PENN IUR **BRIEF**

The Future of the Community Reinvestment Act

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INTRODUCTION

In February 2019, the Federal Reserve Board, Federal Reserve Bank of Philadelphia, and Penn IUR jointly convened a research symposium to consider the future of the Community Reinvestment Act, a federal law enacted in 1977 to combat redlining and discrimination in mortgage markets. Nearly 100 stakeholders—including Federal Reserve Board governors and policymakers, to regulators and rule writers, academics and researchers, community development leaders and policy practitioners—came together at the Federal Reserve Bank of Philadelphia to discuss the past, present, and future of the Community Reinvestment Act (CRA). The conference was especially timely given the recent call by Office of the Comptroller of the Currency (OCC) for comments on how to modernize the CRA. The one-day conference focused on using data-driven approaches to evaluate the effectiveness of the CRA in its current form, lending an evidence-based lens to forecast how to best modify the CRA going forward. Two issues predominated: how to modernize the CRA's local bank branch-centric framework in an age of internet banking and how to respond to the new challenge of access to affordable housing in resurgent urban areas. Here we provide background on the issues and summarize the discussion and research findings presented at the symposium. The resulting papers from the conference are now available as working papers on the Federal Reserve Bank of Philadelphia and Penn IUR websites. They will be published as a special volume of *Housing Policy Debate*, co-edited by Lei Ding and Susan Wachter, that addresses issues surrounding the modernization of the CRA.

WHY THE CRA? A BRIEF HISTORY OF REDLINING, THE COMMUNITY REINVESTMENT MOVEMENT, AND CRA REFORMS

The Community Reinvestment Act (CRA), enacted in 1977, was part of a trilogy of laws adopted in the late 1970s, including the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act, to combat redlining and discrimination in mortgage markets. Prior to the CRA, redlining, the practice of demarking neighborhoods as unsuitable for lending on credit maps based on racial composition, was widely documented and had only been formally outlawed by the Federal Fair Housing Act of 1968.

Recognizing the historical context around the CRA is critical for understanding the Act's original intent and interpreting its efficacy in the modern context. For nearly all of America's history, it was legal to deny someone housing (either to rent or to own) on the basis of race. Through zoning ordinances,[18] racial covenants,[24] and racially discriminatory Federal Housing Administration policy,[19] private real estate markets and the federal government created and maintained a system of what historian Richard Rothstein coined as both *de jure* and *de facto* segregation.[16] Segregation "created two housing markets"[7]: one white, the other black; one backed by the federal government, the other "patrolled by [predatory]" lenders[7];one with virtuous cycles of favorable loan terms and reinvestment, the other with vicious cycles of credit crunch and neighborhood decline.[13]

While race and location-based housing discrimination has its roots in *local* laws and zoning policies, *federal* policy helped standardize the practice nationwide.[11, 22] As part of a New Deal initiative to minimize systemic risk of home foreclosure, the Home Owner's Loan Corporation (HOLC), a government-sponsored agency, surveyed America's largest 239 cities and rated each neighborhood's perceived credit risk on a four point scale. The HOLC suggested "some mortgage lenders may refuse to make loans" (see, for example, HOLC Residential Security Map for Baltimore, MD, https://jscholarship.library.jhu.edu/handle/1774.2/32621) in the lowest graded areas which were colored red on the HOLC's maps. Hence the term "redlining." In making the maps, the HOLC consulted with bankers and builders in each city (thousands of local experts in total) in order to influence local lending standards.[21] The maps and neighborhood appraisal methods were also shared with the Federal Housing Administration[12, 14] to help set neighborhood-level criteria for FHA mortgage insurance.[9]

The connection between race and redlining maps cannot be understated. According to one study of redlining in 51 American cities,[13] 86 percent of African-Americans lived in a neighborhood marked for credit redlining in 1940, despite making up just 8 percent of the study's population. By contrast, only 35 percent of whites lived in redlined areas in 1940 despite making up over 90 percent of the sample population. Today, once-redlined neighborhoods continue to lag behind non-redlined areas on key economic indicators, such as homeownership rates and house values. Causal studies of the effects of HOLC redlining are few, but the literature is growing. Aaronson, Hartley, and Mazumder find that the redlining maps increased racial segregation, while depressing homeownership, house values, and rents.[2] Krimmel finds the redlining maps had significant and persistent negative effects on new construction and population density.[13] Both of these studies do find, however, that the negative effects of redlining—particularly with respect to lower homeownership rates and higher levels of racial segregation—have become more muted since 1980. This is consistent with the effectiveness of the CRA as anti-redlining legislation and raises the broader question as to *why* and *how* the CRA has been effective.

The literature on local credit market imperfections identifies the source of the efficacy of the CRA in the potential for local collective action solutions. The CRA encourages such collective action to respond to neighborhood disinvestment.[5] If lenders fear that other lender will redline, lenders will withhold lending due to this fear, *resulting* in "self-fulfilling prophecy redlining."[11] The inability to borrow to buy and improve homes may consign neighborhoods to continuing disinvestment. In particular, the absence of home sales makes neighborhoods riskier because appraisers rely on sales to provide information on the value of homes in order to determine appropriate loan amounts. Information externalities and asymmetries related to the lack of sales and better understanding of the neighborhood's potential may lead banks to overlook creditworthy borrowers and profitable loans.[15]

THE CRA TODAY: MODERNIZATION AMID A CHANGING LANDSCAPE

The CRA's original and continuing mandate is to ensure that banks meet the lending needs of people and places. The CRA charges banks with meeting the credit needs of local communities where they accept deposits as well as the responsibility of engaging in fair lending practices. The implicit goal of the CRA is then to bring economic growth to these formerly credit redlined areas, as well as to boost minority homeownership rates and to increase access to credit to low and moderate income neighborhoods and households, more generally.

To encourage this, the CRA requires banks to designate assessment areas, without excluding underserved areas, in which regulators evaluate the activity of the banks. The CRA is enforced through periodic federal exams that rate banks based on their compliance with CRA standards in these assessment areas. Bank regulators consider ratings in the approval process for bank mergers and acquisitions as well as for bank branching requests. Banks are encouraged to engage with community stakeholders to identify and fulfill their credit needs in order to strengthen the links between bank activity, profitability, and community development, consistent with safe and sound lending practices.

Subsequent to the original legislation, reforms in 1995 shifted the focus away from process-oriented evaluation to performance-based metrics.[1] This together with newly required data disclosure (and consequent share-price and reputational effects) and an increase in acquisition and merger activity (denials) led to a surge in lending in the latter half of the decade to low- and moderate-income borrowers and underserved neighborhoods.

This lending surge occurred in major US cities, two-thirds of which had lost population from 1970 to 2000. Along with the reinvestment, urban revitalization took hold. Banks engaged with community groups to reinvest, overcoming collective action market failures, which had undermined community redevelopment in historically disinvested and declining neighborhoods.[15] Urban revitalization took off after 2000, alongside the surge in community reinvestment.[23] Many large cities that had experienced decades of population losses began to grow again. In coastal cities such as San Francisco, Boston, Miami, and New York City, and others such as Atlanta and

Washington DC, gentrification accompanied the turn-around. In these cities, many formerly redlined areas have gentrified or are in the process of gentrifying. The geography of poverty within metropolitan areas is changing as longstanding residents are displaced and poorer migrants and immigrants cannot afford to live centrally.

Regional divergence in terms of income, house prices, and employment has also increased; from 1880 to 1980 incomes across states converged at a rate of 1.8% per year but since 1980 this trend has slowed significantly.[16] In other words, rich states and regions are only getting richer, and the poor are only becoming poorer. Rising rents and housing prices, particularly in large cities with strong job growth, have resulted in a new urban crisis marked by a lack of access to affordable housing. This raises new issues and potential conflicts in the CRA's dual mandate to serve people and places.[8] The regional divergence in incomes, house prices, and costs of living has important implications for lending benchmarks and standards in a reformed CRA, especially considering banks and non-bank lenders now operate across states and regions with diverging economic fortunes.

Despite the revitalization of many urban centers, the economic and social inequities that necessitated the CRA are still very much a feature of American society.[24] Though no longer explicit through laws, lending policy, or red lines on maps, the data suggests an individual's financial fate is still tied to his/her race or location. Research by Raj Chetty and coauthors at the Opportunity Atlas Project shows definitively that the neighborhood where one grows up has a continuing and enormous impact on earnings later in life—even after controlling for parental income. Moreover, in the aftermath of the Great Recession, the homeownership gap between whites and minorities (black and non-white Hispanics) increased dramatically, as aggressive lending through private label securitization (that was not regulated or subject to CRA) withdrew from minority markets where such loans were heavily targeted.[3] The result is that the minority-majority homeownership gap is roughly unchanged since the CRA was enacted in 1977.[4] The wealth gap associated with homeownership has once again increased.[6] Barriers to homeownership have also increased, particularly in regions with higher job growth, where access to affordable housing is more limited.[8]

The presenters at the CRA Research Symposium confronted these challenges with thoughtful and frank discussion. They asked questions like: how should the CRA adapt to a world of urban revitalization? What is the role of the CRA in a world where housing and homeownership access diverge regionally? How is local community redevelopment related to job opportunity? As disinvested communities redevelop, how can the CRA respond to local needs for affordable housing? More generally urban redevelopment involves a massive coordinating effort with city, housing authority, public school system, police and safety authorities: what is the role of the CRA in encouraging bank lenders to respond to the local funding needs for inclusive redevelopment, along with philanthropy and social impact funding?

Presenters agreed that progress has been made, though many of the CRA's overall policy goals have not been achieved. And now the financial landscape is very different than it was even 10 years ago, let alone since 1977. Besides the changing geography of low to moderate income borrowers, CRA modernization must grapple with the new reality of online banking. The banking industry has undergone tectonic shifts in the decades since the CRA was first legislated. The rise of national banking, nonbanks, and the internet poses new challenges for implementing CRA regulations. The growth of national banks (with branches across the country), nonbanks (which are not covered by CRA and account for an increasingly large share of mortgage lending), and Fintech companies (which may have only one office, often in the Salt Lake City hot spot cluster) raise questions about the continued relevance of the CRA and, in particular, about the continued salience of the bank branch-oriented tests for whether banks are serving the entire community. How should Fintechs fall under the purview of a reformed CRA? The question of non-banks also came to the fore, as non-banks now dominate the conventional, conforming mortgage market and FHA originations. The transformation of the banking industry raises questions whether a branch-centric regulatory framework remains relevant.

The peer reviewed papers in the special volume of *Housing Policy Debate* address these issues surrounding the modernization of the CRA. The first paper, "Who Lends Beyond the Red Line? The Community Reinvestment Act and the Legacy of Redlining," by Quercia and Park, takes on the central question of the CRA's continued relevance. Despite the new prosperity of cities, the paper demonstrates the persistence of discrimination and disinvestment that afflict communities that were "redlined" nearly a century ago. Two other papers in the special volume address whether the CRA, given recent changes in the structure of the banking industry, continues to affect banking activity. In "The Community Reinvestment Act (CRA) and Bank Branching Patterns," Ding and Reid find that CRA protections do effectively limit the negative impacts of bank branch closures in low-income areas. In "Is the CRA Still Relevant to Mortgage Lending?" Calem, Lambie-Hanson, and Wachter find that although the nonbank share of mortgage lending has indeed increased, the CRA generates significantly greater lending for low- and moderate-income borrowers in assessment areas than would have occurred in its absence.

Three papers in the special volume specifically address the data issues raised by the Office of the Comptroller of the Currency's (OCC) call for comments. In "Quantitative Performance Metrics for CRA: How Much 'Reinvestment' is Enough?" Reid shows how benchmarks for community reinvestment are shifting and how data collection procedures and the CRA exams themselves need to be modernized accordingly. In "The Community Reinvestment Act: What Do We Know, and What Do We Need to Know?" Goodman identifies avenues for more transparent and holistic data reporting on CRA lending. In "Updating CRA Geography: It's Not Just About Assessment Areas," Willis advocates for a broader interpretation of community development and recommends a new way to define assessment areas for Fintech banks.

We conclude the special symposium/issue with two papers that address the overarching question of the continued relevance of the underlying mechanism of the CRA for achieving legislative goals. In "The Community Reinvestment Act at 40: Why Is It Still Necessary to 'Lean' on Banks?" White lays out these objectives, including overcoming discrimination in mortgage lending (which he argues is better addressed by anti-discrimination enforcement) and collective action problems of local community development. In "Concluding Observations on CRA Reform," Barr posits that it is particularly this local need that underscores the CRA's continued relevance.

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