

Defending the CRA

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Amid the largest financial market meltdown since the 1930s, the search for scapegoats is on. Clearly the rapid expansion of mortgage lending and the related proliferation of new loan products offered to unqualified borrowers in an environment of low interest rates and insufficient risk monitoring played a key role in the underlying credit mess. But the reasons why these abusive lending practices prevailed for so long has nothing to do with the Community Reinvestment Act.

The CRA was enacted in 1977 as a response to widespread concerns related to America's deteriorating inner-city neighborhoods, and the belief that lack of access to credit among low- and moderate-income households and businesses played a role in that deterioration. The law asks that banks that take deposits in these working class areas also provide credit services to the households and businesses in those areas, and that such credit is to be consistent with safe and sound banking practices.

Under the CRA, banks are evaluated on how well they serve these credit needs, and they face penalties if such service is not deemed adequate by regulators. Were these practices excessively risky, or less profitable than loans to other types of borrowers? Not at least through 2000. At the behest of Congress, the staff of the Board of Governors of the Federal Reserve System that year surveyed 500 of the largest banks in the United States subject to the CRA and asked for both quantitative and qualitative assessments of CRA loans versus other types of credit. This study revealed that CRA lending on balance was about as profitable as other mortgage lending and performed about as well.

Moreover, according to another 2000 study done at the request of Congress by staff of the Brookings Institution and Harvard's Joint Center for Housing Studies, the CRA-covered institutions increased their lending to low- and moderate-income borrowers from 1993-98 at a much faster pace than to other income groups, reflecting the economic progress being made by this lower income demographic. This new market was served without the increase in foreclosures or credit market turmoil seen recently.

But that was then and this is now. Did CRA lending somehow run amuck during the housing bubble, causing trouble for both borrowers and lenders? Data collected in 2006 under the auspices of the Home Mortgage Disclosure Act suggest not. Banks covered by CRA did make subprime loans, but the great majority of those loans went to middle- or upper-income borrowers or neighborhoods. In fact, of all the subprime loans made by banks covered by CRA, only 6 percent were CRA loans targeted borrowers in their assessment areas.

The real issue is that the CRA only applies to banks regulated by the federal government. The majority of the subprime loans made from 2001 to the peak in 2006 were made by mortgage entities not covered under the CRA. Thus, to the extent that such loans were made to low- and moderate-income borrowers—and many were with well-publicized negative consequences—it was not the government that “made them do it.” Rather, it was some combination of new, overly aggressive, financial products and selling techniques; perverse incentives of the originate-to-distribute model of mortgage financing; easy financing conditions; and, yes, pure greed.

Experience has shown that lending to low- and moderate-income families does not inevitably mean high delinquency or foreclosure rates when care is taken in the lending process and borrowers fully understand their obligations. Take the experience of the Massachusetts Affordable Housing Alliance, which has assisted over 11,000 families of modest means in buying their first home. It boasts a delinquency rate roughly half that of conventional mortgage borrowers.

And how about Self Help North Carolina, which has aided tens of thousands of similar families with comparable results? Community land trusts all over the country report under a 1 percent foreclosure rate on their mortgages, and Neighborhood Housing Services, dealing with loans to borrowers averaging only two-thirds of national median income, reports delinquency rates only a fraction of the reported subprime default rate.

The subprime mortgage crisis afflicting our financial markets today stems from many bad decisions. Borrowers made errors, but so did some of the most sophisticated private-sector financial players and government regulators, as well as Fannie Mae and Freddie Mac. At this point, there are undoubtedly some who are rethinking what is a “safe” loan for a family of modest income and assets, and this may be appropriate.

But the current crop of finger-pointing at the CRA and its mission to help ensure low- and moderate-income borrowers are included in the American Dream of homeownership and business formation comes dangerously close to writing off a whole swath of hard-working potential owners as “too risky” the next time around. That would be a tragedy both for those directly involved and for the continuing resurgence of our inner-city communities.

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