

Although the Community Reinvestment Act has improved loan availability among small businesses run by minorities, equality with equally creditworthy white-owned firms remains elusive.

*In 1977 the Federal Government introduced the Community Reinvestment Act (CRA), which requires banks to provide credit in low-income areas, which often include minority neighborhoods. Using data on small businesses seeking bank loans, **Timothy Bates** and **Alicia Robb** find that banks were using inconsistent standards to evaluate the loan applications of black and Latino small businesses. In minority neighborhoods where CRA scrutiny was high, they were as likely as equally creditworthy whites to receive loans, while in other urban neighborhoods, they were disproportionately rejected. They write that in order to address this loan gap, regulatory authorities should rate banks comprehensively on their minority business lending performance in all areas, and publicize those rankings widely.*



Responding to limited loan availability in minority neighborhoods, activists in America have sought since the 1950s to make financial institutions responsive to the credit needs of those communities. Since 1977, the **Community Reinvestment Act** (CRA) has required American banks to serve the credit needs of low-income areas, including traditionally excluded minority neighborhoods. Although the CRA contained statements about banks financing the housing and economic development needs for minority communities, the statute itself contained few specifics, and directed bank regulators to implement its intent. Initially opposed by bankers *and* their regulatory authorities, CRA has been contentious for decades.



One trait distinguishes minority-neighborhood firms from others: roughly half are owned by African Americans, Latinos, and other minorities, while fewer than 15 percent of the urban firms located elsewhere are minority owned. This fact raises the issue of whether the limited loan availability traditionally handicapping firms operating in minority communities reflected their higher incidence of minority ownership, the lower level of economic well-being and disamenities typifying minority neighborhoods, or, perhaps, other factors.

In new research, we explored CRA impacts by investigating whether firms operating in minority neighborhoods had the same degree of loan access between 2008 and 2011 as equally creditworthy businesses located elsewhere. We found that while neighborhood location per se was irrelevant, small businesses owned by minorities were most likely to have their loan applications approved in neighborhoods where banks faced CRA-related pressures to treat all applicants equally, irrespective of race. Outside of minority neighborhoods where CRA scrutiny was weaker, black- and Latino-owned firms were more likely than equally creditworthy whites to be denied loans. Thus, while the CRA had intended positive effects in minority communities, equality in small-business loan access has remained elusive elsewhere.

Contesting CRA Enforcement

To determine if banks were complying with CRA regulations, regulators periodically conducted audits. Despite widespread evidence of minority-neighborhood redlining by bankers, CRA examinations of commercial banks rarely resulted in “less than satisfactory” ratings. Bank incentives to alter lending policies are based upon possible sanctions for non-responsiveness to community credit needs, especially relevant for banks seeking to expand, since CRA-based sanctions can be used to deny these requests. In the 10 years following CRA passage, bank regulators reviewed about 40,000 expansion applications and denied only eight on CRA grounds.

Responding to regulatory authority laxity, neighborhood associations, civil-rights groups, and others sometimes challenged bank expansion requests. Under the CRA law, these organizations could oppose banker requests to

expand on the grounds of inadequate fulfillment of their obligations to serve local communities. A rising incidence of formal challenges motivated some banks to seek relationships with activists. Community activism, in conjunction with sympathetic media attention, ultimately forced regulators to create institutional processes for assessing CRA performance under the law. Claims of discriminatory bank practices stressed the inter-related issues of racial discrimination negatively impacting household and business borrowers, and spatial discrimination penalizing loan applicants for their minority-neighborhood locations. Subsequent CRA agreements often included banker commitments to expand lending to minority applicants, potentially alleviating loan scarcity problems traditionally plaguing these communities.



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Black and Latino applicants more likely to be rejected by banks

We analyzed [Kauffman Firm Survey](#) (KFS) data describing small businesses seeking bank loans. The KFS database tracks a cohort of businesses started in 2004 through year-end 2011, and their particular strength is inclusion of follow-up information on new capital raised subsequent to startup. These KFS data currently provide the only nationally representative database with firm-specific information on geographic location, loan-application outcomes, and small-business debt sources. We analyzed small-business loan-application outcomes solely for applicants located in urban minority neighborhoods. In this context, equally creditworthy minority and white owners experienced nearly identical loan-application rejection rates; minorities were not penalized for being minorities. Next, we analyzed only urban small businesses *not* located in minority neighborhoods, and found that black and Latino applicants were more likely to be rejected by banks than equally creditworthy whites. Finally, we pooled all urban loan-applicant firms to test whether firm location mattered. Firm geographic location, whether in minority communities or other urban areas, we found, was unrelated to application outcomes.

It is noteworthy that bankers claim to apply colorblind evaluation criteria to all small-business loan applicants irrespective of firm location, a claim inconsistent with our finding that African American and Latino applicants *not* located in minority neighborhoods were penalized for being minorities. Under the glare of CRA requirements reinforced by possible activist-group challenges, bankers appear to be treating minority-business borrowers operating in minority neighborhoods equally, while in geographic locations where the pressure to comply with CRA requirements is less obvious, the minority-owner trait is penalized.

Most banks care intensely about their public image, which motivates them to seek outstanding CRA ratings. A high CRA rating conveys multiple advantages, including the immunity it provides from activist-group challenges. Banks do not want to be stigmatized by their regulators for rejecting minority loan applicants matching the creditworthiness of white-owned firms receiving loans. By rating banks comprehensively on their minority

business lending performance *and publicizing those rankings widely*, regulatory authorities would encourage bankers to apply consistent criteria to small-business loan applicants irrespective of owner race, as they currently do in minority neighborhoods where their fulfillment of CRA obligations is closely monitored.

This article is based on the paper, 'Has the Community Reinvestment Act increased loan availability among small businesses operating in minority neighbourhoods?' in Urban Studies.

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