CRA Did Not Cause the Foreclosure Crisis

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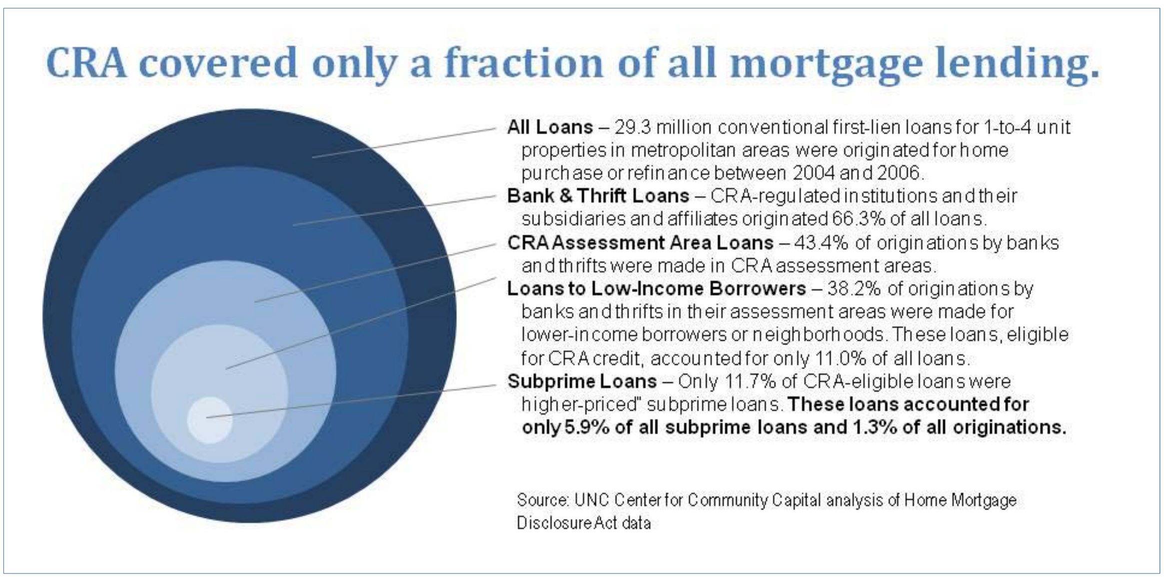
The claim that the Community Reinvestment Act (CRA) led to the foreclosure crisis is a falsehood that persists despite irrefutable evidence to the contrary and repeated attempts to correct the misperception.

Here are some facts about CRA that show clearly it did not cause the current crisis.

CRA was enacted long before the crisis started. Congress enacted the CRA in 1977 to curb "redlining," the discriminatory practice by banks of denying mortgage credit to people living in particular neighborhoods (often literally delineated with a red line on a map). While the law was amended in 1995, it was still a decade before the housing market peaked. In the intervening period, policy reforms overwhelmingly favored de-regulating the mortgage industry.

CRA covers only a small share of mortgage originations. The CRA only applies to deposit-taking institutions. Many of the most prolific subprime lenders, like Ameriquest and New Century, were independent mortgage companies, which obtain capital from secondary markets and are, therefore, not subject to the law in any way. The share of home mortgage debt held by CRA-regulated institutions has fallen steadily, from 73.9% in 1977, when the law was created, to 32.7% in 1995, when it was amended, to 26.4% in 2008, the latest year for which data is available.

Further, CRA-regulated institutions are primarily evaluated only in their assessment areas, roughly the counties in which they have a bricks-and-mortar office. Loans which receive credit toward CRA evaluations are only those made to any low-and-moderate-income borrower or in any low-and-moderate-income neighborhood within these assessment areas.

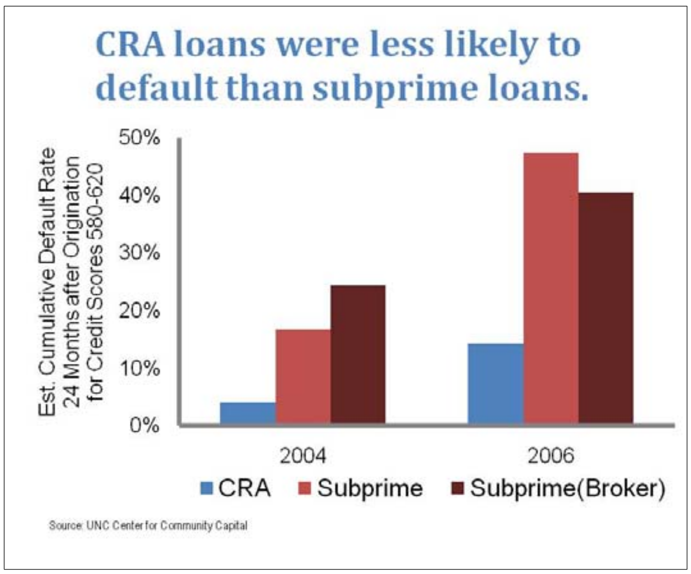


Data available from the Home Mortgage Disclosure Act (HMDA) shows nearly 19.46 million loans for home purchase or refinance were originated by banks or thrifts (i.e., institutions covered by CRA) and their subsidiaries and affiliates between 2004 and 2006. This was 66.3% of all mortgages made during that period. Of these, roughly 8.45 million (43.4%) were originated within the assessment areas of these institutions. Among those, only 3.23 million (38.2%) were made to lower-income borrowers or in lower-income neighborhoods, defined as individual or median household incomes less than 80% of the metropolitan area median. These are the loans that count towards an institution's CRA evaluation and they amount to only 11.0% (38.2% of 43.3% of 66.3%) of all mortgages made between 2004 and 2006.

Moreover, most of these loans would have been made simply as part of the lender's typical business. A 2000 Federal Reserve Bank study found that only 17% of the total dollar amount of CRA-related originations was extended under "special lending programs" and the majority of such programs "are either profitable or marginally profitable on a per program basis."

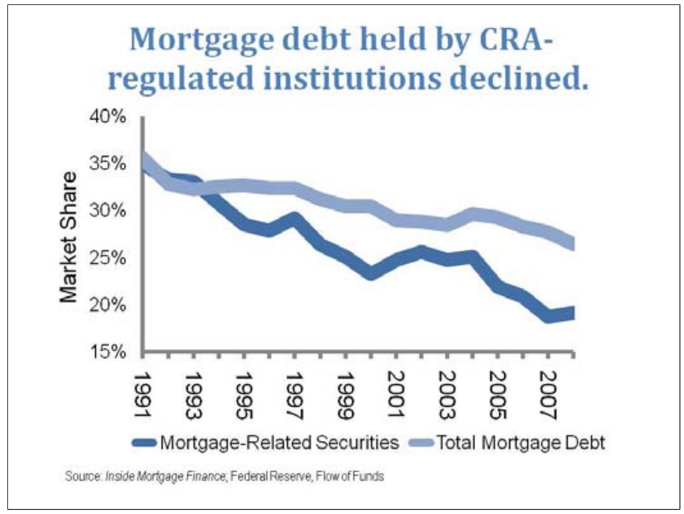
CRA loans are less likely to use exotic features. All CRA-regulated institutions are statutorily required to comply with "safe and sound lending practices," a requirement that does not extend to independent mortgage companies or issuers of private-label securities. While CRA loans typically involve higher loan-to-value ratios and lower credit scores common among borrowers considered high risk, this does not mean they are "subprime" loans. The features of the loan itself can affect credit risk. Compared to subprime lending, CRA loans are much less likely to involve high interest rates, prepayment penalties, etc. Less than 12% of loans covered by CRA are identified in HMDA as higher priced and the total number of such loans is just over 367,000. This is only 5.9% of all higher-priced loans and 1.3% of all mortgages originated between 2004 and 2006.

CRA loans are less likely to default. Traditional mortgage products and closer attention to underwriting mean that most CRA loans perform substantially better than subprime loans. UNC Center for Community Capital research found the default rate for CRA loans was 70% less than for a subprime loans made to borrowers with similar risk characteristics. Similarly, Federal Reserve Bank of San Francisco research found that loans made by a CRA-regulated lender in its assessment area were more than 60% less likely to be in foreclosure than loans made by an independent mortgage company to a comparable borrower.



CRA institutions did not drive the demand for mortgage-backed securities. Critics argue that even if the CRA did not directly originate the poor quality loans behind the foreclosure crisis, it still created the end demand for such loans as banks and thrifts purchased subprime mortgage-backed securities to satisfy the legislation's evaluation of community investment. But banks and thrifts were not the primary force behind the secondary mortgage market.

Data from Inside Mortgage Finance shows that the share of mortgage-related securities held by banks and thrifts steadily declined over the past two decades, from 35% in 1991 to less than 20% in 2007. Between 2003 and 2006, these CRA-regulated institutions accounted for just 12% of the increase in mortgage-related securities outstanding. Using this figure as an estimate of the share of security purchases, combined with the fact that roughly two thirds of mortgages in this time period were securitized, the secondary market activities of banks and thrifts accounted for less than 10% of total originations.



In addition, only a small share of these securities would have been for CRA purposes. A 2010 Interagency Interpretive Letter from the Federal Financial Institutions Examination Council states, "As a general rule, mortgage-backed securities and municipal bonds are not qualified investments because they do not have as their primary purpose community development, as defined in the CRA regulations." In 2005, nearly half of mortgage-backed securities held by banks and thrifts were held by the 10 largest, including companies like Bank of America and Citigroup, which have substantial investment branches not covered by CRA.

Finally, to the extent that banks and thrifts were both originating loans and buying securities (commonly through Fannie Mae or Freddie Mac), the same loans could be double counted. That is, if a bank originated a loan in order to apply it towards the bank's CRA lending test then sold it to another bank to use toward the CRA investment test, the impact of CRA on lending volumes should not be counted twice.

Summary

There is clear evidence that CRA covered only a small fraction of mortgage lending, including risky subprime lending and mortgage-backed securities, in the years leading up to the foreclosure crisis. Further, CRA loans are less likely to default than loans by less-regulated lenders.

The lesson from this evidence is that sustainable homeownership depends on the quality of the loan product. CRA promoted safe and sound lending to low-income borrowers, but the law failed to keep pace with changes in mortgage lending, such as the rise of the secondary market and independent mortgage companies. Less-scrupulous lenders were able to exploit the uneven playing field during the housing boom. Preventing another crisis requires policies that promote constructive lending and are universally applied.

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