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Why the Community Reinvestment Act cannot be blamed for the Subprime Crisis

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It has become common practice – and in particular, but not exclusively, in conservative media – to blame the Community Reinvestment Act (CRA) of 1977 for the US subprime mortgage and foreclosure crisis that triggered the global financial crisis. It is argued that the CRA forced lenders to give mortgage loans to high-risk borrowers. This is non-sense for at least five reasons.

The Blame Game

The US foreclosure crisis and the following global financial crisis have been blamed on almost all of the actors involved. Homeowners took out risky loans that were pushed by greedy loan brokers and lenders who didn't care about the riskiness of these loans as they would be packaged and sold off as residential mortgage-backed securities anyway. It continues to present a network of agents that have not paid enough attention to risk: not only borrowers and lenders, but also the state, regulators, investors and rating agencies. In addition, some commentators have blamed the foreclosure crisis on the Community Reinvestment Act (CRA) of 1977. Of course, blaming an act is not the same as blaming an actor. In other words, blaming the CRA is different from blaming lenders, homeowners or credit agencies. By blaming the CRA one actually blames those that have implemented the CRA, those that have put it on the political agenda and those that monitor compliance. In fact, we see very few commentators blaming the politicians that have voted in favor of CRA. Regulators are mostly blamed for negligent compliance more generally speaking. Indeed, the crisis is blamed on those that have put the CRA on the political agenda and that have supported it since then: the community reinvestment movement.

It is argued that this movement has forced lenders to grant loans to low-income borrowers who should not have been given a loan under "normal" conditions. In this view, the community reinvestment movement pushed the regulators to push the lenders to relax lending standards. Perhaps the best example of this argument is found in the work of University of Texas economics professor Stan Liebowitz. In an article in the *New York Post* he explains how "the greatest scandal of the mortgage crisis is that it is a direct result of an intentional loosening of underwriting standards – done in the name of ending discrimination, despite warnings that it could lead to wide-scale defaults" (Liebowitz, 2008). He argues that lenders did not come up with the idea of looser underwriting standards on their own:

In fact, it was the *regulators* who relaxed these standards – at the behest of community groups and "progressive" political forces. In the 1980s, groups such as the activists at ACORN began pushing charges of "redlining" – claims that banks discriminated against minorities in mortgage lending. In 1989, sympathetic members of Congress got the Home Mortgage Disclosure Act amended to force banks to collect racial data on mortgage applicants; this allowed various studies to be ginned up that seemed to validate the original accusation. (emphasis in original)

Liebowitz continues to argue that “A 1995 strengthening of the Community Reinvestment Act required banks to find ways to provide mortgages to their poorer communities” and that lenders, “to approve minority applications that would otherwise be rejected” had “to stretch the [loan underwriting] rules a bit.” He concludes by arguing that we are blaming the wrong actors: it’s the community organizations like ACORN that are to blame, not “those, such as Countrywide, who did what they were told.”

Similar arguments are made in other, mostly conservative, publications, on TV stations like Fox News and in the Republican Presidential Campaign. *The Wall Street Journal* in an editorial stated that “Acorn has promoted laws like the Community Reinvestment Act, which laid the foundation for the house of cards built out of subprime loans.” Republican senator Phil Gramm of Texas, a former economics professor at Texas A&M University and outspoken champion of financial deregulation, claims that the CRA “forced banks to make subprime (mortgage) loans to people who couldn’t afford them” (cited in Dilanian, 2008). In a TV ad for John McCain that ran early October 2008, it is argued that “ACORN forced banks to issue risky home loans, the same types of loans that caused the financial crisis we’re in today.” The community organization ACORN seems to be a favorite scapegoat, probably because President Obama was their lawyer for a while and also acted as a trainer. Yet, the blame game extends beyond ACORN and blames all those organizations and individuals that pushed regulators to use CRA requirements in assessing banks’ lending behavior. The popular radio show host Rush Limbaugh, for example, argued that “The Community Reinvestment Act was meant to encourage banks to make loans to high-risk borrowers, often minorities living in unstable neighborhoods.” Perhaps more surprising is that independent and progressive media also engage in blaming the CRA for the subprime crisis. They often don’t blame ACORN specifically, but nonetheless argue that the CRA is one of the reasons that risky loans were given to risky borrowers.

But can the CRA and the community reinvestment movement really be blamed for this mess we’re in? In the remainder of this article I will argue that, for at least five reasons, the CRA cannot be blamed for the subprime mortgage and foreclosure crisis.

Not subprime loans but fair loans

First, the CRA did not call for risky loans to subprime borrowers, but for fair loans to minority borrowers. The act and the movement don’t argue banks should be granting loans to just about anyone, they argue that access to credit should be done of equal standards. In the 1960s and 1970s, practices of redlining and other forms of housing market discrimination were widely documented: people were excluded from obtaining a mortgage loan either as a result of the color of their skin or of the neighborhood where they wanted to buy a house. Race-based and place-based exclusion from mortgage loans were common practice. Protests by community organizations in general, many of them associated with the Civil Rights movement, prepared the US for the passage of both the Federal Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA) in respectively 1975 and 1977 (Immergluck, 2004). The first opened up mortgage data for more research while the second required lenders to lend in all neighborhoods from which they received deposits (by the threat of financial and legal sanctions). Simply said, implementation of the CRA implied that different borrowers should get credit on the same conditions. It doesn’t say anywhere that all minority borrowers should get a loan; it says that minority borrowers’ loan application should be processed in the same way as loan applications from majority borrowers. For example, if someone’s income is too low to classify for a loan, a lender could legally reject a loan application, as long as the same

rules are applied to different racial groups. It is true that the community reinvestment movement insistently pushed lenders to lend to minority and low-income borrowers, but it demanded quality loans for borrowers who could afford those loans.

Non-bank lenders are not CRA-compliant

Second, the CRA only applies to bank lenders. More than two-thirds of all mortgage lenders in the US are non-bank lenders that don't have to live up to CRA requirements. The CRA was written in a time that banks and thrifts (savings and loan associations) were the major mortgage lenders in the US. Today, most mortgage loans are not granted by banks and thrifts, but by non-bank lenders. The biggest of all lenders is Countrywide Financial, which, before the take-over by the Bank of America in 2008, was a non-bank lender. In 2006 Countrywide financed 20% of all mortgages in the United States. Together, non-bank lenders not only provide a majority of all loans, but also the lion's share of all subprime loans. Some of the formerly largest subprime mortgage lenders, Ameriquest and New Century Financial Corporation, are also non-bank lenders. According to an analysis based on data of the Federal Reserve Board only one of the top 25 subprime lenders in 2006 was directly subject to the CRA (Goldstein & Hall, 2008). Most bank lenders are also granting subprime loans, but typically the share of subprime loans in their portfolio is smaller than for non-bank lenders. In other words, a majority of mortgage loans is not CRA-compliant and at least two-thirds of all subprime loans and 80% of all adjustable rate mortgages are not CRA-compliant. Some estimates even suggest that 77% or 84% of all subprime loans were issued by non-bank lenders (Ip & Paletta, 2007; Goldstein & Hall, 2008). In fact, CRA-compliant banks were 66% less likely than other lenders to grant a subprime loan (Traiger & Hinckley, 2008). The rise of subprime lending not only analytically, but also empirically co-exists with the decline in CRA-loans. Critics blame the foreclosure crisis on the rise in CRA-loans, but it was not these loans but non-CRA, subprime loans that resulted in high default and foreclosures rates. It is ridiculous to say that it was not lenders themselves who wanted to sell subprime loans, but that the CRA forced banks to supply subprime loans if most subprime loans were issued by non-CRA-compliant institutions.

Subprime loans for prime borrowers

Third, subprime loans are seen as the problem, but in fact most subprime loans did not go to high-risk, subprime borrowers, but to low-risk, prime borrowers (Brooks and Simon, 2007). This implies that lenders systematically overcharged borrowers. Lenders did not sell risky loans because CRA forced them to do so; most subprime loans were sold to prime borrowers whose credit scores should have classified them for prime loans. In addition, 60 to 70% of all subprime loans were sold to middle- or higher-income borrowers. Even more strikingly, only 6% of all subprime loans were sold to low- and moderate-income borrowers by CRA-compliant lenders (Kroszner, 2009). Subprime lending is often defined as lending to a low-income borrower with poor credit, but this would be a misrepresentation of the essence of subprime lending, which is lending at higher fees and interest rates whether or not the borrower actually has bad credit or a low income (Aalbers, 2009). Subprime loans were pushed on borrowers – low- and moderate-income as well as middle- and high-income – because they brought in more money, not because lenders were pushed to offer them. As Kroszner (2009: 10) concludes, “the very small share of all higher-priced [subprime] loan originations that can reasonably be attributed to the CRA makes it hard to image how this law could have contributed in any meaningful way to the current subprime crisis.”

Subprime loans for refinancing

Fourth, most subprime loans were not used to buy a home, but were refinance loans, implying that subprime loans did not enable homeownership for minority or low-income borrowers. Most of the refinance loans were designed in such a way that they looked cheaper than the original loan, but would, in fact, turn out more expensive for the borrowers and more profitable for the mortgage broker and the lender. One study shows how in Massachusetts, 70% of the homes recently lost to foreclosure were originally purchased with prime mortgages (Foote et al., 2008). In other words, is it non-sense to suggest that CRA pushed lenders to grant subprime loans to enable low-income and minority homeownership: most subprime loans were not only overpriced, but also targeted at refinancing existing loans.

Community reinvestment organizations were warning against subprime loans

Fifth and finally, the community reinvestment movement did not promote subprime lending. Many organizations associated with the community reinvestment movement were the first to mobilize against subprime lending. ACORN, the organization that arguably gets most of the blame of all those forming the community development movement, was actually one of the organizations warning against subprime loans. Even the magazine *American Banker* reported that already in 2000, ACORN protested against Lehman Brothers, not because Lehman was selling subprime loans to borrowers, but because it was providing capital and financial support to abusive lenders by buying and securitizing their loans. For ACORN securitization was one of the enabling forces behind subprime and predatory lending: "If investment banks didn't buy the shady loans predatory lenders wouldn't receive the capital to make such loans, ACORN reasoned" (Markey, 2008). Not only did early-warning about the inherent problems of subprime lending and the securitization of those loans come from community organizations like ACORN, but the community reinvestment movement also actively lobbied for stringent regulation of mortgage lending and securitization in general, and the activities of non-bank lenders in particular. In addition, many of these organizations supported state anti-predatory lending laws. In addition, loans originated through community organizations also perform much better: delinquency, default and foreclosure rates for such CRA-loans are significantly lower than for subprime loans, and in many cases even lower than for other prime loans (Kroszner, 2009; Markey, 2008; Quercia et al., 2009).

Conclusion

The CRA was designed to promote fair lending to all borrowers. Subprime lending, on the other hand, was designed by lenders to make money by selling risky and overpriced loans, often to people who didn't need these loans or could have applied for cheaper ones. Most of these loans were pushed by non-CRA-compliant lenders. CRA-loans and subprime loans are simply two different things. Many community organizations were among the first to push government to regulate these non-bank lenders. There are many factors that play a significant part in unleashing the subprime mortgage crisis, but the CRA is not one of them. To the contrary: without the CRA and the community reinvestment movement the foreclosure crisis would have been deeper.

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