments and partnerships at a scale that makes their compliance activities appear commensurate with the volume of their business activities.

Service Test. The service test assesses the accessibility of the bank's delivery channels, branch location changes, reasonableness of hours and services in meeting area needs, and community development service provision. Like the investment test, the service test has produced a range of behaviors and compliance strategies among lenders. Based on regulator assessments expressed in CRA exams, the floor for acceptable performance on this portion of the CRA exam seems to include not closing branches exclusively in lower-income areas, and not having shorter hours, fewer ATMs, or limited product offerings in lower- than in higher-income areas.

Institutions of all sizes also report participating with non-profits, GSEs, faith-based groups, and others to provide homeownership counseling, attend first-time buyer fairs, and improve financial literacy, as part of service test credit generating activities. Participation on the boards of non-profits by an institution's leadership is also counted under the service test component of the exam. One institution expressed its service test strategy as "complying locally." Several others require all employees to volunteer periodically, including one with quarterly mandates for employees of its mortgage division, and another that sets volunteer goals for all staff.

In all cases service test compliance efforts are carefully documented, which forms the basis for many of lenders' complaints about the continuing paperwork burden of CRA in spite of the move in 1995 from 'effort-based' to 'quantitative' assessment methodologies. Lenders, however, take particular care to document activities in less affordable markets such as parts of California where efforts to generate lower-income mortgage lending are crippled by the limited availability of properties in the price range of lower-income prospective buyers. One California lender meticulously documents his institution's counseling efforts in order to be able to demonstrate to regulators the number of loan-ready borrowers coming through their counseling programs that are unable to find homes.

Several lenders discussed reaching the 'unbanked' as part of their service strategies. One lender in California is even attempting to transition customers from its check cashing business into regular accounts. The City of Los Angeles is also initiating a linked-deposit program by which institutions seeking to provide banking services to the city will be graded on their record of serving lower-income clientele in an effort to bring more people into the formal banking system. Participating lenders could apply for service test credit and potentially get additional points for being innovative if they are pioneers in getting the city's program off the ground. Regarding the unbanked generally, however, many lenders noted that the unbanked are expensive to serve and offer limited upstream cross-selling opportunities by graduating to financial services beyond basic checking accounts.

Strategic Plans. In order to manage the uncertainty of the CRA exam, some lenders choose the security of the 'Strategic Plan' option, which one described as appealing given its "static approach." The provision for strategic plans in the 1995 regulations allows lenders to devise a formal three-year plan with annual goals for each section of the test that specify levels that constitute satisfactory, and in some cases outstanding, performance. Emphasizing the appeal of having known numeric goals, one lender attributed the fact that his organization was on a strategic plan



to the fact that the bank's CEO was an accountant. Despite the advantages they offer in terms of certainty, strategic plans have, to date, been used by relatively few institutions. In part this is because plans must be revised as institutions change structure, which has happened frequently for many lenders since the 1995 regulations allowing the strategic plan option went into effect. One compliance officer said that his institution would take the strategic plan route if they did not have future growth plans.

Others suggest that lenders have shied away because the plans must be submitted for public comment prior to regulatory approval. Lenders fear that community groups will use this opportunity to ratchet up goals to potentially unreachable levels, and left with the choice of a messier process but one that they know more or less how to manage already, they stick with the standard exam. One community advocate commented that the strategic plan appeals to "weird banks." Supporting this 'hypothesis,' several banks started by the insurance companies have chosen the strategic plan option, as has IndyMac, an 'inverted' mortgage company that also owns a small bank.

In addition to the potentially discouraging aspects of the strategic plan and the fact that its appeal is greater for unconventionally structured institutions, there is general confusion about it. One lender felt that while the OCC considers the plan an agreement between the bank and regulators, the Federal Reserve Board thinks of the agreement as being between the lender and community advocates. One compliance officer of a bank with several entities evaluated for CRA under different strategic plans reported that regulators in one area made them remove numerical targets for 'outstanding' from their plan, while regulators in another area allowed such targets. Other interviewees reported that one regulatory agency encourages use of the strategic plan option, while others discourage it.

In reporting on the outcome of the decision to take the strategic plan route, one lender indicated that some of the strategic plan anecdotes ring true. This lender felt that the plan increased the institution's visibility, and it landed them in a fight with one vocal community group that sought to have regulators raise their target loan-levels. The lender also stated that being on the plan did not reduce documentation. On the plus side, however, they were able to cut CRA compliance staff by distributing numeric goals to regular business divisions. The lender summed up their experience as a mixed one and recommended that the exam for lenders on strategic plans become more impact-based in the future, to take advantage of the plan's inherently longer-run time horizon and its ability to address potential needs in the bank's assessment area 'strategically.'

LENDER CONCERNS ABOUT REGULATORY BURDEN

In spite of the range of adaptations lenders employ to comply with CRA, and the fact that virtually all lenders achieve a rating of 'satisfactory' or better, several issues came up repeatedly as areas in which it was felt that the exam's emphasis was misdirected or that the requirements were excessive. Of course, most banks have only been evaluated once or twice under the 1995 regulations, so part of their concerns simply reflected their uncertainty about the 'new process.' Even so, many comments went beyond the details of the regulations and focused on generic issues. One common theme, for example, were statements to the effect that "regulators don't understand" certain lines of business. Others related to the challenges of mortgage lending in an unaffordable housing market, and the ability of deep-pocketed players to cream tax credit deals for investment test credit. As mentioned throughout this section, however, the chief concern is the uncertainty inherent in the exam process itself, which raises the cost of compliance and drives lenders into areas outside their expertise.

In addition, several lenders expressed a wish for community development projects made outside their assessment areas to count for CRA credit, because areas most in need of community development are not always within their assessment areas, and/or because viable community development projects are relatively rare. Another issue of contention is the emphasis on quantitative goals since 1995, which ironically was made in response to complaints that the ‘effort-based’ requirements were too subjective. Many lenders nonetheless expressed the opinion that the new quantitative goals direct lenders’ activities away from the “harder work” of “having an actual impact.” The quantitative focus can also set up a situation where CRA-eligible loans are effectively “auctioned” late in the year, as institutions that are not going to make goals by originating loans enter the market to purchase loans made by others in their assessment areas.

One lender bemoaned the fact that no distinction is made between loans to borrowers at different points on the income distribution, pointing out that it is far more difficult to get someone at 50 percent of area median income into a loan than someone in the 70-80 percent range. Yet, all loans to people below 80 percent of area median income count as ‘low-income’ for CRA purposes. Another lender felt that mortgage lending is generally given too much credit in the exam, particularly given the potential spillovers associated with small business lending. Picking up on the small business point, several lenders mentioned that the \$1 million cap is far too high to ensure that lenders target the types of businesses that typically have the most trouble getting credit. One lender suggested that rather than having a business size and a loan size standard, the two should be combined to improve targeting of the small business lending requirement, hopefully to reach those borrowers who are now funding business start-ups with consumer debt.

Another set of concerns results from what small lenders feel are implicit comparisons between themselves and larger players. Smaller players claim not to be able to compete with larger ones on pricing for many products, particularly mortgages. One lender that tries to generate CRA-eligible mortgage business by originating loans through its branch network mentioned the difficulty of being compared to another who competes in the same assessment area by buying loans. Small lenders feel that deep-pocketed competitors have the option of writing off a loan the day they make it while these small institutions must be involved in the costly business of working with the borrower up front and over the long term in order to make the loan work. The president of one small institution justified his decision to shoot for a ‘satisfactory’ rather than ‘outstanding’ rating based on his assessment that the competitive environment is so skewed in favor of larger players that those with more resources should be shouldering an increased share of the burden of CRA compliance.

Finally, some lenders protested the fact that regulators continually raise the bar for compliance. As one put it, “we are already as innovative as we can possibly be – we can’t do loans on Mars.” In focus groups, regulators confirmed the existence of continual upward pressure, but noted that the lenders themselves are the source of some of this pressure. This competitive compliance likely derives from differing specializations and comparative advantages across lenders that allow firms making breakthroughs to temporarily exploit them for CRA benefit, but these advantages do not persist because such activities simultaneously show others the way.

SUMMARY

The interviews conducted for this project confirm that CRA has a significant impact not only on the ways in which banks structure internal operations but also on how they relate to the communities that they serve. In many cases banks have found that compliance-oriented activities are directly profitable (if not always at the same rate as other business lines), productive of good will,



or both. Many banks have found that CRA-eligible activities can be good business, particularly if they are proactive in developing clear compliance plans that take advantage of the strength of existing business units. At the same time, respondents did express concerns with regard to various aspects of the current regulations and generally do feel constrained from engaging in some activities that they calculate would more directly improve the lot of lower-income people and areas. While some interviews consisted largely of predictable gripes about regulatory burden, most respondents were thoughtful and committed to making their CRA activities work better to achieve observable improvements, particularly in the distressed communities in which they operate.



SECTION 9

THE EFFECT OF CRA ON COMMUNITY ORGANIZATIONS

As noted throughout the report, non-profit groups have played a central role in this history of CRA. The movement that culminated with the passage of HMDA in 1975 and CRA in 1977 began in the 1960s with community advocacy against 'redlining,' or the systematic denial of mortgage credit to neighborhoods and groups in less prosperous sections of U.S. metropolitan areas. Anti-redlining activism gave rise to a number of politically powerful and savvy grassroots advocacy organizations that succeeded in attracting the attention of decision-makers in places like Chicago, where legislation similar in spirit to CRA was passed as early as 1975.

Critical to the success of these early efforts, and eventually to the passage of CRA itself, was the leverage community groups obtained through their ability to identify local targets for their campaigns. Since local thrifts and banks dominated mortgage lending at the time, community-based organizations targeted these institutions in their fight to expand credit access in lower-income communities. Though this local focus endured through the first decade after CRA's passage, and into the 1988-1993 period referred to by some advocates as the "Golden Age of CRA," recent changes in the mortgage industry have effectively shifted the ground under advocates' feet. As the mortgage industry has increasingly adopted automated systems and consolidated into national networks, the relationship between community advocacy organizations and mortgage lenders has evolved as well.

This section briefly describes the history of CRA and community advocacy, and discusses how community organizations and the nature of their advocacy is changing in face of the dramatic changes in the structure of the mortgage industry and the growing sophistication of mortgage products. As the regulatory reach of CRA declines in an era of major national lending companies and independent mortgage lenders, there are fewer opportunities for individual community organizations to mount CRA challenges, just as it is increasingly difficult for community organizations to assess the market implications of the growing array of new loan products. These shifts also may threaten the fundraising capacity of smaller, locally-based community groups, as larger banking organizations look to partner with a smaller number of larger and more sophisticated non-profit organizations.

Recognizing these challenges, this section describes how advocates are forging new, and broader, coalitions that have the capacity to prompt regulatory change at the state or local level. Other community leaders are seeking to expand advocacy beyond mortgage lending, and focus instead on issues relating to access to financial services. In any event, community organizations are adapting, as they must, and learning how to advocate effectively for the lower-income people and communities they represent.

CONFRONTATION: THE RISE OF COMMUNITY ADVOCACY

The ability of community groups to pressure banks emerged as a powerful factor contributing to the growth of lending in lower-income and/or minority communities. In 1977, led by Gale Cincotta and the Chicago-based National Training and Information Center, community activists helped win passage of the Community Reinvestment Act. This legislation established for the first time formal lending criteria for banks taking deposits in specific neighborhoods (Bradford and Cincotta, 1992). This was followed in 1989 with legislation that enhanced CRA regulation and



provided community groups with direct access to loan-level Home Mortgage Disclosure Act (HMDA) data on mortgage lending, including borrower and neighborhood characteristics.

What emerged from the combination of community-based activism and legislative efforts was a period in the late 1980s and early 1990s dubbed by one community group leader in Chicago as the “Golden Age of CRA activism” – a period when community-based organizations put significant pressure on banks to expand the reach of their lending and banking activities. Dubbed “regulation from below,” community groups armed with HMDA data could pressure lenders into increasing the number of loans made to minority and/or lower-income borrowers (Fishbein, 1992).

The relationship that evolved between community groups and banks involved both ‘collaboration’ and ‘confrontation’ (Schwartz, 1998, 1999). Negotiations between community groups and local banks focused on mortgage or small business lending, provision of banking services in particular lower-income areas, or the weak record of particular institutions in servicing minority communities. To the extent that lower-income and/or minority borrowers presented unique banking challenges, banks and local community groups working together could create products better tailored to community needs and expand access to credit in many underserved markets.

Arrangements between community groups and lenders were often codified into formal commitments or ‘CRA agreements,’ where banks pledged to meet specific lending or service delivery targets. Some agreements specified monitoring arrangements allowing community groups to review and publicly critique bank performance. In addition, many banks, including some of the nation’s largest, announced voluntary community reinvestment commitments, often designed to pre-empt opposition to a proposed or recently completed merger. To further enforce these agreements - both negotiated and voluntary - community activists could always turn to the ‘regulators from above,’ namely federal bank regulators. Regulators are careful to state that they have no role in enforcing agreements between banks and community groups. Even so, these disputes over CRA agreements often come to the attention of regulators when a community group challenges a bank’s CRA rating, or a bank’s decision to merge, open new branches or engage in new lines of business.

If the bank failed to engage in constructive dialogue, or failed to honor an existing agreement, these relationships often turned confrontational, as community groups protested or otherwise attempted to draw public attention and gain support for their cause by disrupting the operations of bankers and regulators alike. While community groups claimed to focus on banks with poor lending records, even banks with solid records of lending to lower-income and/or minority communities nevertheless were concerned that they would be the target of a community demonstration. Regulators were not immune from confrontational tactics, as community groups angrily testified at public hearings or otherwise charged that regulators were derelict in their duty to hold lenders accountable to CRA obligations.

As might be expected, many lenders reacted negatively to what they argued was “CRA-led extortion.” Lenders expressed concern that under the CRA-banner, community groups were pressuring banks to make “bad loans” to people that had limited capacity to repay.³³ Others pointed to community protests relating to proposed mergers. Here, protests could prove costly as well. Even if a request to merge was eventually approved, as most in due course were, these community protests could delay the merger and force banks to make a substantial investment of senior management time to shepherd an application through the regulatory process (Johnson and Sarkar, 1996).

³³ For a fuller discussion of this point of view see Husock (2000).



Faced with potentially costly delays and damage to their reputation if they resisted addressing community concerns, many bankers reluctantly entered into negotiations with community groups. “I understand the frustration of many community advocates,” lamented one large lender interviewed for this study. “But it is not the responsibility of banks to address the poverty and deterioration of urban neighborhoods. Sure I want to help, but it is not my money that I am lending here. My first responsibility has to be my investors and depositors. If I neglect that responsibility, I won’t have any money to lend – to low-income people or to anyone. At the same time, I can’t run a business with protestors camped out in my offices. I couldn’t ignore them either.”

COLLABORATION: HELPING LENDERS FIND NEW MARKET OPPORTUNITIES

To meet their CRA obligations, many lenders aggressively expanded outreach to lower-income neighborhoods, and to minority borrowers. Forced to take a closer look, banks found that in some instances these markets held potential borrowers that could be served through existing loan products. Of course, many CRA-eligible customers presented additional lending risks such as flawed credit, low incomes, and limited capacity to make a downpayment. In combination, these characteristics made it difficult for banks to serve residents of target areas with existing products and services. In these instances, banks needed to improve their information about potential new customers in order to design new products and services.

As banks expanded their lower-income outreach, marketing and product development, they also improved their relationships with community organizations. One focus group participant claimed that CRA helped “refine bank relations” with community groups. “Community groups have taught bankers a whole new way of business,” another focus group participant observed. Of course this was not always the case, but many lenders discovered that there are many profitable loans to be made in previously underserved neighborhoods. As a result, working in partnership with local community groups not only generated public relations advantages for being a good corporate citizen, it could also be done without harming the bottom line.

A recent report by the Federal Reserve Board lent support to the observation that CRA pushed lenders to expand into what ultimately turned out to be profitable markets. The Board surveyed over 100 large banking organizations concerning the profitability of their CRA-related lending (Federal Reserve Board, 2000). Banks reported that CRA home purchase and refinance lending was profitable or marginally profitable 82 percent of the time. Similarly, the vast majority of banks noted that other CRA-related business lines (small business lending, home improvement lending, and community development lending) were also either profitable or marginally profitable. While conceding that CRA-related lending was not always the most profitable activity a bank could undertake, the Federal Reserve Board study largely confirmed community activists’ contention that “CRA-related lending can lead to new, profitable business opportunities for banking institutions.”

Through the CRA process, many community groups also established a productive relationship with banking regulators. Focus group participants noted several examples of how community groups have worked with banking regulators to help them better understand CRA opportunities and to enhance the effectiveness of regulatory oversight. Regulators from San Francisco, for example, said that community groups now approach them on a regular basis, seeking input into the regulation process. Community advocates in Atlanta reported that regulators often contacted them to learn more about best practices in community lending.

WORKING TOGETHER: HOMEBUYING COUNSELLING AND EDUCATION

Local groups work with lenders in many ways. One common approach is for community groups and banks to join forces to promote homebuyer education and counseling. Homeownership counseling, along with related efforts to promote financial literacy, are particularly important for lower-income and minority homeseekers, groups that in the past lenders have had difficulty serving. Over time the efforts of counseling networks operated by the Neighborhood Reinvestment Corporation, the National Community Reinvestment Coalition, ACORN, and others have enabled thousands of potential buyers to realize their dreams of homeownership.

Consider, for example, ACORN, a national grassroots organization with one of the nation's largest homebuyer counseling operations. Working in partnership with local lending institutions, ACORN affiliates around the country identify potential homebuyers, work with them to establish clear financial and homebuying goals, and provide information on how to overcome obstacles to purchasing a first home, including detailed guidance on how best to 'repair' a spotty credit history. In Chicago, for example, working in partnership with small community banks, ACORN counseled 180 borrowers, including 120 lower-income African American borrowers. The ACORN-counseled borrowers accounted for some 75 percent of all CRA-eligible loans made during this period by these banks.

Another example of effective partnering between non-profits and the private sector is Baltimore's St. Ambrose Housing Center. As a HUD-designated counseling agency, St. Ambrose receives referrals from banks, mortgage lenders and other community groups, and directly from individuals who are having difficulty qualifying for a mortgage. In addition, responding to the recent wave of foreclosures resulting from the rapid rise of predatory lending practices in Baltimore, the St. Ambrose Housing Center has also substantially expanded its pre-foreclosure counseling operations. Based on this strong track record, Freddie Mac recently extended the St. Ambrose Center a \$5 million dollar line of credit to expand the borrowing options for neighborhoods hit hard by predatory lending scams. St. Ambrose has emerged as a leader for their work to join Baltimore-area lenders and community groups in an effort to rid the city of predatory lending activities.

For community groups, homebuyer education and counseling programs have emerged as an important revenue source. For example, HUD funding, for both national organizations such as ACORN, and local groups such as the St. Ambrose Center, was \$20 million in FY2001. Homebuyer education and counseling programs also received significant funding from many of the banking organizations interviewed for this study, while local organizations noted that their homebuying education and counseling work was broadly supported by national and local area foundations and state and local governments.

Homebuyer education and counseling efforts in Chicago and Los Angeles have also focused in recent months on predatory lending issues. In addition to providing general information on how to avoid becoming a victim of a subprime lending scam, neighborhood-based organizations, including Chicago Neighborhood Housing Services and the Legal Assistance Foundation of Chicago, joined with 20 financial institutions to launch an innovative mortgage product called NORMAL (Neighborhood Ownership Recovery Mortgage Assistance Loan). The loan is designed to help families at risk of foreclosure transition back to financial stability and repair the damage to their credit by refinancing them out of a predatory loan. The design of this innovative product was the joint effort of civic-minded local banking officials working in cooperation with leading Chicago-area non-profit organizations.



In Los Angeles, a similar group that combined community-based non-profit advocacy organizations and local legal services groups recently launched the local version of Freddie Mac's broad-based educational campaign, labeled 'Don't Borrow Trouble.' Part of a national effort, this campaign reaffirms the unique contribution that community organizations - working in partnership with banking organizations - can make to homebuyer education and outreach.

In short, what started out as small-scale opportunities for lenders and community groups to work together, has grown to a nationwide network of community-based homebuying counseling and education groups, and has become good business for both banks and community groups. Homebuyer education and counseling efforts may help reduce the lending costs by providing banks with loan-ready lower-income borrowers, and they have emerged as an important line of business and revenue source for community organizations. Increasingly the focus is on how best to make borrowers 'loan-ready,' or package their application within the standards embedded in the now dominant automated underwriting systems. With today's focus on credit scoring as a key component of loan approval and pricing decisions, programs on credit counseling and financial literacy are now the centerpieces of most homebuyer education and counseling efforts and a permanent fixture in the national affordable housing finance system.

CRA COMMITMENTS

In addition to work on marketing, outreach, counseling and product development, over the past two decades banks have negotiated with community-based organizations to forge community reinvestment agreements or commitments that set specific bank goals for lending and the provision of banking services to lower-income people and neighborhoods. CRA commitments include agreements negotiated between community groups and/or local governments and CRA-regulated entities, as well as lenders' unilateral statements of community reinvestment plans and lending targets. They range from national and statewide agreements and commitments to smaller commitments made by smaller institutions at the local level.

A. Background – Chicago Leads the Way

According to the National Community Reinvestment Coalition, an association representing nearly 700 community organizations, since 1977 banks and community-based organizations have entered into nearly 400 commitments to provide over \$1 trillion in loans, investments and services to minority and lower-income households. While most early commitments were limited in scope, following enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, the number and scale of CRA commitments increased dramatically. Indeed, one analyst estimated that almost 99 percent of the over \$1 trillion dollars committed by banks for CRA activities has happened since 1992 (NCRA, 2000).

Chicago provides a useful look at the evolution of CRA agreements. In 1974, three years before the enactment of national legislation, neighborhood organizations there pressured three local banks to sign CRA-style agreements. A few years later in 1980, another local lender, Austin Federal Savings and Loan, under pressure from advocates, signed an agreement with the North-east Austin Organization and the Northeast Austin Council. These early commitments were followed by more extensive agreements with larger banking organizations seeking to get out in front of the wave of CRA protests sweeping Chicago.

In 1984, the Chicago Reinvestment Alliance, an *ad hoc* coalition of community organizations and advocacy groups, negotiated agreements with three of the city's most prominent banks: First Chicago, Northern Trust, and Harris Trust and Savings Bank. At the core of these agreements was something called the Neighborhood Lending Program, which established a set of measurable lending goals for home mortgages, multi-family housing development, and small business lending. Further, to ensure that these agreements were carried out, the Alliance organized separate community development advisory committees to monitor each agreement. All three banks renewed these agreements five years later in 1989. Then, in 1995, the agreements were renegotiated once again. This time they included a new arrangement with the National Bank of Detroit (NBD), which was merging with First Chicago. This agreement and monitoring system survived yet another merger three years later, as it was expanded in anticipation of NBD's impending merger with BancOne in 1998.

Remarkably, the advisory committees created in 1984 and comprised of banking officials, local community leaders, representatives of regional non-profit advocacy organizations, and state and local officials, continue to meet quarterly to monitor performance under these agreements. Today, these meetings are forums, not only for monitoring the performance under existing agreements, but for information exchange between the groups. As such, they have been an opportunity for lenders to educate community leaders about bank policies and market trends. Similarly, they have recently provided an opportunity to discuss how best to collaboratively address the recent wave of foreclosures that have resulted from predatory lending practices in many of Chicago's lower-income neighborhoods.

B. The Diversity of CRA Commitments

While by no means unique, few other metropolitan areas can match the Chicago experience in making, meeting, and monitoring CRA commitments. In large part this reflects the weaker capacity of community-based organization in other places, as well as the reluctance of lending institutions to enter into detailed lending agreements. By way of illustration, Birmingham, which does not have a strong network of community organizations, has had no CRA agreements.³⁴ This is in spite of the fact that one Birmingham regional lender observed that they would be willing to discuss and potentially enter into such an agreement if they could identify a stable neighborhood partner with whom to work. This willingness to enter CRA-type agreements reflects the fact that these agreements can minimize the public relations risks faced by large lending institutions. In the lender's words, such an agreement would minimize the chances that "some wacko would come out of the woodwork, mount a media campaign, or otherwise disrupt our efforts to expand in this market area."

Community advocacy in Los Angeles benefited to some extent from several statewide agreements. (These state-scale agreements reflect the fact that a number of large Californian banking organizations with extensive branch networks operate statewide). These agreements - negotiated most recently by the Greenlining Institute and the California Reinvestment Coalition - garnered significant concessions from major financial services organizations such as Washington Mutual, Wells Fargo, and U.S. Bancorp. However, the impact of these agreements was less visible to community leaders working in Los Angeles who lamented the lack of opportunities to engage with decision-makers. One commentator stated the concern most harshly: "These big agreements

³⁴ While Birmingham was technically under various multi-state agreements - including the unilateral commitment by AmSouth Bancorporation covering Florida, Tennessee and Alabama announced in 1999 - few community leaders interviewed for this study knew that such a commitment was in place, understood its details, or engaged with lenders on the basis of the agreement being in place.

are simply public relations stunts. At best these banks focus on the Bay Area. Here in Los Angeles, predatory lending runs rampant, but the big banks don't care and the high profile agreements do little to help."

The strength of the Chicago agreements' also lies in their provisions for systematic monitoring. By contrast, Baltimore banks have entered into a number of CRA agreements that have eroded over time. Because of the lack of clear enforcement mechanisms, regular monitoring meetings and ongoing communication among the parties, there was little understanding as to whether the commitments had been honored. This came out most directly in a meeting with leading Baltimore advocates who expressed confusion as to the exact status of existing regulatory agreements. This confusion resulted from the fact that several of the banks that had negotiated Baltimore-area agreements had vanished in the wave of consolidation that left Baltimore with few locally-based banking organizations. These mergers presented locally-based Baltimore advocates with the daunting task of developing relationships with lenders headquartered across the country.

C. The Rise of Unilateral Commitments

Over the past decade, larger banking organizations have increasingly issued unilateral commitments to expand access to credit in low-income communities. Some community leaders hail the recent multi-million dollar unilateral commitments as a sign that lenders are now coming to more fully understand the potential of CRA markets as a source of good business opportunity. Others are more skeptical. In Baltimore, one advocate claimed that a lender was meeting its unilateral CRA commitment in part by counting lending in the most prosperous portions of the city. Yet, this participant acknowledged that lacking a detailed understanding of bank operations and the time and resources to carefully examine lending patterns through HMDA data, his conclusion was speculative and based on "what I read in the newspapers." Said one veteran activist who was particularly frustrated by his lack of understanding about a major multi-state agreement that covered Maryland, "It's hard to get even basic information about the activities of lenders headquartered out of state. Heck, I am not even sure who I would call to find out."

In Chicago, an activist familiar with the collaborative agreement oversight process complained that without a formal monitoring arrangement mega-commitments are meaningless, calling them "a public relations gimmick on the part of banks designed to impress regulators and less knowledgeable public officials." Another noted the need to carefully analyze HMDA data to understand whether newly announced commitments reflect an expansion of lender effort, or simply represented an attempt "to take credit for lending that was already happening."

For many community group leaders, the growing number of unilateral agreements and the apparent declining significance of CRA commitments reflects what they fear is a shift in the balance of power toward large lending institutions. Several bankers agreed that as they have grown in scale and their lending operations became increasingly sophisticated, there was less reason to work with community groups. While once community groups could help banks identify 'good borrowers' with opaque credit histories or living in distressed neighborhoods, advocates and lenders alike acknowledged that with today's automated systems, banks now possess so much data about potential borrowers that their need for community group assistance in marketing and outreach was steadily eroding.

As a result, several advocates interviewed for this study expressed concern about how automated underwriting and computer-based loan processing was making it more difficult to establish programs tailored to meet local needs, as was done with Chicago's Neighborhood Loan Program, or more recently with its NORMAL program. One neighborhood advocate from Chicago observed

that many banks no longer had the time or interest to sit down with community group representatives and go through specific loan files. “To be profitable, loan decisions have to be made in a matter of minutes, not days,” said one. “There is just too little room to discuss how to serve those borrowers who don’t conform with standard underwriting guidelines.”

This is not to say that banks are ignoring community groups or that community groups have stopped advocating for expanded lending. ACORN and other national non-profit counseling organizations and networks still reach out to identify (or with the help of counseling to produce) loan-ready applicants. These organizations also continue to refer thousands of borrowers to banks. However, Chicago area advocates acknowledged that even banks with a long history of working in partnership with local community groups are pulling back. “Chicago is a special case, and banks have more reason to deal with us, given the high visibility role that Chicago area advocates play in the national arena. But even the same banks that are renewing CRA commitments here in Chicago are refusing to sign comparable agreements in other cities.”

Baltimore study participants echoed these comments, noting that with the increasingly competitive lending environment, one bank that had once been an active participant in a locally-crafted lending initiative had abandoned its mortgage lending operations and now refers customers to an independent mortgage company. Even banks with a strong commitment to CRA activities confirmed that the increasing competition among banks for CRA-eligible loans made it difficult to deal with ‘special cases.’ “We continue to work with local groups to identify new potential borrowers and work on individual case files, but we lose money on this part of our business. Today, you have to be an automated, high-volume lender to make money in the residential mortgage business.”

CHANGES IN FUNDING AND PARTNERING ARRANGEMENTS

As noted previously, the numerous partnerships formed between lenders and community groups not only were an important element in the ability of banks to meet their CRA obligations, but also represented a major source of both funding and guidance for community-based organizations. Just as homeownership counseling and education were gathering new momentum – especially in light of the new focus on addressing predatory lending issues – many community representatives expressed concerns about how difficult it was to raise money to support their ongoing efforts. In particular, several respondents expressed concern that the rise of big national banking organizations threatened the funding base of community organizations, particularly smaller organizations operating outside of the growing national networks.

The limited role in mortgage lending for smaller locally based banks is well illustrated in Baltimore. First and foremost, community representatives lamented the decline of locally based lending organizations. Of the four cities examined in detail for this study, Baltimore has the smallest share of home purchase loans made by banks operating within CRA-designated assessment areas (20 percent in 2000). Further, nearly half of this 20 percent was made by three large banks headquartered elsewhere. By 2000, as a result of a decade of mergers and acquisitions, in combination with the large number of smaller Baltimore-based banks that were no longer active in home purchase lending, banks headquartered in Baltimore accounted for only about one in ten home purchase loans.

These shifts not only substantially reduced the leverage local community groups once enjoyed and had used to gain concessions from lending organizations based in their community, they also disrupted personal relationships between lenders and advocates, and threatened the core funding



of several Baltimore based advocacy organizations. One experienced community operative described how a major source of support for his organization had disappeared when it was purchased by a national bank that in turn merged to become part of an even larger organization. For twenty years before this consolidation, the locally-based bank not only was a major financial supporter of this community organization, but also “walked the neighborhood with us and helped us craft some innovative programs.” While funding from the new national organization continued (at reduced levels), the community advocate perceived that his area also suffered from the loss of the close personal relationship, and the various forms of technical assistance, support and guidance exchanged between the locally-based lending organization and the group.

While similar stories were repeated in each of the cities visited as part of this study, it is difficult to interpret precisely the extent to which shifts in banking industry structure are changing the aggregate amount of funding banking institutions are providing to local community groups. What does seem clear is that the characteristics of this financial support are changing.

Again, Baltimore provides a series of examples. First, in Baltimore as elsewhere, new national-level funding sources offset, at least somewhat, funding once provided by locally-based banking organizations. Fannie Mae and Freddie Mac represent two of the most prominent examples of this trend. As the two GSEs grew along with the overall shifts in the mortgage industry, they have increased both their charitable giving to local groups, as well as their work with local community groups to develop innovative loan programs and expand counseling efforts. But just as was the case with large banking operations, for many Baltimore-area advocates, these national organizations are “too big and bureaucratic to walk the streets of Baltimore.” While local groups were generally appreciative of the GSEs’ efforts, they expressed concern that most of the assistance was designed to help “fit our people into their underwriting boxes.”

Most major lenders have sophisticated Community Development operations and active foundations, and the large national banking organizations operating in Baltimore were no exception. Yet there is a sense among community groups that the nature of financial support flowing from these larger organizations is changing. Previously, smaller organizations had relatively simple strategic objectives to guide their funding – be a good corporate citizen, promote the health and vitality of the neighborhoods where their branches were located, and avoid the potentially adverse publicity that a ‘bad’ CRA rating could produce. With limited grant money to dispense, and without staff to carefully review and monitor proposals, the institutions tended to identify a handful of seemingly strong organizations, and then “spread their dollars around.”

Philanthropy today is somewhat more sophisticated. Banking institutions still are mindful of their need to generate goodwill to protect their reputation in the marketplace, as well as their need to meet their CRA obligations. In addition, as is the case with foundations and charitable organizations in general, large banks seem to be increasingly concerned about holding their community-based partners accountable for the funds they receive. There also seems to be a tendency toward supporting a smaller number of larger organizations, organizations that both have greater capacity to effectively utilize funds, but also organizations that are likely to be going concerns over the longer run.

As a result, several community advocates noted that grants once “done with a handshake with a local banker,” now require a formal grant proposal at the front end, and detailed monitoring reports during the period of the grant. For smaller organizations, this is burdensome. Indeed, one banker in Birmingham worries that most of the money they provide some smaller organizations is spent simply filling out the grant performance report or writing the coming year’s grant application.

Alternatively, larger, more stable organizations may actually benefit from these trends, in that they have the capacity to be the recipient of larger individual grants, or be designated as the main local community partner of a major institution. These forces are also at work in Baltimore. Just as some smaller organizations were scrambling for funds, other, more established players had the opposite problem of having more opportunities for funding or partnerships than they could handle. One local community group leader noted that his organization was approached by a national banking organization offering a multi-million dollar funding package. “I understood why they wanted to make a big splash in Baltimore, given all the controversy about predatory lending here. Yet I had to ask myself, could I really manage a program of this magnitude. And how will I be able to face all those other community groups in the city that are struggling to make ends meet.”

These shifts have led many local community leaders to take a hard look at their fundraising operations. One approach is to join together to form local networks that unite several local groups into one targeted campaign. Several of the efforts to respond to predatory lending followed that pattern, as banks joined forces to fund an education or counseling effort managed by a single community partner that served as a conduit for numerous smaller participating groups. Such arrangements can be particularly important in areas lacking a significant community-based capacity. For example, as an outgrowth of a region-wide planning effort, Region 2020, a Birmingham based non-profit, is working to form a CDFI that could serve as a conduit for the charitable contributions and CRA-related investments of locally-based institutions.

Recognizing that bank support for their efforts may be declining and certainly is changing, some community organizations have mounted campaigns to diversify their funding base. “CRA gave community groups access to bank resources, but times are changing. We have to convince other major corporate players that the health of our communities is not just important to the mortgage and banking sector – it affects all businesses.” To accomplish these ends, this group is turning to some tried and true techniques, and trying to get corporate leaders in health care, manufacturing, services, and other sectors “to walk the neighborhoods with us,” and learn first hand what effective community-based development can accomplish.

THE RISE OF NATIONAL ADVOCACY ORGANIZATIONS

As noted above, in a move that parallels the growth of large banking organizations, many local groups are now forming national networks to access or pool resources and technical assistance. These national network organizations are increasingly assuming the role of challenging large lenders to expand their lower-income borrower and neighborhood lending. If local groups are now often overmatched in their efforts to win concessions and advocate for resources from national lenders, national-scale advocacy groups and networks are not. These organizations have, in fact, been quite successful in their dealings with major financial services companies.

ACORN’s agreement with Ameriquest, a national-scale subprime lending specialist headquartered in California, illustrates the leverage an advocacy organization with broad scope can bring to bear. Ameriquest had steadfastly maintained that they provided a useful set of loan products that addressed the needs of an underserved class of borrowers. ACORN countered by bringing forth a series of Ameriquest customers who claimed that they were victimized by high pressure sales tactics, tricked into signing up for high priced loans they did not need, and defrauded by home repair contractors who pocketed the proceeds of the loan without completing the required repairs.



Had these stories related only individual borrowers in a particular neighborhood, Ameriquest could have argued that the cases were not representative of the thousands of satisfied customers across the nation. But as a national organization, with the capacity to generate adverse publicity for Ameriquest in markets across the country, ACORN's accusations were not easily dismissed. Instead, Ameriquest decided to reach out to ACORN to find a way to quell the local protests that had the potential to seriously harm their reputation in the national capital markets and undermine their competitive position in the mortgage market. They were therefore looking to make a pre-emptive agreement to demonstrate goodwill and responsiveness to advocates' concerns. In assessing its options for such a partnership, however, Ameriquest felt that many local ACORN chapters lacked the capacity to discuss technical issues surrounding how best to structure new loan products. Moreover, given Ameriquest's reliance on automated credit scoring and underwriting tools, and secondary market funding, the company did not want to develop loan products for each MSA in collaboration with multiple local ACORN units.

A series of meetings and negotiations between ACORN's national leadership and senior Ameriquest management ensued that resulted in a major national agreement detailing the terms of a partnership. Through the agreement Ameriquest pledged to fund a set of specialized loan products, while ACORN agreed to use its counseling network to help Ameriquest identify 'loan-ready' borrowers.

The commitment of Fleet Mortgage to fund \$7 billion in mortgages over a ten-year period, through the Neighborhood Assistance Corporation of America (NACA), a national consortium of local community-based organizations, is another example. Building on protests in Boston and elsewhere, NACA's head, Bruce Marks, was able to extract a major funding commitment that now supports NACA's extensive program of homebuyer education and counseling, which in turn is designed to generate a pool of 'loan-ready borrowers' eligible for the special loan program funded by Fleet.

These are just two examples of many new commitments and partnerships now being forged between national mortgage banking and financial services companies and national non-profit advocacy organizations, including the National Community Reinvestment Coalition, the National Urban League, and national civil rights groups. They represent interesting examples about how the inherent tension between 'cooperation versus collaboration' is playing out today. Done well, both advocacy organizations and lending organizations benefit from these mega-partnerships, as do many thousands of homeowners who participate in the programs that are being funded today.

These examples also imply that, to be successful, CRA advocacy must continually evolve in response to changing mortgage markets. In the NACA example, advocates carefully assessed Fleet's strategic weaknesses, focusing on the company's vulnerability to negative publicity based on several earlier missteps. Combining this understanding with the leverage supplied by CRA, NACA was able to win major concessions. ACORN had a similar strategic vision, but understood that they need not limit their advocacy to CRA-regulated entities. As an independent mortgage company Ameriquest was not covered by CRA but as a major player in the increasingly competitive subprime marketplace Ameriquest was rightfully concerned that the company be viewed as a leader in protecting consumer interests.

These examples also hint, however, at what appears to be a growing tension between locally-based organizations and these national umbrella advocacy organizations. In part, this may reflect the jealousy that under-funded local organizations have toward better-funded members of these networks. For example, several Baltimore respondents were openly critical of NACA's local affiliate. While NACA was able to provide resources and access to Fleet mortgages, some ques-

tioned whether the local NACA group truly represented the best interests of the communities it serves. One advocate lamented, “If I had even a small piece of the Fleet deal, I could make mortgages work in low-income areas in Baltimore. But the real question is whether NACA knows how to build a viable grassroots organization. When the money is gone, NACA will leave, and there will be nothing left behind to show that it was there.”

Others criticized some national network organizations for “selling out.” “Hey, I understand that these national groups have to meet their payroll just like I do,” observed one Chicago-based advocate. “But they are too easily bought off with a major grant. What about us folks working down in the trenches. All this does is make our job harder.” Commenting on the Ameriquest deal, one legal services attorney observed that ACORN let the company off lightly. “ACORN didn’t know what they were agreeing to. Subprime lenders are ruining our communities, at least they should have bargained harder for a more meaningful set of concessions.”

NEW STRATEGIES FOR A NEW ERA

While expressed in different ways, advocates from organizations of all sizes expressed an overriding sense that the ‘Golden Age’ was over and that a time for new advocacy strategies has arrived. As one community group focus group participant put it, “It seems like banks simply are managing us, not partnering with us. Unless we turn up the heat from time to time, they will forget that we are here.” But the question remains as to how community organizations, facing their own capacity and funding challenges, can continue to play an important role. Further, because HMDA data do not include pricing information, one of advocates’ most useful tools in their negotiations with lenders and in efforts to publicize their causes has been substantially weakened as the market has embraced subprime lending.

While community groups and their ‘regulation from below’ helped encourage lenders to extend lending to lower-income borrowers and areas in the past, new approaches are needed if they are to continue to play the role of effective intermediaries in the community reinvestment process. First and foremost, community advocates must understand that the mortgage industry has changed dramatically over CRA’s quarter-century long history. As the regulatory reach of CRA declines in an era of major national lending companies and independent mortgage lenders, there are fewer opportunities for individual community organizations to mount CRA challenges and win.

Another way is to change the focus of CRA advocacy. One Chicago-area non-profit has become much more proficient in commenting on CRA exams. “Typically, examiners ask community groups to comment on CRA exams, but the community group is not prepared. We try to do research ahead of time, so when the examiner contacts us, we are ready.” This can be particularly important as community groups seek to have bank examiners pay more attention to emerging forms of lending that, in the minds of advocates, are problematic. “We were concerned about banks funding pay day lenders,” noted one Chicago respondent. “Our research helped us get out in front of this issue and force the regulator to pay more attention to this issue.”

Other efforts attempt to more directly reflect the changing nature of the mortgage industry. Recognizing the fact that much of the growth in lending is coming through the ‘out of area’ activities of CRA-regulated lenders, some advocates are encouraging regulators to examine carefully the assessment area definitions that they will apply following completion of a merger. And in Massachusetts, community leaders are working to extend a state ‘CRA-like’ regulation to include lenders headquartered out of state. In other places, groups are working to extend CRA-type legis-



lation to insurance companies, reflecting both the importance of insurance as a financial service for lower-income people and areas, and the fact that several large insurers have moved into banking in recent years.

Advocacy efforts, however, continue to be hampered by limited data on new mortgage products. Historically the mainstay of community activism in the mortgage lending arena has been HMDA. Today, HMDA has severe limitations when it comes to assessing the efficacy of alternative loan products or the activities of specific lenders that have only recently begun to be addressed. As lenders increasingly turn to risk-based pricing the focus for efforts to unearth potentially discriminatory treatment is no longer the relative likelihood of loan approvals to various groups or areas since virtually everyone everywhere can in fact qualify for a loan. Potentially discriminatory practices now occur in the more subtle area of pricing, with advocates consistently voicing concerns that certain groups or areas do not receive loans on the best terms for which they might qualify. Until HMDA reporting changes take effect, the lack of price information will continue to limit the value of HMDA data in assessing the potential discriminatory effect of particular loan products, or the potential discriminatory actions of particular lenders.

Meanwhile, advocates have to become more skilled at analyzing existing data. To accomplish this will require a level of sophistication of analysis not commonly present among many non-profit organizations, suggesting the utility of establishing a national-level technical support unit dedicated to assisting community groups confront the complexities of automated technology and massive national lending organizations.

Local community groups may also need to shift their focus away from individual local lenders, who either may not be around in a few years, or who are consumed with the struggle to stay viable in the increasingly competitive banking world, and focus instead on the larger national-scale players and the secondary market. In any event, working in conjunction with national non-profit intermediaries, local groups need to develop strategies that are part of coordinated national efforts to encourage national lenders to expand access to capital to lower-income communities and borrowers. In this regard, advocates must understand that lenders are also seeking new ways to operate in the changing world of mortgage banking, and therefore there may be room for new cooperative approaches that involve advocates and lenders working together to expand the number of families able to make use of new loan products.

Recognizing these challenges, advocates are forging coalitions that have the capacity to prompt regulatory change at the state or local level. Mindful of statewide efforts to develop anti-predatory lending legislation in the Illinois legislature, advocates in Chicago are forming alliances with grassroots groups 'downstate.' In Los Angeles, a broad coalition of grassroots organizations and lenders were successful in convincing local elected officials to commit to funding a major new housing trust fund. Even in Alabama, with a relatively weak non-profit infrastructure, there is an emerging effort for local CDCs to join forces on a statewide basis to share experiences and to advocate about issues of common concern.

Others are seeking to expand advocacy beyond mortgage lending, and shift the focus of the debate to larger issues relating to access to financial services. For example, one welfare rights organization challenged a major national banking operation to offer direct deposit accounts for people participating in a welfare-to-work program. In Birmingham, a church-based group was working with local banks to fund a financial literacy campaign in a local housing development, that included efforts to teach young adults how to manage credit card debt and to start to save for future needs.

These initiatives show not only how advocacy efforts are moving beyond mortgage lending and housing, but the potential for forging new coalitions of groups concerned with the well being of lower-income communities. These examples also illustrate that even as mortgage lending is becoming more and more detached from local banking operations, banks still have significant local presence. But today that local presence comes in the form of an ATM machine on the corner, or the millions of letters banks and financial services organizations send out each day to sign up people for home equity loans, auto loans, credit cards or other financial services. Adapting to the dramatic shifts that are transforming the financial services industry is clearly the central challenge facing CRA advocacy organizations today.

SUMMARY

As the mortgage banking industry has changed, the relationship between community advocacy organizations and mortgage lenders has evolved as well. As the regulatory reach of CRA declines in an era of major national lending companies and independent mortgage lenders, there are fewer opportunities for individual community organizations to mount CRA challenges and win, just as it is increasingly difficult for community organizations to assess the market implications of the growing array of new loan products.

Community groups are responding, as they must, to this changing environment. Some have developed special skills to work cooperatively with mortgage lenders to provide homebuyer education and counseling services. Other advocates are forging new, and broader coalitions that have the capacity to confront large-scale banking organizations, or the sophistication to assess the characteristics of new mortgage products. Others seek to expand their advocacy beyond mortgage lending, and shift the focus of the debate to larger issues relating to access to financial services. In any event, community organizations are adapting as they continue their efforts to advocate for and serve the needs of the lower-income people and communities they represent.

SECTION 10

CONCLUSION

A quarter century since enactment, CRA-regulated entities still lead the market in the provision of mortgage capital to lower-income people and communities, especially lower-income minorities. Detailed multivariate analysis confirms that CRA-regulated lenders originate a higher proportion of loans to lower-income people and communities than they would if CRA did not exist. Moreover, lower-income neighborhoods targeted by CRA appear to have more rapid price increases and higher property sales rates than other neighborhoods, a finding consistent with the proposition that CRA has expanded the provision of mortgage capital to these neighborhoods.

At the same time, this report documents that the impact of CRA on mortgage lending has waned in recent years, as dramatic changes in the banking and broader financial services industries have weakened the link between mortgage lending and smaller branch-based deposit gathering organizations on which CRA was based. By tapping into national and international capital markets and utilizing high speed communication and computer technology, larger banking organizations and their mortgage company affiliates have come to dominate mortgage lending. As recently as 1993, only 14 lenders made more than 25,000 home purchase loans, accounting for only 23 percent of all home purchase lending. By 2000, the 25 lending organizations making more than 25,000 loans accounted for 52 percent of all home purchase loans made that year. Several major mergers announced in 2001 suggest that the trend toward consolidation among the largest lenders continues.

The recent surge in lending to lower-income families and communities has also worked to alter the significance of CRA for lower-income lending. From 1993 to 2000, government-backed, subprime, and manufactured home lending accounted for some 63 percent of the growth of mortgage lending to lower-income households living in lower-income communities, but many organizations specializing in these types of loans are not subject to detailed CRA regulatory reviews. In combination, the rise of bank-owned mortgage companies and growth of new types of loans and new types of lenders has reduced CRA's regulatory reach. From 1993 to 2000, the number of home purchase loans made by CRA-regulated institutions in their assessment areas as a share of all home purchase loans fell from 36.1 percent to 29.5 percent.

In combination, the changing industry structure, along with the fact that CRA expanded the capacity of all industry players to better serve lower-income borrowers, has diminished the extent that CRA-regulated organizations now lead the market. Econometric analysis suggests that on average over the period 1993 to 2000, CRA may have increased the share of loans going to CRA-eligible borrowers by 2.1 percentage points (or from 30.3 to 32.4 percent). Estimates for individual years suggest, however, that the CRA impact has declined from 3.7 percentage points in 1993 to 1.6 percentage points in 2000.

CRA's impact on mortgage lending also varies from one community to the next. As a result of variations in banking industry structure, the assessment area share of home purchase loans varies from under 10 percent to more than 70 percent in the 301 metropolitan areas examined. In each of four metropolitan areas examined in detail, the assessment area share of home purchase lending is lowest in neighborhoods with greatest minority and/or lower-income households.

CRA's impact also appears to be less significant in non-metro and rural markets as well, in part because less-regulated small banks dominate in these areas and community advocacy networks



are relatively weak. Even so, CRA could become a more important factor in non-metro lending in the future, as larger CRA-regulated organizations move aggressively into non-metro counties.

In addition to these broad quantitative findings, the report also presents qualitative insights gained through a series of discussion groups and in-depth interviews with federal regulators, banking and mortgage industry executives, community leaders and housing and financial policy experts. Clearly CRA has influenced the activities of bankers, mortgage lenders and community based advocacy organizations in important, but admittedly in difficult to quantify ways. For example, interviews with industry experts indicate that while CRA generally is not a driver of the business plans of regulated lenders, it is clearly a factor that influences the plans of most lenders at the margin. Moreover, as the lower-income mortgage market has become demonstrably mainstream and more competitive over the past decade, many lenders now deploy products targeted to the CRA-eligible market as part of their standard business practice.

The changing industry structure also has important implications for community based advocacy. The growing complexity of new mortgage products makes it increasingly difficult for advocacy groups to assess lending patterns in the communities they serve. Moreover, many local community groups are finding it increasingly difficult to forge productive partnerships with the newly dominant national mortgage and banking giants. Indeed, as mortgage lenders perfect new products and new methods to reach traditionally underserved markets, their need to enter into mortgage lending agreements with community-based advocacy organizations is reduced.

As a result, many smaller community groups are forging new coalitions that have the sophistication to assess the characteristics of new mortgage products and the capacity to work with large scale banking organizations. Other groups seek to expand their advocacy beyond mortgage lending, and instead focus on broader issues relating to expanding access to financial services in general. In any event, like lending institutions themselves, community groups are adjusting their activities in response to the evolving financial services sector.

Together, the quantitative and qualitative analyses demonstrate that in many important ways, CRA has not kept pace with the changing world of mortgage banking and community advocacy. This report suggests that CRA legislative and/or regulatory modernization could follow one or both of two potential reform directions. Reform could build on CRA's traditional mortgage lending focus by extending assessment areas to cover a larger share of the lending of CRA-regulated entities, and by extending CRA to include newly emerging non-bank financial services organizations that are increasingly important in lower-income communities. Alternatively, federal officials could build on CRA's traditional branch banking focus and reposition CRA to give greater emphasis to the provision of financial services to lower-income borrowers.

Of course these two pathways to reform are not mutually exclusive, and other suggested reforms merit consideration. Indeed, Federal Regulators now are doing just that as they review the many comments generated in response to their recent Advanced Notice of Proposed Rule Making on CRA Regulations. It remains to be seen whether reform will come through this rule-making process, or whether Congress will fashion a CRA Modernization Act to complement the recent Gramm-Leach-Bliley Financial Services Modernization Act. What is certain is that now is the right time for all interested parties to consider how best to enable CRA to keep pace with the evolving financial services sector so CRA will continue to benefit to lower-income people and communities in the years ahead.



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APPENDIX 1

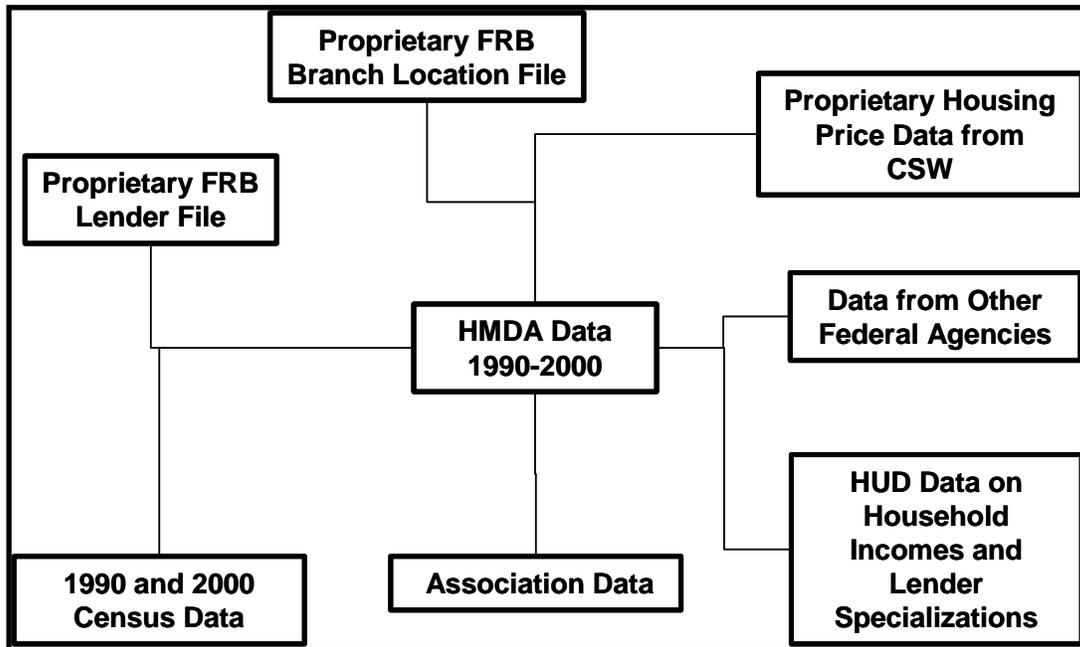
METHODOLOGY

The empirical work reported here extends previous Joint Center research done in cooperation with the U.S. Department of Treasury and The Brookings Institution (Belsky *et al.*, 2001). The research utilizes the Joint Center Enhanced HMDA Database that combines loan-level data on borrower characteristics, with information about the ownership structure of the organization that originated the loan, and the characteristics of the census tract and the metropolitan area where the property is located.

Building on these empirical analyses and drawing on the in-depth interviews and focus group discussions, the report examines the differing roles played by community groups in meeting the credit needs of the communities they serve, as well as the ways that bankers and mortgage lenders are adjusting their operations to meet their CRA obligations. It also presents information on the diversity of CRA's impact within and across metropolitan area markets, as well as the impact of CRA in non-metropolitan America.

A. Quantitative Analysis: The Joint Center Enhanced HMDA Database

The data foundation for the analyses in this report is a coordinated set of information merged from eight important data sources. It expands core loan and loan application information directly available through HMDA to provide a more detailed characterization of applicants, borrowers, lenders, and property locations. The component data sources of the Joint Center's Enhanced HMDA Database are described below.



Home Mortgage Disclosure Act Data: The core data used to complete the statistical tests and to support important parts of the analysis elsewhere in the report is information submitted by financial institutions under the Home Mortgage Disclosure Act (HMDA) of 1977. As currently

amended, the financial institutions subject to the HMDA requirements include: depository institutions and their affiliates, savings and loan corporations, credit unions, and non-depository mortgage lenders. The HMDA reports include information about loan applicant race and income, and about the geographic location of the property included in the application.

Federal Reserve Board Lender and Branch Location Files: The Federal Reserve Board (FRB) maintains two research databases that are also critical elements of the foundation database for this research. The FRB lender file contains information that facilitates aggregation of individual HMDA reporters into commonly-owned or -controlled institutions that can be analyzed as integrated units. The FRB branch location data are the source of assessment area definitions used in the analyses presented here. As a reasonable approximation to true assessment areas, this report assumes that if a lending entity subject to CRA has a branch office in a particular county, then that county is part of that entity's assessment area. Loans made in counties where the lending entity does not have a branch office are assumed to have been originated outside of that entity's assessment area.

Other Sources: Other information on metropolitan area and neighborhood characteristics was linked to the HMDA loan-level data to assess the way economic, demographic, and housing market trends influence lending. These include:

HUD Data: This report uses data developed by the U.S. Department of Housing and Urban Development to classify loans based on both the income of the loan applicant and the income of the census tract where the property is located, relative to the overall median income for the Metropolitan Statistical Area (MSA). In addition, HUD prepares an annual listing of particular HMDA reporters that specialize in subprime or manufactured home lending. The HUD lender specializations were also appended to the core HMDA records in the database.

Census Data: The report also utilizes data from the 1990 Census (such as the age of the housing stock) as control variables, and combined 1990 and 2000 Census data on census tract population to produce growth indicators for each of the 45,000 census tracts included in the analyses.

Proprietary Housing Price Data: Case Shiller Weiss, Inc. (CSW) maintains house price indices for small areas within major metropolitan areas. CSW provided tract-level house price changes for Los Angeles, Chicago, and Boston, which were linked to the HMDA records to analyze whether or not CRA has affected the rate of change of house prices in these areas.

Other Data: Rounding out the database, the report uses data from the U.S. Bureau of Labor Statistics to measure metropolitan area unemployment rates. Data from the National Community Reinvestment Coalition (NCRC) on existing CRA agreements between community groups and lenders was also linked to the database, as were the National Association of Home Builder's (NAHB) estimates of the share of homes in an MSA that are affordable to a median income household. These estimates were used to measure spatial variation in housing affordability.

B. A Note on HMDA Data Quality

This report relies heavily on HMDA data to illustrate mortgage lending trends. HMDA data have been collected since 1977, but because they were not reported at the loan-level by non-depository lenders until 1993, the discussion focuses on the 1993-2000 period. Even over this period, however, HMDA data have a number of limitations. Perhaps most critical is the fact that HMDA's coverage of the mortgage market changed over the 1993-2000 period. One source of this differential coverage is the fact that although non-depository lenders were first required to report in



1993, some subset either did not do so, or did so haphazardly for several years. Consequently, HMDA data are likely to overstate somewhat actual lending growth for the 1993 to 2000 period.

Potentially more serious is the fact that the change in reporting requirements may differ by lender type, based on the specialization of each type of lender. Therefore, some of the growth in lending to lower-income households relative to that for higher-income households could simply reflect differential reporting if lenders specializing in lower-income lending increased the reliability of their reporting over the period.

Finally, regulations governing collection of HMDA data have not kept pace with the changing structure of the industry or the characteristics of new mortgage products. In particular, HMDA does not collect any information on loan pricing and loan characteristics needed to assess the implications of the rapid growth of alternative mortgage products.

Counterbalancing these limitations is the fact that HMDA is a large and fairly rich microlevel data source at the individual loan application level. No other data source affords the opportunity to analyze lending patterns and trends by borrower income, race/ethnicity or gender in such detail. Further, HMDA loans are geo-coded to census tracts, allowing a rich exploration of the impact of CRA on lending in lower-income, minority, or other historically underserved market areas. These strengths and limitations also suggest the importance of disaggregating the results by lender and borrower characteristics in an effort to control for reporting differentials across the various mortgage industry segments. As part of a careful research design, HMDA data can support a rich, and ultimately very insightful, empirical assessment of the trends in mortgage lending.

C. Qualitative Research

Discussion Groups: Between February and April 2000, the Joint Center for Housing Studies held eleven discussion groups with over 100 experts in four cities, three each in Atlanta, New York, San Francisco, and two in New York (Belsky *et al.*, 2001). Each of the discussion groups was made up of people in a particular type of CRA-relevant occupation: financial institution officers, banking regulators, community advocates, or housing researchers. The financial institution representatives, in the main, were community reinvestment officers from larger banks subject to regulation under CRA. Smaller financial institutions were not well represented in these sessions but participants did discuss the views of how CRA influenced small and large financial institutions. The community advocates were representatives of organizations that lobby and use political pressure to improve access to capital for borrowers from lower-income communities or organizations directly engaged in housing and community development. Regulators were officers of one of the four agencies of the federal government charged with enforcing the CRA. Housing experts included academics well versed in mortgage lending and housing markets.

In-Depth Interviews: In addition to the discussion groups, the Joint Center also conducted in-depth interviews with more than 100 individuals in the Baltimore, Birmingham, Chicago and Los Angeles metropolitan areas, as well as in rural Colorado. These interviews examined CRA in the context of the changing organization of the mortgage industry, the growth of new affordable lending tools, and the resulting changes in the provision of credit to lower-income people and communities. In this regard, the interviews looked beyond the direct effect of CRA on the lending activities of CRA-regulated institutions, to explore potential indirect effects of CRA on the broader mortgage industry that may result from the diffusion of CRA best practices.

The five areas where interviews took place are reflective of the diversity of the urban and rural landscape in America, as well as the diversity of CRA activities and the mortgage finance indus-

try. At the same time, because of the unique features of the five areas, each was selected in order to highlight the impact of CRA on lower-income lending patterns in a specific type of market.

Baltimore: Baltimore is representative of many larger, older, industrial cities of the Northeast and Midwest that have been plagued by a weak economy, slow growth of population and jobs, and serious neighborhood blight. Interviews in Baltimore focused on the interplay between CRA lending and the emerging subprime market in meeting the credit needs of lower-income people and communities. A recent HUD report documented the unusually high incidence of foreclosures in Baltimore's rapidly growing subprime market, a trend that has galvanized sentiment to address potentially abusive practices in this segment of the industry.

Birmingham: Birmingham is notable for being the headquarters' city for several large regional banks that operate in the South. In recent years, these banks have been challenged by the expansion of lending by independent mortgage companies that fall outside of CRA's regulatory reach. Despite these changes, or perhaps because of the competitive challenge offered by the new entrants, Birmingham lenders have increased their focus on lending to lower-income borrowers. Detailed interviews examined how Birmingham has maintained a strong regional banking presence while other metropolitan areas have lost their regional banks to mergers and acquisitions lead by out of region institutions.

Chicago: Building on decades of activism, Chicago's network of strong community-based organizations has been able to negotiate and largely to maintain sweeping CRA agreements with Chicago banking institutions. Interviews in Chicago focused on how the CRA agreements evolved, how they are being monitored, and how they have influenced relationships among lenders, regulators, and community groups.

Los Angeles: With major national depositories, mortgage companies, affiliates of other large bank holding companies, and major independent mortgage companies, all competing head-to-head in a large market, Los Angeles was a good place to explore in-depth the relationship between lower-income lending and the changing structure of the mortgage industry. Typical of many growth markets, independent mortgage companies continue to hold a significant share of the market compared with the national average, but so do in area depositories. At the same time, affordability problems make lending to lower-income families a challenge to all lenders in the marketplace.

Rural Colorado: Representative of the diversity of non-metropolitan America, rural Colorado's counties range from depressed agricultural areas, to more prosperous ranching, recreation, and retirement areas. Many rural areas suffer from limited access to financial services, while rural borrowers often face higher rates and less favorable terms than their urban counterparts. In addition to examining how CRA operates in a rural context, Colorado also helps to illustrate how national-level trends in mortgage lending and banking are playing out in diverse rural areas.

Identifying Individuals to Interview: The approach used to select interview candidates was designed to reach a knowledgeable set of individuals reflective of the diverse range of participants in mortgage lending and community development and advocacy. During an initial visit to each of the five areas targeted for in-depth review, Joint Center researchers identified key trends in mortgage lending and met with a series of key informants in each area to develop a diverse list of those banking and mortgage lending industry officials, community leaders, and government officials with greatest knowledge about CRA issues in their area. This process was supplemented with discussions with key contacts, including focus groups participants, in an effort to ensure that

the list of potential study participants represented the diversity of organizations and individuals involved in CRA-related issues in each market area included in this study.

Based on this initial process, a team of Joint Center researchers examined published and internet resources to gain a better understanding of each potential participant, the organization that they represented, and their role in CRA-related matters. Special tabulations of HMDA data were used to ensure that mortgage industry officials represented a diverse mix of representatives of both large national- and regional-scale lenders, as well as representatives of smaller institutions. In addition, Joint Center staff reviewed 100 CRA examinations for all lenders interviewed, and many other lenders in each market, to better understand the interview candidates. This included a review of the characteristics of the organization, its record in community lending, investment and provision of banking services, and their efforts to partner with community-based organizations. For smaller banks, interviewees were typically the CEO or President. For larger organizations, interviews were typically conducted with the person or persons responsible for CRA compliance activities.

Similarly, community advocates interviewed for this study ranged from large multi-service organizations and grassroots advocacy organizations, to smaller Community Development Corporations. Interviews typically consisted of meeting with the Executive Director of these organizations, often with other senior staff most knowledgeable about CRA-related matters.

In all, over 100 interviews were conducted from June through September 2001. Responses documented are consensus views unless otherwise noted and represent an effort to distill reactions and opinions on a range of issues related to the past, present and future of CRA, compliance activities, community reinvestment more broadly, mortgage lending, and banking in general. To encourage a more frank discussion of the issues, each participant was informed that their comments would be ‘on background’, and that no specific comment would be attributed to any particular respondent. At the same time, much of the information discussed also was present in the public domain through newspaper accounts and other publicly available sources. Only in cases where public sources of information are widely available does the report discuss the activities of specific organizations.

Advisory Committee: Finally, the analysis presented in this report benefited from an Advisory Committee established by the Joint Center for Housing Studies (membership detailed in appendix 2). The Committee included senior officials from bank regulatory agencies, as well as nationally recognized experts drawn from the housing and mortgage finance industries, and national and local non-profit community development and advocacy organizations. The Committee met three times during the course of the study, including an initial meeting to discuss project scope and methodology, and a second time to discuss preliminary findings from the group discussions and to review the selection of the metropolitan and rural areas for in-depth interviews. At its third and final meeting, the Advisory Committee reviewed and commented on a draft of the final report. In addition, numerous Advisory Committee members submitted detailed written comments.



APPENDIX 2

ADVISORY COMMITTEE MEMBERS

Malcolm Bush
President, Woodstock Institute

Diane M. Casey
President and CEO, America's Community Bankers

James Chessen
Chief Economist, American Bankers Association

Fritz Elmendorf
Vice President, Communications, Consumer Bankers' Association

Deborah Goldberg
Director, Neighborhood Revitalization Project, Center for Community Change

Ron Grzywinski
Chairman of the Board, ShoreBank Corporation

Kenneth Guenther
Executive Vice President, Independent Community Bankers of America

Bart Harvey
Chairman and CEO, Enterprise Foundation

John D. Hawke Jr.
Comptroller of the Currency, Office of the Comptroller of the Currency

David Holland
CEO, Boston Federal Savings Bank

Ellen Lazar
Executive Director, Neighborhood Reinvestment Corporation

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Ellen Seidman (formerly)
Director, Office of Thrift Supervision

Stephanie Smith
Strategy and Business Development Executive for Consumer and Small Business E-Commerce
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John E. Taylor
President and CEO, National Community Redevelopment Coalition

Keith Todd
Executive Secretary, Federal Financial Institutions Examinations Council

Stockton Williams
Legislative and Policy Advisor, Enterprise Foundation

Mark Willis
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