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The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges

1. Introduction and Summary[1]

The U.S. Congress passed the Community Reinvestment Act (CRA) in 1977 to encourage depository institutions to meet the credit needs of lower income neighborhoods. The CRA was built on the simple proposition that deposit-taking banking organizations have a special obligation to serve the credit needs of the communities in which they maintain branches. At the time of the CRA's passage, banks and thrifts originated the vast majority of home purchase loans. The CRA's initial focus on areas where CRA-regulated institutions maintained branches made sense because restrictions on interstate banking and branching activities were limiting the geographic scope of mortgage lending operations.

Today, the CRA continues to provide significant incentives for CRA-regulated institutions to expand the provision of credit to lower income and/or to minority communities where those institutions maintain deposit-taking operations. Yet in the quarter century since the act's passage, dramatic changes have transformed the financial services landscape, especially in home mortgage lending. These changes have combined to weaken the link between mortgage lending and the branch-based deposit gathering on which the CRA was based. Today, less than 30 percent of all home purchase loans are subject to intensive review under the CRA. In some metropolitan areas, this share is less than 10 percent.

With a substantial portion of home purchase lending no longer subject to detailed scrutiny under the CRA, the issue of how best to modernize the CRA has emerged as an important public policy challenge. Some argue that the CRA's costs exceed its benefits. Others advocate expanding regulatory oversight. Congress considered changes to the CRA in the debate leading up to the passage of the 1999 Gramm-Leach-Bliley Financial Modernization Act (GLBA), but in the end it

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did little to make the CRA conform to the realities of the financial services marketplace. Although the 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 the communities they serve.

1.1 Summary of Key Findings

This paper draws on a more extensive Joint Center for Housing Studies assessment of the CRA, funded by the Ford Foundation. The larger study not only assesses the impact of the CRA on home purchase and home refinance lending, it also presents commentary on the CRA's impact on small-business and multifamily lending, as well as on the provision of financial services more generally. In addition, the Ford Foundation study presents qualitative findings concerning the CRA's impact on the operation of banks and mortgage lenders as well as the impact on the relationship between mortgage lenders and community-based advocacy organizations.

Our paper focuses on the regulatory and legislative challenges that confront the act at age twenty-five. In addition to providing a brief review of the evolution of CRA regulations, we document the impact that the CRA has had on home mortgage lending to lower income people and communities and assess changes in industry structure. We conclude with a discussion of current legislative and regulatory challenges.

The CRA Has Expanded Access to Mortgage Capital

Working in combination with the Home Mortgage Disclosure Act (HMDA) and the closely related Fair Housing and Fair Lending Legislation, the CRA continues to expand access to capital for CRA-eligible borrowers. Here, CRA-eligible borrowers include those with an income of less than 80 percent of the area median income and/or those living in census tracts with a median income of less than 80 percent of the area median. CRA-regulated lenders refer to federally regulated banks and thrifts as well as their mortgage company and finance company affiliates.

- In both 1993 and 2000, CRA-regulated lenders operating in their assessment areas (areas where they maintain deposit-taking operations) had shares of conventional, conforming prime home purchase loans to CRA-eligible borrowers that exceeded the equivalent shares for out-of-area lenders or noncovered 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.

The Changing Mortgage Industry Structure Reduces the CRA's Impact

Dramatic changes in the structure of the financial services industry—and particularly in mortgage banking—have combined to weaken the link between mortgage lending and the branch-based deposit gathering on which the CRA was based. Consequently, this may also be reducing the CRA's effect on the mortgage market.

- In 2000, the twenty-five largest lenders each made more than 25,000 home purchase loans and accounted for 52 percent of all home purchase loans made that year. In contrast, only fourteen organizations made more than 25,000 loans in 1993 and accounted for only 23.5 percent of all home purchase lending.
- Banking organizations operating out of their 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.
- Assessment-area lending varies from one market area to the next. Of the 301 metropolitan areas examined in this study, the assessment-area share of lending varies from 6 percent in Denver, Colorado, to 74 percent in Dubuque, Iowa.

The CRA Fails to Keep Pace with the Changing Industry Structure

The changing industry structure, along with the fact that over time the 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. When Congress modernized financial services through the GLBA, it did little to bring the CRA into conformance with the rapidly evolving world of financial services. Reform could follow one or both of two distinct pathways:

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

Before turning to a more detailed discussion of these findings, we briefly review the methodology used to generate these results.

1.2 Methodology

The work presented here uses the Joint Center for Housing Studies Enhanced HMDA Database, which combines loan-level data on borrower and loan characteristics with data on lender characteristics and branch locations from the Board of Governors of the Federal Reserve System. The Federal Reserve's lender file contains information that facilitates aggregation of individual HMDA reporters into commonly owned or commonly controlled institutions that can be analyzed as integrated units. The Board's branch-location data are the source of assessment-area definitions used in the analyses presented here. For a reasonable approximation of true assessment areas, this report assumes that if a lending entity subject to the 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.

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 data included U.S. Department of Housing and Urban Development (HUD) data used to classify loans based on both the income of the applicant and the income of the census tract where the property is located. HUD was also the source for the annual listing of HMDA reporters specializing in subprime or manufactured-home lending.

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 eleven discussion groups with more than 100 experts in four cities—three each in Atlanta, New York, and San Francisco, and two in Washington, D.C. (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 in rural Colorado. These interviews examined the 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.

1.3 HMDA Data Quality

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 nondepository 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 the HMDA's coverage of the mortgage market changed over the 1993-2000 period. One source of this differential coverage is the fact that although nondepository lenders were first required to report in 1993, some subset either did not, or did so haphazardly for several years. Consequently, HMDA data are likely to overstate somewhat actual lending growth for the 1993-2000 period.

Potentially more serious is the fact that the change in reporting requirements may differ by lender type, based on the specialization of each lender. Therefore, some of the growth in lending to lower income households relative to that to 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 the HMDA database 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, and gender in such detail. Further, HMDA loans are geocoded to census tracts, allowing a thorough exploration of the CRA's impact 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.

2. The Regulatory Environment

This section examines issues associated with the CRA and related legislation. We begin by discussing the early history and rationale of the act and then consider the evolution of the CRA and related legislation in the 1980s and 1990s. Despite numerous changes over its nearly twenty-five-year history, the CRA continues to focus on the presumed spatially determined link between retail deposit-gathering activities and a depository institution's obligation to meet community credit needs.

2.1 Early History and Rationale

The CRA directed federally insured depository institutions to help meet the credit needs of the communities in which they operate.[2] This focus on 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.

The CRA directed bank regulators to evaluate the effectiveness of depository institutions in meeting the credit needs of their communities, including those of lower income borrowers and neighborhoods, consistent with safe and sound banking operations.[3] 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 to consider an institution's CRA performance in evaluating consolidation and expansion applications.

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, it 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.

2.2 The 1980s and a Renewed Focus on Fair Lending

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

This is not to say that the CRA had no impact in the early years. Armed with a legislative mandate that a bank should serve the "the credit needs of its entire community, including low- and moderate-income (LMI) neighborhoods" and with Home Mortgage Disclosure Act data on lending patterns, community activists confronted banks and demanded that they expand lending (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 with 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 (Fishbein 1992).

Despite this progress, there could be little doubt that more needed to be done to expand credit access to lower income communities. This awareness was heightened by the publication in 1988 of the *Atlanta Journal-Constitution* Pulitzer Prize–winning "Color of Money" (Dedman 1988) series documenting the disparities in mortgage lending between blacks and whites in Atlanta. This not only generated 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 passage of the Equal Credit Opportunity Act of 1974 and the Community Reinvestment Act of 1977.[4] Stimulated in part by the continuing community activism around racial disparities in lending, Congress enacted the Fair Housing Amendments Act of 1988. This law, passed twenty-five years after the initial legislation, significantly expanded the scope of the initial legislation and strengthened its enforcement mechanism (Schill and Friedman 1999).

2.3 Changes in the Late 1980s and the Financial Institutions Reform, Recovery, and Enforcement Act

The failure of the Community Reinvestment Act to have a more pronounced effect on lower income lending lay largely in its failure to provide regulators with tools to punish poor performance or reward successful behavior. The 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 in any case was never implemented in the first decade following the act's passage. Furthermore, both lenders and advocates perceived the examination process as capricious. Lender accountability was limited because lenders were evaluated on the strength of their plans to serve lower income areas rather than on the outcome of these plans on improving conditions in lower income markets. Additionally, any reputational risk and public scrutiny faced by lenders for poor performance was minor because examiners' ratings were not made public. This was to change, as the combination of additional regulations and changing market conditions gave new bite to the CRA in the late 1980s and early 1990s.

In 1989, Congress strengthened both the HMDA and the CRA in several key ways through the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). The act enhanced HMDA disclosure requirements to include the race, ethnicity, gender, and income of mortgage loan applicants, and the disposition of mortgage loan applications. These additional data—when combined with census data on the racial composition; median family income; and central-city, suburban, or rural location of the property—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 system[5] to replace a numeric scale, and required banking regulators to prepare a detailed written evaluation of the institution's CRA record.

Heightened congressional concern over the effectiveness of CRA oversight also coincided with bank regulators' more aggressive use of authority. In 1989, the Federal Reserve denied on CRA grounds an application by the Continental Bank Corporation to acquire Grand Canyon Bank of Scottsdale. The Federal Reserve ruled that in light of inaccurate filings and a lack of significant efforts to ascertain the credit needs of its community or advertise its products—with no compensating activities—Continental Bank's commitments to improve its CRA performance did not absolve it for a weak CRA record. In an equally significant move and on the same day that it announced its decision regarding the Continental Bank Corporation, the Federal Reserve released a policy statement outlining a more aggressive stance concerning the CRA, including a checklist of items that regulators should consider when deciding whether to approve an application to merge 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. These events focused 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 after passage of the Riegle-Neal Interstate Branching and Efficiency Act of 1994.

The growing congressional concern about lending discrimination also prompted the U.S. Department of Justice to expand its fair lending enforcement activity (Galster 1999). In a high-profile case, the Justice Department accused Decatur Federal Savings and Loan Association of Decatur, Georgia, of redefining its market area to exclude African-Americans and of rarely advertising its products in African-American communities. The Justice Department also sued the Shawmut Mortgage Company of Boston, Massachusetts, in 1993, alleging discriminatory treatment in loan approval. In 1994, the Justice Department accused Chevy Chase Federal Savings Bank of Washington, D.C., of violating fair-lending laws by failing to extend services to African-American neighborhoods. The Justice Department prevailed in each of these high-visibility actions. Settlements ranged from requiring banks to give aggrieved borrowers specific relief, to requiring the banks to expand lending to minority borrowers by enhancing outreach and marketing, altering underwriting procedures, and creating special loan packages for lower income applicants.

2.4 Further CRA Changes in the 1990s

The changes in the CRA continued into the 1990s as the banking industry and community advocates complained that CRA evaluations still relied too heavily on efforts 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 the CRA by examining actual performance in their assessment areas—the geographic areas where the institution has its main office, branches, and deposit-taking ATMs—and neighboring areas in which the institution originates or purchases 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). The 1995 regulations went furthest toward standardizing, quantifying, and objectifying performance criteria for large retail depositories.[6] For these institutions, the CRA examination consists of three distinct tests: lending, investment, and service.

Lending is the most heavily weighted component in the overall rating equation and is most widely scrutinized by community advocates. 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. Furthermore, 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 the HMDA allows community organizations to monitor the activities of lenders.

Despite the effort to focus on quantitative results, the CRA examination remains largely 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 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 mortgage companies in the CRA examination 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 the CRA's inducement to expand lower income lending by allowing institutions to select the combination of reporting that will produce the most favorable lending record.

Interestingly, the revised 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 the CRA. 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, the 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.

2.5 CRA and the Gramm-Leach-Bliley Act of 1999

The most recent changes to the Community Reinvestment Act occurred with the Gramm-Leach-Bliley Financial Modernization Act of 1999. The 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. The GLBA's "sunshine" provision requires public disclosure of agreements entered into by depository institutions and community organizations or other entities in fulfillment of CRA obligations. The GLBA also changed the frequency of small banks' examinations 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, the GLBA also raised important concerns about the privacy of borrowers and placed limits on the use of credit history reports for purposes other than credit scoring.

3. The Impact of the CRA on Residential Mortgage Lending

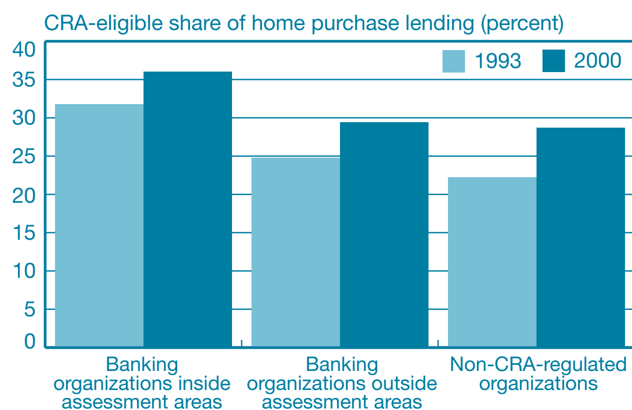
This section summarizes an analysis of the effect of the CRA on regulated lenders by comparing their home purchase lending record with that of other lenders. Since CRA-regulated lenders and other lenders were influenced by the same changes in the marketplace, the comparison has the potential to highlight the independent effects of the CRA on lending patterns. The analysis suggests that CRA-regulated entities continue to lead the market in the provision of prime, conventional residential mortgage loans to lower income people and neighborhoods, particularly in terms of their greater outreach to minority borrowers.

3.1 CRA Expands Access to Mortgage Credit

Chart 1 shows the share of all conventional, conforming prime loans made to CRA-eligible borrowers. Lenders are divided into three groups: CRA-regulated banking organizations lending in their assessment areas, CRA-regulated banking organizations lending outside their assessment areas, and non-CRA-regulated entities. Here, banking organizations include commercial banks and savings associations and their mortgage and finance company affiliates, while non-CRA-regulated organizations include independent mortgage companies and credit unions. Chart 1 excludes prime loans with government backing, including loans insured by the Federal Housing Administration (FHA), as this lending is mostly a pass-through operation, with loans largely originated by mortgage brokers and sold into the secondary market. Finally, limiting this assessment to conforming loans avoids giving undue weight to those lenders operating chiefly in the jumbo market.

Chart 1

Assessment-Area Lenders Lead in the Provision of Conventional, Conforming Prime Loans



Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

Note: CRA is the Community Reinvestment Act.

The chart confirms that CRA-regulated entities operating in their assessment areas make a higher share of these conventional, conforming prime loans to CRA-eligible borrowers than do either CRA lenders outside their assessment areas or non-CRA lenders. It also shows that the gap across lender types is closing, possibly in response to an enhanced understanding of how to lend to these markets profitably through experience acquired by CRA-regulated lenders in response to CRA obligations.

Table 1 extends this analysis to examine racial and ethnic variations in lending patterns. It highlights the fact that loans to blacks and Hispanics are much more likely to be CRA-eligible, presumably because these groups have lower average incomes than whites and are more likely to live in lower income census tracts.

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 was higher than the lending to blacks and Hispanics by regulated entities operating outside the assessment area as well as the lending 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 shares for lenders outside assessment areas and 20 percentage points (48 percent) higher than shares for non-CRA lenders. For Hispanics, the CRA-eligible share for assessment-area lenders is 13 percentage points (28 percent) higher than that for outside-assessment-area lenders and 16 percentage points (39 percent) higher than that for non-CRA lenders.

Even twenty-five years after its enactment, the CRA continues to encourage CRA-regulated entities to extend conventional prime lending to 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 increased risks inherent in serving these markets. But in addition to their growing use of alternative lending products, CRA-regulated entities continue to lead the market in extending prime conventional loans to lower income people and communities.

Table 1
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
Hispanics	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
Hispanics	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
Hispanics	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

Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

Notes: "Other" includes Asian, Native American, and all other groups, and loans where the applicant and co-applicant were of different races. CRA is the Community Reinvestment Act.

3.2 Multivariate Analyses Confirm CRA's Effect

Detailed econometric analyses discussed at length in the larger Ford Foundation study confirm that the CRA continues to have an important effect on mortgage lending. In particular, the act appears to have encouraged CRA-regulated lenders to originate a higher proportion of loans to lower income people and communities than they would have if the act did not exist. Moreover, CRA-regulated entities appear to have gained market share in the provision of loans to lower income people and communities, in effect crowding out lenders falling outside of the CRA's regulatory reach. Finally, lower income neighborhoods targeted by the CRA have had more rapid price increases and higher property turnover rates than other neighborhoods, a finding that is consistent with the proposition that the CRA has expanded the provision of credit in these neighborhoods.

These econometric studies also suggest that CRA-regulated entities respond both to the regulatory requirements set forth by the act as well as to pressure from community-based organizations that the act has enabled. As a result, the econometric models suggest that even controlling for other mortgage lending supply and demand factors, CRA-regulated entities originate a higher share of their loans to lower income people and communities in their assessment areas—the areas under the most intense CRA scrutiny. Moreover, lower income lending is greater in areas covered by agreements made with community groups that commit CRA-regulated entities to expand their outreach.

Interestingly, both effects seem to be waning. Just as the growth of large banking organizations has fostered rapid growth of nonassessment-area lending, so too has the growth of these organizations changed the ability of community organizations to extract concessions from lenders operating in their neighborhoods. As in the case of the simple descriptive

statistics presented earlier, the econometric analyses confirm that CRA-regulated lenders continue to outperform other lenders in the lower income lending arena, but the CRA effect appears to be on the decline. For example, the econometric models suggest that from 1993 to 2000, the act may have increased the share of loans 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.

4. The Changing Mortgage Industry Structure

The mortgage industry has witnessed a dramatic restructuring in the past decade. It has experienced an explosion of new forms of lending, 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.

4.1 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 portfolios 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. Although 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 HUD conducted its Survey of Mortgage Lending Activity), mortgage companies were the dominant (56 percent) originator of one-to-four-family mortgages 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, 43 percent of originations by banks and thrifts flowed through their mortgage banking subsidiaries.

The rise to dominance of nondepository 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 government-sponsored enterprises (GSEs) and private conduits issue replace deposits as the source of funds for these loans. Fannie Mae and Freddie Mac—by mandating the standardization of loan contracts and through their sheer scale—have played a role in streamlining and rationalizing the mortgage market role that extends beyond incorporating additional sources of funding within it.

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) is typically sold to Fannie Mae and Freddie Mac, nonconforming 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 has largely affected the market for prime mortgages—those made at the most favorable rates and terms to borrowers who 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 joint report by the U.S. Department of the Treasury and the U.S. Department of Housing and Urban Development (2000) notes 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. Issuers of subprime mortgage-backed securities have tended to be private firms, because, until recently, Fannie Mae and Freddie Mac purchased only prime loans.

4.2 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 noted that from 1975 to 1997, the number of banking institutions dropped 40 percent as a result of industry consolidation and a substantial number of bank failures (Avery et al. 1999). Following the shakeout in the late 1980s and early 1990s, the number of liquidations slowed, but the number of mergers and acquisitions continued to rise, stimulated by the globalization of financial services and efforts to increase efficiency, reduce costs, or gain competitive advantages.

Regulatory changes also supported the consolidation of the financial services industry as most state-level restrictions in the 1980s on intrastate banking were removed or relaxed. At the federal level, interstate banking 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 allowed larger organizations to enhance the scale and scope of their operations further through mergers and acquisitions. Federal Reserve System data indicate the scale of consolidation in the mid-1990s. From 1993 to 1997 alone, the number of banking institutions obtained 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 within the mortgage sector and in the broader financial services industry (Avery et al. 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 allow 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, technological advances also spurred major changes in the structure of the mortgage industry. The link today between the location of the borrower and the location of the lender is less important than it was even a decade ago because loan origination systems increasingly started to operate via telephone, fax, and now the Internet. As a result, many banks have abandoned conducting 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, have reduced the costs of loan origination and loan servicing and have allowed lenders to reduce costs by managing risk better.

For the most part, the new technology requires high fixed investment by firms, but once installed, it 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 still may benefit from a presence in a local market area, and some face-to-face communication with loan applicants. Here, scale economies are decidedly less significant, and relatively small organizations continue to thrive as mortgage brokers.

In 2000, only twelve lending organizations made more than 50,000 home purchase loans, but these twelve accounted for 39 percent of all such loans made that year (Table 2). In 1993, only four 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 overall market was flat. Together, the top twenty-five home purchase lenders originated fully 52 percent of all home purchase loans in 2000.

Table 2 divides the lending organizations into two categories: banking organizations (that is, commercial banks and savings associations with their mortgage and finance company affiliates) and other organizations (independent mortgage and finance companies and credit unions). The table indicates that banking organizations led the growth of large organizations. By 2000, home purchase lending for the ten largest banking organizations totaled more than 1.1 million loans, and the top twenty combined for a total of 1.5 million loans.

The emergence of large bank lending operations reflects, in large measure, forces that prompted dramatic consolidation of retail banking operations within and across individual

Table 2
Large Banking Organizations Lead Mortgage Lending Growth

	Banking Organizations				Non-CRA-Regulated Organizations			
	Lenders		Loans		Lenders		Loans	
Number of 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
Fewer 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

Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

Notes: 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. CRA is the Community Reinvestment Act.

metropolitan market areas. Within-market consolidations reflect the increasing economies to scale of 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 reflects the efforts of larger banks to capitalize on potential scale economies and name recognition as well as to reduce risk by diversifying across numerous spatially distinct market segments (Avery et al. 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, each of which 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, which was acquired by Dime Savings Bank, and Norwest Mortgage, which merged with Wells Fargo & Company.

At the other end of the spectrum, the data confirm that the number of banking organizations originating fewer 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, the number of smaller independent mortgage companies and credit unions was on the rise. For example, over the period, the number of independent mortgage companies and credit unions making fewer than 100 home purchase loans rose 28 percent (from 1,163 to 1,483) and the number of home loans made by these organizations rose 42 percent.

Consolidation among home refinance lenders was also strong, as the effect 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 home refinance loans. 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 to be seen whether the dominance of larger organizations helps or hinders the provision of affordable home loans. Many housing advocates argue that smaller, community-based institutions have an enhanced capacity to better understand and address the credit needs of the communities 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 any disadvantages. In any case, there seems to be little doubt that the trends of consolidation in 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 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 market. At the same time, since these technologies operate at low marginal or incremental costs, they foster fierce competition among those firms operating in the market. Going forward, the result will likely be both a continued consolidation of mortgage lending activities and a growing reliance on mortgage brokers to take loan applications. In addition, the continued evolution of better products, services, and pricing can be expected, as large firms seek to identify and exploit competitive advantage in their pursuit of customers in an increasingly competitive marketplace.

5. Industry Structure and Current Regulatory Issues

Changes in the structure of the financial services industry, particularly in mortgage banking, have combined to weaken the link between mortgage lending and the branch-based deposit-taking on which the Community Reinvestment Act was based. This section discusses these trends at the national level and their implication for the CRA's impact on lending to lower income borrowers and communities, as well as their implication for the variation in the act's regulatory reach across metropolitan areas and individual lenders.

5.1 The CRA and the Changing Industry Structure

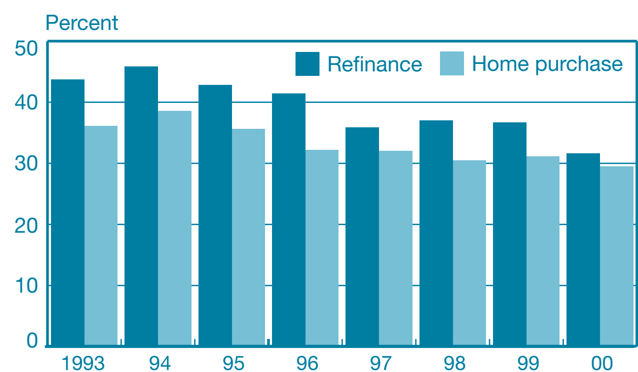
The increasing share of loans by the mortgage banking subsidiaries or affiliates of bank holding companies and by independent mortgage companies has brought a concomitant decline in the share of mortgage loans originated by deposit-taking institutions in the assessment areas where they maintain branch banking operations. An increasing share of all loans is not subject to detailed CRA review because the act mandates the most extensive review of assessment-area lending. 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 to 29.5 percent (Chart 2).

The fact that loans made by CRA-regulated institutions in their designated assessment areas as a percentage of all loans (or assessment-area share) has declined has several implications. First, a large and growing share of the mortgage lending industry (independent mortgage companies, finance companies, and credit unions) falls entirely outside the CRA's regulatory reach. Next, even among CRA-regulated institutions, the fastest growth has been in out-of-area lending, or lending that takes place outside 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 lending by CRA-regulated banking organizations; out-of-assessment-area lending by CRA-regulated banking organizations; and lending by noncovered organizations) 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, CRA-regulated depository institutions and affiliates operating in their assessment areas made 38 percent of all prime conventional home purchase loans. In contrast, in the rapidly growing subprime segment, only 3 percent of all loans were made by CRA-regulated organizations within their assessment areas. 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

Chart 2
Assessment-Area Lending Has Fallen Steadily



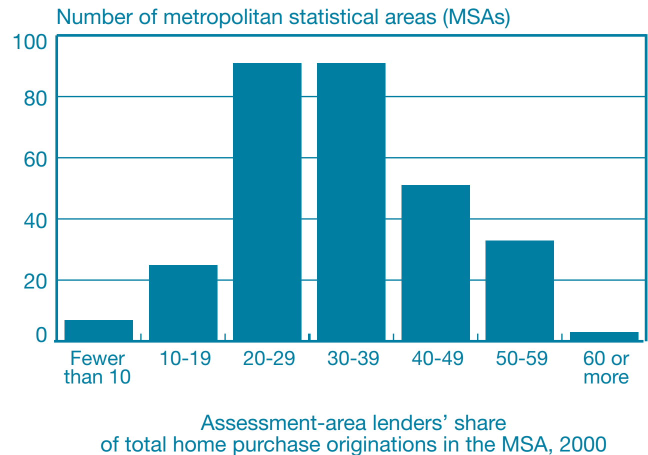
Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

(indicating that depositories' branch networks remain advantageous in this market). Even so, the vast majority (96 percent) of all subprime refinance loans are made by independent mortgage companies and out-of-area lenders, and as a result fall largely outside the CRA's regulatory reach.

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

Chart 3

The Assessment-Area Share of Home Purchase Originations Varies Widely



Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

5.2 Metropolitan-Area Variation in Assessment-Area Lending

Significant variation in assessment-area lending also exists across metropolitan statistical areas (MSAs). The demand for mortgage credit will depend 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. Accompanying this housing market variability is equally significant metropolitan-area variation in banking and mortgage industry organization. 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.

In some MSAs, only a handful of loans are originated by CRA-regulated entities operating in their assessment areas, while in other MSAs, well over half are (Chart 3). From a CRA perspective, there are two important implications of metropolitan-area variation in housing and banking markets. First, CRA-eligible lending is significantly more challenging for lenders in some MSAs than in others. Second, vastly different shares of lending pass through the CRA-regulatory apparatus in more places than others. Consequently, the CRA's effect from one MSA to another varies substantially based on MSA characteristics and the MSA-specific structure of the mortgage industry there.

Table 3 extends this analysis and displays the ten metro areas with the lowest share and the ten metro areas with the highest share of assessment-area lending. At the extreme, the assessment-area share of lending varies from a low of 6 percent in Denver to a high of 74 percent in Dubuque. Although there is a slight tendency for smaller metropolitan areas to have somewhat higher assessment-area shares, at least one large MSA and a complement of medium and smaller ones are included in the list of MSAs with the highest and lowest shares. For example, San Francisco's 60 percent share is some ten times higher than Denver's share. Similarly, Brazoria, Texas, with one of the lowest shares, had a much smaller share of assessment-area lending than Lincoln, Nebraska, which is in the top ten, though the two MSAs had nearly identical numbers of home purchase originations in 2000.

This MSA variation also bears little relationship to the share of lending that is CRA-eligible. 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.[7] These two markets 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.

Table 3 does suggest, however, that the variation in assessment-area shares may relate to 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

Table 3
Top and Bottom Metropolitan Statistical Areas (MSAs) for Assessment-Area Home Purchase Lending Originations in 2000

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

Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

industry, putting branch-based mortgage operators at a disadvantage relative to independent and affiliated mortgage companies. Moreover, a wrenching regional recession in the 1980s led to the collapse of many Denver-based banking operations. Today, Denver and other metropolitan areas in Colorado are experiencing explosive growth, but this growth is largely being served by national mortgage companies—both bank affiliates and independent mortgage companies.

5.3 The Diversity of Mortgage Lenders

Against these general trends stand the rich and varied stories of the rise of individual organizations. The twenty-five largest home purchase lenders depicted in Table 4 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, there are strikingly few similarities these organizations share. Among large independent mortgage companies, Countrywide Home Loans operates nationally and focuses on lending to lower income, first-time home buyers. In contrast, Cendant Mortgage serves customers with slightly higher incomes through a unique marketing approach that yields a mixture of applicants, while Conseco 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 the independent mortgage companies in Table 4, the share of refinancing loans ranges from 6 to 36 percent of total loans.

The banking organizations in Table 4 are equally diverse. Overall, the banking organizations in the top twenty-five 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 more than 80 percent of its more than 240,000 home purchase and refinancing loans in its CRA assessment areas. At the other end of the spectrum, J.P. 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 its refinancings took place in the bank's CRA assessment areas.

The top banking organizations also have significantly different home purchase and refinance lending shares. Chase is again extreme, with refinancing loans accounting for 18 percent of its loans. In contrast, Citigroup (55 percent) and Bank One Corporation (78 percent) made 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. Although physical location—sticks and bricks—within a particular community can boost a mortgage lending operation, it is not an essential feature. As a result, many mortgage companies that have emerged over the past several decades 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 allows IndyMac to tap into traditional secondary-market sources, while also diversifying its funding by raising deposits in Los Angeles as well as in the national capital market through the Internet and other electronic channels.

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

Table 4

Assessment-Area Lending Varies Significantly among the Top Mortgage Lenders in 2000

			Assessment-Area Shares (Percent)		CRA-Eligible Loan Shares (Percent)	
Organization	Total Home Purchase Loans	Total Home Refinance Loans	Home Purchase	Home Refinance	Home Purchase	Home Refinance
Wells Fargo and Co.	219,623	74,118	19.1	52.0	27.8	30.4
J.P. 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 New York, 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

Source: Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act Database.

Notes: Top lenders are the twenty-five organizations that made at least 25,000 home purchase loans in 2000 based on activity in metropolitan statistical areas (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 the area median income and/or loans made on properties in census tracts to borrowers with incomes less than 80 percent of the MSA median as of 1990. CRA is the Community Reinvestment Act.

6. Regulatory Challenges

In recent years, Congress, through the Gramm-Leach-Bliley Act, has focused on financial services modernization, but little has been done to help the CRA conform to the rapidly evolving world of mortgage banking and financial services. During the debate on the GLBA, some sought to scale back the 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 rating. Advocates pushed to expand the CRA by extending its reach to all segments of the financial services industry, including nonbanks that were involved in the provision of financial services. In the end, the GLBA left the CRA more or less where it had been, although discussion continues about the need to "modernize CRA" (Goldberg 2000).

6.1 CRA Assessment of Mortgage Loans Is Uneven and Often Ineffective

The growth of large and diverse lending organizations poses regulatory challenges to the CRA. In their Advanced Notice of Proposed Rulemaking (ANPR), issued in 2001, federal regulators requested comments 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, assessment areas 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 the CRA was enacted, this focus made sense because locally based depository institutions dominated mortgage lending.

Today, the assessment-area concept results in an unevenness of application of CRA oversight. Detailed CRA review is conducted on virtually all loans made by some smaller depository institutions operating in a single area, but scant review is applied to the fastest growing segment of home purchase lending, namely, those loans made outside areas where organizations maintain deposit-taking operations. Furthermore, no review of loans is 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 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 generated numerous proposals for expanding assessment areas for CRA-regulated institutions to include 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 (2001) advocates that assessment areas be defined as areas where CRA-regulated entities deliver retail banking services, whether or not they have physical deposit-gathering branches or ATMs in that locale. In a similar fashion, the National Community Reinvestment Coalition (2001) proposes expanding assessment areas to include those metropolitan areas where a lending institution accounts for at least one-half of 1 percent of all home purchase and/or refinancing loans.

Other proposals call for the extension of the CRA to all financial services organizations, including nondepositories. 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 multiyear congressional debate on how best to "modernize" the financial services industry, Congress should continue to assess critical aspects of the CRA, including the act's original focus on assessment areas linked to deposit-gathering activities.

6.2 One Size Doesn't Fit All

Much of the CRA examination process continues as if the examination 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 the 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. Although 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," that often make 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 the addition of criteria that would mandate "full scope reviews" in rural areas or assessment areas that are generally deemed to be "underserved." The National Training and Information Center (2001) calls 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 multistage sampling procedure. This approach would first review HMDA and other readily available data to obtain an initial series of indicators of a given institution's performance in each assessment area. Then, "full scope reviews" would be conducted in all areas where these initial indicators suggest that the lender's performance may fall in the low range of satisfactory or below, while at the same time 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.

6.3 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 examination 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 examination. In a typical CRA examination report, the service test gets a fraction of the space devoted to the lending test. The test focuses largely on the hours of operation and equality of access to branches in lower—as compared with higher—income areas where the bank operates branches. It also focuses on the pattern of branch openings and closings according to neighborhood income since the previous examination.

Lenders clearly perceive the community-development services portion as onerous to document, if not 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. Lenders also must take on the somewhat tedious task of describing the location of ATMs 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, the examination's component on retail banking services is 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 located just about anywhere.

Meanwhile, many people in lower income areas frequently use 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 the CRA may provide an opportunity to encourage banks to meet the financial services needs of lower income people, who today are underserved with respect to many other financial services to a greater degree than they are with respect to mortgage lending (Stegman, Cochran, and Faris 2001).

6.4 Small-Business Lending

Prior to the 1995 changes to CRA regulations, limited data existed for tracking small-business lending. Although assessments of banks' mortgage lending benefited from relatively detailed information reported under HMDA, the 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 examination, although small-business data remain less detailed and comprehensive than HMDA filings. In addition, the small-business data collected and distributed pursuant to the CRA include limited information

on business characteristics, failing in particular to report on the race and gender of business owners. These factors combine to limit the effectiveness of the 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 examination) 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, the HMDA mandates reporting by most nondepository residential mortgage lenders, but only depository lenders file small-business data. Also, unlike the HMDA, lenders report only on originated small-business loans, not ones that they reject. Furthermore, 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 firm 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 of their loan being approved.

6.5 Regulatory Toughness

Focus on the effectiveness of the implementation of the small-business lending or the service-test portions of the CRA is part of a larger set of issues relating to the uniformity of CRA enforcement by the four regulatory agencies. The regulatory agencies do coordinate their activities through the Federal Financial Institutions Examination Council, but in practice there is wide variation in how the CRA is enforced. In 1995, a U.S. General Accounting Office study (1995) reviewed forty CRA evaluations and found general evidence of inconsistent grading from one examiner to another. Similarly, Thomas (1998) reviewed 1,407 CRA examinations and found significant variation both between and within regulatory agencies. Using data from the Thomas study, Zinman (2001) 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 the provision of small-business loans.

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 the CRA is "unfairly" administered. At the same time, housing advocates will counter by noting that when "properly implemented," the CRA does produce clear benefits and that there is significant room to extend the reach of the CRA beyond the world of residential mortgage lending. In short, the debate over how to implement the CRA effectively is likely to continue into the foreseeable future.

6.6 HMDA Data Collection

Closely related to the ongoing discussion of CRA enforcement is the discussion of HMDA data collection. The structure of the large-bank CRA examination 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 the HMDA to evaluate and in some instances lodge protests with regulators about the performance of lenders in their communities. However, despite its important role in the struggles of the 1980s and the first half of the 1990s, HMDA's usefulness waned as reporting requirements failed to keep pace with the rapid restructuring of the mortgage 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 the HDMA's 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, although 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 he or she owns the land, knowing the property characteristics would allow regulators to assess differentially banks' lending of each type during the examination. Although this information is known to the lender at the time the loan is made, many bankers argue that including this information in the 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 examinations do not take advantage of this potential. As a result, most examinations merge all loans to lower income people and communities to produce an aggregate lending total. This results, for example, in equal credit being awarded in examinations 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 understanding more fully 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 nondepository institutions subject to HMDA reporting requirements. The rule also called for disclosing pricing data on higher cost loans and identifying loans on manufactured homes. In particular, the new rule extends HMDA coverage to nondepository institutions making more than $25 million in mortgage loans. Currently, nondepository lenders report under the HMDA only if their residential mortgage lending (including home purchase and refinance loans) during the previous year equaled or exceeded 10 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 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.

7. Conclusion

On this twenty-fifth anniversary of the Community Reinvestment Act's enactment, reform is needed to ensure that the act keeps pace with dramatic shifts in mortgage lending and the financial services industry. Reform could come either as a result of new rulemaking by federal regulators or new legislation. In either case, there appear to be two major pathways to reform: 1) reform could maintain and improve upon the CRA's historical focus on residential mortgage lending, or 2) reform could reposition the CRA to give more emphasis to community-development activities and the provision of banking services to lower income people and communities more generally.

Residential mortgage lending has been central to the CRA since its passage, yet the act's historical focus on assessment areas linked to deposit-taking activities makes little sense today. Limiting detailed CRA scrutiny to assessment-area loans arguably distorts the efficient operation of the marketplace. Minimally, it seems unfair for the CRA to mandate detailed scrutiny of a relatively large share of home loans made in some metropolitan areas and by some lenders, while at the same time devoting so little attention to the vast majority of loans made in other areas and by other lenders. In order to extend the CRA's legacy of expanding home-buying opportunities to lower income people and communities, federal regulators should consider expanding assessment-area definitions to include loans made by the CRA-regulated entities operating outside the areas where they maintain deposit-taking branches. In addition, Congress should also consider expanding the CRA to include the residential mortgage lending operations of a diverse set of nondepository organizations now playing an increasingly important role in lending to lower income people and communities.

Alternatively, if Congress and/or the federal regulators choose to focus the most extensive CRA-imposed obligations only on the CRA-regulated entities operating in assessment areas defined by the location of deposit-taking branches, then the CRA needs to be "repositioned" to better reflect what these organizations actually do. Given the growth of large banking organizations, many smaller banks and thrifts have abandoned their historical residential lending operations, focusing instead

on other forms of lending, including small-business and community-development lending. In this regard, retail banking services are arguably most closely linked to the branch-banking mechanism through which CRA obligations are defined and operated. Going forward, new CRA regulations could expand the CRA's focus on small-business and community-development lending and investment as well as the provision of banking services.

In any event, the Community Reinvestment Act must change. It is hoped that Congress, having finished work on the Gramm-Leach-Bliley Act, will continue to work with housing advocates, industry representatives, and regulators to craft a consensus on "CRA modernization" and how best to address the ongoing needs of lower income communities for improved access to credit and financial services.

Endnotes

1. This paper draws on research funded by the Ford Foundation and contained in the Joint Center for Housing Studies report, "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System." See also previous work completed by the Joint Center and the Brookings Institution for the U.S. Department of the Treasury (Litan et al. 2000, 2001). An earlier version of this paper, "The Evolution of CRA: Changing Industry Structure and CRA Regulations," was presented at the American Real Estate and Urban Economics Association Annual Meeting in January 2002.

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

3. The federal banking regulators responsible for administering the statute are the Office of the Comptroller of the Currency 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 for bank holding companies; the Federal Deposit Insurance Corporation for state-chartered banks and savings banks that are not members of the Federal Reserve System and whose deposits are insured by the FDIC; and the Office of Thrift Supervision for savings associations whose deposits are insured by the FDIC and for savings association holding companies.

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

5. The four-tiered rating system was: outstanding, satisfactory, needs to improve, substantial noncompliance.

6. Institutions are defined as those with $250 million or more in assets or those belonging to a holding company with $1 billion or more in assets.

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

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