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SEPTEMBER 2021

CRA MORTGAGES: A FAILURE TO IMPLEMENT

ANALYSIS OF MORTGAGES IN CHICAGO BASED ON COMMUNITY LENDING FACT BOOKS, 1984-2020

PREPARED BY THE WOODSTOCK INSTITUTE

ABOUT WOODSTOCK INSTITUTE

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Learn more at https://woodstockinst.org

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EXECUTIVE SUMMARY

Banking has changed considerably since the Community Reinvestment Act (CRA) was passed in 1977, and updates to its implementing regulation in the mid-1990s were soon outdated. In 2015 the agencies responsible for regulating banks subject to CRA requirements (CRA banks) began to update the law yet again. This report uses Woodstock Institute's annual Community Lending Fact Book data of mortgage lending in Chicago from 1984 to 2019 as a proxy to evaluate whether the CRA has achieved its goal of closing the gap in lending disparities.

Analysis of data from those Fact Books shows some of the issues that CRA modernization needs to address. We find that:

1. CRA banks do not meet the goal of lending to low- and moderate-income borrowers and in low- and moderate-income neighborhoods as required by the CRA:
   - CRA banks originated nearly 84% of all mortgages in 2007; by 2019 that share had dropped to just 45%.
   - CRA banks originated mortgages of roughly the same average amount per loan as lenders not subject to CRA requirements until 2011; by 2019, the average loan amount for CRA banks was roughly $155,000 higher than the average for lenders not subject to CRA requirements.
   - CRA banks cut back on originating government-backed mortgages between 2008 and 2019, with their share of government-backed mortgage originations declining from 62% to 19%.

2. CRA banks originated many more loans in the predominantly White Central/North region than the rest of the city, including majority communities of color, between 1984 and 2019.
   - CRA banks originated an average of 1.2 times the number of loans per 100 owner-occupied units in the Central/North region as in the rest of the city in 1984; by 2019, that had increased to 2.1 times the number of loans.
   - The average loan amount that CRA banks originated in 1984 was 3.1 times as large in the Central/North region as in the rest of the city; by 2019, the average was 4.7 times as large.
   - In 1984, CRA banks originated 49% of their mortgages, 71% of the total amount they originated, in the Central/North region that had 44% of all owner-occupied units at the time; in 2019, they originated 73% of their mortgages, 86% of the total amount they originated, in the Central/North region that then had 56% of all owner-occupied units.

In conclusion, the data show CRA banks originate mortgages in patterns inconsistent with the goals of the CRA, and the gap has widened substantially between 1984 and 2019. Yet over the same time period, between 90 and 95% of banks received Satisfactory or Outstanding CRA ratings from the federal bank regulators.

Those findings suggest the federal CRA reform must:

1. **Hold banks to a higher standard.** Lax enforcement condones and perpetuates a race to the bottom in serving lower-income borrowers and neighborhoods. Banks will do what they have to do to receive a Satisfactory rating, but there is little incentive to do more, especially if doing more is expensive and labor intensive.

2. **Include effective sanctions for receiving less than a Satisfactory rating**. Right now, the only sanction is the possibility that regulators will prevent a bank from opening branches and merging with or acquiring another bank. Unless a bank has plans to expand, failure to attain at least a Satisfactory CRA rating has virtually no impact on the bank's operations. Without some incentive in the form of sanctions that would have an impact, banks have little reason to do more than the minimum.

In addition to those recommendations, regulatory reform should reconsider some aspects of the CRA examination system:

- Examiners should look at longer term trends, not just the past few years. This analysis shows longer-term trends can reveal serious issues in bank practices inconsistent with the letter and intent of CRA.
- Examiners should compare a bank's performance with all lenders in the area, not just peer banks subject to CRA requirements.
- Examiners should expand the geographic scope to include areas beyond those in which the bank has a physical presence to reflect the new reality of online banking.

Thirty-six years of mortgage lending data for Chicago paint an unflattering picture of what has happened under the CRA. Having laws on the books with the goal to promote reinvestment in disadvantaged communities and provide access to financial services and resources for residents of those communities has been shown to be inadequate, although the federal regulators have rated the performance of 95% of banks as Satisfactory or better. Regulatory reform needs to look long and hard at how it can change that reality.

INTRODUCTION

This report examines mortgage lending data for Chicago from 1984 to 2019 to see the extent to which mortgage lending in the city has been consistent with the goals of the 1977 Community Reinvestment Act (CRA).

The purpose of the analysis is to inform current efforts to reform the regulations implementing the CRA, to adapt the regulations to changes in banking that have occurred since the last reforms in the 1990s, and to suggest changes in implementation of the regulations to more effectively achieve the goals of the CRA.

The CRA is the federal law which encourages federally regulated, Federal Deposit Insurance

Corporation (FDIC) insured banks to lend in low- and moderate-income[1] neighborhoods and to low- and moderate-income borrowers. Congress passed the act as one part of efforts to reduce the practice of redlining by banks, the wholesale denial or limitation of loans to lower-income and predominantly minority neighborhoods. One effect of redlining was disinvestment, banks taking deposits from residents and businesses in lower-income neighborhoods and investing those deposits in higher-income neighborhoods, essentially transferring capital from poorer areas to richer ones.

The structure of the CRA reflects the state of the banking industry in 1977, and efforts to modernize the implementing regulations in the mid-1990s were limited. FDIC-insured banks are subject to CRA requirements (CRA banks); lenders, such as Credit Unions and non-bank mortgage companies that do not have FDIC insurance, are exempt from the CRA (non-CRA lenders). Federal regulators evaluate each CRA bank's performance based on its lending, investment, and the services it offers in neighborhoods where it has physical branches approximately every 3 to 4 years.

One problem that community advocates noted with the CRA from its inception was the lack of an adequate enforcement mechanism. CRA banks can receive one of four ratings based on the regulator's findings after the examination: Substantial Noncompliance; Needs to Improve; Satisfactory; and Outstanding.

Unless a bank receives a Satisfactory or Outstanding rating, regulators can prohibit it from opening a branch and either merging with or acquiring another bank. In practice, that means that only banks interested in expanding face any possible sanction for not meeting their CRA obligations. Moreover, regulators give more than 90% of banks ratings of Satisfactory or Outstanding, further limiting even the possibility of sanctions.

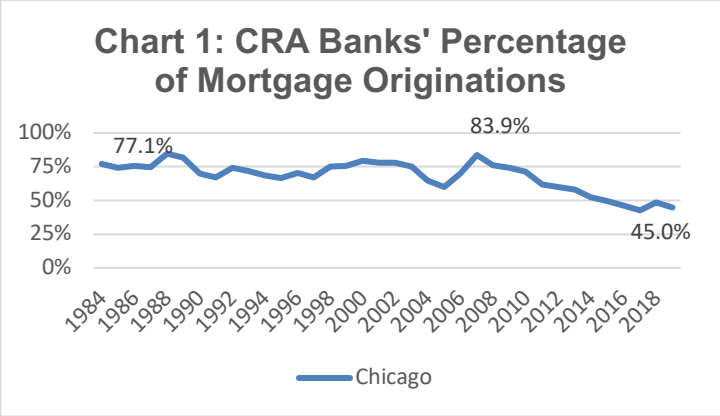
As the CRA model adopted in 1977 and updated in 1995 became increasingly outdated due to mobile banking and the emergence of online, non-bank lenders doing business across state lines, the three federal regulatory agencies responsible for enforcing the CRA, the Office of the Comptroller of the Currency (OCC), the Federal Reserve System, and the FDIC, began efforts to update the CRA regulations in 2015.

The CRA allows each regulatory agency to draft its own rules for the banks it regulates. Aside from a short period of time in the 1990s, the federal bank regulatory agencies have traditionally maintained consistent regulations for the different groups of banks they oversee. The OCC recently broke with that practice and unilaterally adopted new regulations in June, 2020, which apply only to national banks. In May of 2021, it decided to reconsider those new regulations and suspended most of the new compliance requirements in an effort to allow all the agencies to once again adopt consistent regulations.

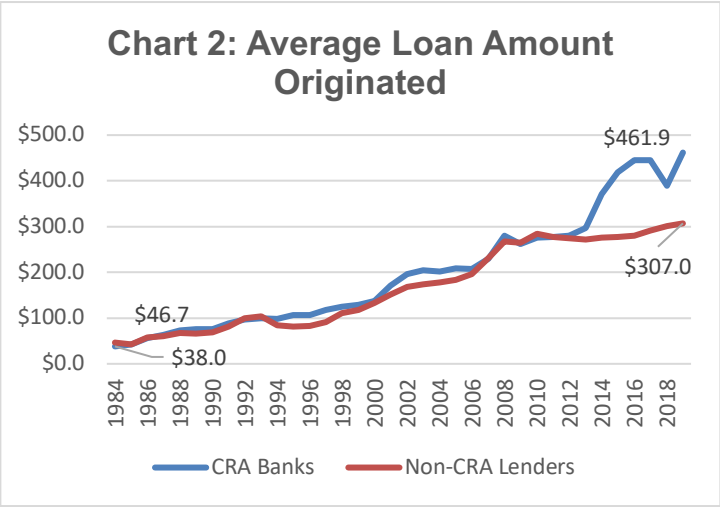
[1] Defined as less than 80% of U.S. Department of Housing and Urban Development Area Median Income

MORTGAGE ORIGINATION TRENDS FOR CRA BANKS IN CHICAGO

Of all lending products, mortgages represent the financial product that builds the most wealth for families. It is also the loan product for which public data is most readily available, thus, making it a suitable proxy for examining the impact of the CRA. Woodstock Institute has published mortgage lending data for Chicago in its Community Lending Fact Book since 1984, and analysis of data from those Fact Books shows some of the issues that CRA modernization needs to address.



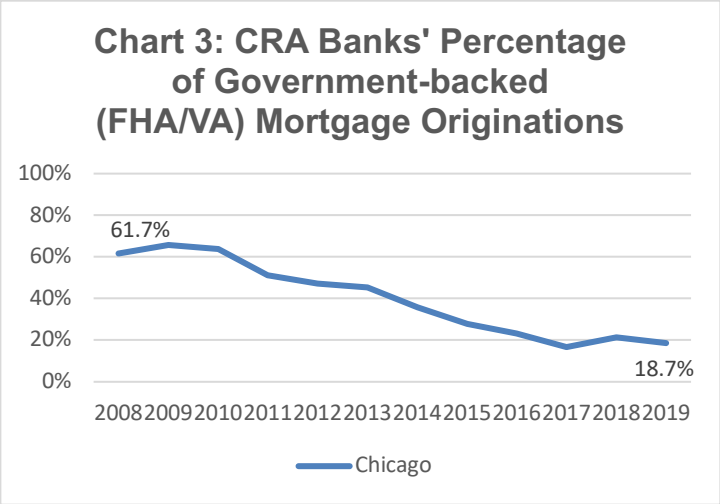
One issue that is clear from the data is that the limitation of CRA requirements to federally-insured lenders exempts a larger share of the market now than when the CRA was first in effect. CRA requirements now apply to lenders originating less than half of all mortgages (Chart 1). In 1984, CRA banks originated over 77% of all mortgages in Chicago, rising to nearly 84% in 2007; by 2019 that share had dropped to just 45%.



Another issue is that lenders subject to CRA requirements have shifted their focus to originating

larger mortgages (Chart 2). That shift works counter to the goal of the CRA, which is to promote lending in lower-income neighborhoods and to lower-income borrowers who would generally need smaller, not larger, loans.

The data show that until about 2012 the average loan amounts were about the same for CRA banks and non-CRA lenders. Then CRA banks started to make generally much larger loans than non-CRA lenders. The difference in the average loan amount went from zero in 2011 to over $165,000 in 2016.



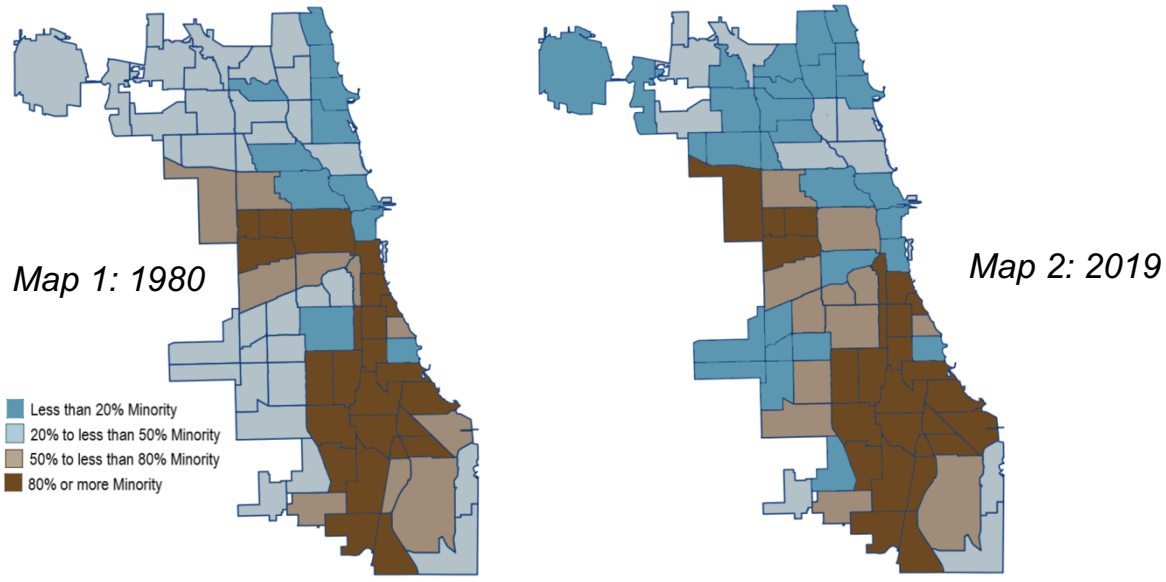
CRA banks have also dramatically reduced their origination of government-backed mortgages, Federal Housing Administration and Veterans Administration loans, that are specifically designed to help low- and moderate-income borrowers buy homes (Chart 3). Between 2008 and 2019, the share of government-backed mortgages that CRA banks originated in Chicago declined from 62% to 19%.

The move away from originating government-backed mortgages is consistent with the trend toward originating larger mortgages. Both suggest that banks subject to CRA requirements encouraging them to lend to lower-income borrowers are now doing less of what the CRA intended than in the past.

CRA BANK MORTGAGE ORIGINATIONS BY REGION WITHIN THE CITY

These trends hold true when examining lending for different parts of the city. Chicago is a highly segregated city, and has been for a long time. A comparison of the racial makeup of Chicago's 77 Community Areas over time shows the existence and persistence of that racial segregation, with minorities concentrated in the south and west, and Whites in the north. (Maps 1 & 2).

Maps 1-2: 1980 & 2019 Community Areas, percentage people of color residents

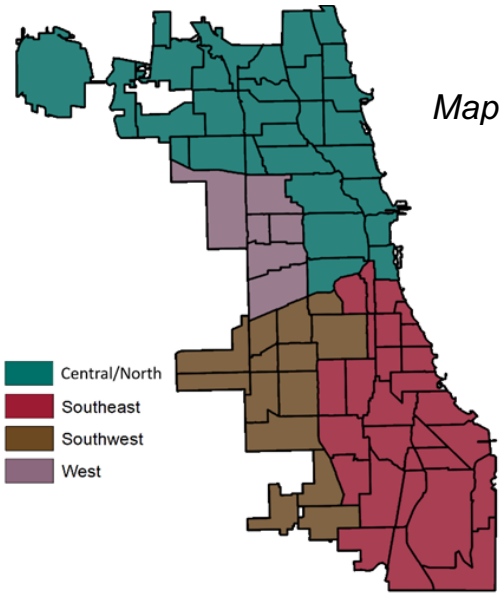


The pattern is highly durable, as well; of the 24 Community Areas that were 80% or more minority in 1980, 22 (92%) were still that way in 2019, while the north side of the city has remained majority White that whole time.

The persistent racial segregation make it possible to analyze the lending data for regions, composed of groups of Community Area neighborhoods with markedly different racial composition.

Table 1 & Map 3: Regions of Chicago by percent people of color

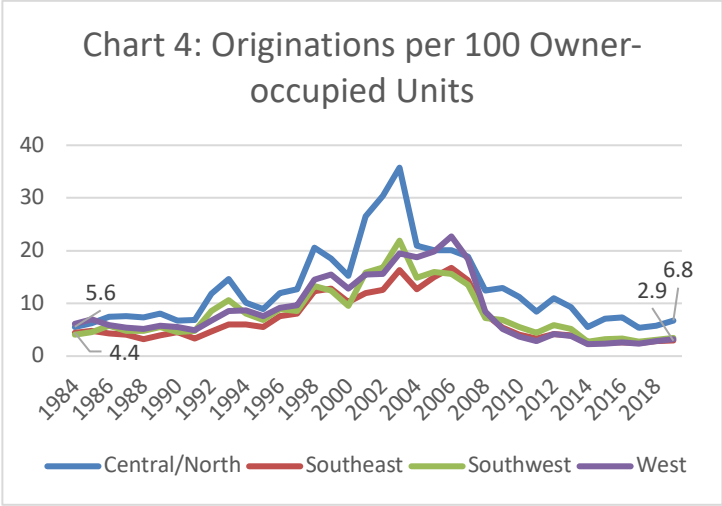
Region	*1980*	*2019*
Central/North	24.0%	29.9%
Southeast	86.5%	84.7%
Southwest	16.5%	49.4%
West	76.8%	76.9%



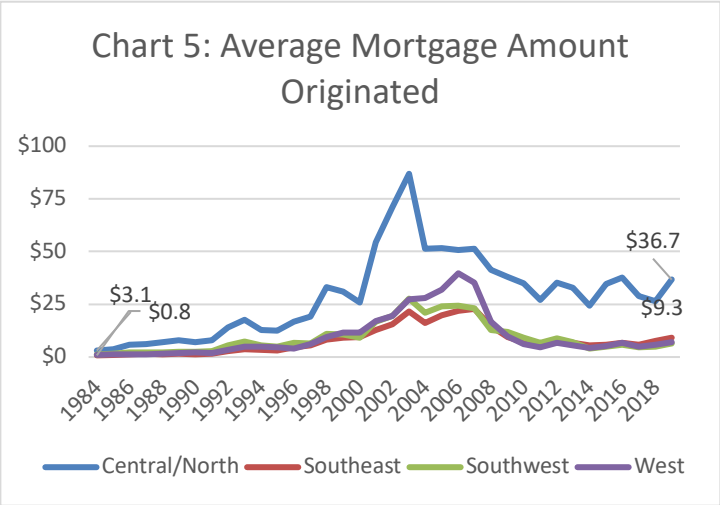
Map 3: Regions

Census data from 1980 and 2019 show that the neighborhoods with the Central/North region have remained predominantly White, neighborhoods with the Southeast and West regions have remained predominantly minority, and neighborhoods within the Southwest region have transitioned from White to mixed (Map 3 and Table 1).

The lending patterns for banks subject to CRA obligations show clear differences among the regions. Between 1984 and 2019, CRA banks consistently originated more mortgages in the predominantly White Central/North region than in the other three regions, controlling for the number of owner-occupied units in the region, and the disparity increased over time (Chart 4).

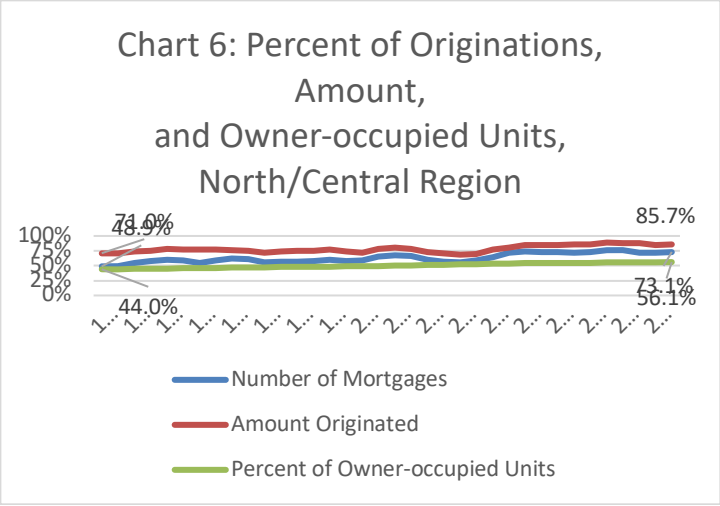


For example, CRA banks made an average of 1.5 times as many loans per owner-occupied unit in the Central/North region as in the Southeast region in 1984; by 2019, they made 1.9 times as many. The disparity was even greater between the Central/North region and the other two regions.



]The differences in the average loan amount per owner-occupied unit that CRA banks originated are even more pronounced between the predominantly White Central/North region and the other three regions (Chart 5).

The average loan amount in the Central/North region was twice as large as the average in the Southeast region in 1984; by 2019 it was 3.5 times as large. As with the number of originations, the disparity was even greater between the average amount in the Central/North region and the other two regions.



Finally, the combination of originating an increasingly high number of larger mortgages in the predominantly White Central/North region has resulted in CRA banks concentrating their lending more and more in that region, which necessarily means that they are doing less lending in the predominantly minority regions of the city (Chart 6).

The Central/North region has gone from 44% to 56% of the city's owner-occupied units between 1984 and 2019. Over that same period, CRA banks' lending in the region have gone from 49% of their originations to 73%, and from 71% of their total amount to nearly 86%. Put simply,

CRA banks are now lending just over 14% of the total amount of mortgages they originate to the three regions that have 44% of all owner-occupied units in the city.

DISCUSSION AND RECOMMENDATIONS

The data suggest that banks subject to CRA requirements are neither originating the smaller loans that lower-income borrowers need nor meeting the mortgage needs of residents in the city's minority neighborhoods. Worse, the situation has been deteriorating for years.

The data on market share (Chart 1) suggest that the CRA needs to be extended to cover credit unions and the non-bank lenders, such as Guaranteed Rate and Quicken Loans, that now account for the majority of all originations in Chicago. Unfortunately, the reach of the CRA is determined by whether the lender has FDIC insurance, and non-bank lenders don't. Because the limitation is contained in the law, extending CRA requirements to non-bank lenders is not possible as part of any regulatory update.

The rest of the data in Charts 2 thru 6 suggest that, between 1984 and 2019, CRA banks moved further from the goal of the CRA to lend to lower-income borrowers and in lower-income neighborhoods. Over the same time period, between 90 and 95% of banks received Satisfactory or Outstanding CRA ratings from the federal bank regulators. Those facts point to some clear deficiencies with CRA that regulatory reform should address. If CRA reform is to change banks' behavior to achieve the goals of the CRA, it must do two things.

First, regulators have to hold banks to a higher standard. Right now, nine out of ten peer banks can be doing a better job than XYZ Bank at meeting its CRA obligations, and yet XYZ Bank may still receive a Satisfactory rating. Lax enforcement condones and perpetuates a race to the bottom in serving lower-income borrowers and neighborhoods. Banks will do what they have to do to receive a Satisfactory rating, but there is little incentive to do more, especially if doing more is expensive and labor intensive.

For example, originating a $200,000 mortgage takes about the same effort as originating a $700,000 mortgage, but the bank's profit is higher on the larger loan. Because banks receive CRA credit for purchasing loans that the non-CRA lenders originate, the obvious strategy for banks is to let the non-CRA lenders do the hard work of reaching lower-income borrowers and handling the underwriting of the small loans they need, and then the bank can buy the loan and get CRA consideration.

Another example, shown clearly in the data (Chart 3), is the diminishing percentage of FHA/VA loans that CRA banks are originating. Participation in government loan programs, such as FHA and VA loans, is one of the original regulatory factors that was retained in the 1995 CRA regulatory revisions.

The data show that CRA banks' share of FHA/VA originations in Chicago has dropped from a high of 66% in 2009 to less than 19% in 2019. Despite an almost total withdrawal from FHA/VA lending, one of the factors specifically included in the lending test – the most important

of the three CRA regulatory tests – regulators still found the performance of about 95% of banks to be Satisfactory.

Mortgages, however, are only one of the services that the CRA is trying to get banks to offer in low- and moderate-income neighborhoods. If CRA banks originate mortgages for neighborhood residents, that can establish the personal relationships that lead those banks to offer other services, such as small business loans, personal lines of credit and savings products.

By outsourcing their mortgage lending to non-CRA lenders, banks aren't establishing the relationships that can bring residents into contact with the full range of mainstream financial services that banks are supposed to offer to lower-income customers and neighborhoods under the CRA.

One option would be for banks to get only partial credit for purchasing mortgages, with full credit only if the bank actually originated the mortgage itself. Another option would be to consider purchased loans as part of a bank's investment test, not as part of its lending test. Either way, the examination standards should do more to encourage banks to get into lower-income communities and interact with lower-income borrowers, actually making loans, as the CRA intended.

Raising the bar for a Satisfactory rating also needs to take into account that banks' activities may also harm lower-income borrowers and neighborhoods. Engaging in or supporting harmful activities should factor into the overall CRA examination as a strong negative factor. Whether it's excessive fees for overdrafts, excluding accounts designed for lower-income customers from features offered to other low-cost accounts, or allowing predatory lenders to use their bank charter, banks should be downgraded for activities that harm borrowers and strip wealth from neighborhoods.

Second, CRA reform needs to include effective sanctions for receiving less than a Satisfactory rating. Right now, the only sanction is the possibility that regulators will prevent a bank from opening branches and merging with or acquiring another bank. Unless a bank has plans to expand, failure to attain at least a Satisfactory CRA rating has virtually no impact on the bank's operations. Without some incentive in the form of sanctions that would have an impact, banks have little reason to do more than the minimum.

One suggestion would be to revoke the Financial Holding Company (FHC) status and benefits provided to financial institutions in the Gramm-Leach-Bliley Act of 1999 if any subsidiary within the FHC has less than a Satisfactory CRA rating. The FHC would have to reorganize its structure and abandon certain business lines as a result of reverting to the more limited Bank Holding Company structure. This threshold currently exists, but only in the process of <u>becoming</u> an FHC, not maintaining the FHC status.

Beyond raising the standard for receiving a Satisfactory rating and the possibility of sanctions that would impact the FHC of any bank that failed to reach that standard, there are other reforms that the analysis of 36-years' worth of mortgage lending data suggests. Currently, regulators look at two- to three-years' worth of data in a CRA examination. The longer-term trends that are

apparent in this analysis might not show as clearly in that short a period of examination. Regulators should look at data covering a longer period of time, perhaps ten years, to see whether banks are slowly moving away from the CRA's goals. It would be hard for a bank regulatory agency to justify a financial institution's CRA performance as "Outstanding" or "Satisfactory" if its lending to low- and moderate-income individuals and communities dropped by half in 10 years, but that's exactly what our analysis of mortgage lending in Chicago shows.

Another possible reform would be for examinations to compare a bank's performance to all lenders originating mortgages in the market, not just peer banks, at least for the lending test. If Guaranteed Rate can make loans in a given neighborhood without any CRA obligation, strictly on the investment merit of the loan, banks subject to CRA should be able to as well.

Finally, the regulations need to be adapted to the modern banking environment. Regulators look at banks' performance in neighborhoods where it has a physical presence. With the expansion of online banking options, banks can now do business virtually anywhere. Regulatory reform needs to take into account that new reality, possibly by applying CRA obligations to banks based on the entirety of any state in which they are legally allowed to accept deposits, at least in markets where they have a substantive marketshare.

CONCLUSION

Thirty-six years of mortgage lending data for Chicago paint an unflattering picture of what has happened under the CRA. Perhaps that the picture might have been even uglier without the CRA. And that's just mortgage lending.

Long-term data on small loans to businesses, community development investment, provision of affordable banking services, and any other banking activity that might benefit, or not harm, lower-income borrowers and neighborhoods may very well show similar patterns, moving away from the goals of the CRA. Additionally, the trend by banks to outsource lending transactions to non-bank entities represents a new form of redlining.

Having laws on the books with the goal to promote reinvestment in disadvantaged communities and provide access to financial services and resources for residents of those communities has been shown to be inadequate. Regulations must target the entities whose behavior has to change in order to reach that goal, with effective incentives and sanctions.

Then, regulators have to implement those regulations vigorously and consistently to make sure that they achieve the statutory objective. The data show that this has not happened with the CRA over the past 36 years, and regulatory reform needs to look long and hard at how it can change that reality.

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