CRA and the Subprime Crisis

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What is the Issue?

- As the financial crisis has unfolded an argument that the Community Reinvestment Act (CRA) is at its root has gained a foothold
- Similar arguments have been put forth about the role of the affordable housing goals and the activities of Fannie Mae and Freddie Mac
- The basic argument is that the CRA forced lenders to relax underwriting standards and to extend credit to unqualified home buyers

Summary of Basic Findings

- Available evidence does not support the contention that the CRA contributed in any substantive way to the crisis in the subprime market
  - CRA-related lending was a small share of the subprime market
  - Only a small share of loans purchased by CRA-covered lenders from non-CRA covered lenders were higher-priced and potentially CRA related
  - Delinquency rates on subprime loans are high in all neighborhood-income categories, not just lower-income areas.
  - Most foreclosures involve properties in middle- or higher-income areas
  - Foreclosures have increased at a faster rate in non-lower income areas

The CRA

- The CRA directs the four federal banking agencies to use their supervisory authority to encourage banking institutions to help meet the credit needs of their **local** communities **in a manner consistent with safe and sound lending practices**
  - Banking agencies assess the record of an institution in serving its entire community including low- and moderate-income areas
  - Agencies take record into consideration in reviewing applications for mergers, acquisitions and branches

Coverage of the CRA

- Institution Coverage
  - Limited to bank and thrift institutions
  - **Excludes** credit unions and independent mortgage companies
  - Banking institutions can elect to have lending of non-bank affiliates counted in their local community (CRA assessment area) but it must be lending to all borrower income groups and areas within the community
    - CRA assessment area is essentially the geographic areas where an institution has its branch offices– typically an entire MSA or county

Focus of the CRA

- CRA evaluations focus on three basic aspects of performance
  - Lending, Investment and Service tests for large banks
- Regulatory changes in 1995 required more quantification of performance (number and dollars of lending activity) and less focus on process
  - No prescribed minimum targets
  - Focus on lower-income neighborhoods (any borrower income)
  - Focus on lower-income borrowers (any location)

- Regulatory changes in 2005 focused on encouraging CRA activity in economically distressed **middle-income rural** communities

- **Effectively there has been no change in basic CRA rules or enforcement process since the changes in 1995**

CRA-Related Higher-Priced Lending, 2005-2006

- Nearly three fifths of higher-priced loans are to non-lower income borrowers or borrowers in non-lower income areas. These borrowers are not the focus of the CRA
- **Only 6%** of all higher-priced loans were made to lower-income borrowers or to borrowers in lower-income areas within CRA assessment areas

Higher-priced	Banking institutions and affiliates		Independent mortgage company (%)	Total (%)
	Within CRA assessment area (%)	Outside CRA assessment area (%)		
Non-lower-income	7	20	28	55
Lower-income	**6**	17	22	45
Total	13	38	50	100

Loan Purchases by Banking Institutions from Independent Mortgage Companies

- Banking institutions purchase loans from lenders not subject to the CRA (mostly independent mortgage companies)
  - In 2006, independent mortgage companies sold about 2.56 million conventional loans; about 9 percent of these were purchased by depositories
    - Among the purchases by banking institutions, about 15 percent were higher-priced loans extended to lower-income borrowers or neighborhoods; **thus less than 2 percent** of the loans sold by independent mortgage companies were higher-priced CRA-eligible; (see table next slide for details)

Loan Purchases by CRA Covered Lenders

Note: Nine percent of the loans sold by independent mortgage companies were purchased by banking institutions

Loan Sales by Independent Mortgage Co.	Depository Purchases (percent distribution)
Lower-priced loans	
Not lower income	45
Lower income	18
Higher-priced loans	
Not lower income	22
Lower income	15
Total	100

Previous Research on the Performance of CRA-Related Lending

- Studies have found CRA-related mortgages are about as profitable as mortgages not related to CRA
  - 82% of institutions reported CRA-related mortgage lending profitable or marginally profitable compared to 94% of institutions for all mortgage lending (FRB 2000)

- Studies have found CRA-related loans are more costly to originate and service
  - Delinquency rates, but not necessarily default rates tend to be higher
  - Performance tied to layering of risk factors
  - Risk mitigation activities can lower costs of elevated loan delinquency and default but these activities can be relatively expensive

Performance of Loans by Zip Code Income Group

Zip Code Relative Income Group	Subprime	Alt-A	Total
Lower	25.0	16.1	21.5
Middle	21.3	12.9	17.7
Higher	19.5	10.9	14.5

Note: 90-day or more delinquency rate as of August 2008 by relative income of zip code (for loans originated from January 2006 through April 2008). Source: Staff analysis of data from First American LoanPerformance.

Delinquency Rates at the Margin of the CRA

- Analysis shows performance of loans just below the CRA threshold performed about the same as loans just above the threshold

Zip Code Relative Income Group	Subprime	Alt-A	Total
75-80 percent	24.1	15.6	20.7
80-85 percent	24.9	15.4	21

Note: 90-days or more delinquency rate as of August 2008 by relative income of zip code (for loans originated from January 2006 through April 2008). Source: Staff Analysis of data from First American LoanPerformance.

Loan Performance Comparisons

Comparative Data on Single-Family First Mortgage Home Loans
(As of June 30, 2008)

	Past Due Loans			Total Past Due	Foreclosures (Started 04/01/2008-06/30/2008)
	30 days	60 days	90+ days		
All Loans (U.S.)	3.23%	1.24%	1.75%	6.22%	1.08%
Prime Loans	2.08%	0.72%	0.93%	3.73%	0.61%
Subprime Loans	8.30%	3.87%	6.04%	18.21%	4.26%
VA	3.76%	1.23%	1.67%	6.66%	0.57%
FHA	6.64%	2.33%	3.19%	12.16%	0.95%
NeighborWorks® Campaign Clients	3.90%	1.93%	3.54%	9.36%	0.21%

Source: NeighborWorks® Campaign clients' data pertaining to Neighborhood Housing Services of America (NHSA) portfolio of 2,986 loans, amounting to $234.30 million; all other data are provided by the Mortgage Bankers Association of America's (MBAA) economic department.

Foreclosure Filings and the CRA

- Most foreclosure filings from January 2006 – August 2008 were in middle- or higher-income areas
- Foreclosure filings increased at a greater rate in middle- and higher-income areas

Zip Code Relative Income Group	Share of Filings (%)	Percentage Change in Filings from 1/06 to 8/08
Lower	30	118
Middle	51	158
Higher	20	143
Total	100	

Source: Staff analysis of foreclosure filings (1/06 to 8/08) from RealtyTrac