Assessing Community Credit Needs

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Establishing that a community has "unmet" credit needs" means, essentially, showing that lenders have failed to recognize creditworthy borrowers in a neighborhood. While lenders may legitimately deny credit because an individual cannot support a loan, or because the collateral is not valuable enough to cover the lender's risk, a community group may perceive that there are other reasons for lender reluctance to serve its area. It may feel that there are safe, secure and profitable loans which are not being made because the lender lacks information or expertise, discriminates, or just feels comfortable doing what it is doing.

In building the CRA case, an organization will want to demonstrate a lender's lack of performance in making needed loans, the area's unmet need for loans, and the lender's capability for meeting that need. The following narrative outlines some of the major research sources which can be used to answer these questions. The first guidebook in this series, *Assessing Community Credit Needs* provides more detail on these research sources and techniques.

A. HOME MORTGAGE DISCLOSURE ACT DATA

The best source of information on real estate credit in a locality is data required by the Home Mortgage Disclosure Act (HMDA, or Public Law 94-2000, 1975).

Reporting institutions must annually release a publically available disclosure statement. For each census tract in which an institution made at least one loan during the year, it must report the number of loans and total loan dollars originated in each of the following categories:

- Single family (1-4 units) mortgage loans with government (FHA, VA, FmHA) mortgage insurance;
- Single family conventional mortgage loans;
- Single family home improvement loans;
- Single family loans given to non-owner occupants; and
- Multifamily (5+ unit) loans.

In addition, the institution must report the census tract and type of loan for real estate loans purchased from other institutions during the year. Loans originated outside of the institution's home SMSA are reported by the above types, but without a breakdown by location. HMDA disclosure covers lending back through 1975 with lenders required to keep their disclosure statements for five years.

WHICH INSTITUTIONS MUST REPORT

All depository institutions (commercial banks, mutual savings banks, savings and loan associations, and credit unions) must report HMDA disclosure unless:

- they are neither federally chartered nor insured;
- they have assets of $10 million or less: or
- they have no offices within an SMSA.

HMDA disclosure is thus not applicable to institutions in many rural areas, or to smaller institutions. It is also not applicable to nondepository lenders (e.g., mortgage companies).

HOW TO OBTAIN THE DISCLOSED INFORMATION

Each reporting institution will have a HMDA disclosure statement at its main office. A copy of this statement should be available to the public perhaps for a copying charge.

Community-based groups in several cities have gotten help from city agencies in obtaining and compiling the HMDA disclosure reports. If there are many institutions in a city, this would save leg work and money. As will be shown in the next section, time and some analytical ability is required to compile and interpret disclosure reports. This is an appropriate role for city agencies.

HOW TO USE THE HMDA DISCLOSURE

Techniques for using the disclosure reports are described in detail in the companion CRA guidebook, *Assessing Community Credit Needs*. These techniques will be briefly overviewed here.

1. Evaluation/monitoring. HMDA disclosure of a year, or series of years, can provide the 'baseline' of data necessary for monitoring and evaluating future efforts by lenders.
2. Geographical comparisons. Many studies have used HMDA dusclosure data to compare lending in one part of a city (or SMSA) with lending in another section. The assumption in these comparisons is

that lending in one area (often the suburbs) is at a level necessary to maintain a healthy amount of investment. If lending in the compared area is beneath this level, further reinvestment is needed.

3. Lender comparisons. Other studies have compared the lending records of different institutions within a neighborhood, city, or SMSA. HMDA disclosure data can be used to rank the performance of lenders, or to compare the efforts of a responsive lender to other institutions.

4. Neighborhood impact. HMDA disclosure data details credit activities by census tract. The credit activities can be compared with measures of neighborhood credit needs, to derive the impact upon the neighborhood of one (or all) lenders. These measures of neighborhood credit needs comes from census tabulations or data from city agencies. Examples of this would be to compare mortgage activity with property turnover, or just with the number of 1-4 unit structures.

In summary, HMDA disclosure data by itself will describe 'what is going on' for real estate credit from one or many institutions in a neighborhood, city, or SMSA. The data can be used to describe 'what could be going on' through comparisons of one area with another, one lender with another, or credit activities with more concrete expressions of need.

B. CITY OR STATE DISCLOSURE

HMDA is not the only law mandating the disclosure of real estate credit practices. California, Connecticut, Illinois, Massachusetts, New Jersey, New York, Michigan, Ohio, and Washington have state disclosure laws or regulations. The cities of Chicago, Cleveland, Minneapolis, Rockford (Illinois), and St. Louis have disclosure ordinances. Colorado, West Virginia, and the District of Columbia place government deposits partially on the basis of lending records. Any institution competing for these deposits must disclose lending patterns.

There are two common advantages to city/state disclosure data, as compared with HMDA disclosure data. First, more information is generally available. The information disclosed varies across jurisdications, but could include loan terms (interest rates, loan length, downpayment), deposits, foreclosure, small business credit, and agricultural credit, in addition to data comparable to HMDA diclosure. Second, dity and state agencies often compile and interprete the disclosed data. The use of this information is summarized in the preceding section of HMDA, and detailed in the companion CRA Guidebook, *Assessing Community Credit Needs.*

C. PROPERTY TRANSFER ANALYSIS

All cities keep records of mortgage holdings and property transfers. These records can be used to analyze real estate credit patterns in much the same way as HMDA disclosure. There are advantages to using property transfer data, notably:

- data can be obtained on lenders not covered by HMDA (mortgage companies, smaller depositories, etc.);
- data can be obtained for non-metropolitan regions where HMDA is not applicable;
- data can be obtained for areas smaller than a census tract, as a few blocks within a neighborhood; and
- data can be obtained as far in the past as one may want to go.

Property transfer data can be as useful as disclosure data. There is one major disadvantage to property transfer data: it is extremely time consuming to compile. Readers interested in property transfer data should refer to *Assessing Community Credit Needs* for details.

D. COLLECTING NEW INFORMATION

The preceding methods of analysis use information already disclosed by lenders. It is convenient to have lenders do the work; however, there are areas of credit practices not covered by detailed disclosure. These areas include loans for mobile homes, businesses, energy conservation, and agriculture. Institutions broadly disclose information in these categories, but without much detail. Analysis of lending practices in these areas requires collecting new information through interviews and surveys and individuals or firms which have (or have not) received loans. In addition, disclosed data on real estate credit can be supplemented by surveys or interviews with neighborhood residents and other actors in the real estate market.

The new information collected may be "hard" or "soft." "Hard" information is collected through surveys which have some statistical validity, while "soft" information comes through talks with individuals. For mobile home credit, for example, this would include mobile home dealers, people owning and renting mobile homes, people who might want to live in a mobile home (generally, those renting housing in dilapidated, overcrowded conditions, or

The South Shore area was developed as an exclusive, middle-class section in the early part of the century.
Photo courtesy of Erica Pascal

elderly home owners), and mobile home park developers. The objective in collecting "soft" information is to obtain a feel for local credit practices without attempting to make a statistical case.

Following is an overview of the types of information to collect to assess the credit needs of local businesses or agriculture, or for mobile home or energy conservation material purchase. If the types of information appear useful, refer to *Assessing Community Credit Needs* for details on how to obtain the information.

1. BUSINESS LOANS. Businesses need credit to purchase property for acquisition, to expand their facilities or services, and to safely weather emergencies. A few state disclosure laws include information on small business credit. Property transfer data also includes information on commercial and industrial real estate credit. Information on SBA-guaranteed loans -- by lender -- can be obtained from the national SBA office. But research on small business lending may have to rely on interviews or surveys. Whatever the source, researchers may want to ask,

- Are there types or sizes of firms excluded from local credit sources?
- Are there types of loans necessary for local businesses which are not being made by lenders?
- Does a firm's location, ownership or organization (e.g., minority owned; cooperatively organized) exclude it from local credit sources?
- Are some lenders more responsive than others?
- Are there creditworthy needs from local firms which are not being met?
- Do local lenders participate in governmental insurance programs?

2. MOBILE HOME LOANS. Living in a mobile home is fast becoming one of the few significant ownership options for low and moderate income people. New information must be collected to understand mobile home credit. Questions to ask include:

- Do lenders participate in FHA and VA mobile home loan insurance programs?
- Do lenders provide credit for used as well as new homes?
- Do lenders provide credit for homes located outside of mobile home parks (e.g., on individual lots)?
- Do lenders provide credit to female heads of household?
- Do lenders set loan terms to promote affordability?

3. LOANS FOR ENERGY CONSERVATION. Most persons and firms cannot afford the initial capital costs necessary to save money through energy conservation or purchase of alternative energy systems without credit. The issue here is the method by which a lender appraises the value of energy conservation or alternative energy materials. If the appraisal is low, less money will be loaned than is necessary for purchase. At the worst, a lender will completely discount the value of energy saving materials or systems. Questions to ask include:

- Do lenders have specific energy loan programs?
- Do lenders set the terms of energy related loans to maximize affordability?

- Do lenders unduly discount the future value of energy-related systems when they are appraising loan potential?

4. AGRICULTURAL LOANS. Credit is an absolute requirement for agriculture, whether highly mechanized or not. A typical farm requires short-term and intermediate credit as well as long-term credit, to survive, and family farms find it increasingly hard to obtain regular and reasonable financing. Questions to ask include:

- Do lenders exclude small farms from credit opportunities?

- Do lenders refuse credit for certain types of farms?

- Do lenders provide the necessary amounts and reasonable terms for agricultural credit?

E. INSTITUTIONAL ANALYSIS

An "institutional analysis" is research into a particular lender's overall investments, drawing primarily on corporate financial statements. It is useful for community groups because it can put into perspective a bank's or S&L's commitment or lack of commitment to a neighborhood. It can also uncover dramatic and convincing arguments for increased CRA responsibility.

There are two main kinds of information available for "institutional analysis":

1. Annual Reports, Reports of Condition, Reports of Income. These periodic financial statements show income and expenditures, and kinds of loans in a bank's or S&L's portfolio. The quarterly "report of condition," or "call report," is especially useful since it details by dollar amount the kinds of loans in the lender's portfolio, by the following types:

- 1-4 unit, nonfarm family residential properties (further broken down by FHA, VA and other);

- Multifamily nonfarm real estate loans;

- Business, industrial and commercial real estate loans;

- Loans to financial institutions;

- Securities loans;

- Loans to farmers;

- Commercial and industrial loans;

- Loans to individuals (including breakdowns of mobile home and home improvement loans).

Community groups can compare the kinds of loans an institution makes with one another determining, for example, whether its lack of mortgage loans stands out in comparison to commercial and industrial investments. Surveys and interviews can follow to compare a lender's investments with credit needs in a community, for example, for agricultural or mobile home loans.

2. 8K and 10K Reports. These are filed annually with the Securities and Exchange Commission by firms whose stocks or bonds are registered with the SEC, including many commercial banks and stock savings and loan associations.

These reports include:

- Details about subsidiaries owned in whole or in part by the parent company. Many large bank holding companies have mortgage and other subsidiaries whose operations may impact -- or fail to serve -- local neighborhoods.

- "Material changes," such as significant investments or losses, by the company.

F. WRITTEN UNDERWRITING CRITERIA

Federally regulated S&Ls, and some state-chartered ones, must make public information on their "underwriting criteria," that is, the criteria they use to decide who is creditworthy, what interest rates and downpayments to adopt, and so forth. Groups should review these criteria for loan policies, terms or standards which may have a discriminatory effect against minorities or neighborhoods.

Community organizations can collect and compare these criteria, coming up with an analysis of the relevance of loan rates and terms to community characteristics. For instance, underwriting criteria may contain definitions of the minimum borrower income or housing stock characteristics necessary for obtaining credit. This information can be compared to local census and housing data. Other underwriting criteria, such as income to debt ratio, job stability, age of applicant and age of property required for creditworthiness can likewise be compared to an organization's knowledge of the individuals and homes in its neighborhood. Any discriminatory criteria uncovered can be made part of a CRA case, submitted to the Public File, or used in a civil rights complaint with the regulatory agency.