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Recommended Citation
Littrell, J. & Brooks, F. (2010). In defense of the Community Reinvestment Act. *Journal of Community Practice, 18*(4), 417-439. doi: 10.1080/10705422.2010.519211

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Revised May 25, 2010; revised July 19, 2010

In Defense of the Community Reinvestment Act

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Initial submission: December 10, 2009

Key Words: Affordable Housing; Housing Advocacy; Community Reinvestment Act; Subprime Lending Crisis

Abstract

In the wake of the 2008 global financial crisis, the Community Reinvestment Act (CRA) of 1977 has probably received more media attention in the past two years than it garnered cumulatively over the previous 30 years. Numerous conservative pundits and commentators have blamed the CRA for the subprime crisis and the subsequent world-wide financial meltdown. Most social workers are probably unaware that the CRA is probably responsible for more investment, loans, and wealth creation in low and moderate income neighborhoods than any other single piece of federal legislation over the past 40 years. This paper highlights the following features about the CRA that social workers need to know: the CRA was created and passed only because of grassroots community organizing; the CRA has been directly or indirectly related to eight trillion dollars of investments, mortgage and small business loans in low income neighborhoods since 1977; community organizing has always been the primary enforcement mechanism of the CRA; contrary to widespread right-wing media accounts, the CRA was not responsible for the housing bubble and worldwide financial crisis in 2008. In this paper, we will articulate the veridical factors contributing to the financial collapse. Presently Congress is debating reforms for the financial sector and the way banking functions will be transacted in the future remains unclear. Regardless of the eventual restructuring of finance, moving forward, social workers should continue to advocate for legislation that will ensure housing for low and moderate income people.

In Defense of the Community Reinvestment Act

Some radical conservatives have laid blame for the 2008 collapse of the financial system on government initiatives to increase home ownership among low income persons. Specifically, the Community Reinvestment Act of 1977 has been identified as a culprit in the widespread insolvency of financial and banking institutions (Bhutta & Canner, 2009; Goldstein & Hall, 2008; Quercia & Ratcliffe, 2009). This paper will rebut this argument. First, we will explain what the Community Reinvestment Act does. Following this, we will examine the impact of the CRA on increasing loans for housing in low income communities and offer data showing that CRA covered institutions were not involved in subprime loan activity. After exonerating the CRA, we will focus on the reasons for the 2008 collapse of the financial sector: the housing bubble; predatory lending (called subprime lending) targeted toward low income and minority communities; the false security provided by the development of bundling mortgages and selling these to investors; the rise of derivatives enabled by the shadow, unregulated insurance and financial system. We will end by surveying the various issues which are currently being debated in Congress to prevent another financial catastrophe and protect consumers.

What is the Community Reinvestment Act?

The Community Reinvestment Act of 1977 is considered to be one of the last major pieces of Civil Rights legislation. Its purpose was to end redlining (the practice of banks refusing to consider mortgage applications from minorities based on the neighborhood they lived in rather than their personal credit and financial situation) and to defeat capital export (banks using the deposits made by persons from low income neighborhoods to lend to persons in more affluent neighborhoods). For decades redlining had been a routine practice of the Federal

Housing Authority and the Veterans Administration housing finance programs. According to the statute the goal is to "encourage such institutions to help meet the credit needs of local communities in which they are chartered consistent with the safe and sound operation of such institutions." Only banks, FDIC insured depository institutions, are covered by the CRA. The CRA does not contain mandates or quotas requiring banks to make loans to minorities. Rather, regulators at four federal agencies (Federal Deposit Insurance Corporation; Office of Comptroller of the Currency; Office of Thrift Supervision, previously called the Federal Home Loan Bank Board; and the Federal Reserve Bank), rate community banks on the extent to which they were in compliance with the CRA spirit of community development, that is, whether loans were made during the evaluation period to individuals within their community for home mortgages or business development. They are also given credit for making checking accounts accessible to persons in low income communities, as well as for investing in Community Development Corporations, which finance projects such as rehabilitating apartments or making small business loans. These ratings are then used in considering a bank's application for expansion (e.g., mergers with or acquisitions of another financial institution, or opening of a new branch). At the time the bank applies for expansion, community groups are allowed to challenge a bank's CRA ratings (Braunstein, 2008; Immergluck, 2004).

The Community Organizing Roots of the CRA

It is probably not a coincidence that the initial community organizing around redlining and investment issues was in Chicago. Ever since the turn of the 20th century, Chicago has been the birthplace of pioneering organizing efforts from Jane Addams' Hull House to Saul Alinsky's precedent setting organizing drives of the 1940s. Chicago's history of community organizing and activism made it a natural birthplace of the modern community reinvestment movement (Pogge,

1992). The original flashpoint for organizing that eventually led to the CRA was associated with two Alinsky-style, direct-action, neighborhood organizations in Chicago—the Northwest Community Organization (NCO) and the Organization for a Better Austin (OBA) (Squires, 2003). In the course of one week in 1971, two members of the Northwest Community Organization were denied loans at a local neighborhood bank. After inquiries were made, bank officials eventually admitted that the loans were refused according to the general policy of denying loans to applicants who lived in particular geographic areas (Mariano, 2003). The NCO group immediately launched a campaign with multiple demands including: the re-processing of the two denied loans, the establishment of a $4,000,000 mortgage loan pool for the community, and NCO citizen review of future rejected loans. In response to the bank's refusal, the NCO began a direct action campaign designed to raise public awareness (Mariano, 2003).

Next, in 1971, OBA and NCO formed a citywide coalition to investigate mortgage denials and redlining in the larger Chicago area. It was quickly apparent that the practice of denying mortgages based on the location of the purchased home was not unique to Chicago, but was standard banking practice all across the nation. In response, the lead organizers from OBA and NCO, Gail Cincotta and Shel Trapp respectively, arranged a national conference of community organizations that drew 2000 delegates from 36 states in March 1972. A national advocacy organization, the National Peoples Action bringing together 302 community organizations from 38 states, emerged from this conference. In addition Trapp and Cincotta formed the National Training and Information Center (NTIC) to provide research, technical assistance, and support for organizing primarily around banking and housing issues (Mariano, 2003).

An initial obstacle to effective advocacy for changes in banking policies was the absence of documentation on how mortgages were allocated as a function of area in cities. In the early 70s, banks were not required to track or disclose where they were making loans. Organizers demanded that the Board of Directors of the Federal Home Loan Bank of Chicago (the local regulator of area Savings and Loans) conduct a survey to ascertain the geographic distribution of deposits and mortgages. The 1973 survey showed clear evidence that redlining and capital export were occurring. In response, the Illinois Commission of Savings and Loan Associations developed the first anti-redlining policy in the nation. Then, Chicago City Council passed an ordinance requiring that banks that held municipal deposits disclose their loan data by zip code. This ordinance later became a model for federal legislation: Home Mortgage Disclosure Act (HMDA) of 1975 (Mariano, 2003).

In the mid-1970s, ACORN, the Center for Community Change, and other community organizations joined the fight against redlining. The first national victory from this flurry of anti-redlining organizing was passage of the Home Mortgage Disclosure Act (HMDA) in 1975 sponsored by Wisconsin Senator William Proxmire. Although HMDA did not require the banks to disclose all the data community organizations were asking for (such as race and gender of applicants), it did require all FDIC insured commercial banks and savings and loans with assets of $10 million to disclose annually the geographic distribution of mortgage across urban areas (Mariano, 2003). After two more years of intensive organizing, community groups joined Civil Rights organizations, numerous City Mayors, and traditional Washington based public interest groups to push Congress to pass the Community Reinvestment Act of 1977 (Immergluck, 2004).

Considering that both the HMDA and CRA bills were opposed by the banking lobby and all four banking regulatory agencies (who already felt like they had the authority to monitor the

flow of credit) (Immergluck, 2004), these two victories were watershed accomplishments. Senator Proxmire himself gave direct credit to the community organizations in stating "this disclosure bill would never have become a law but for the research and local organizing activity undertaken by NPA" (Mariano, 2003). The literature on the grassroots activities providing the impetus for the passage of the CRA and HMDA offers excellent case studies of community organizing and successful policy practice.

Community Organizations as Enforcers of CRA Regulations

The CRA was written in a way that placed the onus for enforcement on the community rather than regulators. There were no clear-cut guidelines in the law to measure whether a bank was meeting its credit obligations in a community. There were no explicit penalties or punishments for banks that earned unsatisfactory CRA ratings. If a bank received a negative rating, the regulatory agency retained the right to approve the bank's application for a merger or opening of a branch. Regulatory agencies were originally against passing the CRA (Immergluck, 2004) and had historically been biased in favor of banks and against community organizations. The CRA allowed community organizations to challenge a bank's application for expansion, but if a community organization wanted to successfully challenge a bank, organizers had to conduct excellent research, mobilize numerous affected constituents, and make compelling arguments to convince reluctant regulators. When a regulator ascribed credibility to a challenge, regulators often instructed banks and community organizations to reach agreement (Immergluck, 2004). The onus was on the community organizations to ensure that the spirit of the legislation was honored.

Further Changes to the CRA and the Impact of the CRA over the Years

During the first eight years of the CRA through 1985, only eight out of 40,000 applications for expansion were denied (Immergluck, 2004). In 1989 community organizations won several significant amendments to HMDA and the CRA. With the 1989 Financial Institutions Reform Recovery and Enforcement Act (the Savings and Loan Bail-Out Bill), regulators were required to publicly disclose an institution's ratings and performance evaluations (Immergluck, 2004). In 1989, the first bank was denied an application for merger under the CRA grounds (Barr, 2005). In 1995, the Clinton Administration issued directives to revise CRA regulations to make them more performance based, to make the review process more consistent, and to make compliance less burdensome for banks (Braunstein, 2008; Ludwig, Kamihachi, & Toh, 2009). Subsequently, more denials of banks' request to expand their operations occurred. Finally, 18 years after enactment of the CRA law, real changes in lending followed (Ludwig, et al., 2009). Voluntary pledges from banks to increase lending to low income communities increased (Ludwig et al., 2009; Schwartz, 2006).

A 2000 study conducted by the Brookings Institution and the Joint Center for Housing Studies at Harvard University requested by the US Department of Treasury credits the CRA with "nearly $620 billion in home mortgage, small business, and community development loans to low and moderate income borrowers and communities" (Barr, 2005). The National Community Reinvestment Coalition, an organization founded in 1990 to monitor agreements between community organizations and financial institutions, estimates that ". . . lenders and community organizations have signed CRA agreements totaling more than $6 trillion in reinvestment dollars" (2010, p. 3). From 1993 to 1999, financing of new homes by CRA obligated lenders increased by 93.7% and refinancing increased by 39.1% (Litan et al., 2001). From 1996 to 2006, the annual dollar amount of loans for community development increased by 319 percent from

$17.7 billion to $56.6 billion (Taylor, 2008). Additionally, the CRA reduced disparities in home ownership between whites and minorities (Schwartz, 2006; Segal & Sullivan, 1998). From 1993 to 1999, the number of home purchase loans made to Hispanics increased 121.4%; to Native Americans, 118.9%; to African Americans, 91.0%; to Asians, 70.1%, and to whites, 33.5% (Barr, 2005). The Joint Center for Housing Studies at Harvard (2002) estimates that for the period 1993-2000, 336,000 fewer home purchases would have been made to low income borrowers and communities were it not for the CRA. Moreover, CRA-covered entities, operating in their assessment areas, were the largest originators of low cost loans to low income persons (Avery, Courchane, & Zorn, 2008; California Reinvestment Coalition et al., 2009; Joint Center for Housing Studies, 2002; Ludwig et al., 2009).

In addition to mortgage loans, CRA covered institutions also report on small business loans made to those in low income areas. From 1997 to 2003, small business loans doubled to firms with revenues under $1 million (Barr, 2005). The CRA increased access to credit by 12-15% in low income communities, increasing payrolls and reducing bankruptcies (Zinman, 2002). In addition to increasing lending in minority communities, under the CRA, banks are given credit for innovations in banking. Because of the CRA, banks have invested in locally based Community Development Corporations partnering with these Institutions to experiment with new market opportunities allowing more flexible underwriting and specialized servicing techniques along with credit counseling (Kroszner, 2008). Barr (2008) concludes that the CRA has instigated innovations by banks in lending to low income communities as well as induced banks to invest in Community Development Financial Institutions that lend to low income persons and offer financial education.

Low Default Rates on Loans by CRA Regulated Banks

The proximal cause of the insolvency in the banking system was occasioned by the widespread default on subprime mortgages. The CRA was not heavily involved in the subprime loan sector. While the CRA did increase mortgages for low income people, only 6% of the subprime loans originated during the 2005-2006 period were made by CRA covered institutions, while 66% of subprime loans were made by non-bank entities (Bernanke, 2007; Bhutta & Canner, 2009; 2008). The loans made by CRA covered institutions to low income communities had an equivalent default rate to loans made to more affluent individuals (Essene & Apgar, 2008; Kroszner, 2008; Ludwig et al., 2009). Unlike the eventually unprofitable subprime loans, CRA covered institutional loans to poor people were profitable (Barr, 2008; Board of Governors at the Federal Reserve, 2000; Gramlich, 2007).

A number of studies have specifically teased apart whether high default rates are associated characteristics of the borrower or the loan's subprime characteristics (high fees and interest rates). A study in North Carolina by Ding et al. compared borrowers receiving subprime loans to borrowers receiving conventional loans, after matching them on credit scores, income level, and educational level. For the period from 2003 to 2004, the default rate for those receiving conventional loans was 4.1% versus 16.3% for subprime loans. For the period between 2005 to 2006, the default rate was 13.35 for conventional loans versus 47% for those receiving subprime loans. The North Carolina study squarely places the blame for high risk of foreclosure on the financial product rather than characteristics of the borrower. Subprime loans place too great a burden on low income borrowers (Quercia & Ratcliffe, 2009). Additionally, the delinquency rates on subprime loans are high regardless of neighborhood income (Kroszner, 2008).

Consistent with the conclusion that characteristics of the loan rather than characteristics of the borrower contributes to high default rates, there is a study by the Federal Reserve Bank of San Francisco (Canner & Bhutta, 2008; Laderman & Reid, 2008). The study found that CRA-covered lenders making loans in their assessment areas were half as likely to enter foreclosure as high-interest rate loans originated by independent mortgage companies (which were not covered by the CRA). Similar results were obtained in a study from Ohio (Coulton, Chan, Schram, & Mikelbank, 2008). A review of the default rates by low income people participating in mortgage programs through Community Development Corporations also illustrates that poor people do pay back their loans when the terms of the loans are fair (Abromowitz & Ratcliffe, 2010).

Taylor (2008) speculates on the reasons why CRA-obligated lenders did not make the subprime loans (which were more likely to default). He suggests that the fact that the CRA regulators gave banks credit for preparing borrowers for home loans by providing quality homeownership counseling may have precluded loans with high interest rates and other expensive features. Additionally, because CRA-obligated loans were not sold to others, the CRA originator had a big stake in ensuring that the loan would be repaid (Stein, 2008).

What Caused the Collapse of Financial Institutions in the Fall of 2008?

Because of the collapse of the financial system in the fall of 2008 many have lost their homes to foreclosure. Housing values have declined by 25% since 2006. Unemployment has doubled to 10.2%. The economy contracted by 4% between 9/08 and 9/09. State tax bases have shrunk, so that state governments have decreased spending for social programs. The National Debt has increased vitiating the national appetite for social programs (Baker, 2010; Berenbaum, 2009; Johnson & Kwak, 2010). National attention is now focused on reforming the financial system. In order to be active participants in this legislative process, social workers need to

identify the factors leading to the collapse of the financial sector so that they can advocate for changes in the statutes that remedy the veridical causes of the 2008 financial collapse.

The Housing Bubble's Role in the Financial Collapse

Robert Shiller (2008) argues that the cause of the crisis was "irrational exuberance" in the housing market. Indeed, housing prices rose 70% in the decade from 1998 to 2008 whereas rents rose only 35%. Some economists suggest the housing bubble (artificially high prices of homes) was created by the rise in the money supply attributable to very low interest rates from Federal Reserve under Alan Greenspan. Another source for an increasing money supply in investment markets was the Chinese. The Chinese had accumulated American dollars as a result of the long-standing trade imbalance. The Chinese invested their accumulated dollars in American financial institutions, flooding them with dollars needing to be invested (Wessel, 2009). This contributed an additional inflationary factor. In 2004, the Securities and Exchange Commission further increased the money supply in the investment arena by increasing the leverage ratio for investment banks from 12-to-1 to 30-to-1. Thus, investment banks were making more loans with borrowed money, adding to the money supply, but increasing risk to the system (McArdle, 2009). Rather than all these increases in money (relative to available goods) leading to general inflation, a housing bubble ensued (Shiller, 2008).

Financial institutions came to overvalue the housing assets. No one believed that the bubble could burst, that is, that suddenly the price of houses could collapse. The wide-spread practice of *asset-based lending* ensued. With conventional loans, banks make profits on the interest paid by the borrower. The value of the loan to the bank is based on the borrower's ability to repay the loan. The bank has a stake in the repayment of the principle and the interest by the borrower. With asset-based lending, the banks view their profits as deriving from the

value of the collateral, i.e., the value of the property. If the borrower defaults, the property, whose value is inflating, can be resold at a higher value than the original loan. The business model is to earn a profit on the rising value of the asset (Brescia, 2008b; Schwartz, 2006).

Changes in Mortgage Industry Facilitating the Rise in Subprime Products

The world of home finance has bifurcated. Mortgage companies have encroached on the territory of banks and Savings and Loans (thrifts) in financing home-ownership. While in 1980, banks and thrifts originated more than 70% of mortgages; by 1997, mortgage companies were initiating 56% of mortgages (Immergluck, 2004; Schwartz, 2006). In terms of the mortgage products they offer, banks and mortgage companies (represented by brokers) differ. Brokers initiated 50% of subprime loans but only 28% of prime loans (Barr, 2008; Bhutta & Canner, 2009; Brescia, 2008b). In terms of loans to low income individuals or individuals in low income areas, 50% percent of subprime loans were made by brokers working for mortgage companies, (entities not covered by the CRA). Banks tended to offer prime rate loans (Canner & Bhutta, 2008; Essene & Apgar, 2008; Gramlich, 2007; Ludwig et al., 2009). Brokers and banks also differ in terms of who initiates the sales of the loan. Most subprime loans were initiated by lenders rather than borrowers, whereas the banks wait for the customers to approach them (Immergluck, 2004; Kim-Sung & Hermanson, 2003).

There were other differences between traditional banks and brokers as well. Brokers were not regulated by any of the laws regulating traditional banks (Essene & Apgar, 2008; Immergluck, 2004; Immergluck & Smith, 2005). Brokers quickly sold the loans they originated to secondary financial institutions, whereas banks were more likely to retain the loans they originated (Bagley, 2004; Kiff & Mills, 2007; Schwartz, 2006).

Securitization Facilitates the Rise in Subprime Lending

The bundling of mortgages and selling the bundles to others is called securitization. This is a recent financial innovation. During Clinton's presidency, the Banking Act of 1933 (Glass-Steagall) was repealed by the Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act). This allowed for banks to conduct both investment and depository banking, thereby allowing banks to bundle and sell mortgages.

Securitization further fueled the subprime market activity, because the money received by brokers for the mortgages could be used to make new loans. The practice of securitization of mortgages had become widespread before the 2008 collapse. By 2006, approximately 80% of the $600 billion in mortgages were securitized (Avery et al., 2008; Bair, 2007; Ludwig et al., 2009).

Buyers of securities (bundled mortgages) were reassured by the Triple-A ratings given to them by rating agencies. Rating agencies had a strong incentive to overvalue the securities because they were paid for their ratings by the sellers of these products who could go to other rating agencies for alternative ratings (Berenbaum, 2009). Additionally, buyers of securities also believed in asset-based lending, assuming that the responsible managing-agents of these securities could foreclose on the property and resell the property to recapture the investment capital, should a borrower be unable to pay. Back at the point of origin of the loans, where brokers spoke with new homebuyers, borrowers were reassured that they could refinance their homes should adjustable rate mortgages become too large (Brescia 2008b; Stein, 2008). All assumed that the value of homes would increase or at least remain stable (Berenbaum, 2009).

With respect to the impact on the financial sector of the economy, securitization distributed the risk of a local real estate collapse across geographic regions and increased the flow of money (Avery et al., 2008; Bagley, 2004). However, with banks buying each other's

products, securitization also linked the outcomes of many institutions and investors. If one failed, they all failed (Sorkin, 2009). Moreover, the practice of securitization introduced new risks of higher rates of foreclosure into the system. Unlike traditional mortgages, where the bank retained the loan and retained the authority to reset the terms of the loan should the borrower experience a financial hardship impairing the ability to make a payment; with securitization, the identity of the actual owner of the mortgage, who might have authority to negotiate, was impossible to trace (Brescia, 2008a; 2008b). The finding that even when local banks make high interest loans, the mortgages originated by the banks have lower foreclosure rates than those originated by brokers is consistent with this idea (Coulton et al., 2008).

Reasons for the Development of Subprime Lending

The increase in money supply placed pressure on financial institutions, which were in competition for investment dollars, to make bigger profits on the money invested with them. Subprime lending offered a way to increase profits on investment dollars. Once bundled into securities, investors could potentially earn high interest rates on their securities. The demand for the securities came from Wall Street investors (who purchased the bulk of subprime loans) hungry for high interest earning products (Mian & Sufi, 2007; Stein, 2008). According to Alan Greenspan speaking to Jon Meacham and Daniel Gross (2007)

> "The big demand was not so much on the part of borrowers as it was on the part of the suppliers who were giving loans which really people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less in size."

Changes in the banking laws made subprime lending possible. In 1980, the Depository Institutions Deregulation and Monetary Control Act effectively ended state usury laws and

allowed for banks to vary interest rates based on risk. Thus, interest rates could be high enough to make risky loans profitable (Ludwig et al., 2008; Shiller, 2008). In 1982, The Alternative Mortgage Transaction Parity Act was passed permitting adjustable mortgage rates. These deregulatory changes allowed for the development of the subprime market.

Subprime loans are characterized by the following: higher interest rates than conventional loans, higher fees and closing costs, penalties for early repayment of loans, high appraisal fees, and initially, seductively low rates of interest followed by later higher interest rates. Additionally, sometimes, the initial payment rates were insufficient to cover the accumulating interest, thereby increasing the amount of principal owed on the loan (Immergluck, 2004). In subprime loans, taxes and insurance on homes are often not included in the mortgage, thus placing an unexpected expense on the income of the borrowers (Stein, 2008). Some sub-prime mortgages also included credit life insurance. This insurance would repay the entire debt given the death or disability of the borrower. However, the cost of the insurance was added to the principal sometimes amounting to 15% of the principal amount of the loan (Bagley, 2004; Immergluck, 2004). In addition to the original subprime loan, flipping with the same lender, was wide-spread. Flipping is the repeated refinancing of a loan in a short period of time with high fees and prepayment penalties (Barr, 2008). With the practice of flipping, rather than incrementing a borrower's percentage ownership of their homes, they lost equity in their homes over time (Barr, 2008).

Much of the subprime lending involved refinancing of homes, rather than financing of new home purchases (Immergluck, 2004; Stein, 2008). In 1986, the Tax Reform Act was passed. This law allowed people to deduct interest from mortgage payments from income in figuring their tax bill. Interest on credit card debt was not, however, deductable. From the late

1990 to the present, there has been an explosion of credit card debt and bankruptcy occasioned by lower wages and higher costs of health insurance (Warren & Tyagi, 2003). Many refinanced their homes to pay off credit cards. Credit card consolidation motivated 58% of subprime refinancing, compared to 25% of prime refinancing (Immergluck, 2004). Indeed, about a third of refinance money went to pay down credit card debt (Greenspan and Kennedy, 2007; U.S. Department of Housing and Urban Development and U.S. Department of Treasury, 2000). As real estate agent Dave Simonsen stated, "people used their homes as ATM machines" (Goodman, 2007).

Growth of Subprime Lending

Subprime lending experienced substantial growth from 2003 to 2006. Whereas only 5% of mortgage originations were subprime in 1994, by 2005 this figure was 20% (Gramlich, 2007). From 2003 to 2006, the percentage of all mortgages that were subprime increased from 8% to 20% (Barr, 2008). In 2006, 20% of mortgages originated were subprime and 25% of total mortgage securitizations were for subprime mortgages (Kornfeld, 2007). Concomitant with the growth of subprime mortgages, in 2006, homeownership hit a high of 69% (Kiff & Mills, 2007).

The riskiness of subprime loans was particularly acute after 2006. Little documentation of a borrower's ability to repay occurred. Loans were made for 100% of the value of the property rather than requiring a down-payment (Brescia, 2008b, p. 296; Kornfeld, 2007). While in 2000, only 2% of loans involved adjustable rate mortgages or mortgage payments for only the interest, in 2006, 39% of mortgages carried these features (Berenbaum, 2009).

Subprime loans were eight times more likely to default than prime loans (Immergluck, 2004; Immergluck & Smith, 2005). Loans made after 2006 were particularly likely to default (Brescia, 2008b, p. 296; Kornfeld, 2007). As of December 2008, only 40 percent of subprime

loans with adjustable rate mortgages were current, 22 percent were 60 or more days delinquent, 16 percent were in foreclosure, and 10 percent were owned by the real estate company (Berenbaum, 2009). As mentioned previously, since 2006, housing prices declined by 25% (Berenbaum, 2009). Currently 23% of mortgages are underwater, with borrowers owing more money on their homes than the market value of the home (Pepitone, 2009).

Subprime lending targeted minorities. While the majority of subprime loans went to white borrowers, minorities were over-represented among subprime borrowers (Stein, 2008). The market for white, middle class loans was saturated. Making loans to minorities was a market that was not yet saturated, so minorities were identified as a market for the new subprime products (Brescia, 2008b). Over 50% of mortgages to African Americans were subprime products and 40% of mortgages to Latinos were subprime products (Avery, 2006). Examining seven metropolitan areas, 40% of subprime loans were made in predominantly minority neighborhoods, whereas 10% of subprime loans were made in white areas (California Reinvestment Coalition et al., 2009).

For minorities, having middle class incomes was not a protection against falling victim to subprime lending. According to a HUD 2000 analysis of lending in five large cities, 39% of refinancing in upper-income black census tracts were subprime products compared to only 18% in lower-income white census tracts (Immergluck, 2004). Examining results from several studies, Immergluck (2004) concluded that the most important factor explaining the concentration of subprime lending was the homogeneity of minorities in the area. The concentration of racial minorities in an area was more important than income level of the borrower, educational attainment of the borrower, or credit history of the borrower, although older people were more likely to be targeted as well (Berenbaum, 2009; Immergluck, 2004).

Ironically, many of those who took out subprime loans could have qualified for prime lending (Berenbaum, 2009). Brokers initiating loans were given extra compensation for selling mortgages which charged interest rates above the rates to which a borrower's credit score entitled the individual (Gramlich, 2007). Freddie Mac had estimated that 35% of all subprime borrowers could have qualified for prime loans (Association of Community Organizations for Reform Now, 2002; Immergluck, 2004). Others, including Franklin Raines, Chairman of Fannie Mae, estimated that closer to half of subprime borrowers could have qualified for prime loans (Association of Community Organizations for Reform Now, 2002; Brooks & Simon, 2007; Courchane, Surette, & Zorn, 2004; Schwartz, 2006).

Some explanation is needed for why affluent minorities agreed to subprime products. According to a HUD-Treasury Report, in white communities, there is more competition among prime lenders (banks, thrifts, credit unions) for making loans. Moreover, in communities with greater competition among prime lenders, loan terms are more transparent and more homogenous (Cortes, Wilson, Herbert, & Mahdavi, 2006). Among African Americans, 64% of mortgages were through a broker, as opposed to 38% of mortgages sold to whites. Whites were more likely to finance their mortgages through a bank or thrift, institutions more often offering prime loans (Brescia, 2008b).

Fight against predatory/subprime lending. Consumer groups (e.g., AARP, National Consumer Law Center, Consumer Federation of America) did protest predatory lending in minority communities (Immergluck, 2004). Their activities led to the passage of the Home Ownership and Equity Protection Act (HOEPA) of 1994. This bill required more disclosure and warnings to consumers taking out high priced loans with exorbitant interest rates. However, lenders found ways around the law. The practice of refinancing and then refinancing again, when

the borrower could not make a payment, enabled lenders to charge large fees for each refinancing while keeping interest rates just below the HOEPA trigger levels (Bagley, 2004; Schwartz, 2006). Only about 5% of subprime loans were covered by HOEPA according to a study conducted by the Office of Thrift Supervision (Bostic, Engel, McCoy, Pennington-Cross, & Wachter, 2008). Unfortunately, HOEPA did little to curb the rise of subprime loans, particularly refinancing loans (Immergluck, 2004).

In 2000, the Clinton administration again demonstrated concern over the growth in subprime lending. The U.S. Department of Treasury and the U.S. Department of Housing and Urban Development produced a report on predatory lending and Freddie Mac and Fannie Mae tightened underwriting criteria for the mortgages they purchased (Schwartz, 2006). The Justice Department of the Clinton Administration also brought suit against Huntington Mortgage and Fleet Mortgage in 1996 for charging higher upfront fees to minorities (Immergluck, 2004).

There were other attempts to fight predatory lending. Various states (California, Georgia, Massachusetts, New York, North Carolina) passed laws against predatory lending. In Chicago, ordinances forbade the city from doing business with predatory lenders. After these state laws were passed, prime lending in minority communities increased, possibly because banks did not have to compete against the aggressive tactics of subprime brokers (Immergluck, 2004). However, in 2004, the Office of Controller of the Currency (OCC) interpreted national banking laws as preempting the right of state governments to pass predatory lending legislation. Then, under the Bush administration, the OCC and Office of Thrift Supervision issued injunctions to states with predatory lending laws preventing the enforcement of these laws ending the brief period that offered some protection (Bagley, 2004; Brescia, 2009a; Ding, Quercia, White, 2009; Stein, 2008).

The Role of Credit Swap Derivatives in the Financial Collapse

As with the emergence of securitization, Wall Street was developing more complicated financial products. New products, called derivatives emerged. Collectively, the term derivative means that the value of the product is based upon the value of some other more tangible, more easily valued product (e.g., the value of a particular nation's currency; the value of a commodity such as a barrel of oil or bushel of wheat). An argument can be made that the use of computers and sophisticated mathematical models in estimating the value of these derivatives is what has facilitated the rise of these derivatives (Schwartz, 2006).

In the mid-1990s, Brooksely Born, Chair of the Commodities Futures Trading Commission, became alarmed by the emergence of risky derivatives on the market and took steps toward regulation of these products. She was quickly countered by Clinton's economic team (Alan Greenspan, Arthur Levitt of the Security and Exchange Commission, Robert Rubin, Larry Summers, Timothy Geithner) who ultimately induced Congress to pass legislation against regulating derivatives (Partnoy, 2009b). In 2000, the 106th Congress passed the Commodity and Future's Modernization Act with both parties supporting the legislation, the blessing of Alan Greenspan, and Bill Clinton's signature. This Act allowed financial houses to sell insurance, called credit swap derivatives, against the possibility of failure of debtors to pay back those mortgages that had been securitized (bundled into tranches for sales to investors). Unlike regular insurance sold to those assuming risk (who sought to ensure something they owned), the credit swap derivatives could be sold to anyone who wanted to "place a bet" on whether borrowers would fail to pay their mortgages. Although similar practices of running Bucket shops where bets were placed on the directions that the stock market would move, had been outlawed after the panic of 1907, the Commodity and Future's Modernization Act specifically overrode local laws

against Bucket Shops. If this insurance had been labeled "insurance" then sellers would have been required to hold particular levels of reserve so that they could pay off their obligations (Stein, 2008), but these new products were unregulated. When large numbers of subprime mortgage borrowers defaulted, insurers such as American International Group (AIG), Bear Sterns, and Lehmans owed large sums to those who had placed losing bets. People such as John Paulson and Bill Ackman, managers of hedge funds who had bet against the integrity of the housing market, made millions (Lewis, 2010). The Federal Reserve and the Congress bailed out AIG and Bear Sterns. This action was prompted upon witnessing the devastating effect that the bankruptcy of Lehmans had on the short term borrowing of small businesses (Sorkin, 2009).

Frank Partnoy (2009a), a former derivatives salesman at Morgan Stanley who is now a professor of Law at University of San Diego, blames the current financial collapse on derivatives, specifically credit default swap derivatives. Partnoy argues that subprime loans, even given heavy defaults rates, would not have been catastrophic for the entire banking system had not credit default swap derivatives been sold. "The total size of the subprime mortgage loans outstanding was well under a trillion dollars. Derivatives multiplied the losses from subprime mortgage loans, through side bets based on credit default swaps. Still more credit default swaps, based on defaults by banks and insurance companies themselves, magnified losses on the subprime side bets" (Partnoy, 2009a). Ludwig et al. (2009) agree with this assessment. Truly, Warren Buffett's term for credit default swaps, "financial weapons of mass destruction" was not an exaggeration (BBC News, 2003).

Blind Faith in Deregulation's Role in the Financial Collapse

Cassidy (2009) credits the zeitgeist of faith in the integrity of unregulated free markets as a major cause of the financial collapse. The faith that markets function perfectly led to the

failure to recognize the housing bubble by the Federal Reserve and provided the rationale for deregulation. Certainly the repeal of Bank Act of 1933 (Glass-Steagall) by the Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act) was not the beginning of deregulation. The Division of Research and Statistics at the FDIC (1997) compilation of the history of deregulation through the l980s and 1990s suggests that deregulation was the zeitgeist through much of the epoch. During the Reagan administration and the close of the Carter administration, the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Depository Institutions Act of 1982 both resulted in de-regulation. There was some stronger regulation following the Savings and Loan crisis in the late 1980s (itself brought about by the deregulation of S+Ls with the Garns-St. Germain Depository Institutions Act of 1982, Black, 2005). The Financial Institutions Reform, Recovery, and Enforcement Act of 1987 and the Federal Deposit Insurance Corporation Improvement Act of 1991 were regulatory bills. However, with the abatement of losses from the Savings and Loan insolvency, deregulation was once again embraced as seen in the passage of the Riegel Community Development and Regulatory Improvement Act of 1994 and the Riegel-Neal Interstate Banking and Branching Efficiency Act of 1994. Moreover, the climate of deregulation was an undercurrent at regulatory agencies (viz., Office of Comptroller of the Currency and Federal Reserve Board) throughout the decades of 1980s and l990s. During the early 1980s, state chartered banks entered securities, insurance, and real estate activities prohibited by Glass-Steagall without any federal response (FDIC, 1997). Regulatory agencies had become convinced that deregulation was needed so that banks could compete in the globalized financial industry (FDIC, 1997). While the Home Ownership and Equity Protection Act of 1994, which prohibited banks from offering mortgages to borrowers who did not have the capacity to make their payments, would have ended predatory

lending (Johnson & Kwak, 2010) , the Federal Reserve, under Greenspan, failed to administer the law. The deregulatory zeitgeist at the OCC and Federal Reserve under Greenspan effectively deregulated finance, even when the laws lagged behind. In responding to a question from Congressman Henry Waxman on October 23, 2008 regarding the reasons for the financial collapse, Greenspan admitted to having found a "flaw" in his economic model (PBS.org, 2008).

Where Do We Go from Here?

By the early 2000s many organizers and CRA scholars agreed that changes in the finance industry had rendered the CRA less effective than it had been in the 90s. In response to the withering effectiveness of the CRA, the National Community Reinvestment Coalition (NCRC) drafted the Community Reinvestment Modernization Act of 2009 (HR 1479). Representative Eddie Johnson introduced the bill in March 2009 (National Community Reinvestment Coalition, n.d.). The proposed law would require CRA type evaluations of insurance companies, credit unions, securities companies, and mortgage banks thereby amending many laws regulating various entities. Since the 2009-2010, Congress has been preoccupied with the stimulus bill, health care reform, and financial reform; HR 1479 has been sitting in a committee. However, if HR 1479 is going to pass, it will take strenuous organizing similar to the 1975-1977 campaigns resulting in the passage of the HMDA and the original CRA. Social workers need to help NCRC (which has 600 affiliates distributed across most major cities) win passage of HR 1479.

The current rise in foreclosures has exerted a devastating impact on the lives of low income people. Shelia Bair of the FDIC has argued that more should be done to force banks to refinance loans rather than moving to foreclosures (Mullins, 2008), which, in 2009, were at 11% of all mortgages (Mortgage Bankers Association, 2009). As much assistance should be given to Main Street as Wall Street. Many of the subprime mortgages which are going into foreclosure

were federally insured by the Federal Housing Administration (FHA) (Schwartz, 2006). FHA regulations require that foreclosed properties remain vacant until they are sold. Vacant houses contribute to blight, crime, and deterioration in a community and the property values in a community. Given that subprime loans were geographically concentrated (in minority communities), rather than being distributed across a city, means that whole sections of a city can become abandoned and blighted with serious declines in property values (Brescia, 2009b; Stein, 2008). Thus, avoiding foreclosures is important for the health of the community in general as well as the individual mortgage holder. In 2009, the Helping Families Save their Homes Act was passed into law, initiating the Making Home Affordable Refinancing Program through HUD the purpose of which is to decrease foreclosures. The details of this new program are available through government websites such as http://makinghomeaffordable.gov/pr_042809. The Making Home Affordable Program website reports that as of April 2010, 300,000 borrowers had been granted permanent mortgage modifications. In May of 2010, the Administrative Website for Servicers of Home Affordable Modification Program announced a Home Affordable Unemployment Program offering payment relief for unemployed home owners. Social workers should learn the details of these programs so they can ensure that clients avail themselves of these programs. Sources such as the National Consumer Law Center (2009) manual on avoiding foreclosure can be consulted.

It is important for social workers to be aware of the reasons for the financial cataclysm of the fall of 2008. Social workers should continue to advocate for reforms that preserve the goal of providing affordable, quality housing to poor people. Assistance to low income people, for example by the CRA, cannot be blamed for the fall 2008 collapse of the financial system. Minorities and poor people were the victims of the subprime lending craze resulting in the

collapse of the financial system. Indeed, Brescia (2009a) has argued the 2008 catastrophe did not occur because of the CRA but because of the weakness of the CRA. If the laws against exploiting the disenfranchised by predatory lending had been in place or enforced, the financial disaster could have been avoided. Moving forward, we should all be clear about what needs to change in order to ensure the health of the economic system. Assisting poor people to move into the middle class will restore economic health rather than vitiating the health of the system.

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