

The Community Reinvestment Act and Mortgage Lending in Lower Income Neighborhoods

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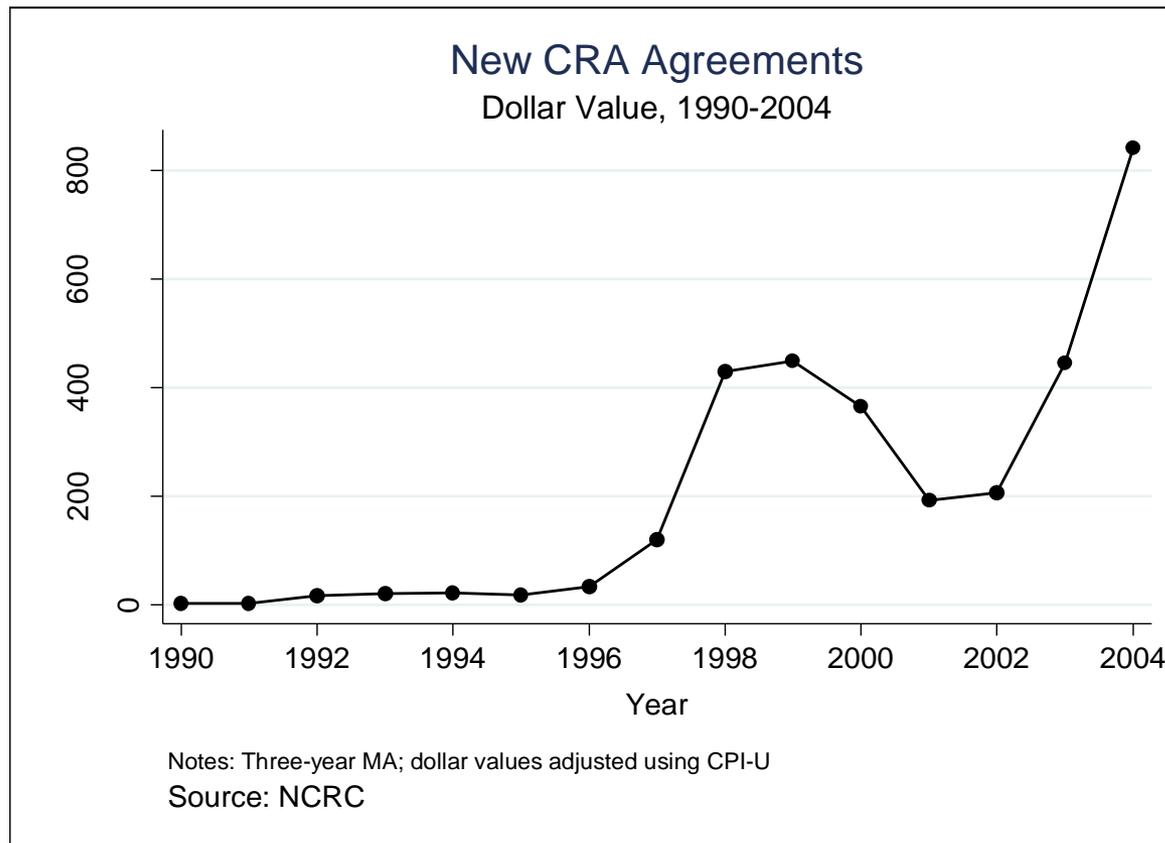
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The views expressed herein are solely those of the author

How effective has the CRA been?

- In light of a potential expansion and/or modernization of CRA in the near term, this is a key question
- e.g. why expand coverage of a law that has had little or no effect on currently covered institutions?

How effective has the CRA been?



How effective has the CRA been?

Narrower question:

What effect has CRA had on mortgage credit flow to lower-income neighborhoods?

Measuring the effect of the CRA in lower-income neighborhoods

“Lower-income neighborhoods” (LMI) =

census tracts with median family income (MFI) less than 80% of the area (e.g. MSA) MFI

→ Have targeted tracts experienced greater mortgage credit flow than they would have in a world without the CRA?

Measuring the effect of the CRA in lower-income neighborhoods

Strategy:

credit flow in targeted neighborhoods

vs.

credit flow in not-targeted neighborhoods

Issue:

by construction these two groups are of different economic circumstances

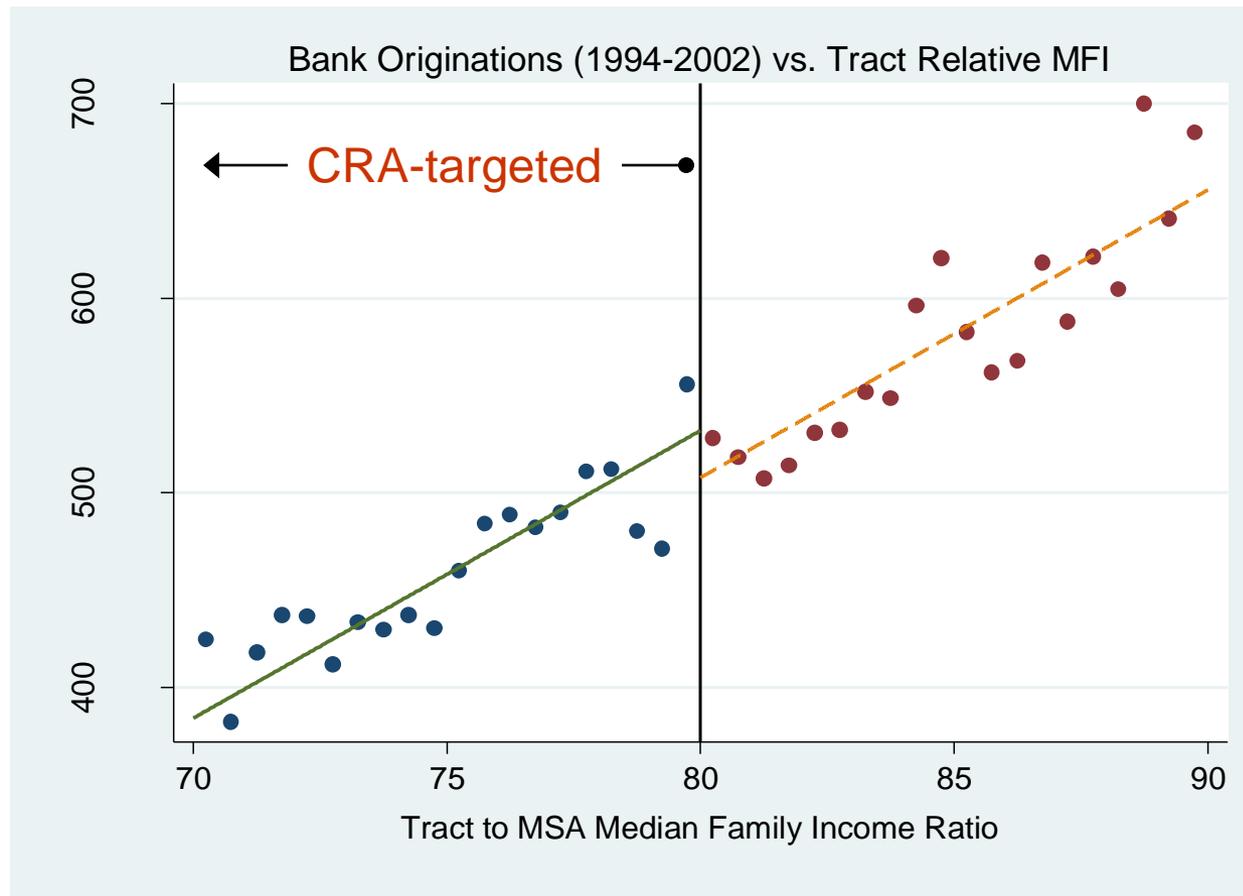
→ need to adjust for *ex-ante* differences in credit demand

Measuring the effect of the CRA in lower-income neighborhoods

Solution: measure the *discontinuity* in credit flow at the cutoff

Rationale: banks get CRA “credit” for lending in tracts with relative MFI of 79%, but not in tracts with relative MFI of 80%.

Measuring the effect of the CRA in lower-income neighborhoods



Measuring the effect of the CRA in lower-income neighborhoods

Data:

- HMDA, 1-4 family originations in MSA census tracts
- Separate loans into 3 lender groups:
 1. Banks (regulated)
 2. Non-deposit bank subsidiaries/affiliates (regulated?)
 3. Independent mortgage companies (not regulated)
- Count up number of loans in each tract during some given time period
- Baseline census tract characteristics from Census

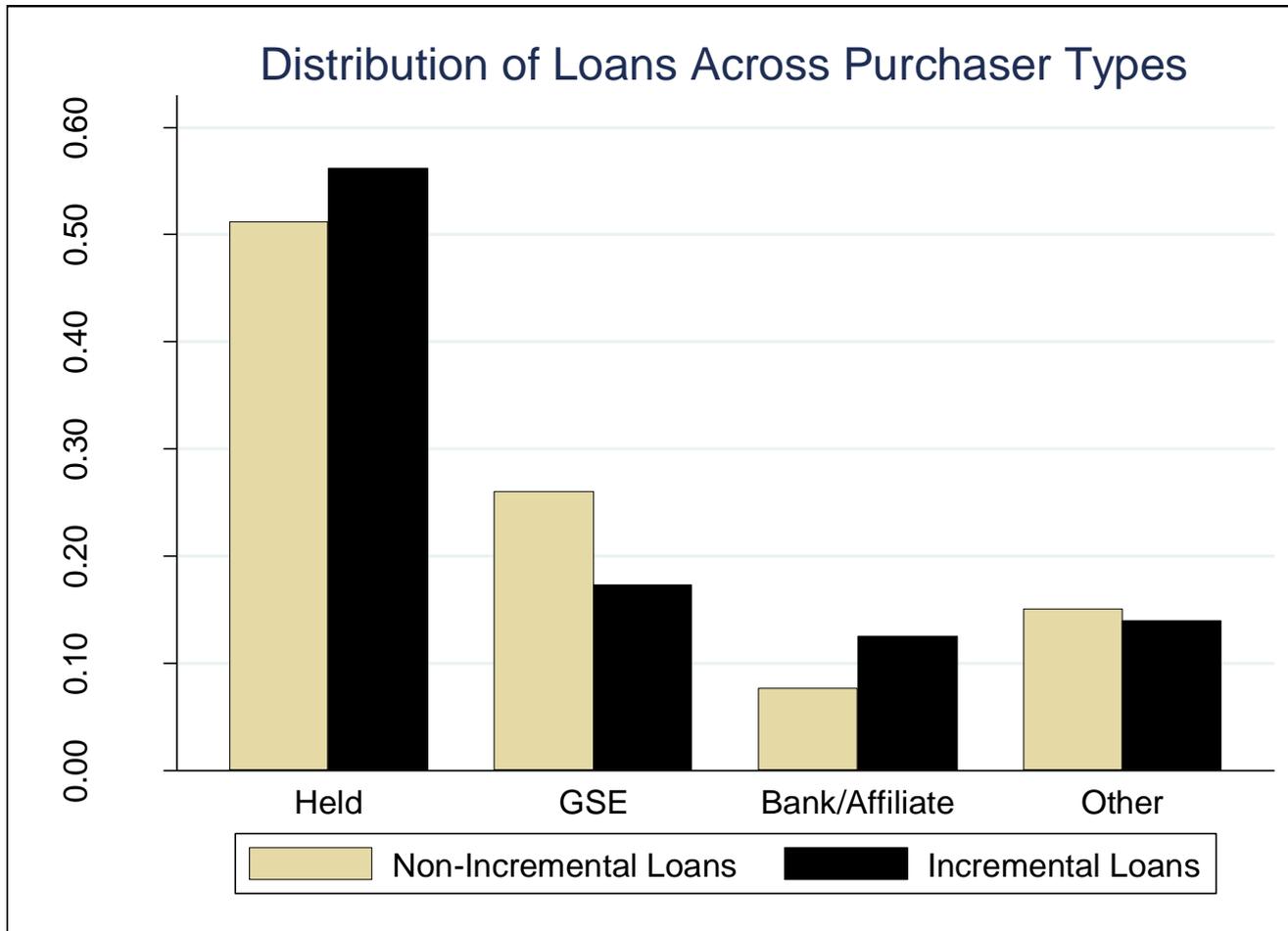
Findings (I), 1994-2002

1. CRA only affects bank lending in large MSAs

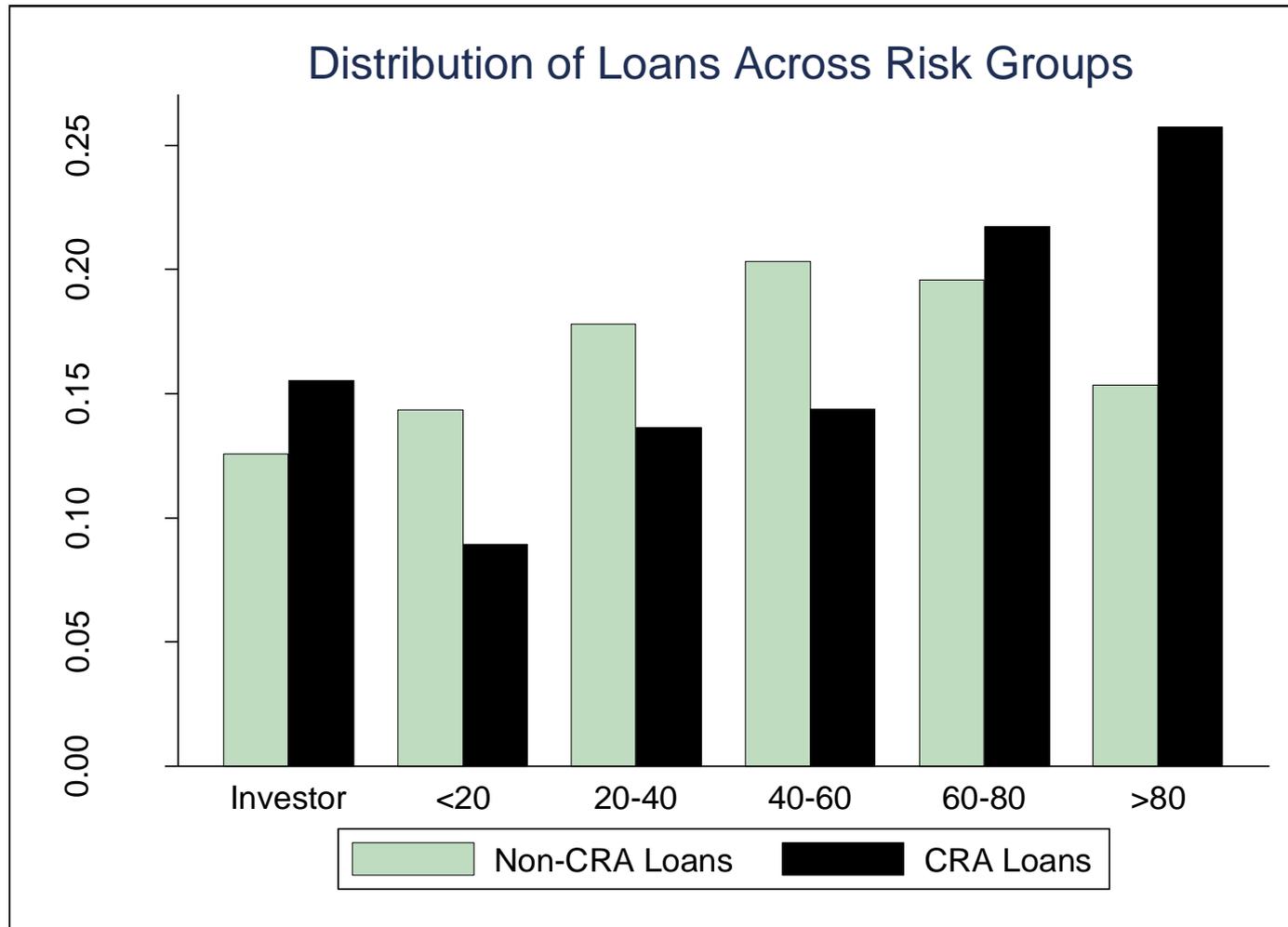
- 1994-96: CRA increased bank originations by 4% (about 2 loans per tract per year)
- 1997-2002: CRA increased bank originations by 8% (about 5 loans per tract per year)
- Mortgage applications rise also
- No evidence of “crowd-out”

2. Banks also fulfill CRA obligations by *purchasing* mortgages

Findings (I), cont.



Findings (I), cont.



Findings (I), (cont.)

In large MSAs, for a targeted tract at the cutoff, my estimates suggest that CRA increased 1-4 family mortgage flow from about 1335 to 1400 loans, or by \$8 million (\$2007), over the 1994-02 period.

Findings (II), 2004-2006 (preliminary)

1. No detectable effect of CRA on bank originations (in newly targeted tracts)
2. In large MSAs, CRA increases bank *purchases* by 10%

Other research

1. Avery, Bostic & Canner (2005)

- a) 1999 survey evidence suggests CRA has spurred banks to do more CRA-related lending
- b) Marginal CRA-related lending is a small portion of business
- c) Some marginal lending economically profitable

2. Berry & Lee (2008)

- Similar discontinuity approach; conclude CRA has had no effect on banks' mortgage lending

Caveats

CRA's effect appears to be limited, especially in recent years, but...

1. CRA-effect may be stronger in tracts away from cutoff
1. CRA may affect other credit outcomes (e.g. community development loans)
1. CRA may have had unquantifiable effects (e.g. open banks' eyes to new possibilities)

Some questions/concerns going forward

1) Why does CRA treat nearly identical neighborhoods differently? And very different neighborhoods the same?

1a) Can CRA be tied to more specific objectives?

Some questions/concerns going forward

2) If CRA has a limited effect, how much will expanding it to other institutions really achieve?

2a) Does the same “quid pro quo” argument really apply to non-banks?

Some questions/concerns going forward

3) CRA focuses on quantity... might this have some painful side effects?