Safe and Sound Lending in Neighborhoods:
An Examination of the Community Reinvestment Act (CRA) at Work in Washington, DC and Houston, TX

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EXECUTIVE SUMMARY

Prepared by National Community Reinvestment Coalition
The National Community Reinvestment Coalition is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations and social service providers from across the nation. Their work serves primarily low- and moderate-income people and minorities.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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Executive Summary

The Community Reinvestment Act (CRA) requires banks to serve communities, particularly low- and moderate-income communities, consistent with the safety and soundness of the banks. In this study, NCRC compares lending in two metropolitan areas and finds that CRA mitigated the significant decreases in lending accompanied by the current foreclosure crisis and severe recession. CRA has also ensured that lending conducted by banks is safe and sound. However, CRA’s impact on a neighborhood level has been uneven. CRA-covered lenders in the Washington, DC metropolitan area generally reached a larger percentage of homeowners with prime home loans in modest income neighborhoods and communities of color than predominantly white communities and upper-income neighborhoods. In the Houston area, however, this was not the case. Moreover, in both Washington, DC and in Houston, disparities in small business lending and bank branching were evident by the race and income level of neighborhood.

NCRC chose Washington, DC and Houston because both metropolitan areas are large geographical areas with divergent experiences during the foreclosure crisis. The Houston metropolitan area has escaped the worst effects of the foreclosure crisis whereas the Washington, DC was not initially affected heavily, but has experienced accelerating foreclosures during the last few years.¹ NCRC sought to determine whether CRA’s impact would vary in these two markets encountering different economic conditions. At the same time, while the DC area is affected to a greater extent by foreclosures than Houston, the DC area has not been devastated by foreclosures like other metro areas in states like Florida, California, and Nevada.

NCRC avoided the most devastated areas because determining CRA’s impact would be more difficult in these areas. In addition, CRA-related lending was responsible and did not contribute to the high defaults and rampant foreclosures associated with lending conducted by institutions not covered by CRA. Therefore it would have made little sense to evaluate CRA in areas devastated by activities not covered by CRA.²

² As NCRC and Federal Reserve Research demonstrates, foreclosures are most closely associated with high-cost lending which was conducted mainly by non-CRA covered lenders during the years of high volume subprime lending. See NCRC, Foreclosure in the Nation’s Capital: How Unfair and Reckless Lending Undermines Homeownership, http://www.ncrc.org/images/stories/pdf/research/ncrc_foreclosure_paper_final.pdf, and Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, “CRA Lending during the Subprime Meltdown in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act,” a Joint...
NCRC used publicly available data on home lending, small business lending, and bank branching from 2006 through 2008. CRA-covered lenders include banks and thrifts while non-CRA covered lenders include credit unions and independent mortgage companies.

The report’s findings include:

• Consistent with Federal Reserve research, NCRC reveals that CRA-covered lenders in geographical areas where they are examined issued a small percentage of high-cost loans.3 CRA-covered lenders undergoing CRA exams in Washington, DC and Houston made only 4.3 percent and 12.5 percent, respectively, of the high-cost loans in 2006, a year of heavy subprime volumes. CRA-covered lenders made a larger share of high-cost loans in 2007 as several independent mortgage companies went out of business or started winding down their operations. Nevertheless, CRA-covered lenders issued a considerably smaller share of high-cost loans in geographical areas where they had CRA exams than in areas outside of their exams. This was the case in Houston, Washington, DC as well as nationally.

• Financial institutions decreased their lending but lenders not covered by CRA decreased their lending to a much greater extent. In Washington, DC, for example, CRA-covered banks issued 97,216 prime home loans in 2006 and 61,178 loans in 2008 (a drop of 37 percent over the time period). Non-covered CRA institutions issued 52,960 prime loans in 2006 and 30,973 in 2008 (a drop of 41.5 percent).

• Many large mortgage companies went out of business due to non-performing and risky loans during this time period. For example, of the 169 lending institutions that went out of business in 2007, 167 were independent mortgage companies.4 In contrast, banks with a greater degree of regulatory oversight were more successful in surviving adverse economic conditions and maintaining loan volumes. Regulatory oversight of CRA lenders thus mitigated the destabilizing effects of declines in credit.

• Another way to measure the greater stability of bank lending is to compare the volume of loans in neighborhoods to the number of homeowners. In the Washington, DC metropolitan area, for instance, CRA-covered lenders issued prime loans to 13 percent of the homeowners in low-income census tracts, on average, while non-CRA covered lenders made prime loans to only four percent of the homeowners in low-income tracts.


during 2008. In 2006, the percentages were 17 and 14 percent for CRA-covered and non-CRA covered lenders, respectively.

- CRA-covered lenders also offered higher percentages of prime home loans to homeowners in minority and modest income neighborhoods in the Washington, DC metropolitan area. For example, CRA-covered lenders issued loans to 12 percent of homeowners in predominantly minority tracts and 9 percent of homeowners in predominantly white tracts in 2007. The same results favoring homeowners in low-income tracts compared to middle- and upper-income tracts occurred from 2006 through 2008. For instance, CRA-covered lenders made prime loans to 13 percent of the homeowners in low-income tracts compared to eight percent of the homeowners in upper-income tracts in 2008.

- In contrast, CRA-covered lenders were less successful in making loans to small businesses than to homeowners in modest income and minority census tracts in the Washington, DC metropolitan area. In 2008, for example, 50 percent of small businesses in upper-income census tracts received loans, on average, compared to 27 percent and 33 percent of small businesses in low- and moderate-income tracts, respectfully. Likewise, 53 percent of the small businesses in predominantly white tracts received loans but only 29 percent of the small businesses in predominantly minority tracts received loans in 2008.

- The small business analysis in this report could not compare CRA-covered lenders to non-CRA covered lenders because only CRA-covered lenders are required to publicly report data on small business lending. This will change in the future because the Dodd-Frank Wall Street Reform and Consumer Protection Act requires more detailed small business loan data disclosure from both banks and non-bank financial institutions. It is beyond the scope of the present study to assess the extent to which differences in the characteristics of the small businesses or their neighborhoods account for differences in lending outcomes. In the future, studies should attempt to control for as many characteristics as possible and can also compare the performance of CRA versus non-CRA lenders when the data for non-CRA covered lenders becomes available. If the CRA-covered lenders exhibit more penetration in minority and modest income neighborhoods than non-CRA covered lenders, then at least some of the differences in lending outcomes can be accounted for by differences in regulatory oversight as opposed to differences in the characteristics of the small businesses and their neighborhoods.

- Disparities in access to branches occurred by race and income of neighborhood (again, this section of the report confined itself to analyzing branches of CRA-covered banks because information on branches of non-CRA covered credit unions is not readily available). In 2008, for instance, there was one bank branch for every 5,408 people in predominantly minority tracts but one branch for every 1,770 residents of white
neighborhoods in the Washington, DC area. Likewise in 2007, there was one branch for every 3,176 residents of low-income tracts but one branch for every 2,192 residents of upper-income tracts.

- In the Houston metropolitan area, CRA-covered lenders were more successful in maintaining larger loan volumes than non-CRA covered lenders. CRA-covered lenders decreased their prime home loan volume 13.8 percent from 55,102 loans in 2006 to 47,477 loans in 2008. Non-CRA covered lenders decreased their prime home loans 18.7 percent from 35,621 loans in 2006 to 28,946 loans in 2008. Just as in the Washington DC area, the CRA-covered lenders started with a higher number of loans in 2006.

- Yet, despite the success in maintaining larger loan volumes, CRA-covered lenders, like non-CRA covered lenders, issued higher percentages of prime loans to homeowners in affluent and white communities than modest income and minority communities in the Houston metro area. Nevertheless CRA-covered lenders served a higher percentage of homeowners in traditionally underserved communities than non-CRA covered lenders over the three year time period. For example, CRA-covered lenders issued prime loans to three percent of the homeowners in low-income tracts while non-CRA covered lenders made loans to one percent of the homeowners in low-income tracts in 2008. Similarly, CRA-covered and non-CRA covered lenders issued prime loans to four percent and two percent of the homeowners, respectively, in substantially minority neighborhoods during 2008 in the Houston area.

- Like the DC metropolitan area, disparities by race and income in small business lending were evident in the Houston metropolitan area. For example, 36 percent of the small businesses in predominantly minority tracts received loans from CRA-covered lenders while 54 percent of the small businesses in predominantly white tracts received loans during 2008. Likewise, 33 percent and 56 percent of the small businesses in low-income and upper-income tracts, respectively, received loans from CRA-covered lenders in 2008.

- Also, similar to the DC metropolitan area, disparities by race and income were present in bank branching in Houston. In upper-income tracts, there was one branch per every 1,930 people while there was one branch for every 7,422 residents of low-income tracts and one branch for 4,691 residents of moderate-income tracts during 2008. Likewise, there was one branch for every 2,047 people in predominantly white tracts while there was one branch for every 7,501 people in predominantly minority tracts in 2008.

- The analysis also separates lending trends in the central city and suburbs to determine whether trends are similar or divergent in the largest central city and surrounding suburbs of the metropolitan areas. While there are divergent trends, the overall finding is that trends are usually similar. For example, in the Washington, DC metropolitan area, CRA-covered lenders generally issued a higher percentage of prime home loans to homeowners
in modest income and minority census tracts than middle- and upper-income tracts. Disparities in small business lending and branches are evident by race and income of census tracts in the city and suburbs, with greater disparities experienced by suburban than urban minority neighborhoods in small business lending and branches in the Washington, DC metro area.

- The pattern of overall similarities in the city and suburbs repeats itself in Houston. Both CRA-covered lenders and non-CRA covered lenders issued loans to a lower percentage of homeowners in minority and modest income census tracts than white and affluent tracts in the city and suburbs, but CRA-covered lenders issued a larger percentage of loans to homeowners in minority and modest income tracts than non-CRA covered lenders.

- Some differences in lending patterns in the city and suburbs also manifested themselves in Houston. For example, racial disparities in small business lending were greater for the suburbs than the city.

- It is beyond the scope of the study to account for the differences observed in Houston and Washington DC, particularly in the area of home lending. Differences in the make-up of the lending industry, concentration levels in the industry, and borrower and neighborhood characteristics could possibly contribute to different patterns in the home lending analysis. In contrast, the small business and branching results were more similar in the two metro areas, suggesting that the structural, economic, and demographic factors could be influencing home lending differently than small business lending and branching. Further probing the influences of structural, regulatory, economic and demographic factors on lending outcomes is an important topic for future research.

- While this study of two metropolitan areas cannot answer all research questions, it suggests certain conclusions common to both areas. In two diverse metropolitan areas, CRA-covered lenders were more successful than non-CRA covered lenders in maintaining prime home lending volumes and in serving traditionally undeserved neighborhoods over a tumultuous three year time period. At the same time, CRA-covered lenders need to focus more attention on small business lending and branching since greater disparities by income and race were present in small business lending and branching than in home lending.

Policy Recommendations

Building upon the positive findings in the report and addressing the weaknesses in CRA performance, NCRC recommends the following:

- Stronger CRA Enforcement: The findings on home lending were mixed, with success in serving underserved neighborhoods with prime loans in the Washington, DC area and
less success in Houston. In contrast, CRA-covered lenders had more challenges serving modest income and minority neighborhoods with small business loans and branches. The inconsistent performance suggests that bolstering the rigor of the CRA ratings is needed, particularly since 98 percent of banks and thrifts pass their CRA exams. More ratings could be introduced to more clearly differentiate gradations in performance. In addition, more emphasis needs to be placed on small business lending and branching since bank performance in these activities was weaker than bank performance in home lending.

- **Expand CRA Assessment Areas:** Consistent with other research, this study reveals that CRA-covered lenders issued a lower percentage of high-cost and risky loans in assessment areas (geographical areas on CRA exams) than in areas not on CRA exams. Intuitively, lenders would be more careful to make safe and sound loans in areas that will be included on a test that has a publicly available rating. In order to ensure that all communities banks serve receive responsible loans, assessment areas need to be expanded to include geographical areas encompassing the great majority of banks’ loans.

- **Apply CRA to Non-Bank Financial Institutions:** This study shows that banks were more successful in maintaining their lending volumes than non-CRA covered institutions, in part, because their lending was less likely to be risky and high-cost than non-CRA covered institutions. In order to create a vibrant financial industry that is able to resume healthy lending volumes, CRA must be expanded to non-bank institutions including independent mortgage companies, mainstream credit unions, and investment banks.

- **Lending and Service to Communities of Color Must be on CRA exams:** Other research, including NCRC’s studies, document significant pricing disparities based on race, even after accounting for borrower income, other borrower characteristics, loan terms and conditions, and neighborhood variables. In order to reduce those disparities identified in this and other studies, CRA exams must explicitly evaluate lending, investment, and service to communities of color.

- **Data Enhancements:** Data has been instrumental to reducing disparities in access to credit and banking services by holding lending institutions publicly accountable. Additional data is needed on loan terms and conditions, the demographics of the small business borrower including race and gender of the small business owner, and information of the neighborhoods receiving bank deposit and savings accounts. The Dodd-Frank Act requires desirable improvements in home and small business data that provide more information on loan terms and borrower demographics but improvements to the deposit and savings account data are still needed.

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5 See NCRC’s foreclosure report cited above.

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