REINVESTMENT ALERT

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Community Development Banks Substantially Outscore Other Banks in Serving Low-Income and Minority Communities:

Implications for the Federal Budget and the Community Reinvestment Act

Introduction

Community development banks (CD banks) are banks that include in their mission the specific goal of serving underserved communities.[1] Given this mission, they should score well, indeed better, than regular financial institutions on this service.[2] Yet recently questions have been raised about whether community development banks, along with other kinds of community development financial institutions (CDFIs), have demonstrated their effectiveness.[3] Specifically, the U.S. Treasury Department has in the last several years asserted that CDFIs have not produced evidence of effectiveness. Since 1996, the Treasury Department has been an important funder of CDFIs, so this criticism has very practical consequences for the level of federal funding for community development banks. It also has implications for the current federal review of the Community Reinvestment Act (CRA) regulations, particularly the debate about whether the existing tripartite division of CRA examinations into lending, investment and service tests, should be maintained. Community development banks receive important investments from other banks that in turn receive credit under the investment test portion of CRA examinations. Many community reinvestment groups and some bankers suspect that the adoption of one proposal, the merging of the three tests into a lending test and a community development test, would diminish the importance of investment into CDFIs.

There are several ways to measure the effectiveness of community development banks. However, the underlying premise about their utility is that some populations remain underserved by financial

[1]The commonly accepted technical definition of a community development bank is a bank that has been certified a community development financial institution by the Community Development Financial Institution (CDFI) Fund in the U.S. Department of the Treasury. The purpose of the Fund is to expand the availability of credit, investment capital, and financial services in distressed and urban and rural communities.

[2]Other regulated financial institutions do, however, have a specific federal mandate that relates to underserved populations. The Community Reinvestment Act (12 USC 2901, 1977) provides that regulated financial institutions have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered. It also states that they should be examined as to whether they serve the credit needs of their entire communities, *including low- and moderate-income neighborhoods* consistent with the banks' safe and sound operations.

[3]The other major forms of CDFIs are community development credit unions, loan funds, microloan funds and venture capital funds.

institutions. A recent and comprehensive analysis of community reinvestment from the Joint Center for Housing Studies at Harvard University shows that while the percent of minority and lower income populations receiving home mortgage loans increased considerably between 1993 and 2000, much of that increase was accounted for by subprime and government backed loans.[4] While these loans reach populations that may not qualify for conventional financing, these loan products have disadvantages compared to conventional financing. A portion of subprime loans are very high cost, very high fee loans called predatory loans. The report goes on to assert that there is recent evidence that discriminatory practices still persist in the housing marketplace.

It is clear, therefore, that some populations remain underserved by financial institutions. So the question is, do community development banks outperform their peers in serving these populations and if so, by how much?

CD Banks' Performance in Lower-Income and Minority Communities

New data show that a high percent of community development banks' home loans go to low-income borrowers and neighborhoods, and an even higher percent of all CD bank loans go to minority borrowers and neighborhoods. A much higher percent of CD bank home loans go to low-income borrowers than is in the case for all other lenders, and twice as high a percent of CD bank loans go to minority borrowers than the percent for non-CD bank lenders.

The following data describe the performance of CD banks and all other mortgage lenders in the city of Chicago.[5] All the CD banks are certified CDFIs by the Treasury Department. There are eight CD banks in the sample and 681 other lenders.

Table 1
Percent of Loans to LMI Borrowers in Chicago, 2001[6]
for Each Type of Lender

Loan Purpose	Community Development Banks	All Other Lenders
Home Purchase	52.31%	34.37%
Home Improvement	59.32%	55.07%
Refinance	51.51%	37.31%
All Single Family Loans	**53.01%**	**37.32%**

Table 1 shows that 53 percent of all the single family home loans originated by CD banks in Chicago in 2001 were for low- and moderate-income borrowers. The comparable figure for all other mortgage lenders in the Chicago area was 37 percent.

[4] The Joint Center for Housing Studies, Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, March 2002.

[5] The population of lenders included here, CD banks and others, is all lenders in Chicago that are mandated under the Home Mortgage Disclosure Act (HMDA) to report lending data. The population, therefore, excludes several CD banks that are not large enough to trigger HMDA reporting and many mortgage companies and small community banks that are also not required to report data.

[6] Source for all lending data, Federal Reserve Bank, Federal Financial Institutions Examination Council (FFIEC), 2001

Table 2
Percent of Loans to LMI Census Tracts in Chicago, 2001
for Each Type of Lender

Loan Purpose	Community Development Banks	All Other Lenders
Home Purchase	68.21%	47.00%
Home Improvement	75.69%	47.14%
Refinance	70.32%	43.51%
All Single Family Loans	**70.48%**	**44.86%**
Multifamily	91.58%	69.40%

Table 2 shows that 70 percent of CD banks home loans went to borrowers in low- and moderate-income census tracts compared to a figure of 45 percent for all other lenders. Ninety-two percent of CD banks' multifamily loans went to low- or moderate-income census tracts compared to 69 percent for regular lenders.

Table 3
Percent of Loans to Minority Borrowers in Chicago, 2001
for Each Type of Lender

Loan Purpose	Community Development Banks	All Other Lenders
Home Purchase	84.67%	41.95%
Home Improvement	93.71%	59.11%
Refinance	91.44%	45.17%
All Single Family Loans	**89.44%**	**44.68%**

Table 4
Percent of Loans to Minority Census Tracts in Chicago, 2001
for Each Type of Lender

Loan Purpose	Community Development Banks	All Other Lenders
Home Purchase	63.82%	40.37%
Home Improvement	84.14%	49.77%
Refinance	83.74%	37.28%
All Single Family Loans	**76.77%**	**38.97%**
Multifamily	96.63%	56.45%

Both the absolute percentages and the differences between CD banks and all other lenders are even more dramatic for loans to minority homeowners and minority neighborhoods. Table 3 shows that 89 percent of CD banks' home loans go to minority homeowners compared to 45 percent of the loans of all other lenders. And as shown in Table 4, 77 percent of CD banks' home loans go to borrowers in minority tracts[7] compared to 39 percent of the loans of all other lenders. The percent of all CD banks' multifamily loans that are made in minority tracts is 96 percent compared to 56 percent for all other lenders.

These data are also revealing about CD banks' market share. In some current policy discussions, CD banks run the risk of being dismissed because of their small size. On the other hand, those that have achieved some scale are often deemed no longer worthy of special support. While CD banks command a tiny portion of all bank assets, in some markets their market share is significant. So, in Chicago, CD banks *in the aggregate* would rank as the 13th largest lender in the city and have a market share for all home loans of 0.72 percent. This is in a market where the market share of the market leader is 9.8 percent and only four institutions have a market share over 4 percent. In the important, special market of multi-housing loans, the Chicago CD banks *aggregate market share* is a substantial 13.27 percent in lower-income tracts and 13.25 percent in minority tracts.

Community development banks are also a growing phenomenon. Recent, related Woodstock Institute research shows that the community development-banking sector nationally grew steadily between 1992 and 2001.[8]

- Nationwide, the number of CD banks increased from 27 in 1992 to 39 in 2001.
- In the same period, deposits grew from 1.72 billion to 4.22 billion.
- Lending also increased, from $802 million to $2.91 billion.
- Community development banks are meeting or exceeding minimum capital requirements.
- While community development is the primary goal of community development banks, profitability measure indicate that community development banks are doing well by regular bank performance standards.

Conclusion

There are a number of legitimate ways to assess the effectiveness of CD banks. The data described here comprise several important criteria. These data show that CD banks in Chicago devote the greater part of their home lending resources to serving lower-income and minority communities, and a far higher percent of resources than all other home lenders. Furthermore, while the aggregate resources of CD banks are tiny in comparison to all other lenders, in Chicago, CD banks' share of the home loan market is significant, and their share of the multifamily lending market is very significant. Lastly, CD banks are growing in number, size, and performance.

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[7] For this analysis, census tracts with a minority population of over 50 percent are defined as minority tracts.

[8] Kimbra Nieman and Malcolm Bush, *Doing Well by Doing Good: The Growth of Community Development Banking, 1992-2001*, Reinvestment Alert #18, September 2002, Woodstock Institute.

The persistent evidence of discrimination in home mortgage lending as exemplified in the underserving of key markets with competitive products and the overserving of those same markets with high cost and predatory products is a challenge to mainstream lenders and to CD banks. Federal government policy impacts both sectors. The government has two important tools for assisting CD banks carry out their mission of bringing market-based financial services to their target communities. Both tools are threatened by current policy. The CDFI Fund in the US Department of the Treasury has been cut for two years in a row and is threatened with further cuts. The continued existence of the investment test in the CRA examination, a clear incentive to banks to invest in CD banks, is under review. The reversal of these two threats would greatly strengthen an industry that has much more impact on the economics of lower-income and minority communities than its small size would suggest.

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