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Encouraging Housing Equity

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Commentary: Encouraging Housing Equity

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On the 40th anniversary of the Community Reinvestment Act (CRA)[1], it is worth thinking about how federal regulations have worked to address inequities in housing markets. The civil rights movement launched a period of activism and optimism for government intervention into housing discrimination, leading to the passage of The Fair Housing Act (FaHA)[2] of 1968 and the 1977 CRA. FaHA and CRA share some common traits; they are both federal regulatory tools that rely on a notion of minimum obligation and encourage innovations that promote greater access by lower-income and protected-class households to housing and economic opportunities. In addition, both statutes employ sanctions to motivate regulated entities toward nondiscriminatory behavior and help establish standards for what is considered responsible behavior in housing markets.

This article reviews the similarities and differences between one significant component of FaHA, the 2015 Affirmatively Furthering Fair Housing (AFFH) rules, and CRA. Substantial evidence suggests that CRA has had a positive impact on home lending practices (Apgar and Duda, 2003; Bhutta, 2008), despite the fact that it has often been laxly implemented over the years (Immergluck, 2004; Silver, 2016). It is too early to say definitively whether or not the 2015 AFFH regulations will generate such an impact. By examining AFFH alongside CRA, however, it is possible to identify a number of structural and design characteristics of the rules that may limit their effects.

Most critically, AFFH is limited by the fact that its primary potential sanction—the withholding of funding from the U.S. Department of Housing and Urban Development (HUD)—may not prove much of a consequence to the local governments against which it is most likely to be applied, a problem exacerbated by continual declines in HUD funding. It is unclear whether such a sanction would ever be exercised, and it is unclear whether the offending localities would be likely to care much if it was. Conversely, CRA's main sanctions—the possible delay or denial of a bank merger or acquisition and also the risk to a bank's reputation for being socially responsible—are significant, if underutilized, consequences that can be used to encourage compliance from most banks and savings institutions.

[1] Pub. L. 95–128, 91 Stat. 1147, Title VIII.
[2] 42 U.S.C. § 3601–3619.

Background

The AFFH provision, originally part of FaHA, has often been viewed as a dead letter. Until the 2015 AFFH rule was produced, the provision was criticized for weak implementation and enforcement. In particular, the Analysis of Impediments (AI) process, which was supposed to identify barriers to fair and affordable housing in a jurisdiction, has been characterized as ineffective (GAO, 2010; National Commission on Fair Housing and Equal Opportunity, 2008). AIs frequently were issued with minimal critical oversight and effectively no community engagement. AIs were not required to be submitted to or reviewed by HUD, and compliance with the AI process was weak. GAO (2010) examined more than 400 AIs and found that 29 percent of entitlement communities' AIs were more than 5 years old. Many AIs did not include timeframes for implementation, and top officials did not sign off on others. More fundamentally, the sense that the AI process generated improvements in fair housing across the U.S. is scarce.

With the advent of the new AFFH rules in July 2015, the idea that local jurisdictions might take the AFFH provision more seriously holds some promise. However, the AFFH rules suffer from a variety of limitations, some of which are the creatures of the FaHA statute, the result of the structure and design of the regulations, or derived from fundamental issues of power relations between the regulator and the regulated party. Comparing the AFFH process with that of CRA serves to illustrate some of these limitations.

In a general sense, FaHA and CRA have some similarities. Arguably, both statutes have helped promote a more socially responsible business culture that has influenced housing markets in important ways. In the case of FaHA, most real estate agents understand what is considered acceptable or not acceptable under the law. The National Association of Realtors®—despite its historic opposition to FaHA and the 1988 improvements—regularly offers a wide variety of training and programs related to the law (Burke, 2016; NAR, 2016). Although some real estate agents may prefer that the law not exist, and some may overtly flout it, most have generally accepted the norms of fair housing that FaHA introduced and helped standardize. Fair housing is an area in which large segments of the private sector generally accept the law as good business practice.

CRA raised the consciousness of financial institutions, in terms of their responsibilities to serve the banking and credit needs of lower-income communities and households. Arguably, the change to CRA under the Financial Institutions Reform, Recovery, and Enforcement Act[3] of 1989—in which CRA exams and ratings were made public—was the most important policy driver of that change. Large banks, especially, are not only at risk of having a merger delayed or having their reputations damaged if they do not do well on their CRA exams, but they often strive for "outstanding" ratings to maintain their profile as socially responsible corporate citizens.

In addition, both types of law can be seen as *social contract* regulation, in which parties benefiting from federal government support (not necessarily direct financial aid) are held to a set of standards and are subject to evaluation under these standards. The AFFH rules specify the process by which recipients of federal housing and community development funding assess their own efforts at

[3] Pub. L. 101–73, 103 Stat. 183.

affirmatively furthering fair housing by completing an Assessment of Fair Housing (AFH; HUD, 2015). HUD is then required to review the AFH for completeness and for whether the recipient is making adequate steps to further fair housing. The AFH can be seen as very roughly equivalent to the CRA performance evaluation.

In the case of AFFH, the receipt of federal housing and community development monies is the benefit accruing to state and local governments that are subject to AFFH rules. In the case of CRA, banks and savings institutions benefit from deposit insurance and a host of other federal benefits—access to the Federal Reserve System, Fannie Mae, Freddie Mac, the Federal Housing Administration (FHA), and the Home Loan Banks; the support and credibility of the federal bank supervisory system; and, as evidenced since 2007, access to many potential emergency assistance programs. In fact, CRA historically was viewed as a specification of banks' responsibilities to serve the credit needs of their communities, with a particular focus on underserved neighborhoods and communities (Immergluck, 2004).[4]

Despite the similar goals of the AFFH and CRA regulations, they have fundamental differences, including whom is being regulated, the power of the sanctions to change behavior, and the data and metrics that are used to measure progress.

Differences in the Regulated Parties and Their Roles in the Assessment-and-Evaluation Process

The first key difference between the AFFH and CRA regulations relates to the regulated parties. CRA covers federally insured depository institutions, whereas the AFFH rules apply to state and local governments who are "entitlement communities" (that is, receive HUD funding) and public housing authorities (PHAs). The motivations, political power, and context of banks and savings institutions (most of which are small institutions) are quite different from those of local governments and PHAs, which influences the degree to which these regulations may induce positive actions. Although the financial industry holds a great deal of political power, the typical bank, especially if it is not large, tends to have limited ability to call on its congressional representatives to defend it if it receives a poor CRA rating. Federal banking regulators are also arguably more insulated from local political pressure than is a line agency like HUD. Moreover, a poor CRA rating may put the bank at odds with voters in the bank's service area, especially when local advocacy organizations are involved in critiquing the bank's practices, and further constrain its access to political power. Conversely, many local governments found to perform poorly under the AFFH rules might find their congressional representatives or political constituencies quite willing to take their side against HUD.

[4] In fact, since at least the early 2000s, community reinvestment advocates have called on federal policymakers to expand CRA to a much broader array of financial institutions, because most receive some form of significant federal support (Immergluck, 2004). Most nonbank mortgage companies, for example, utilize Fannie Mae, Freddie Mac, FHA, or a combination of the three for a significant share of their home lending. Many finance companies rely on large federally insured banks for their warehouse lines of credit, without which they could not make business or other types of loans. Investment banks, even if they are not affiliated with insured depositories, rely heavily on a federally regulatory infrastructure, without which they could not attract many investors.

The Value of the Sanctions to the Regulated Parties

A second, and closely related, difference between AFFH and CRA is the value of the potential sanctions. A weak CRA rating—a rating of "substantial noncompliance" (SNC) or "needs to improve" (NTI)—may imperil or delay current or future plans to merge with or acquire another bank, which could be costly. In contrast, an "outstanding" CRA rating can work as a sort of immunization from the risk of having a merger or acquisition delayed on CRA grounds. Even during times when banks are less likely to engage in mergers or acquisitions, a strong CRA rating serves as a signal to the bank's customers and investors that it is a socially responsible corporate citizen. Institutional investors, including pension funds, religious institutions, state and local governments, and large nonprofit organizations, may be less likely to do business with banks that do not maintain strong CRA ratings.[5] A bank receiving a rating of SNC or NTI is especially likely to suffer from significant reputational risk. The evidence suggests that, when faced with a poor CRA rating, most banks are motivated to improve that rating. Exhibit 1 shows that of the 357 banks receiving a SNC or NTI CRA rating since 2000, only 85 (less than 25 percent) received two or more such ratings in a row. This finding suggests that most banks are motivated to shed poor CRA grades.

In contrast, in the case of AFFH, the value of the potential sanction is likely to vary widely, based on the socioeconomic and political context of the entitlement community or PHA. In large central cities or suburbs that greatly value HUD funding (for example, the Community Development Block Grant and HOME programs), the risk of losing such funding will comprise a substantial sanction. In some other communities, however, especially ones that are not very reliant on HUD funding and where political leadership may not be greatly concerned with issues of affordable housing or community development, the value of the sanction is much less clear.[6] Some communities may not want to be sanctioned by HUD for fear of being labeled exclusionary, but in other contexts it is conceivable that some local political leaders may be rewarded politically by residents who are unwelcoming of housing or community development subsidies.

More fundamentally, the question remains of whether HUD will have the political will or ability to withdraw funds from localities, even on an infrequent basis. Two systematic attempts have been

Exhibit 1

NTI and SNC Ratings From CRA Performance Evaluations Published January 1, 2000—July 1, 2016

	Number of Banks	Number of Exams
CRA rating of NTI or SNC	357	539
Repeated CRA rating of NTI or SNC	85	161
Percent of CRA NTI or SNC ratings or banks that increase to satisfactory or outstanding rating by next exam	76.2	70.1

CRA = Community Reinvestment Act. NTI = needs to improve. SNC = substantial noncompliance.
Note: Author's calculations for all bank CRA ratings from January 1, 2000, through July 1, 2016.
Source: Federal Financial Institutions Examination Council Interagency CRA Ratings Database (http:// www.ffiec.gov/%5C/ craratings/Rtg_spec.html)

[5] For example, several large cities have passed "responsible banking ordinances" in recent years, and many of these ordinances look to CRA ratings as a part of their evaluation of socially responsible banking (Holeywell, 2012).
[6] If the loss of a broader array of federal funding were brought to the table as a sanction—as in George Romney's Open Communities proposal—then AFFH would contain a much more powerful sanction, but that has not been proposed.

made to deny funding to localities on fair housing grounds, but both were met with substantial resistance. George Romney's Open Communities plan—in which federal funding would be withheld from exclusionary localities—was key to his eventual exit from the Nixon Administration (Hannah-Jones, 2015). In 1998, HUD Secretary Andrew Cuomo briefly suggested denying HUD funding to communities that did not comply with AFFH, but he met swift resistance from the local government lobby (Hannah-Jones, 2015). In general, HUD has never consistently held back funding based on fair housing grounds in any systematic way.

Specificity of Quantitative Indicators and Comparability Across Assessments

The third difference between CRA and AFFH is in their approaches to data collection and performance metrics. Federal regulators evaluate banks every 2 to 5 years on their CRA performance. Regulations and procedures governing CRA performance evaluations ("exams") specify the sorts of measures that bank examiners should use in conducting an exam. An examiner develops an analysis of the "performance context" of the bank being evaluated, which situates the bank's CRA activities within the local area's economic conditions and needs. Using the performance context, examiners have significant discretion in what a particular exam might emphasize or precisely what indicators or ratios it might display.

Despite the flexibility to take into account local conditions, the regulations and associated guidelines specify a good deal of common approaches to evaluating key data on lending patterns. For example, examiners are generally instructed to calculate an "institution's share of reported loans made in low- and moderate-income geographies versus its share of reported loans made in middle- and upper-income geographies within the assessment area(s)" (OCC, FRB, and FDIC, 2014: p. 7). Exhibit 2 is an excerpt of a table from a "large bank" CRA exam conducted by the Office of the Comptroller of the Currency (OCC) in 2014. It examines the geographic distribution of home purchase loans across census tracts of different income levels. The table examines the bank's home lending in the Greenville, South Carolina metropolitan area, where the bank is based.

Exhibit 2 shows that the bank made 0.81 percent of all home purchase loans in upper-income census tracts but only 0.48 percent of all loans in moderate-income census tracts and 0 percent in low-income census tracts. Thus, the bank's market share in higher-income neighborhoods was much larger than its market share in lower-income neighborhoods. The ratio of the market share in

Exhibit 2

Excerpt From a Table in a Large Bank CRA Performance Evaluation, 2014

Table 2. Geographic Distribution of Home Purchase Loans

Geographic Distribution: Home Purchase — Geography: South Carolina — **Evaluation Period**: January 1, 2012 To December 31, 2013

Assessment Area:	Total Home Purchase Loans		Low-Income Geographies		Moderate-Income Geographies		Middle-Income Geographies		Upper-Income Geographies		Market Share (%) by Geography*				
	#	% of Total**	% Owner Occ Units***	% BANK Loans****	% Owner Occ Units***	% BANK Loans	% Owner Occ Units***	% BANK Loans	% Owner Occ Units***	% BANK Loans	Overall	Low	Mod	Mid	Upp
Full Review:															
Greenville	324	79.22	3.37	0.62	14.95	7.41	47.78	36.11	33.91	55.86	0.72	0.00	0.48	0.69	0.81
Limited Review:															
Anderson	27	6.60	2.08	0.00	19.37	0.00	47.91	66.67	30.64	33.33	0.19	0.00	0.00	0.34	0.10
Spartanburg	58	14.18	1.73	0.00	17.16	12.07	53.25	55.17	27.86	32.76	0.18	0.00	0.00	0.27	0.08

CRA = Community Reinvestment Act.
Source: Reproduced from OCC (2014)

higher-income neighborhoods to the market share in lower-income neighborhoods is not necessarily the dominant criterion on which a bank's CRA lending is judged, but it is one commonly used indicator. More importantly, these sorts of measures are specified in the regulations and operating procedures of the regulatory agencies.

In the case of the AFFH process, the local governments complete the AFH document. The guidebook for preparing an AFH is on the order of 200 pages long (HUD, 2015). The guidebook does instruct localities to conduct certain common measurements, such as the level of segregation within the metropolitan area. In terms of measuring local government activities and determining how well they further fair housing, however, the guidebook is quite vague; it provides a variety of data and a mapping tool but very little guidance on what measures should be constructed with such data. In this aspect, the AFH involves more discretion on the part of the authors than does a CRA exam. Moreover, because AFHs are performed by the localities and not by trained examiners, the variability in indicators and methods across AFHs is likely to be much greater than the variability across CRA exams. The ability to generate AFHs that are consistent across 4,600 entitlement communities and PHAs could be a major challenge, one that might severely tax HUD staff.

CRA exams also focus on outcomes that are largely (although not completely) under a bank's control. That is, whereas lending to lower-income neighborhoods may be limited by the demand for homeownership in such neighborhoods (although demand is partly a function of mortgage availability), the CRA examiner compares the bank with its peers (or the "aggregate" market), through the market share comparison described previously and by comparing a bank's lending with various proxies for potential demand (for example, the number of owner-occupied homes in lower-income and higher-income census tracts).

In the case of AFFH, localities are being assessed for their actions across a much wider range of governmental activities—including funding decisions and local regulations—that may affect fair housing outcomes. The rules also call for them to be assessed for whether levels of segregation within their communities have improved or worsened. Arguably, some localities—especially ones with predominantly minority or lower-income populations—have limited influence over these broader governmental activities or the ultimate outcomes. Perhaps understandably, the rules are vague on the extent to which localities should focus more on end outcomes or on intermediate objectives such as distributing housing subsidies in a desegregated fashion.

The Staffing and Resources of HUD Compared With Bank Regulators

Finally, CRA and AFFH differ in terms of evaluative capacity and the scale of review that is required. Approximately 6,000 commercial banks and savings institutions are regulated for CRA. Most banks fall under the "small bank" CRA evaluation process, which is much less detailed and extensive than the "large bank" CRA exam. Some CRA exams—especially of banks that serve multiple states—can run into the hundreds, in terms of page count. Moreover, a bank is evaluated for CRA by one of three federal bank regulators—the OCC, the Federal Reserve, or the Federal Deposit Insurance Corporation—none of which has a budget subject to annual congressional appropriations. These regulatory agencies devote hundreds of high-level staff to the CRA evaluation process.

Although HUD does not need to conduct AFHs in the same way that regulators evaluate banks under CRA, with more than 4,600 entitlement communities and PHAs, HUD may need to review 900 or more AFHs per year.[7] HUD has 60 days to notify a locality whether it is or is not accepting the AFH. The two classes of reasons for not accepting the AFH are (1) that it is inconsistent with fair housing or civil rights requirements, or (2) that it is substantially incomplete. Obviously, these two grounds for rejection of an AFH leave a great deal of uncertainty. One might expect that the second class of reasons for not accepting an AFH would be the most common, at least in the first 5 years of the new rule, so the interpretation of "substantially incomplete" is likely to be a critical one. It may also be possible that some AFHs will go through more than two iterations before being deemed acceptable. These issues suggest that the administrative and staffing challenges for HUD will be substantial, especially because HUD is subject to congressional appropriations and its available resources to review and direct thousands of AFHs will likely pale in comparison to resources commanded by the bank regulators.

Conclusion

The differences between CRA and AFFH regulations reveal some key limitations in the AFFH regulatory structure. Although the new AFFH rules and data tool may prove to be an improvement over the previous AI process, they suffer from a number of key challenges, some of which are evidenced in comparing the AFFH rules with the CRA regulatory process. These include issues involving intergovernmental regulation and related power structures, the lack of consistency and specificity of the quantitative measures in the AFH, the unclear focus of the assessment measures, and the staffing and resource challenges that lie ahead for HUD.

The most important flaw in the AFFH structure, however, is the likelihood that some localities—especially those most likely to merit critical action under the AFFH process—may also be those least worried about any loss of HUD funding. Therefore, the AFFH regulations may have limited power to break down barriers to fair housing in the very places where those barriers are the highest.

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[7] Joint or regional AFHs are possible, which may reduce the number of AFHs that HUD needs to review, but such AFHs may also be more complex.

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