Revitalizing California Communities: A Call for a California Community Reinvestment Act

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Introduction

The federal Community Reinvestment Act (CRA) has had a profound impact on financial equity and inclusion. Designed to ensure that banks meet the credit needs of the communities in which they operate, the CRA has played a pivotal role in addressing disparities in access to financial services.

Despite its nearly 50 years of existence, fundamental questions about the effectiveness — particularly as it relates to meeting modern-day needs — of the CRA persist.

To answer the persisting questions of the CRA and to fill the policy gaps, Rise Economy (formerly the California Reinvestment Coalition) is leading the effort to establish a California Community Reinvestment Act (CA CRA), which will make our financial system more equitable and spur increased investments, financial services and credit to low- and moderate-income (LMI) communities and communities of color.

Here’s what a CA CRA would accomplish:

1. Encourage financial corporations via a reinvestment obligation to finance affordable housing development and preservation to help address the state’s shortage of housing affordable to low-income residents.
2. Address disparities in access to financial services and narrow the racial wealth gap by ensuring that covered financial institutions offer products and services fairly to all communities, including Black, indigenous, Latine and People of Color (BIPOC) communities.
3. In a state burdened with rising climate change-related disasters, a CA CRA would incentivize banks to finance California's transition to a just and greener economy and discourage financing activities that fuel climate change.
4. Democratize oversight and accountability of financial institutions by allowing for meaningful public participation in the process of examining whether these institutions are meeting community credit needs.

Background

From the 1930s to 1960s, the federal government created and maintained incentives for lending institutions to deny credit to individuals based on where they lived, even if they personally qualified for the credit. Neighborhoods occupied by Black and other communities of color were deemed “undesirable” and high risk. The federal government drew red lines around predominantly people of color neighborhoods and yellow lines around other, more mixed neighborhoods. The lack of capital in these communities led to economic decline and is the basis of the wealth gap we see today.

In 1977, the last of the civil rights era victories was the enactment of the federal CRA. The goal of this legislation is to address redlining in the banking industry - the discriminatory practice by financial institutions of refusing to provide credit and services in neighborhoods of color - by encouraging banks to meet the credit needs of the low and moderate income (LMI) communities they operate in. But by not explicitly mentioning race, the federal CRA does not address historic racial inequities. And while there have been clear historic benefits from this important federal legislation, the financial services industry has changed drastically since its passage when banks dominated, leaving wide swaths of the industry uncovered by its requirements.
A California State Community Reinvestment Act (CA CRA) is necessary

A CRA specifically for California can address gaps left by the federal CRA and realize the goal of reconciling the harmful legacy of redlining. California has the opportunity to be a bold leader and create robust reinvestment and fair access obligations for companies that occupy a large part of the financial services market and yet have no such requirements.

As independent mortgage companies (IMCs) have grown to comprise a majority of the mortgage market and the use of alternatives to traditional banks such as credit unions and financial technology (fintech) payment systems, like digital wallets and stored value cards, is increasing, creating a state-level affirmative obligation for these financial institutions to reinvest in historically disenfranchised and underserved communities is imperative to ensuring equal access and financial economic security for all Californians.

1. **Credit unions** benefit from nonprofit tax-exempt status and some also access additional tax breaks and supplemental government capital if a majority of the credit union’s membership meet low-income thresholds. Yet, state-chartered credit unions have a high reliance on revenue collected via non-sufficient funds and overdraft fee charges compared to state-chartered banks. State chartered credit unions make up 15 of the top 20 highest fee-charging state-chartered financial institutions in the state by dollar amount with a total of $211.3 million in 2022 alone. For example, The Golden 1 and Redwood credit unions have a low-income designation and yet collected $44.5 million in junk fees from their majority low-income membership in 2022.

2. In 2021, independent mortgage companies (IMCs) originated 72.7% of all mortgages in California. Mortgage companies do more lending to BIPOC borrowers and communities, but lend higher cost loans such as government-insured FHA loans, even among mid- to-upper income Black borrowers, who may have qualified for lower cost conventional loans. IMCs demonstrate an ability to benefit from public subsidies without a corresponding public obligation from its reliance on government insured loans and the business model of “originating to sell” to the Government Sponsored Enterprises Fannie Mae and Freddie Mac. Additionally, certain IMCs have been subject to enforcement actions for violating fair housing and other laws. A CA CRA can scrutinize these lenders to address unfair lending practices and unlawful steering of borrowers into higher-cost products, and can go further to rectify the industry’s harms by establishing an obligation to reinvest in low-income affordable housing development and homeownership, among other things.

3. The failures of Silicon Valley Bank and First Republic Bank, suggest that greater regulatory oversight is needed to ensure state-chartered banks are stable enough to serve their communities. Further, state-chartered community banks, despite a common narrative, can engage in activities that are harmful to communities and in ways that disproportionately impact communities of color. As one example, Rise Economy’s 2023 analysis of banks’ Paycheck Protection Program (PPP) loans to oil and gas extraction companies found that Tri Counties Bank, a small state-chartered regional bank, did the most PPP lending to oil and gas extraction companies, financing nearly $42 million in such loans while generating for itself over $1 million in PPP fees. State-chartered community banks can have a large impact, both positive and negative, on their communities. An enhanced reinvestment obligation will encourage state chartered banks to do more to support small businesses, homeowners, affordable housing development and preservation, and community development activities in our state.

4. **Financial technology (fintech) companies** have seen an explosion in market share as our reliance on technology increases. Fintech apps like Paypal, Cashapp and Venmo allow users to send payment directly to friends and companies and hold funds similar to a bank debit account. However, where a traditional bank has a reinvestment obligation, none exists for fintechs. Additionally, while deposit-taking institutions like banks insure the deposits of their customers through the FDIC, the rapidly growing number of payment app users are left vulnerable to losing their funds without deposit insurance or other consumer protections.
California regulators can step in to protect consumers with a CA CRA. Notably, some apps like Cashapp have a higher usage by black and low income borrowers. Companies that offer such bank-like products have become ingrained stakeholders in the financial services marketplace and thus should be subject to bank-like obligations and accountability. The Consumer Financial Protection Bureau (CFPB) is currently proposing to provide enhanced oversight of such providers of funds transfer and digital wallet apps. This step by the CFPB illustrates the momentum to scrutinize fintech companies’ practices and business conduct. California should follow suit by being the first state to create accountability and reinvestment obligations for fintech digital wallet and payment systems to play a part in addressing California’s affordable housing climate crises.

Reinvestment can close the racial wealth gap

At a time when homelessness, affordable housing needs and lack of access to credit and homeownership are at an all-time high in California, legislation like a CA CRA is crucial to resolve deep inequities in access to housing, small business and financial services.

The proposed institutions have the potential to reinvest upward of $15.3 billion per year for affordable housing and economic development.

1. **Reinvest in homeownership.** California’s Department of Housing and Community Development (HCD)’s Statewide Housing Plan has identified the legacy of racist land use and housing finance policies, which banks have played a role in as a contributing factor to the state’s affordable housing crisis. The federal Community Reinvestment Act was created to rectify these harms. A California-specific CRA can bridge the lending gap that still exists for LMI and BIPOC first-time homeowners and communities, and augment financing for the affordable housing development and preservation.

2. **Reinvest in rental affordable housing.** HCD’s housing plan estimates that California must plan for more than 2.5 million homes over the next eight-year cycle, and no less than one million of those homes must meet the needs of lower-income households. Further, HCD and the California Housing Partnership (CHPC) identified that more than 22,000 affordable homes are at risk of conversion to market rate in the next five years. HCD’s housing plan explicitly states that “… the lack of housing supply is not a challenge the state can fix alone—everyone has a role to play... Developers and lenders must finance and build new housing.” An affirmative reinvestment obligation can generate capital to support this need. A CA CRA is an opportunity to provide a strong incentive for new lenders to finance and/or contribute to a development fund for housing.

3. **Reinvest in climate resiliency and frontline communities impacted by the climate crisis.** Equally pressing is the fact that low income and BIPOC communities are at greater vulnerability of climate-related impacts across the country and particularly in California. As climate change continues to impact frontline communities disproportionately, the state must secure funding to implement climate resilient policies like CALGreen and rehab of existing properties to make them more climate resilient and better able to secure needed insurance, while also addressing the historical affordable housing crisis. A California CRA is an opportunity for state regulators to reward institutions financing climate resiliency projects in the most vulnerable communities.
Reinvestment Capital calculation

State-chartered banks and credit unions have the potential to reinvest upward of $15.3 billion per year for affordable housing and economic development. According to community benefit agreements (CBAs) negotiated by Rise Economy and members in the last few years, banks committed to reinvest at least four percent of their annual deposits into homeownership and community development initiatives, such as affordable housing. The top 20 state-chartered credit unions hold more than $98.9 billion in deposits, and the top 20 state-chartered banks hold more than $282 billion in deposits. Using the estimate of 4% of annual deposits, the top 20 state-chartered credit unions and banks could respectively reinvest a potential of $3.9 billion and $11.28 billion to California communities annually.

Five of the top mortgage companies in California with publicly filed information had a cumulative three-year average revenue of more than $19.69 billion generated from their lending nationally. Fintech companies similarly make substantial revenue off of transactions they facilitate and hold a significant amount of customer funds. For example, Block, the company that owns fintech companies like Square and Cash App, reported holding $3.18 billion in customer funds across the company’s entire footprint and making $10.2 billion in revenue from transactions, subscriptions and services fees.

California communities not only need more information about how much of this revenue is generated from Californian capital, which a CA CRA data collection would uncover, but also an understanding of how that revenue is being reinvested in communities and whether those financial products and services are being made equally available to all community members.
Precedence

There has been substantial momentum across the country to enact state-level CRAs. The CFPB recently published a comprehensive report summarizing CRA laws in seven states plus the District of Columbia.

Several of these states have CRA laws that cover credit unions and mortgage companies. Notably, New York recently added IMCs as covered entities under its state CRA in reaction to evidence of redlining in Buffalo by these companies. Many state financial regulatory agencies coordinate with federal agencies and use preexisting data reporting and datasets to make the state laws relatively easy to implement and evaluations easy to conduct.

California should not only pick up on the momentum from these states, but it should also be a leader. If enacted, our proposed CA CRA would be among the first state-level CRAs to explicitly evaluate financial institutions on their lending to racial groups and majority-minority communities and their impact on climate change, as well as be the first state CRA to include fintech companies.

Conclusion

All Californians deserve equal access to the home mortgage, small business and other financial products that bring financial stability and open doors to the kind of wealth building that is at the heart of the American Dream. For too long, the financial services industry has created barriers, discriminated, redlined and gouged underserved families through no fault of their own, while also failing to fully help the state meet its affordable housing and economic development needs.

A CA CRA can improve upon the existing federal community reinvestment framework by learning from its failures, filling in gaps, addressing blind spots, and by being a vehicle for those companies that want to contribute to financial equity in our economy. A CA CRA can also advance existing state efforts to strengthen the relationship between the financial services industry and the community, thereby better meeting the needs of California households.
Works Cited | Endnotes


3 Ibid.


7 Buell, Jamie, & Stein, K. (2023). Whose Paycheck Are We Protecting? The Role Banks Played in Funding Climate Change Through the Paycheck Protection Program. https://rise-economy.org/research_crc/whose-paycheck-are-we-protecting/


10 The Statewide Housing Plan lays out the state’s affordability crisis and quantifies the housing needs, as well as what policies are needed to actualize the housing goals set across the state’s next eight-year housing need (RHNA) planning cycle. California Department of & Housing and Community Development. (2022). Statewide Housing Plan. https://statewide-housing-plan.caahd.hub.arcgis.com/.

11 Ibid., “Overview: Who Must Act to Address the Housing Crisis?” https://storymaps.arcgis.com/stories/94729ab1648d43b1c1811c1c63@ref-n-ZW5k6v


17 State chartered banks are currently subject to a federal CRA obligation and are reinvesting in their communities. A CA CRA would encourage them to invest more in California communities, and to do so in ways that more closely meet local credit needs.


20 Ibid., p. 69.


This report was produced by Rise Economy