FEDERAL RESERVE BANK OF PHILADELPHIA

CASCADE

NO. 96 SUMMER 2017

COMMUNITY DEVELOPMENT STUDIES & EDUCATION

A Perspective on the Community Reinvestment Act*

By Eric S. Belsky, Ph.D., Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System

This year marks the 40th anniversary of the passage of the Community Reinvestment Act (CRA). The CRA placed an affirmative obligation on banks and thrifts to provide credit in the communities in which they serve, particularly in low- and moderate-income (LMI) neighborhoods. Indeed, there is evidence that the CRA has made important contributions in bringing capital into these communities.

Background Behind the Impetus of the CRA

The CRA was enacted in 1977 against a backdrop of redlining — literally outlining neighborhoods in red ink on maps to denote areas where lending was perceived as too risky. In fact, federal lending agencies used such maps when deciding whether they would guarantee mortgage loans.[1] Not surprisingly, redlining stifled opportunities for people living in these areas, leading Congress to enact the CRA. The CRA requires regulators to encourage depository institutions (banks and thrifts) to help meet the credit needs of the communities they are chartered to serve, including LMI neighborhoods, consistent with safe and sound banking practices. It also requires regulators such as the Federal Reserve to evaluate how well institutions help to meet credit needs and assign ratings to their performances.[2]

Current CRA regulations were promulgated in 1995 and revised in 2005 to be more responsive to the needs of distressed and underserved communities and to create a new evaluation method for intermediate small banks.[3] Bank agencies also issue guidance periodically, most recently to address issues regarding how community and economic development activities will be evaluated for CRA purposes. The federal bank regulatory agencies have also added more details on the factors that examiners should consider when determining whether credit and deposit services are designed to meet the needs of LMI individuals.[4] The most recent CRA revisions detail the criteria regulators must use in determining whether alternatives for delivering banking services, such as

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* The views expressed here do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

[1] See Greg Miller, "Newly Released Maps Show How Housing Discrimination Happened," *National Geographic*, October 17, 2016, available at news.nationalgeographic.com/2016/10/housing-discrimination-redlining-maps. This article details how maps created by the Home Owners' Loan Corporation in the 1930s were used to designate areas considered hazardous for mortgage lending and influenced whether mortgage loans qualified for government guarantees from the Federal Housing Administration. To view interactive historical maps, see https://dsl.richmond.edu/panorama/redlining/#loc=10/44.1788/-84.8433&opacity=0.8.

[2] See 12 U.S.C. § 2901, available at https://tinyurl.com/y8bu99bh. The assigned ratings are Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance.

[3] The thresholds for small banks, intermediate small banks, and large banks are indexed to inflation. At present, the threshold for intermediate small banks is at least $307 million and not more than $1.226 million in assets in each of the prior calendar years.

[4] See 81 Fed. Reg. 48506, "Interagency Questions and Answers Regarding Community Reinvestment," July 25, 2016, available at www.gpo.gov/fdsys/pkg/FR-2016-07-25/pdf/2016-16693.pdf.

online and mobile banking, meet the needs of LMI as well as other bank customers. Through guidance, regulators are able to clarify expectations and address questions from CRA stakeholders as financial markets evolve.

The Impact of the CRA on LMI Neighborhoods

Over the past four decades, the CRA has provided an incentive for collaboration among banks and community stakeholders. The growth of community organizations since its enactment, both in number and sophistication, has helped enable financial institutions to identify community credit needs and deploy capital effectively. Public–private partnerships have also blossomed since the CRA's enactment, allowing banks to work with local governments to address some of the more difficult community and economic development problems in their communities. These partnerships have successfully leveraged bank capital by offering credit enhancements that help make private investment possible. Studies by the Federal Reserve and other agencies have demonstrated that the CRA has had positive effects on LMI neighborhoods and that lending practices have been implemented in a safe and sound manner. One Federal Reserve study demonstrates that CRA-related mortgage loans had delinquency rates lower than average across all 2006-vintage mortgages and sharply lower than those of subprime loans.[5] In addition, a study of mortgage loans originated between 2003 and 2006 as part of a CRA-targeted LMI homebuyer program found that these loans performed nearly as well as prime mortgage loans and much better than subprime mortgage loans throughout the financial crisis.[6]

While measuring the impact of the CRA on credit is challenging, several studies by Federal Reserve economists have suggested a positive impact. One study found that between 2003 and 2004, when the number of banks covered by the CRA increased in an area because of the redefinition of metropolitan statistical areas, refinances of mortgage loans increased substantially in these tracts relative to others.[7] Another study found a moderate impact on mortgage originations from 1997 to 2002 by modeling credit flows in areas that were just under and just over the cutoff for CRA-eligibility consideration.[8] These studies support the notion that banks are attentive to CRA obligations in the communities they serve.

Data reported under the CRA for small business, small farm, and community development lending (which is a substantial majority but not the totality of all such lending by banks because some are exempt from reporting requirements) show considerable activity. In 2015, CRA-reported lending to small businesses totaled $228 billion and to small farms $13.5 billion. CRA-reported community development lending totaled $87 billion in 2016, up more than fourfold from 1998, which was the first full year the new regulatory framework was in effect. This rate of increase greatly outpaced general price inflation of just 50 percent over the same period. Furthermore, CRA-regulated banks are important investors in Low-Income Housing Tax Credit programs and New Markets Tax Credit programs, likely resulting in more competitive pricing that stretches these federal tax incentives further.

To ensure the continued effectiveness of the CRA, the Federal Reserve and other banking agencies are committed to making continued improvements to policies and processes for implementing CRA regulations. Periodic revisions to CRA guidance help promote effective and consistent implementation of the CRA. Other ways in which the agencies can promote

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[5] Neil Bhutta and Glenn B. Canner, "Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA-Credit Record Data," *Federal Reserve Bulletin*, 99:4 (November 2013), available at www.federalreserve.gov/pubs/bulletin/2013/pdf/2012_HMDA.pdf.

[6] Lei Ding, Roberto G. Quercia, Janneke Ratcliffe, and Wei Lei, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," *Journal of Real Estate Research*, 33:2 (2011), pp. 245–277.

[7] Daniel R. Ringo, "Refinancing, Default, and the Community Reinvestment Act," unpublished paper, Board of Governors of the Federal Reserve System, 2015.

[8] Neil Bhutta, "The Community Reinvestment Act and Mortgage Lending to Lower-Income Borrowers and Neighborhoods," *Journal of Law and Economics*, 54:4 (November 2011), pp. 953–983.

the continued flow of bank capital into LMI communities include making improvements to the procedures, tools, and training available to bank examiners.

These initiatives are all designed to recognize the importance of the CRA in bringing private capital to local markets. The CRA is an important incentive to promoting economic growth through sustainable rental and homeownership opportunities in LMI communities. Financial institutions are key participants in providing capital and are primary beneficiaries of the improved economic conditions that result from investments in local infrastructure, technical assistance to small businesses, educational and job opportunities, and quality neighborhood health-care and child-care options.

The Federal Reserve, through its bank oversight and community development functions, is committed to ensuring that all neighborhoods are well served by banks now and for years to come.

Eric S. Belsky has served as director of the Division of Consumer and Community Affairs at the Board of Governors of the Federal Reserve System since August 2014. A specialist in housing finance, economics, and policy, Belsky brings 20 years of experience to the division. He oversees the Federal Reserve's work in consumer-focused supervision, research, and policy analysis, with the aim of promoting a fair and transparent consumer financial services marketplace and effective community development. Before joining the Federal Reserve Board, he served as managing director of the Joint Center for Housing Studies of Harvard University. Belsky also was director of Housing Finance Research at Fannie Mae and senior economist at the National Association of Home Builders, and he taught at Harvard University and the University of Massachusetts at Amherst. In addition, in 2001 and 2002, Belsky served as research director for the bipartisan Millennial Housing Commission established by the Congress of the United States. He has a Ph.D., M.A., and B.A. from Clark University.

Capital for Communities: Investing in America's Workforce - Cascade: No. 96, Summer 2017

Explore This Section

Capital for Communities: Investing in America's Workforce*

Interview with Todd Greene, Vice President, Community and Economic Development, Federal Reserve Bank of Atlanta

Hi. I'm Chevelle Wilson with the Federal Reserve Bank of Atlanta. Today I'm speaking with Todd Greene who is the vice president of the Community and Economic Development function here. Todd also leads the [Federal Reserve] System's workforce development working group. We will discuss a new initiative entitled Investing in America's Workforce: Improving Outcomes for Workers and Employers. Welcome, Todd.

Thank you, Chevelle.

So what is the Investing in America's Workforce initiative?

Thank you for asking that question, Chevelle. It's a two-year initiative at the Federal Reserve as well as with our partners, an opportunity to look at reframing the workforce development conversation to really think about [it] in terms of investments. Heretofore, we've been thinking about workforce efforts in terms of the cost to the worker. How much does it cost me to pursue this certification or this credential or this college degree, and what are the returns associated with that? We also think about the cost, too, of these workforce development programs. And then, the other kind of costs that we think about is the cost to employers. So what are the costs associated with them hiring or making sure that they have a properly trained workforce? So we're attempting to reframe the conversation into one of an investment instead. That allows us to think about what are the returns. So as part of this initiative, we've been in over 50 cities across the country understanding and listening to workforce developers, industry, [and] a broad array of stakeholders — and understanding what are the opportunities, what are the challenges associated in thinking about [an] investing framework. The next component is that we'll have a conference — a national conference [on October 4–6, 2017] in Austin, TX, where we'll further explore these concepts. And then, finally, we'll have a publication that will come out next year where we have a broad range of stakeholders also involved who'll be presenting essays about various components of the workforce development process and helping to reframe some of these familiar concepts, but reframe them in a way that really focuses on the return to make sure that we are being efficient and effective in terms of how we're addressing our workforce development needs.

Right. Exciting. Now, who are the partners involved with this?

We're fortunate to have all 12 Federal Reserve banks as well as [the] Board of Governors [of the Federal Reserve System] participate in this effort and partnership. But we also have some other partners who are bringing some exciting new perspectives to the work that we're doing. They include the [John J.] Heldrich Center for Workforce Development at Rutgers University, the Ray Marshall Center for [the Study of] Human Resources at the University of Texas, as well as the W.E. Upjohn Institute for Employment Research.

Great. Now, one might ask why is the Federal Reserve involved in this?

The Federal Reserve Bank has really been involved in thinking about workforce development specifically, for about the last seven or eight years or so in — to a high degree of engagement within our community development function. Back during the Great Recession, we identified that [there] were several paradoxes, or at least there was one main paradox, that confounded us when we began to think about our labor market. So, for example, we experienced a very high level of unemployment, but yet when we engaged employers, they shared with us that they were having challenges finding skilled workers or people who would be — have the requisite skills to enter into those jobs. So that really led us to this identification of the workforce development system as a prime opportunity for making sure that our employers were able to receive the types of employees that they needed. So over the course of time, we identified that there were, in some cases, inefficiencies, as I mentioned earlier, with the workforce development system, but we also identified mismatches in terms of what communities were training for versus what the employers needed. So that creates challenges for employers, but it also creates challenges for the job seeker.

I know that one element of the initiative is focused on creating good jobs. Why is this a part of the effort?

Yes. When we think of good jobs, we think of jobs that are paying a wage that is consistent with a person being able to live in that local community, but we also think about benefits. Paid time off, for example, is one that is typically associated with a good job. But we know that communities are investing — states and localities are investing a fair amount of resources engaged in recruiting businesses to their local area but also in retaining businesses. And we want to make sure that the workforce development system is aligned to supporting those types of investments but also ones that are focused on jobs that are really going to be beneficial in the long run to the community. So every job is not created equal, and we know that we need to have a spectrum of jobs within any community, but we also know that workers are very much interested in making sure that they have a job that perhaps has a pathway for advancement and that can allow them to continue to learn.

Now, do banks' responsibilities under the Community Reinvestment Act involve workforce development?

Well, Chevelle, that's really a great question. We have — most people don't think about banks participating in the workforce development process, and, in fact, that very much is a new aspect. The Community Reinvestment Act is a law that was passed decades ago that requires financial institutions to engage in certain community development activities within their areas that they serve, particularly to help low- and moderate-income populations. And so, through the years, there's been a lot of interpretations of what that act does as our economy has changed. And we're very fortunate that, most recently, through interagency guidance, we've had more clarification about how that act can actually support activities that surround workforce development. So this is a new opportunity — a relatively new opportunity to think about new partnerships. But beyond financial institutions, philanthropies and lots of other entities are now beginning to realize that, in order to improve communities, the very foundation is a good job. So that means banks and others are really looking at how it benefits them, and also, of course, communities are thinking of that as well.

So it sounds like there [are] a lot of players involved. How exactly will the Investing in America's Workforce initiative affect workforce development practitioners, employers, foundations, or other groups?

Yes. Within the workforce development ecosystem, we know that it starts with the worker, and it also ends on the other end with the employer. But in between, there are a number of actors and [we are] making sure that all of the actors are thinking about it in a similar way. So we think that having an investing overlay across this really helps each of the entities to understand where they fit in to this whole spectrum, and it also helps to create a common dialogue or at least an opportunity for each of those entities to really understand we all want a return on an investment. And if there's a common way that we can think about this, then perhaps there's an ability for the policies and the practices to really line up better in order to create a better outcome.

My next question is why now? Why is this the appropriate time to convene?

That's an important question about the timing. Well, if you think about today's economy where we have a very tight labor market, that means that employers are having challenges — even greater challenges in finding the talent that they need. So that means our workforce development system has to work harder. Unfortunately, a lot of our federal investments in workforce development have declined over the last 20 or 30 years. But when we think about the pace of technological change, for example, and the dynamic economy in which we find ourselves, we know that workers keeping up with their skills — that creates even more of a challenge with these kind of global factors that we are experiencing. So to make sure that our companies — our employers can remain competitive and that our economy functions properly, we need to make sure that we have everything right. We also know that with having fewer available workers, with demographic factors like the aging workforce, for example, that employers are going to have to really work harder in thinking about engaging those people who perhaps have barriers or who are harder to employ. And we know that in order for them to become engaged in the workforce we need to re-double our support or rethink about ways to get people engaged in the workforce development system that may be outside of the traditional way that we've approached it so far.

So the community development offices at the Fed have been conducting research on workforce issues. Can you share some of the highlights of that research?

Sure. It would take me forever. We'd be here forever discussing all of the work that is being done across the Federal Reserve System and when we think about issues that impact workers and workforce development. But I'll just mention a few research opportunities that have come along the way. In [the] Boston Fed, they've been very involved in what we call working cities, and they've been thinking or helping those communities to think through how they transition from former traditional economies into more modern ones and what that means for the workforce. [The] Richmond Fed has been engaged in working with watermen in the Chesapeake Bay area and understanding the changes and the needs of that particular workforce occupation. But in addition to that, [the] Board of Governors in Washington, D.C., has been looking at young workers and what are some of the factors that impact young workers in terms of their engagement in the workforce. [The] San Francisco Reserve Bank has been looking at issues related to those who are underemployed and those people who are working perhaps part time but who wish to work full time. And so what are some of the workforce development opportunities or engagements associated with that? We've had other Reserve Banks [that] are engaged with community colleges, and we've had others [that] are looking at opportunity occupations. Those are occupations that pay above the median income for a particular metropolitan area and yet don't require a college degree. Those are just a few examples, and, as I mentioned, I can really go on and on. But certainly, I would encourage others to take a look at the resources that we have in the Federal Reserve. They really are tremendous.

Great. Well, this sounds like an awesome initiative and lots of opportunities involved. So thank you for sharing with us today.

Thank you. It's my pleasure.

New CDFI Community Investment Fund - Cascade: No. 96, Summer 2017

By Keith L. Rolland, Community Development Advisor

Explore This Section

New CDFI Community Investment Fund*

The Opportunity Finance Network (OFN) and Woodforest National Bank (NB), based near Houston, TX, created a new fund in early 2017 to provide equity-equivalent investments[1] to community development financial institutions (CDFIs) in Woodforest NB's 17-state region,[2] which includes Pennsylvania.

The CDFI Community Investment Fund, LLC, has an initial funding commitment of $5.5 million with an option to increase the commitment to up to $22 million over the next four years. Robin Odland, executive vice president for financial services at OFN, said that "the fund will provide much needed flexible capital, which can be leveraged with conventional senior debt capital."

Woodforest NB is the primary capital provider to the fund, while OFN is the managing partner that identifies viable investment opportunities and manages the underwriting, closing, and investment follow-up. The investment committee has three members from Woodforest NB and two from OFN.

The fund provides investments of $250,000 to $750,000 for 10 years. According to Odland, the return on the investment is fixed for the life of the investment and is based on market conditions. Currently, OFN is targeting a 3 percent yield on the investment, Odland said, adding that the investments are subordinated to other debt and do not have standard loan covenants.

According to Odland, "Equity equivalent investments are critical for CDFIs because most of them are nonprofits that have limited opportunities to raise equity. At the same time, a nonprofit CDFI's ability to attract additional debt capital depends on increasing its level of equity and/or net assets."

To be eligible for a fund investment, an applicant must be certified as a CDFI by the CDFI Fund but need not be an OFN member, Odland explained. Interested CDFIs must initially send an expression of interest to OFN. OFN seeks to provide capital to CDFIs that provide excellent coverage in an area that is part of the 17-state target region. OFN ultimately invites suitable CDFIs to submit a detailed application for a fund investment.

The fund's first investment was for $400,000 to Justine PETERSEN, a CDFI based in St. Louis, MO, that provides microbusiness and small business loans, homeownership financing, and credit building in Missouri and Illinois. OFN is currently underwriting eight more transactions for the fund.

Nina Fields, of Cahokia, IL, prepares packages for shipping after she received a $14,000 microloan from a subsidiary of Justine PETERSEN, a CDFI that received financing as part of a partnership between the Opportunity Finance Network and Woodforest National Bank. Her business, Nina the Helper, has grown rapidly by providing door-to-door service for a variety of household and commercial tasks such as shipping parcels, housekeeping, and lawn care. Her microloan enabled her to purchase additional equipment and make improvements to her workspace.
Photo Credit: Foveal Media.

Odland explained that the fund was developed after Woodforest NB approached OFN with a desire to efficiently deploy investment dollars into CDFIs. He said that the fund was "an off-balance sheet way" for OFN to generate more capital for CDFIs.

Doug Schaeffer, executive vice president and Community Reinvestment Act executive director for Woodforest NB, said that the bank has a substantial focus on small business and that one part of this focus is increasing investment in CDFIs that serve entrepreneurs. The bank makes unsecured and secured small business loans, commercial loans, small dollar unsecured consumer loans, and unsecured home improvement loans.

Woodforest NB, formed in 1980, has assets of about $5 billion and nearly 800 branches in its 17-state region. Most of the branches are in Walmart stores. From July 2015 to March 2017, the bank made over $131 million in community development investments and loans, and the bank's employees volunteered nearly 40,000 hours in financial literacy education, according to Schaeffer.

Odland said that OFN plans to invite other community and regional banks to become investment partners on additional equity funds in states outside Woodforest NB's 17-state region.

> *For information, contact Robin Odland at 215-320-4328 or rodland@ofn.org (http://ofn.org/cdfi-community-investment-fund) or Doug Schaeffer at 212-203-1428 or dschaeffer@woodforest.com (www.woodforest.com).*

OFN Publications

The Opportunity Finance Network, a national membership organization for the community development financial institution (CDFI) industry, has released several publications of interest to community development organizations and financial institutions. The publications involve small business lending, employer-based loan products, quality jobs, and best standards in financial management.

- "Small Business Underwriting Innovations"
Published June 2017
Three CDFIs document innovative underwriting approaches and processes to overcome insufficient owner equity, simplify and accelerate underwriting, and expand the credit box without compromising asset quality. One case study documents how a CDFI cut the length of its loan policies from 100 pages to three pages; another case study examines a new risk rating matrix that reflects historical factors correlated to asset quality.

- "Employer-Based Loan Products as a New Benefit"
Published January 2017
This white paper documents loan products offered by employers in partnership with nine CDFIs. The loans enable employers to offer a new benefit to employees and provide individuals with a simple and

affordable alternative to predatory and payday loans. The paper provides background for employers on marketing and outreach, customer experience, technology, financial counseling, measuring impact and outcomes, and creating partnerships.

- *Reducing Income Inequality Through Quality Jobs*

Published September 2016
Five CDFIs and their borrowers explain the approaches and tools that CDFIs and financial institutions can use to promote the creation of quality jobs and, thereby, reduce income inequality.

- Performance Counts

Published 2014 to 2016
Performance Counts seeks to develop CDFI best practices on financial management and financial statements for the benefit of CDFIs and bank investors. Three publications address the following topics:

Presentation and classification of grants and net assets in CDFI financial statements

CDFI portfolio reporting, including definitions, accounting treatment, and reporting guidance

CDFI liquidity and cash management, including definitions, practices, and examples

– Pam Porter, Opportunity Finance Network

Federal Reserve Study Finds Evidence of Significant Impact of the Community Reinvestment Act - Cascade: No. 96, Summer 2017

Explore This Section

Federal Reserve Study Finds Evidence of Significant Impact of the Community Reinvestment Act*

By Kyle DeMaria, Community Development Research Analyst, and Lei Ding, Community Development Economic Advisor

The Community Reinvestment Act (CRA) of 1977 incentivizes depository institutions to meet the credit needs of low- and moderate-income (LMI) people and neighborhoods. Federal regulators periodically examine CRA-regulated depository institutions' (banks, hereafter)1 performance in lending and financial services. Banks' CRA ratings are considered when regulators approve bank mergers, acquisitions, and branch openings.

In 2013, the Office of Management and Budget published new metropolitan statistical area (MSA) and metropolitan division (MD) boundaries, which influenced the neighborhoods that were considered LMI and, therefore, the neighborhoods in which banks could receive CRA credit for mortgage lending.

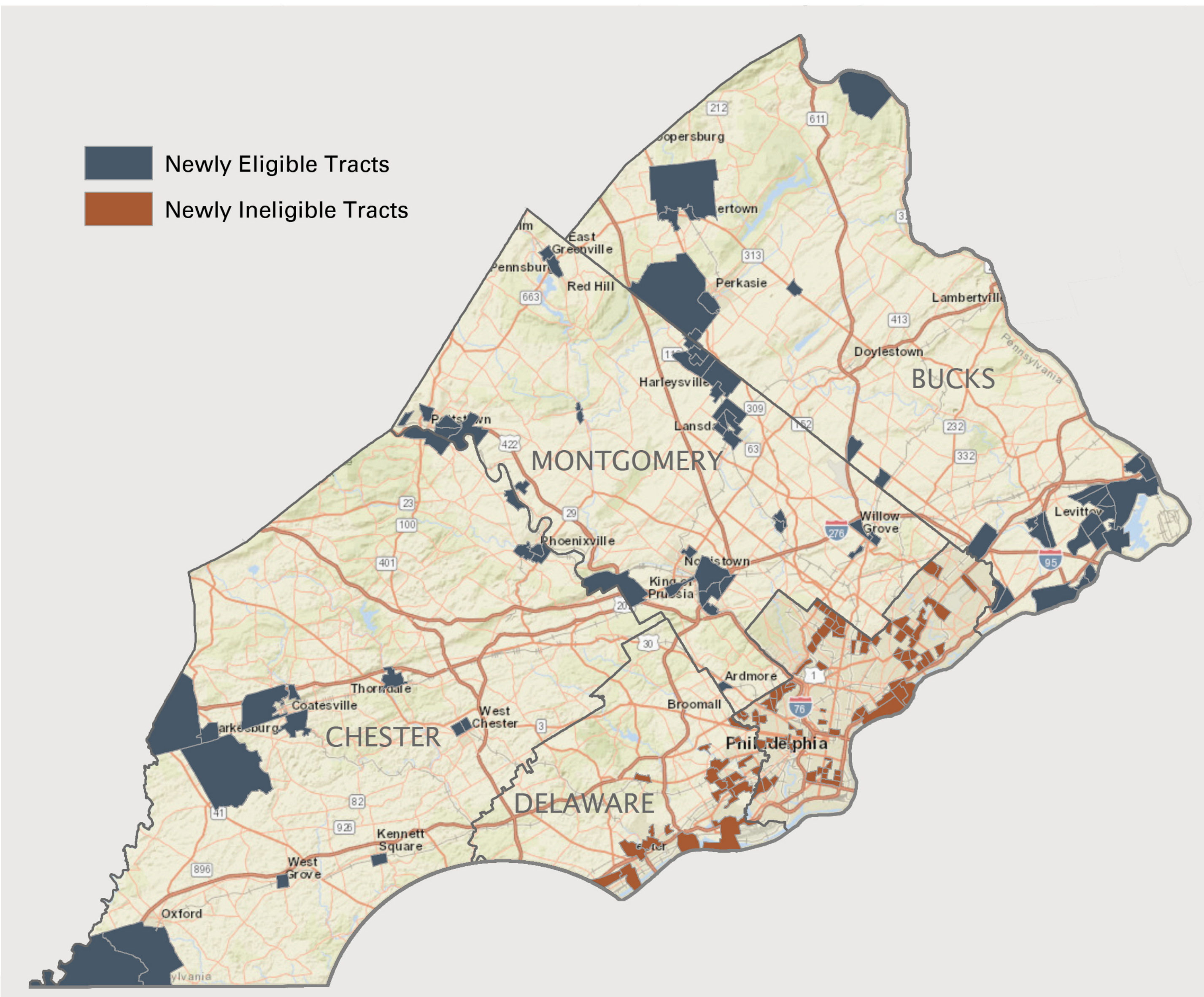
In a study2 recently released by the Federal Reserve Bank of Philadelphia, we examined the effectiveness of the CRA and the role of nondepository institutions (nonbanks) in mortgage lending in LMI neighborhoods by focusing on those neighborhoods in the previous five-county Philadelphia MD that became eligible and ineligible for CRA credit as a result of the new MSA/MD boundaries. We present a few findings from the full report here.

We found that the growth in home purchase loans made by banks following the boundary change was restrained in neighborhoods that lost their CRA eligibility and that this slowdown in lending provided an opportunity for nonbanks, which are not subject to the CRA, to expand their market share. Purchase lending by banks increased in newly eligible neighborhoods, but the increase was not significant when compared with lending in nearby similar-income neighborhoods with unchanged CRA-eligibility status.

Unintended Consequences of Changes in Metropolitan Division Definitions

Updates to metro area definitions can affect the designation of LMI neighborhoods. In 2013, the former five-county Philadelphia MD was split into two: a new Philadelphia MD consisting of Philadelphia and Delaware counties and a second MD consisting of Montgomery, Bucks, and Chester counties (MBC MD). Because LMI neighborhoods are identified by comparing the income level of a census tract with the income level of the corresponding MD, the split of the former Philadelphia MD changed which neighborhoods were considered LMI by CRA standards.[3] There were a total of 102 census tracts exclusively in the new Philadelphia MD that became middle-income tracts and lost CRA eligibility status; we termed these tracts "newly ineligible" tracts. There were a total of 80 census tracts exclusively in the MBC MD that became moderate-income tracts and gained CRA eligibility status; we termed these tracts "newly eligible" tracts. Figure 1 shows the location of the newly eligible and newly ineligible tracts.

Figure 1. The Location of Newly Eligible and Newly Ineligible Census Tracts



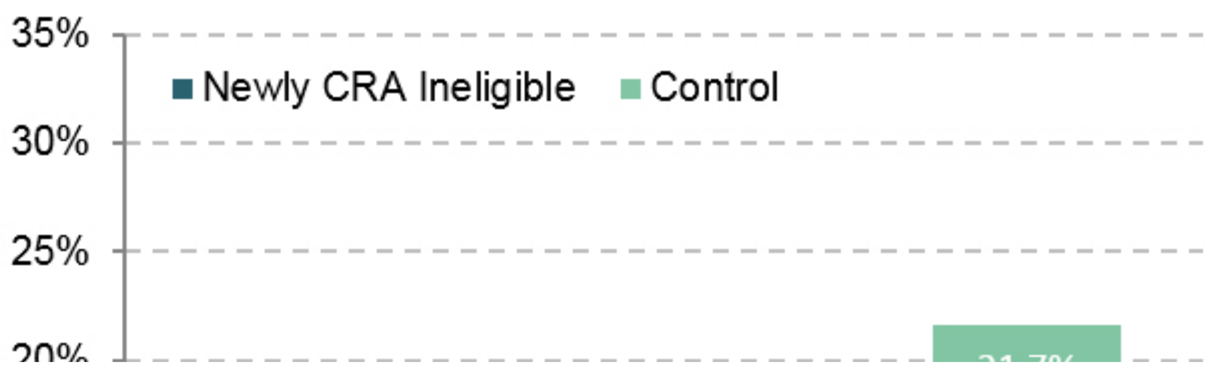
Putting this into context, about one-third (34.5 percent) of previously CRA-eligible tracts in the new Philadelphia MD became CRA ineligible after 2014, whereas the number of CRA-eligible tracts in the MBC MD tripled from 2013 to 2014. Across all the major metropolitan areas in the U.S., the Philadelphia area observed the largest prevalence of neighborhoods with changed LMI designations from 2013 to 2014. This definitional change provided a unique opportunity to determine the impact of the CRA on mortgage lending in LMI neighborhoods.

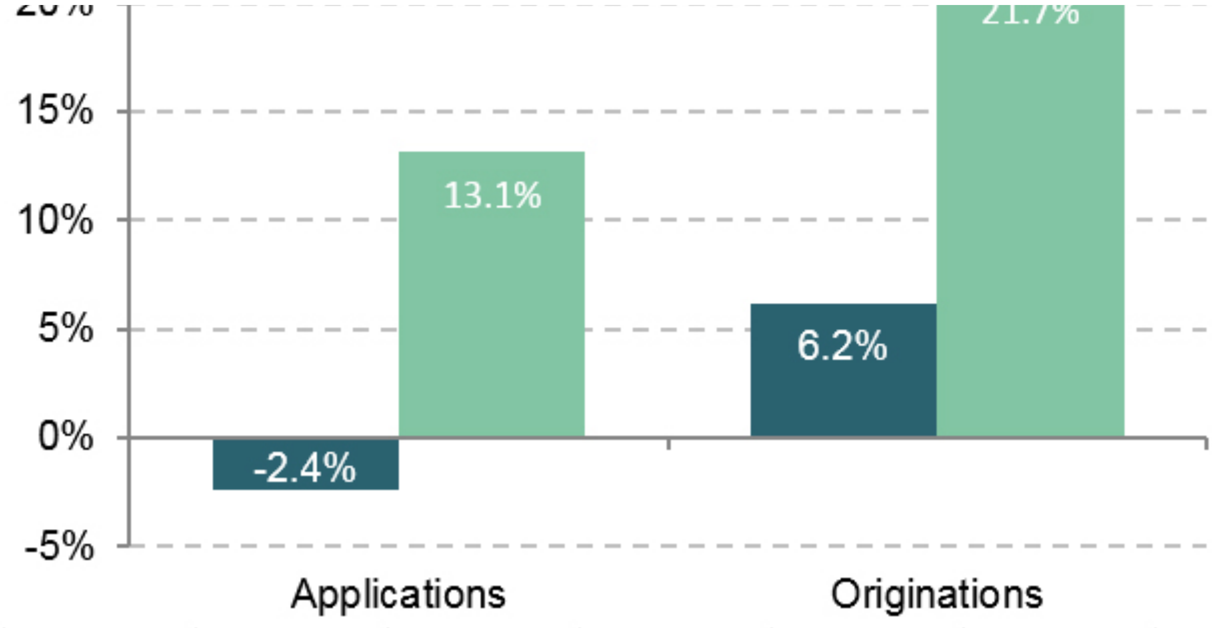
To isolate the impact of the CRA, we constructed two control groups: one for newly eligible tracts and another for newly ineligible tracts (the "treatment" groups); each control group was composed of nearby tracts whose CRA eligibility status had not changed and whose income was similar to that of the respective treatment group. To capture banks' responses to the geography change, we aggregated mortgage applications, originations, and volume for the two-year period before and after the MD split occurred (2012 to 2013 compared with 2014 to 2015). By comparing lending activity between the treatment and control tracts and including other controls in a regression analysis, we were able to isolate the effect of the change in metro area boundaries on CRA lending.4

The Effect of Losing CRA Eligibility

The loss of CRA eligibility inhibited the growth in home purchase loans made by banks in newly ineligible neighborhoods in the new Philadelphia MD. Home purchase loans made by banks increased by 6.2 percent in the newly ineligible neighborhoods but grew by 21.7 percent in the control neighborhoods (Figure 2). This difference was found to be statistically significant in the tract-level regression analysis. Was this lending gap between newly ineligible and control neighborhoods due to tighter underwriting standards or to less outreach and marketing to those neighborhoods that lost their CRA eligibility status? Denial rates declined similarly in both the newly ineligible and control neighborhoods, while purchase applications submitted to banks declined in newly ineligible neighborhoods. Therefore, the inhibited purchase lending growth in newly ineligible neighborhoods was likely due to reduced outreach and marketing efforts than to tighter underwriting standards.

Figure 2. Percent Change in Home Purchase Loans Made by Lenders Subject to the CRA, Philadelphia MD



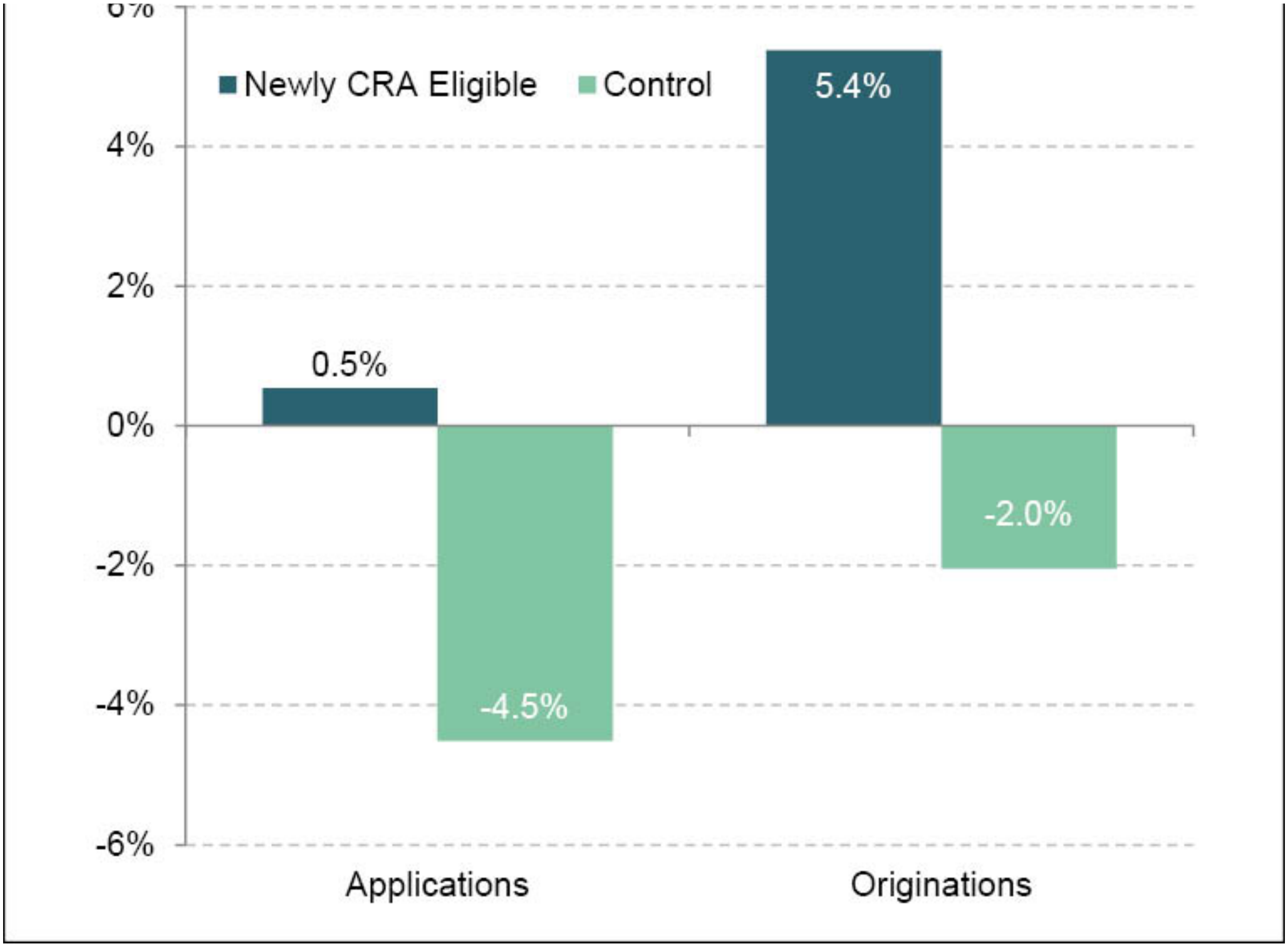


Nonbanks partly filled the void created by banks in the newly ineligible neighborhoods. Nonbanks originated 46.6 percent of all home purchase loans in newly ineligible tracts between 2012 and 2013. During 2014 to 2015, nonbanks originated 53.1 percent of all home purchase loans, an increase in market share of 6.5 percentage points, which was larger than the increase of 3.3 percentage points for nonbanks in the control group.

The Effect of Gaining CRA Eligibility

If banks reduced their home purchase loans in neighborhoods that lost their CRA eligibility status, then conversely, did banks increase their lending activity in neighborhoods that gained CRA eligibility status? The answer is not straightforward. Banks increased their home purchase loans in newly eligible neighborhoods in the MBC MD by 5.4 percent and decreased their purchase lending by 2.0 percent in neighborhoods in the control group (Figure 3). While this suggests that CRA coverage translates into a 7.4 percentage point boost in purchase lending between newly CRA eligible and control neighborhoods, this difference becomes insignificant in the tract-level regression. At least two factors could help explain the lack of significance in the CRA effect in the MBC MD. First, residents of the MBC MD have higher incomes on average than do Philadelphia MD residents, so it is possible that banks were serving these neighborhoods even before they became CRA eligible. Second, the current lending environment is characterized by significant regulatory change and heightened lender caution, both of which could explain why banks might be quicker to reduce lending in newly ineligible neighborhoods than pick up lending in newly eligible neighborhoods.

Figure 3. Percent Change in Home Purchase Loans Made by Lenders Subject to the CRA, MBC MD



Overall, our findings suggest the CRA plays an important role in expanding access to credit to LMI communities. While revising MDs is important for accurately representing metropolitan areas as they undergo change, our research indicates that these types of changes can yield unintended consequences for CRA lending activities.

Editor's Note

The Federal Reserve Bank of Philadelphia received a commendation from the Philadelphia City Council for its study on the CRA.