Executive Summary

Concerns about the availability of credit to lower-income populations and areas and to small businesses and farms are longstanding. Government policy has addressed these concerns in various ways, including through the regulation of private-sector activities. In this regard, the Community Reinvestment Act of 1977 (CRA) was enacted to encourage banking institutions to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution.

Although much is known about the ways in which banking institutions have responded to the CRA and about the volumes of CRA-related loans they have extended, little is known about the performance and the profitability of such lending. To learn more about the performance and profitability of lending activities undertaken in conformance with the CRA, the Congress, through the Gramm-Leach-Bliley Act of 1999, directed the Board of Governors of the Federal Reserve System (the Board) to "conduct a comprehensive study . . . of the Community Reinvestment Act of 1977, which shall focus on (1) the default rates; (2) the delinquency rates; and (3) the profitability; of loans made in conformity with such Act, and report on the study" to the Senate and House Banking Committees. The Board was directed to make the report and supporting data available to the public. This report was prepared in response to this directive.

Because relatively little information has been publicly available about the performance and profitability of CRA-related lending, the Board undertook a special survey of the lending experiences of large banking institutions to gather such information. The survey is in two parts. Part A focuses on experiences associated with one- to four-family home purchase and refinance mortgage lending; other one- to four-family residential lending, including home improvement and home equity lending but excluding home equity lines of credit; small business lending; and community development lending. In addition, because special lending programs are sometimes an important aspect of the CRA-related lending activities of banking institutions, Part B of the survey gathers information on these programs.

For the survey, CRA-related mortgage loans were defined as mortgages to low- and moderate-income populations and neighborhoods in a banking institution's CRA assessment area. CRA-related small business loans were defined as small business loans to low- and moderate-income neighborhoods and to small businesses in the institution's CRA assessment area. All community development lending was considered to be CRA-related. These definitions reflect the emphasis placed by the current CRA regulations on such lending.

In Part A, the survey gathers qualitative and quantitative information about absolute and relative performance and profitability of CRA-related lending in 1999 for each of the four product areas separately. Respondents were asked to provide quantitative information on profitability, measured by return on equity, and performance, measured by delinquency and charge-off rates. Also, respondents were asked qualitative questions about profitability and about differences in profitability, origination and servicing costs, credit losses, and pricing between CRA-related and other lending. In Part B, respondents were asked to provide detailed information about their five largest CRA special lending programs. In addition to qualitative and quantitative questions about absolute performance and profitability, respondents were asked to provide information about the reasons for establishing each program and descriptive characteristics of each program.

Participation by banking institutions in the survey was voluntary. On January 21, 2000, each prospective respondent was mailed a copy of the questionnaire accompanied by a cover letter from Chairman Alan Greenspan explaining the purpose of the survey and seeking voluntary cooperation in the study. The sample of institutions selected to participate in the survey consisted of roughly the largest 500 retail banking institutions, including 400 commercial banks and 100 savings institutions. The sample was limited to the largest banking institutions because they account for the vast majority (estimated at more than 70 percent) of CRA-related lending nationwide. Survey responses were received from 143 banking institutions--114 commercial banks and 29 savings associations. Since most of the largest institutions responded to the survey, the survey respondents are estimated to account for between 40 percent and 55 percent of CRA-related lending in each loan product category, even though the number of respondents was relatively small.

Results on the Nature of Responses

Survey responses and follow-up telephone contacts suggest that banking institutions generally do not separately track the performance and profitability of CRA-related lending. Except for community development lending, fewer than half of the banking institutions that responded to the survey provided quantitative information on the performance of CRA-related lending and less than a quarter of institutions that responded to the survey provided responses to quantitative questions on the profitability of such lending. Given the relatively small number of institutions that provided quantitative responses, quantitative estimates of performance and profitability measures presented in the tables in this report must be viewed with caution.

A substantially higher proportion of respondents provided answers to the *qualitative* questions on profitability. As a result, qualitative results regarding profitability are emphasized in the report. Because responses to quantitative questions on performance are provided by fewer than half of the respondents, caution should also be exercised in considering qualitative inferences comparing the performance of CRA-related and other lending drawn using these quantitative responses.

Results for Part A--Survey of CRA-Related Lending

Aggregate statistics on performance and profitability are presented in two ways. First, results are presented on a *per institution basis*, which provides an estimate--based on actual responses--of what responses would have been if all surveyed institutions had participated in the survey and answered all applicable questions. Second, results are also presented on a *per CRA dollar basis*, which gives additional weight to the responses of institutions that originated more CRA-related loans. The "per CRA dollar" results provide an estimate of what the distribution of dollars across responses would have been if all surveyed institutions had participated in the survey and answered all applicable questions.

To ensure that appropriate comparisons between CRA-related lending and other lending activities were made, the product-level analysis focuses on the subset of respondents that provided answers to questions on both CRA-related lending and overall lending activities.

Results for Home Purchase and Refinance Lending

Among the loan products considered in most CRA performance examinations, home purchase and refinance lending has by far the largest origination volume. It is estimated that the 500 banking institutions sampled in the survey originated more than $570 billion in home purchase and refinance loans in 1999. This amount far exceeds the estimated amount of lending by these institutions in the other loan product categories: $117 billion in small business loans, $12 billion in home improvement loans, and $13 billion in community development loans. It is estimated that about 10 percent of all home purchase and refinance lending for 1999 is CRA-related.

Survey responses indicate that home purchase and refinance lending is profitable or marginally profitable for most institutions on a per institution basis (figure 1). CRA-related home purchase and refinance lending is either profitable or marginally profitable for 82 percent of survey respondents (chart 1a). For about one-sixth of the respondents, such lending is either marginally unprofitable or unprofitable. This pattern holds generally across banking institutions of different asset size, although a greater proportion of large banking institutions report their CRA-related home purchase and refinance lending is either marginally unprofitable or unprofitable than medium- or smaller-sized institutions.

Although CRA-related home purchase and refinance lending is reported to be at least marginally profitable for most of the survey respondents, *overall* home purchase and refinance lending is reported to be at least marginally profitable for an even larger proportion of these institutions (chart 1b). For slightly less than half of the respondents, the profitability of CRA-related home purchase and refinance lending is either lower or somewhat lower than that of *other* home purchase and refinance lending (chart 1c). However, the remaining 56 percent of respondents report that the profitability of their CRA-related lending is about the same as the profitability of their other home purchase and refinance lending. Consistent with the pattern noted above, large banking institutions are more likely than smaller institutions in the sample to report that the profitability of their CRA-related home purchase and refinance lending is lower than the profitability of their other home purchase and refinance lending.

Weighting the responses on a per CRA dollar basis produces results that differ somewhat from those computed on a per institution basis (figure 2). Regarding the profitability of CRA-related lending, the implications for the profitability of home purchase and refinance lending are similar when viewed on a per CRA-dollar basis as compared to a per institution basis (chart 2a). For example, 84 percent of CRA-related loan dollars originated were originated by institutions that report that their CRA-related home purchase or refinance lending was profitable; survey responses indicate that CRA-related home purchase and refinance lending is profitable or marginally profitable for 82 percent of respondents on a per institution basis. Also, as in the per institution analysis, more respondents report that their overall home purchase and refinance lending is at least marginally profitable than report that their CRA-related home purchase and refinance lending is at least marginally profitable (chart 2b). However, 63 percent of the CRA dollars originated in 1999 were originated by respondents that report that CRA-related one- to four-family home purchase and refinance lending is less profitable than other lending, higher than the 44 percent of institutions that report that CRA-related lending is less profitable on a per institution basis (chart 2c).

As with profitability, the experiences of individual respondents vary regarding the absolute and relative *performance* of CRA-related loans on a per institution basis (no figures on performance). Many institutions report no difference in performance between CRA-related and other home purchase and refinance lending. However, when there is a difference in performance, respondents tend to report that CRA-related home purchase and refinance lending performs less well than other home purchase and refinance lending. For example, about half of the survey respondents have higher rates for measures of delinquency for CRA-related home purchase and refinance loans than for overall home purchase and refinance loans; about one-third report no difference in delinquency rates and one-sixth report lower delinquency rates for CRA-related loans. As was the case for profitability, larger institutions are more likely than smaller institutions to report that CRA-related home purchase and refinance loans do not perform as well as home purchase and refinance loans in the aggregate.

CRA-related home purchase and refinance loans do not appear to perform as well as other home purchase and refinance loans when the analysis is conducted on a per CRA-dollar basis. Moreover, the differences appear to be larger than when measured on a per institution basis. For example, 46 percent of the dollars associated with CRA-related loans were originated by institutions that report that credit losses are higher for CRA-related home purchase and refinance loans than for other home purchase and refinance loans, whereas only 28 percent of institutions report such an experience on a per institution basis. Similar patterns are observed when performance is measured by delinquency and charge-off rates.

A large proportion of respondents report that origination and servicing costs, credit losses, and pricing are about the same for CRA-related and other home purchase and refinance loans on a per institution basis. However, for those respondents that do report differences, the difference most often indicates higher costs or credit losses or lower prices for CRA-related home purchase and refinance loans. When assessed on a per CRA dollar basis, CRA-related home purchase and refinance loans appear to have higher origination and servicing costs, but similar pricing, when compared with the costs and pricing of other home purchase and refinance loans.

Results for Home Improvement Lending

Home improvement lending is a substantially smaller component of total bank lending than either home purchase and refinance or small business lending. It is estimated that the banking institutions sampled in the survey originated about $12 billion in home improvement loans in 1999, about 18 percent of which is CRA-related. This volume equals less than 1 percent of the estimated dollar amount of home purchase and refinance lending originated in 1999.

Regarding profitability, the results for home improvement lending are similar to those for home purchase and refinance lending, although fewer differences between CRA-related home improvement and other home improvement lending are generally observed (figures 3 and 4). On a per institution basis, the vast majority of institutions report that both their overall and CRA-related home improvement lending are either profitable or marginally profitable (charts 3a and 3b). Nearly three-quarters of respondents report that the profitability of their CRA-related and other home improvement lending is about the same (chart 3c). Of those reporting a difference, all report that profitability of CRA-related home improvement lending is either lower or somewhat lower than the profitability of other home improvement lending.

Consistent with the pattern observed for home purchase and refinance lending, larger banking institutions are more likely than smaller institutions to report that the profitability of their CRA-related home improvement lending is lower than that of their other home improvement lending.

Nearly 80 percent of the dollars of CRA-related home improvement lending were originated by institutions that report that their CRA-related home improvement lending is either profitable or marginally profitable, a percentage similar to that reported on a per institution basis (chart 4a). However, weighting the responses by the amount of CRA dollars originated produces results for relative profitability that differ somewhat from those computed on a per institution basis and more closely track the per institution results for large banking institutions. Fifty percent of the dollars of CRA-related home improvement were originated by institutions that report that the profitability of CRA-related home improvement lending is lower or somewhat lower than the profitability of other home improvement lending (chart 4c).

For most measures of performance, a majority of respondents on a per institution basis report that the performance of CRA-related and overall or other home improvement lending is about the same. Moreover, for those institutions that do report a difference, the proportion that report that CRA-related lending performs better than overall or other lending is about equal to the proportion that report that CRA-related lending performs worse than overall or other lending. The exception to this pattern is the 30-89 day delinquency rate measure. By this measure, CRA-related home improvement loans do not perform as well as home improvement loans in the aggregate.

The results on a per CRA dollar basis for performance are consistent across the measures of performance, but differ somewhat from the results of the per institution analysis. By all measures of performance, CRA-related home improvement loans perform relatively less well than home improvement lending considered in the aggregate.

On both a per institution and per CRA dollar basis, the majority of respondents in all asset-size categories report that origination and servicing costs, credit losses, and prices associated with CRA-related and other home improvement lending are about the same.

Results for Small Business Lending

The estimated total dollar volume of small business lending originations for 1999 for the 500 banking institutions that were surveyed is $117 billion. This amount is about 20 percent of the estimated total dollar volume of home purchase and refinance lending originated by these institutions. Unlike for mortgage-related lending, the dollar volume of CRA-related small business lending is about the same size as the volume of other small business lending. The significant proportion of overall small business lending that is CRA-related suggests that measures of performance and profitability for CRA-related and overall lending will be more similar than would be the case if CRA-related lending were only a small fraction of overall lending.

In addition, in assessing the relative measures of profitability and performance for CRA-related small business lending, one must consider the comparability of CRA-related small business loans and non-CRA small business loans. The survey defined a CRA-related small business loan as any small business loan made *within* the banking institution's CRA assessment area to (1) a firm with revenues of $1 million or less (regardless of neighborhood income) *or* (2) in a low- or moderate-income neighborhood (regardless of firm size). By contrast, loans (1) extended outside the banking institution's CRA assessment area and (2) extended to businesses with revenues exceeding $1 million in a middle- or upper-income neighborhood within the institution's CRA assessment area were not considered to be CRA-related small business loans.

Whether measured on a per institution or per CRA dollar basis, virtually all banking institutions providing responses, regardless of asset-size category, report that their CRA-related small business lending is either profitable or marginally profitable (figures 5 and 6). In addition, most respondents report that the profitability of CRA-related and other small business lending is about the same. There is also relatively little evidence that performance differs systematically between CRA-related and overall small business lending. Banking institutions in each asset-size category report roughly the same delinquency and charge-off rates for CRA-related and overall small business lending, although large institutions generally experience poorer performance than smaller institutions for both types of loans. There are also few reported differences for origination and account maintenance and monitoring costs, credit losses, and pricing.

Results for Community Development Lending

Because community development lending encompasses a wide range of loan products, it was unlikely that banking institutions could construct valid comparison groups from other portions of their loan portfolios. As a result, the survey collected information only on quantitative and qualitative measures of the performance and profitability of community development loans. No information comparing the performance and profitability of community development loans with a comparison group of loans was collected.

Survey respondents report that community development lending offers a variety of benefits to banking institutions. Virtually all survey respondents report that they benefit from their community development lending because it promotes community growth and stability and responds to the credit needs of the local community. Virtually none of the respondents report that they undertake community development lending solely to obtain a satisfactory or outstanding CRA rating.

On a per institution basis, nearly all banking institutions that provided responses, regardless of asset-size category, report that their community development lending is either profitable or marginally profitable (chart 7a). The performance of community development lending, however, differs across banking institutions grouped by size. As was generally the case for the other product categories, larger banking institutions are more likely than smaller institutions to report poorer loan performance, whether measured by delinquency or charge-off rates.

As in the per institution analysis, virtually all respondents report that community development lending is profitable or marginally profitable on a per CRA dollar basis (chart 7b). Regarding performance, the per CRA dollar results differ somewhat from the per institution results, although the differences are not consistent across the measures of performance.

New Opportunities from CRA-Related Lending

CRA-related lending can potentially lead to new, profitable business opportunities for banking institutions, and the survey gathered information on whether such opportunities exist and, to the extent they exist, their sources. More than two-thirds of the respondents report that their CRA-related lending has led to new, profitable opportunities. About two-thirds of the survey respondents also report that they receive some other benefit not related to loan profitability from CRA-related lending, such as promoting a good image in the community. At the same time, however, about one-quarter of the institutions report some costs not related to loan profitability that they incur because of their CRA-related lending activities.

Results for Part B--Survey of CRA Special Lending Programs

The survey includes detailed information on 341 CRA special lending programs. About 73 percent of the banking institutions participating in the survey report offering at least one CRA special lending program and, on average, institutions report that they offer about 4 programs. Evidence suggests that loans originated under CRA special lending programs make up a relatively small portion of the total CRA-related loans originated for most respondents. However, about 16 percent of institutions report that more than 40 percent of their CRA-related home purchase and refinance lending is originated under CRA special lending programs. Information reported for individual programs also suggests that they are generally small. An estimated 63 percent of the CRA special lending programs reported in the survey had total 1999 originations of $2 million or less.

Results for CRA special lending programs are generally presented on a per program basis. For profitability, results are also presented on a per program dollar basis. These figures are calculated using weights based on the reported dollars originated under each CRA special lending program in 1999. In addition, because it was unclear how to define a reasonable comparison group, the survey did not collect information on the relative profitability or performance of CRA special lending programs.

Banking institutions cite many reasons for establishing or participating in CRA special lending programs. Nearly all survey participants cite responding to the credit needs of their local community, promoting community growth and stability, and improving the public image of the institution as reasons for establishing such programs. Obtaining either a satisfactory or outstanding CRA rating is a reason mentioned for about 75 percent of the programs.

There is a great variety in the characteristics of CRA special lending programs. CRA special lending programs target a number of different populations, including lower-income borrowers and lower-income neighborhoods, and involve a range of credit products. About 75 percent of the programs involve the activities of third parties, including activities that reduce the costs that banking institutions might otherwise incur in extending credit to the populations served by the special programs.

Although third parties provide services and contribute to the implementation of many CRA special lending programs, banking institutions also offer a wide range of special features or services in connection with these programs. For example, respondents report that they offer reduced interest rates and fee waivers or reductions for about 47 percent of the programs and provide pre-loan education or counseling to loan applicants in connection with 36 percent. Respondents also frequently report that they alter their customary underwriting standards for a large majority of their special lending programs. The most frequently cited underwriting variances are lower downpayments, higher debt-to-income ratios, and the acceptance of alternative measures of credit quality, such as rent and utility payment histories, in lieu of more traditional measures of credit risk.

According to respondents, the majority of CRA special lending programs are either profitable or marginally profitable on a per program basis (figure 8). One-quarter of the programs are considered either marginally unprofitable or unprofitable. Results on a program dollar basis differ only slightly from the results on a program basis. In both cases, experiences vary across banking institutions grouped by asset size. Compared with smaller institutions in the sample, large- and medium-sized institutions report a higher percentage of programs that are either marginally unprofitable or unprofitable.

On a per program basis, respondents report that a majority of the CRA special lending programs have low delinquency and charge-off rates. For example, the median charge-off rate for these programs is reported to be 0. Performance results on a per program dollar basis are mixed. Responses show that delinquency rates tend to be higher on a per program dollar basis than on a per program basis, suggesting that larger programs have higher delinquency rates. By contrast, responses indicate that charge-off rates are lower on a per program dollar basis than on a per program basis, which suggests that larger programs have fewer charge-offs associated with them.

Limitations and Caveats

The survey and resulting data provide new information about the experiences of banking institutions with CRA-related and other lending. This information provides opportunities to better understand and measure the effect of the CRA on lending markets. In reflecting on these results, a number of issues should be kept in mind. First, this survey has a limited scope. It focuses on one aspect of the CRA--the performance and profitability of CRA-related lending. Because it does not examine activities such as investment and service activities, data from this survey do not allow researchers to answer broader questions regarding the overall effects of the CRA on the performance and profitability of banking institutions. Nor do the data speak to the effect of the CRA on local communities, the stated purpose of the law. A recent study by the U.S. Department of the Treasury, also mandated by the Gramm-Leach-Bliley Act, addresses these issues.

Second, there are a number of other analytical concerns that must be highlighted. Sample sizes are relatively small, which leaves some statistics vulnerable to extreme values. In addition, because many respondents were unable to provide quantitative answers regarding the performance and profitability of CRA-related lending, quantitative estimates of profitability and delinquency and charge-off rates should be considered with considerable caution; qualitative assessments may be more reliable. However, it should be borne in mind that many qualitative inferences regarding performance are drawn based on responses to quantitative performance questions.

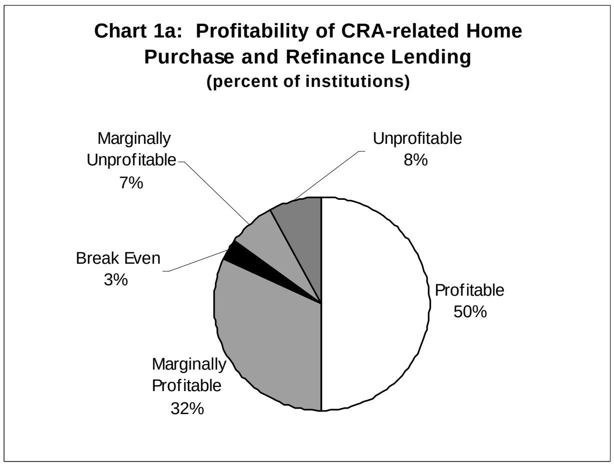
Moreover, the survey data reflect the experiences of only larger banking institutions in a particularly healthy economic environment. Experiences may differ for smaller institutions or under different economic conditions. In addition, the broad patterns observed in the survey results may not reflect the experiences of specific institutions or markets. Because of these and other issues, results of analyses using the survey data may not provide a complete picture of the performance and profitability of CRA-related lending.

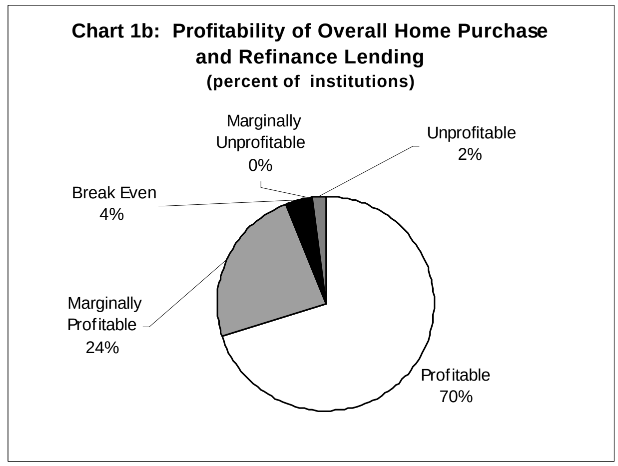
Public Access to the Survey Data

The Gramm-Leach-Bliley Act requires the Board to make the basic information that underlies the study publicly available. Tables can be obtained either from the Board's CRA survey web site at www.federalreserve.gov/boarddocs/surveys/CRAloanssurvey or by placing a request via the CRA survey assistance line at 1-800-281-4930. As stated by the Board in its letter to banking institutions seeking their voluntary participation in the survey, measures have been taken to ensure that survey responses provided by any particular banking institution cannot be associated with the identity of that institution. The tables therefore include only aggregate data.

Figure 1. Absolute and Relative Profitability of Home Purchase and Refinance Lending, per institution

Estimated 1999 volumes for surveyed institutions:
$56.0 billion for CRA-related lending, $570.3 billion for overall lending





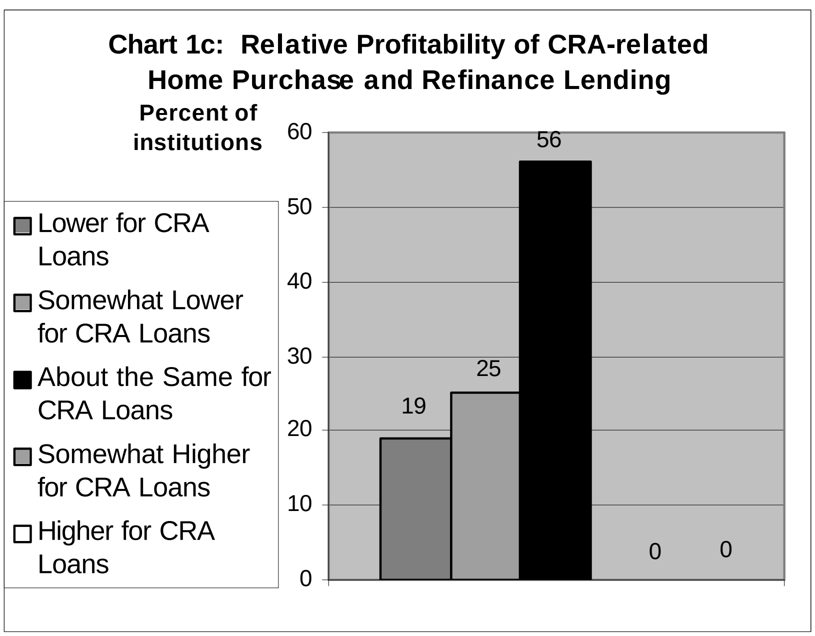
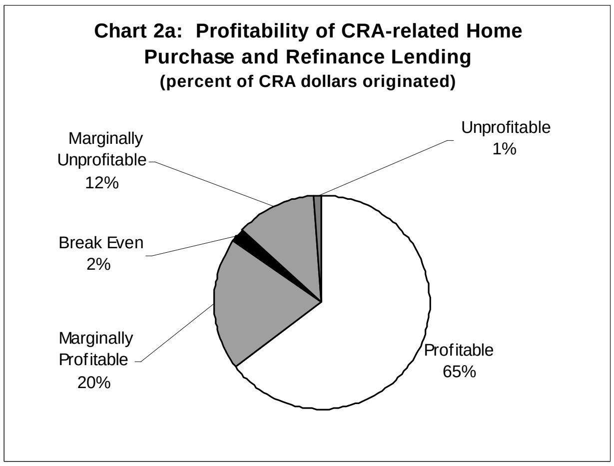
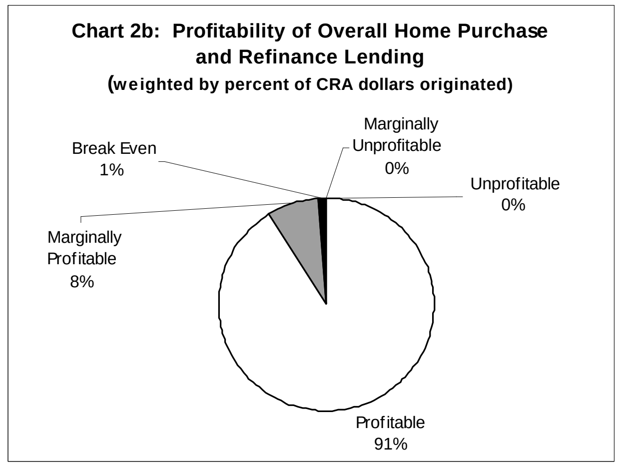


Figure 2. Absolute and Relative Profitability of Home Purchase and Refinance Lending, per CRA-related dollars of 1999 originations

Estimated 1999 volumes for surveyed institutions:
$56.0 billion for CRA-related lending, $570.3 billion for overall lending





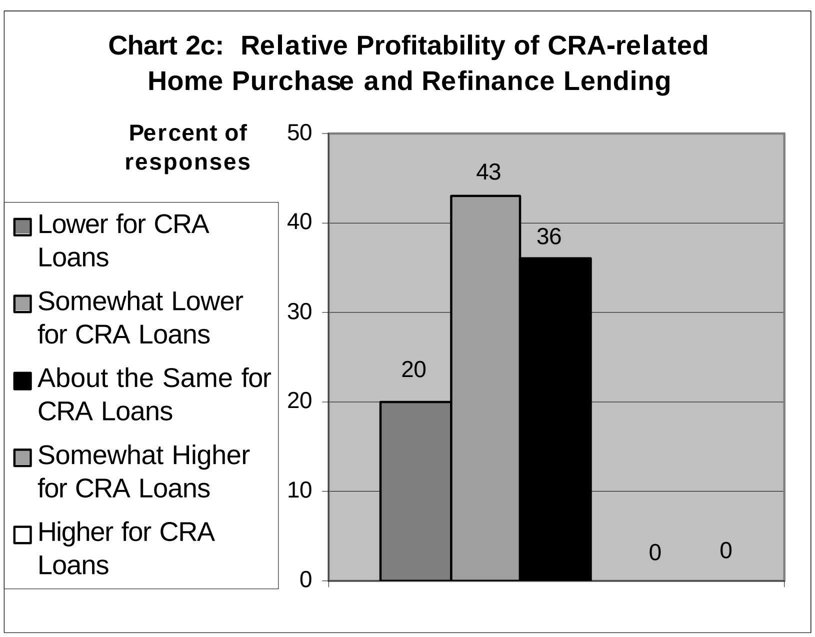
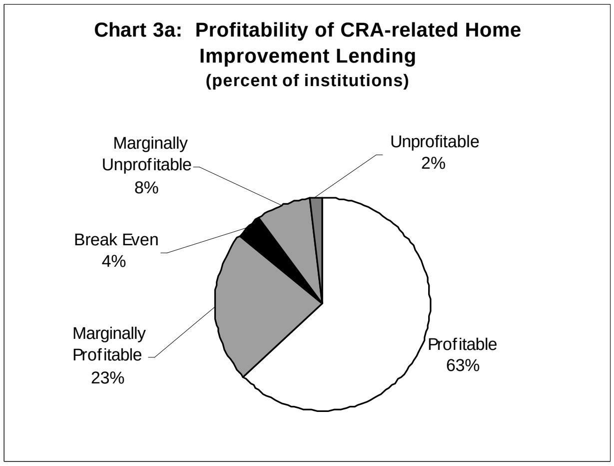
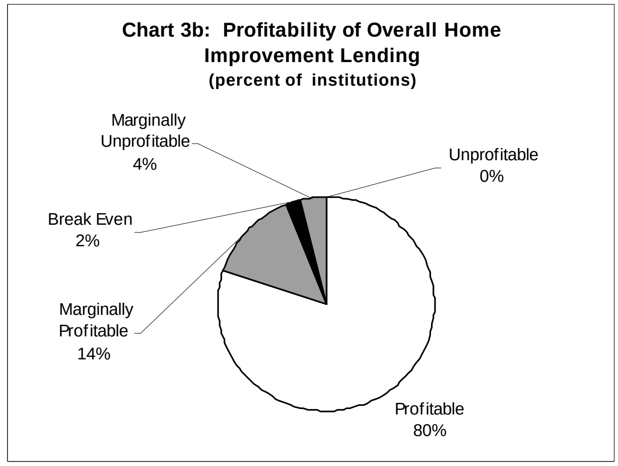


Figure 3. Absolute and Relative Profitability of Home Improvement Lending, per institution

Estimated 1999 volumes for surveyed institutions:
$2.2 billion for CRA-related lending, $12.0 billion for overall lending





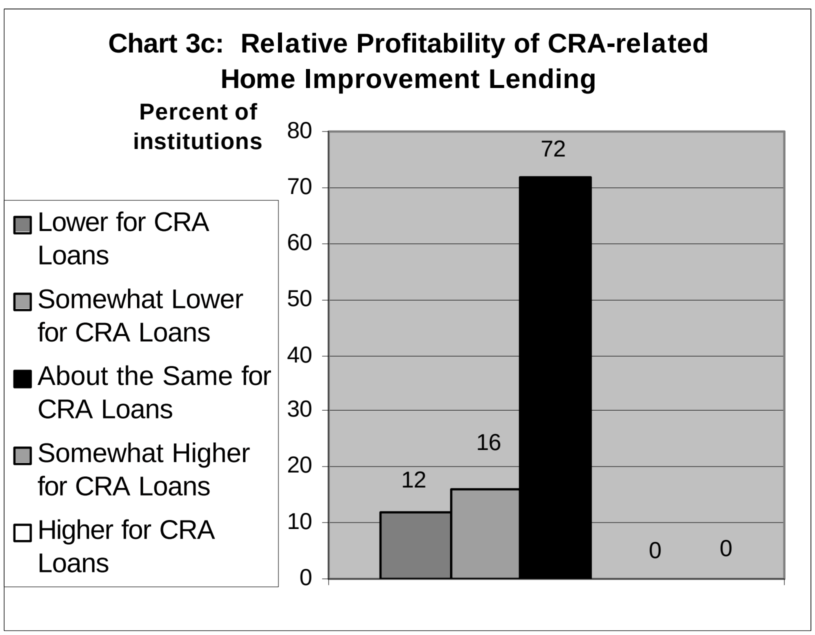
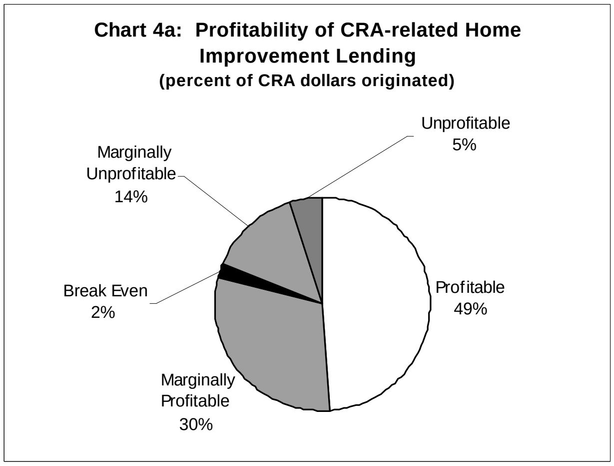
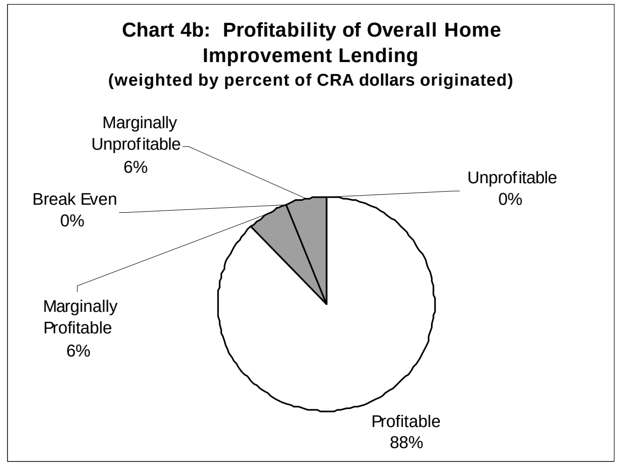


Figure 4. Absolute and Relative Profitability of Home Improvement Lending, per CRA-related dollars of 1999 originations

Estimated 1999 volumes for surveyed institutions:
$2.2 billion for CRA-related lending, $12.0 billion for overall lending





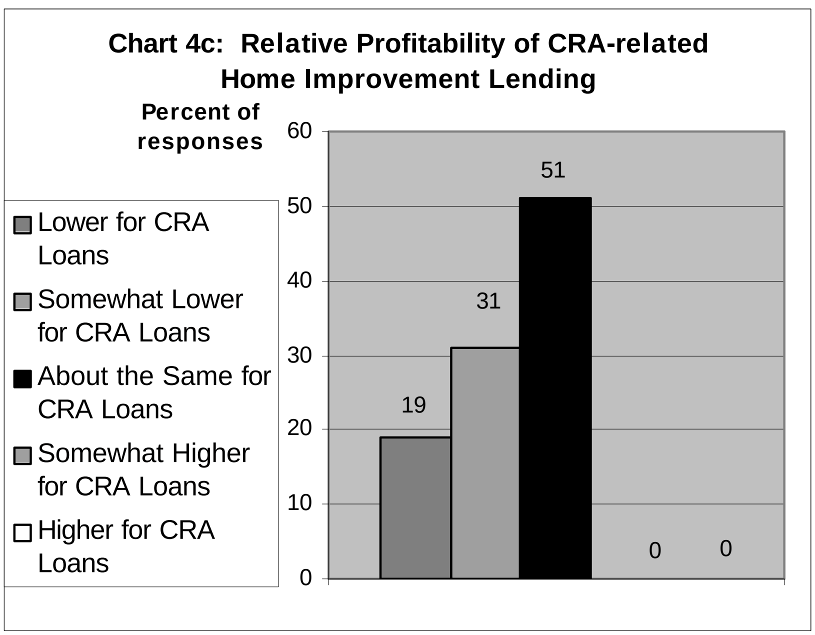
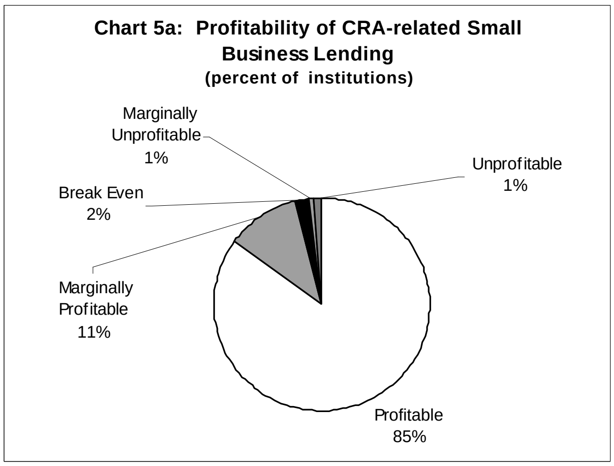
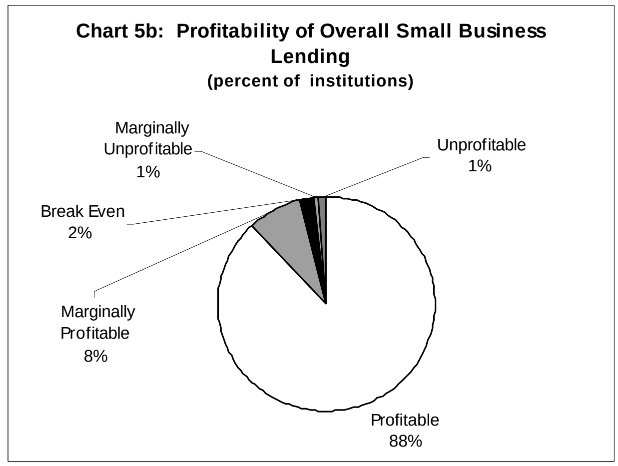


Figure 5. Absolute and Relative Profitability of Small Business Lending, per institution

Estimated 1999 volumes for surveyed institutions:
$58.9 billion for CRA-related lending, $117.0 billion for overall lending





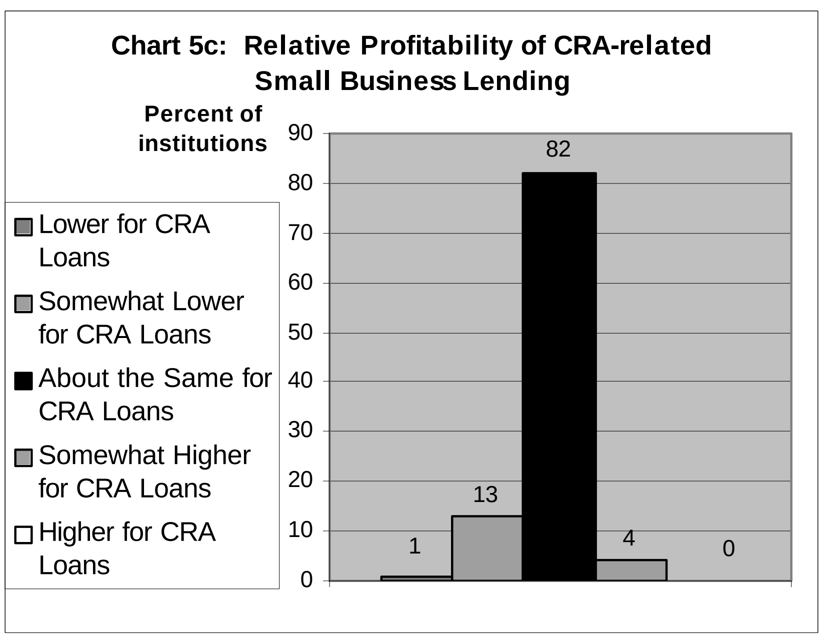
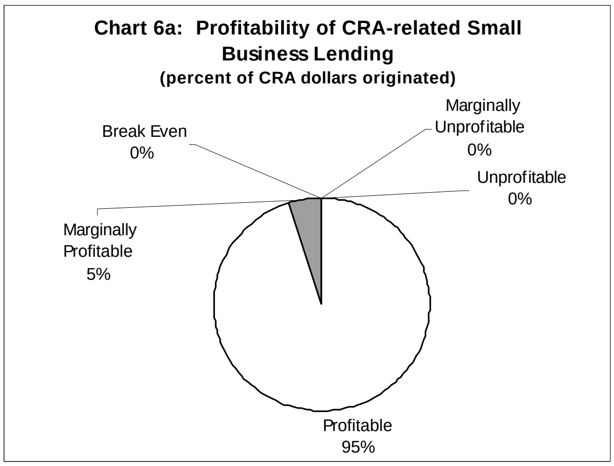
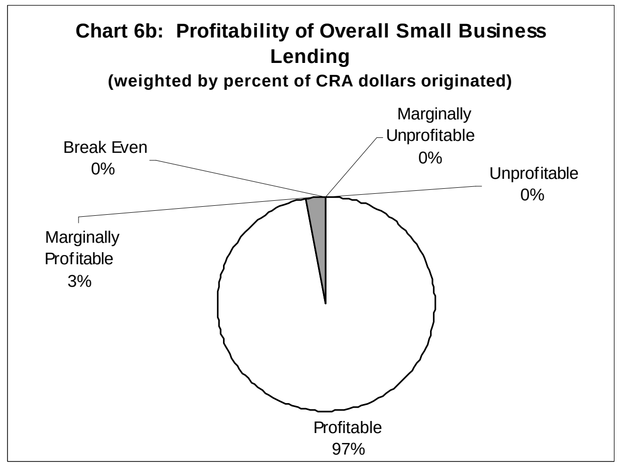


Figure 6. Absolute and Relative Profitability of Small Business Lending, per CRA-related dollars of 1999 originations

Estimated 1999 volumes for surveyed institutions:
$58.9 billion for CRA-related lending, $117.0 billion for overall lending





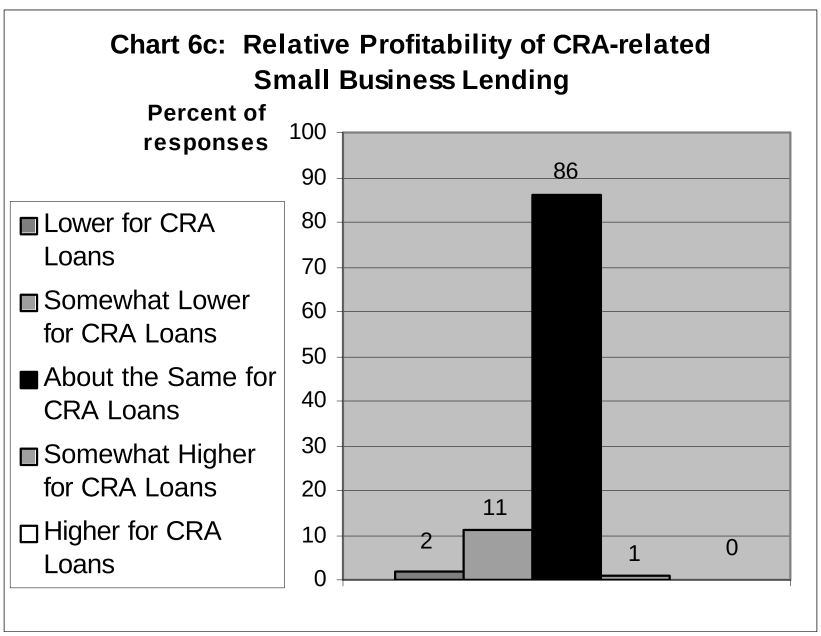
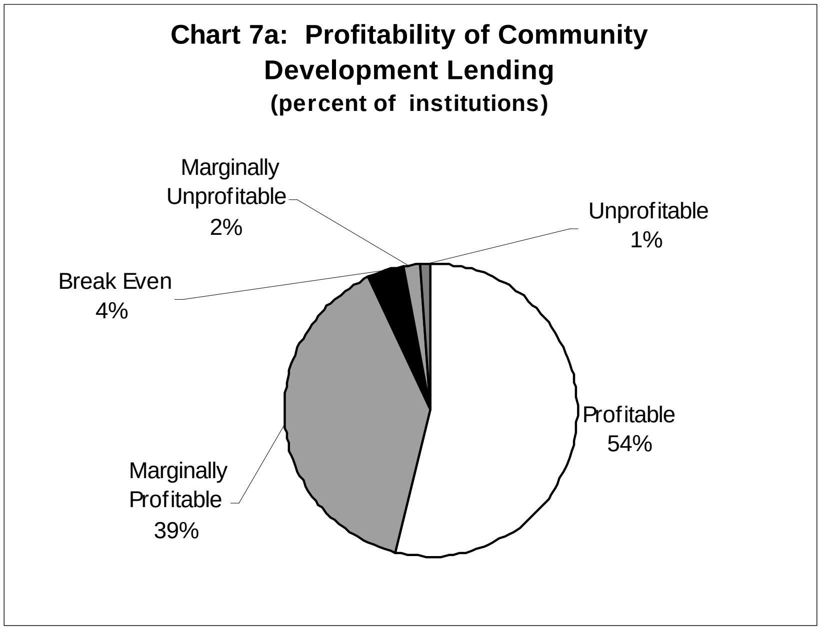


Figure 7. Profitability of Community Development Lending

Estimated 1999 volume for surveyed institutions: $13.2 billion

A. Per institution



B. Per community development dollars

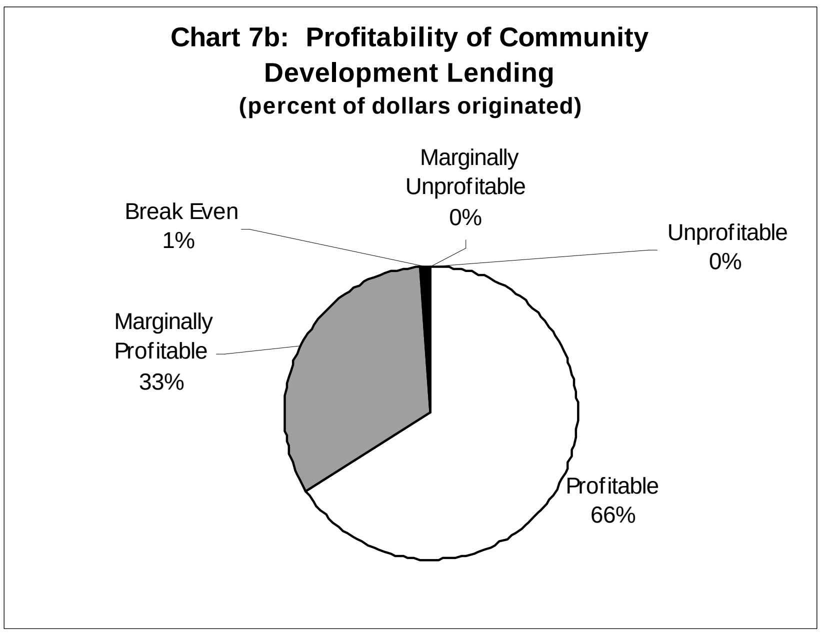
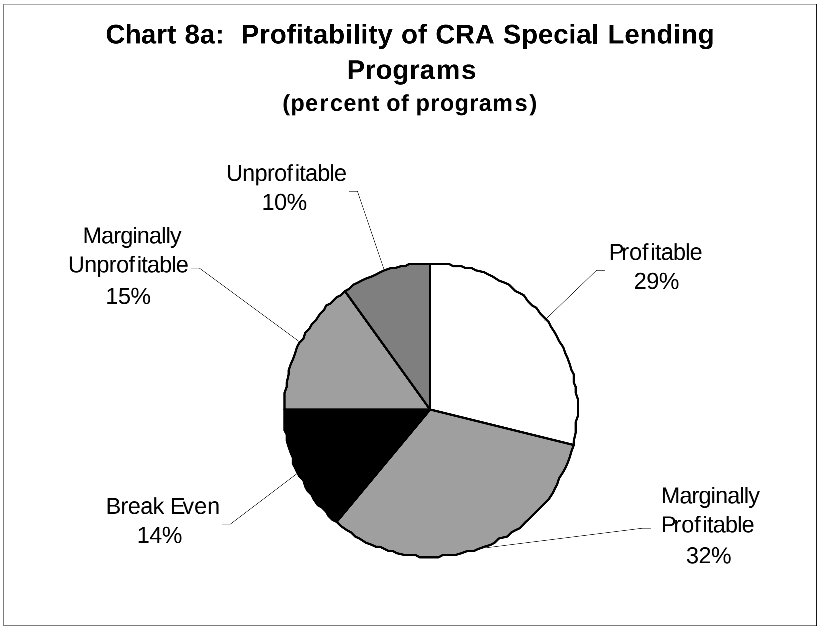


Figure 8. Profitability of CRA Special Lending Programs

Estimated 1999 volume for surveyed institutions: $11.2 billion

A. Per program



B. Per CRA special lending program dollars