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Why Not Abolish the Community Reinvestment Act?

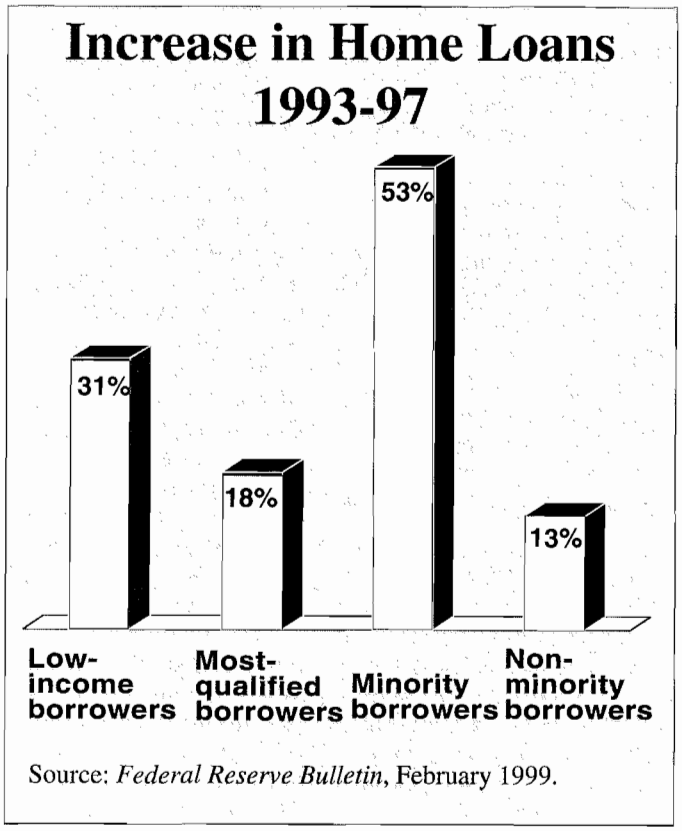
Before a bank can merge with another bank — or even open a new branch — it must get permission from federal regulators. And in giving that permission, regulators are obliged by the Community Reinvestment Act of 1997 (CRA), to consider whether the lender has served the entire community, including low- and moderate-income neighborhoods. Congress' declared intention was not to prescribe the allocation of credit, but rather to encourage lending to borrowers of small or moderate means, consistent with "safe and sound" lending practices.

The CRA is currently at the epicenter of a controversy over federal legislation to reform the financial services industry. Reform legislation permitting banks to underwrite and sell insurance and securities and permitting insurance companies and brokerage houses to acquire banks passed the House by one vote last year. Senators briefly considered the bill, letting it die as Congress adjourned.

This year, Sen. Phil Gramm (R-Texas), chairman of the Senate Banking, Housing and Urban Affairs Committee, has said the CRA must be modified before his committee will approve any financial services reform. Gramm and Sen. Richard Shelby (R-Ala.) want to exempt small, generally nonurban banks (banks with less than $100 million in assets) from the CRA. Gramm also fears that lowering the barriers between banks and other financial institutions would suck non-banking affiliates into the CRA's maw, and wants changes to prevent this result. President Clinton says he will veto any legislation that undercuts the CRA's effectiveness.

More Low-Income and Minority Borrowers. Since home mortgage data were first made public in the late 1980s, they have shown conventional home mortgage lending increasing at a much faster rate for black families than for white families and for low-income families compared to those with higher incomes. For example, from 1993-97, as the figure shows:

- Home loans to low-income borrowers rose 31 percent — nearly twice as much as the 18 percent increase in loans to the most qualified borrowers.
- Home loans to minority borrowers increased 53 percent, to nonminorities 13 percent.



The CRA may have contributed to this trend, but it is not all strictly attributable to federal intervention. The economic boom has clearly played its part, as has the decline in mortgage interest rates.

- Between 1981 and 1990, median black family income rose 12.3 percent after controlling for inflation, compared to 9.2 percent for the median white family.
- Between 1990 and 1994, the average interest rate for a 30-year mortgage fell from 10.01 percent to 7.47 percent.
- With the interest rate decline, the number of black families qualifying for a $100,000 mortgage rose by 537,000 and the number of qualifying Hispanic families rose by 359,000.

What's Wrong with the CRA? Small, nonurban banks seek relief from what they regard as CRA's impositions. For instance, banks small and large must document efforts to extend their outreach into different areas of the community. Small bankers view the resultant paperwork as unnecessary, unfruitful and burdensome.

About 4,000 financial institutions would be exempted under Gramm's proposal. This is about 38 percent of all banks and savings and loans, but their combined assets are only $179 billion, about 2.8 percent of all bank and

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savings and loan assets. Although most of them would go out of business if they did not serve their communities, they still have the expense of a CRA compliance officer and CRA paperwork.

Larger bankers looking for new opportunities have found partnerships with nonprofit community organizations and neighborhood groups a fruitful source of business development. But Gramm calls the CRA in its current form a vehicle for fraud and extortion, with many organizations threatening protests against bank mergers unless they are paid off one way or another. For example:

- Despite a high CRA rating, a New England bank, Fleet Financial Group, finally had to give the Neighborhood Assistance Corporation of America (NACA), headed by a self-described "urban terrorist," more than $200,000 to end a four-year campaign of protests and lawsuits, and stop attacks on Fleet when it tried to buy other banks.
- The Greenlining Institute, which spearheaded protests against a NationsBank-Bank of America merger even though both had been ranked "outstanding" in CRA compliance, acknowledges, "Companies fund us hoping that the money that they give us is going to temper our advocacy against them."
- When Household International tried to merge with Beneficial Corporation, it had to pay cash to an organization which had no operations where either bank is located to get it to withdraw a protest that threatened to delay the merger indefinitely.

Gramm proposes that a bank that has earned a "satisfactory" or better rating for the past three years be presumed in compliance with the CRA unless substantial verifiable evidence of noncompliance is presented.

Government Barriers to Low-Income Housing Progress. Old-fashioned racial discrimination, though hardly absent, has relatively little impact in today's essentially color-blind marketplace. Money is the great social leveler. Aside from financing problems, however, a major irony is that government itself — unintentionally perhaps, but nonetheless efficiently — throws up regulatory barriers to the restoration of old neighborhoods, often seen as a key to increasing low-income housing. Among the government-erected barriers:

- The federal Davis-Bacon Act sets construction wages at the prevailing level — which turns out to be the level set by the building trades unions. No federal money can go to a project that doesn't pay at this deliberately inflated scale. Many states have little Davis-Bacon laws, with similar provisions and effects.
- One-size-fits-all federal environmental rules raise housing costs in neighborhoods where environmental problems have long gone untreated. Both developers and banks naturally are wary of taking on a property where they may be liable for pollution discovered in the future but caused by owners decades before. Banks can't take environmental improvements as collateral. Thus the amount of equity financing required for a given project increases.
- Local policies complicate the clearing of titles on abandoned inner-city properties. Developers seeking to acquire these properties are required to pay back taxes, sometimes dating back a quarter of a century or more. The message here: Don't buy and improve vacant land that may be dragging down the property values of the entire neighborhood.

Conclusion. The main factor depressing home ownership for low-income Americans is ... low incomes. A sustained round of prosperity, such as the United States is currently enjoying, is making hundreds of thousands of home-loan applicants look better than government regulation ever could.

Government's greatest contribution to increasing low- and moderate-income housing could be addressing and changing tax and regulatory policies that result in the underdevelopment — or nondevelopment — of valuable properties. Organized labor has always resisted repeal of the various Davis-Bacon laws. Even if they continue to do so, creative thinkers can engineer exemptions for the development of properties in low-income areas.

The CRA in its current form may have helped to galvanize lenders unaware of or uninterested in inner-city development two decades ago. However, flexibility and creativity as economic attributes are infinitely more prized today than in 1977, when deregulation of markets was a new and, to some, astonishing concept. Today, if a few lenders remain unresponsive, others are eager to do business. Financial services deregulation, assuming it comes to pass during this term of Congress, can stimulate more competition for making loans than ever before — to the benefit of both those lending the dollars and those seeking to borrow them to buy or improve homes.

This Brief Analysis was prepared by syndicated columnist William Murchison.