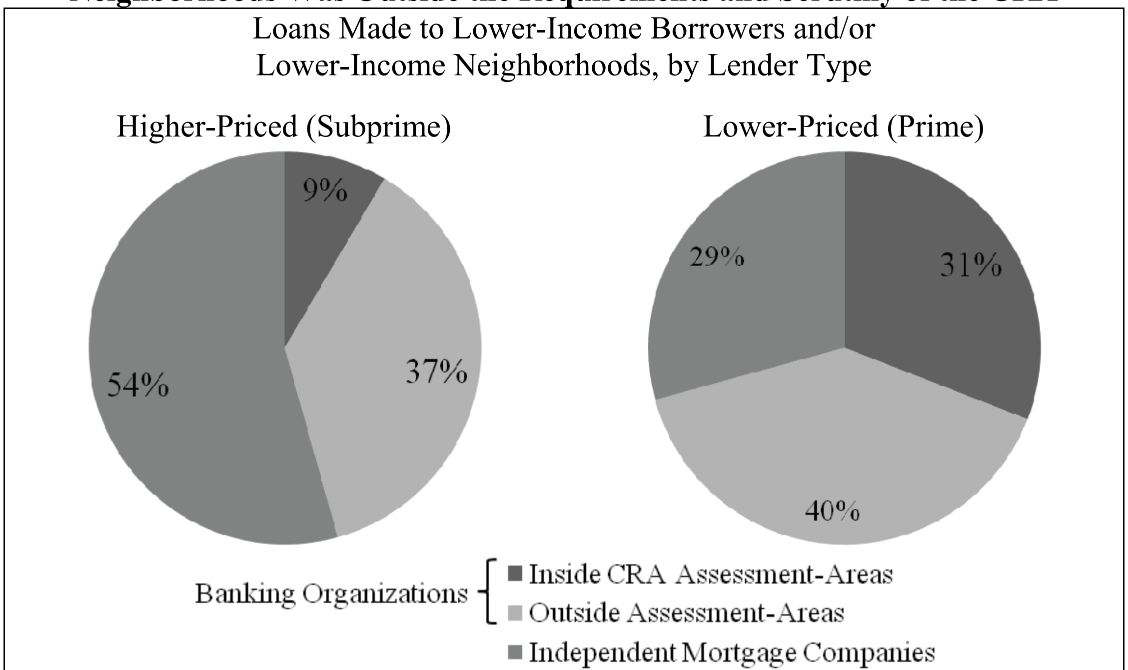
Joint Center for Housing Studies
Harvard University

Subprime Lending and the Community Reinvestment Act

Kevin Park
November 2008
N08-2

The Community Reinvestment Act (CRA) encourages banks to expand mortgage lending in the communities in which they have branch offices, subject to maintaining overall levels of financial safety and soundness. Some have argued that this regulation forced banks to lower their credit standards and engage in riskier mortgage products in order to extend credit to lower-income individuals, who perhaps should not have received such loans. However, data provided by the Home Mortgage Disclosure Act (HMDA) reveal that loans covered by the CRA accounted for only a fraction of mortgage lending to lower-income borrowers and neighborhoods. This is especially true of higher-priced, or subprime, mortgages.[1] CRA assessment-area lending accounted for only nine percent of higher-priced loans to lower-income borrowers and neighborhoods, while independent mortgage companies accounted for the majority. Further, the subprime share of assessment-area loans made to lower-income borrowers and lower-income neighborhoods was lower than the subprime share for all loans made between 2004 and 2006.

The Vast Majority of Subprime Lending to Lower-Income Borrowers and Neighborhoods Was Outside the Requirements and Scrutiny of the CRA



Source: JCHS Enhanced HMDA Database.
Note: Lower-Income Borrower/Lower-Income Neighborhood defined as a personal or median neighborhood income less than 80% of the MSA/MD median income. Higher-priced, or subprime, loans are defined as having an APR at least 3 percentage points above a Treasury security of comparable maturity. Chart includes conventional first lien loans for owner-occupied site-built one-to-four family properties, purchase and refinance, between 2004 and 2006.

[1] The Home Mortgage Disclosure Act database does not distinguish between prime and subprime loans, but rather requires lenders to indicate if the interest rate on a first lien loan is 3 percent or greater than the yield on a Treasury security of comparable duration.

CRA Assessment-Area Loans to Lower-Income Borrowers and/or Lower-Income Neighborhoods Were Less Likely to be Subprime

	Higher-Priced (Subprime) Share of Loans
Loans to Lower-Income Borrowers/Neighborhoods	40.1%
CRA Assessment-Area Loans	*15.0%*
Other Loans	20.7%
All Loans	22.0%

Source: JCHS Enhanced HMDA Database.
Note: Loans eligible for CRA credit are those made in assessment-areas to Lower-Income Borrowers/Lower-Income Neighborhoods (LINH/LIBR) defined as a personal or median neighborhood income less than 80% of the MSA/MD median income. Higher-priced, or subprime, loans are defined as having an APR at least 3 percentage points above a Treasury security of comparable maturity. Chart includes conventional first lien loans for owner-occupied site-built one-to-four family properties, purchase and refinance, between 2004 and 2006.

Signed into law in 1977, the Community Reinvestment Act directs federally-insured depository institutions "to help meet the credit needs of the local communities in which they are chartered, consistent with the safe and sound operation of such institutions." The legislation was based on the principle that institutions accepting deposits from a community have an obligation to reinvest in that community, particularly if it is a lower-income neighborhood. Each CRA-regulated lender has an assessment-area around their branch locations. A lender's CRA performance is gauged in part by the number of loans to lower-income borrowers or borrowers in lower-income neighborhoods relative to total originations within their assessment-area.[2]

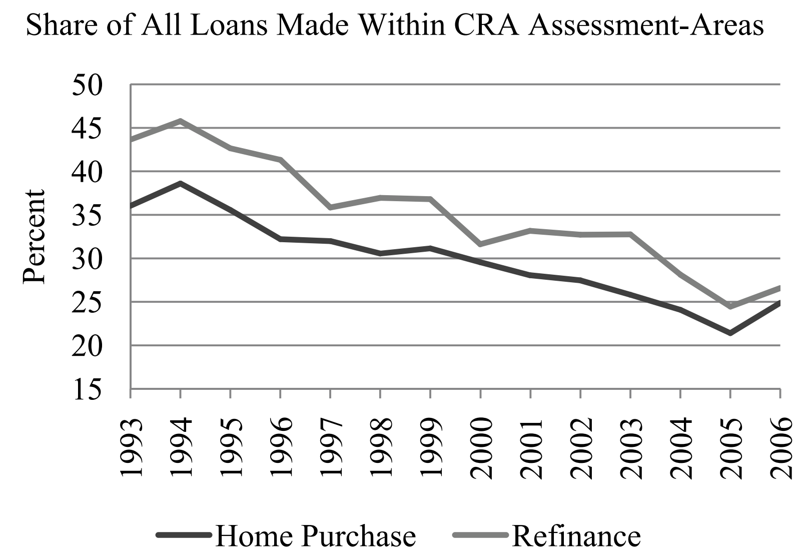
In 1980, seventy-one percent of all one-to-four family home mortgages were originated by a deposit-taking bank or thrift. However, over the last several decades, innovations in capital markets enabled companies to raise capital by selling mortgage-backed securities into the secondary market. Without deposits, the CRA did not have the jurisdiction to regulate the new independent mortgage companies.

Independent mortgage companies accounted for the majority of one-to-four family mortgage loans by 1997, the last year that the Department of Housing and Urban Development conducted its Survey of Mortgage Lending Activity. In addition, much of the banks' share flowed through their mortgage banking subsidiaries, where they are given the option whether or not to include mortgage originations in their CRA evaluations. Combined with the increasing

[2] Borrowers which contribute to a bank's CRA score include those with an income of less than 80 percent of the area median income and/or those living in census tracts with a median income of less than 80 percent of the area median.

ability of banks to lend outside their local communities, the share of loans made within CRA assessment-areas, has steadily declined over the last 15 years.

The Share of Loans Under CRA Oversight
Has Steadily Declined Over the Last 15 Years



Source: JCHS Enhanced HMDA Database.

There are many causes to the collapse of the housing market and the recent financial turmoil, but the contribution of the CRA appears marginal. While banks did engage in subprime lending in their assessment areas, they did so at a lower rate than the market in general and accounted for only a small fraction of subprime loans to lower-income borrowers and lower-income neighborhoods. The data suggest that far from being forced into risky corners of the market, the institutions under the scrutiny of the CRA were crowded out by unregulated lenders.