Mortgage Companies' Compliance with the State-Level Community Reinvestment Act -- Performance Management or Real Investment?

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May 2025

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We thank Matt Bloomfield, Caleb Bobo, Jeff Burks, Mike Iselin, Jeff Ng, Pervin Shroff, Sugata Roychowdhury, Sarah Stuber, Lynn Wang, seminar participants at Hong Kong University, 2024 Minnesota Accounting Empirical Conference and the 6th Annual Workshop on Financial Institutions Research at St. Louis Fed for their helpful comments and suggestions. We are grateful to Jim Campen for providing the historical Massachusetts CRA examination results.

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ABSTRACT

This paper examines whether non-bank mortgage companies' compliance with *state-level* Community Reinvestment Act (CRA) is a result of performance management or real investment. Leveraging the 2007 CRA rule change in Massachusetts (MA), we find that affected mortgage companies increase purchases, but not originations, of low-to-moderate-income (LMI) loans that qualify for CRA credit. In addition, inconsistent with the argument that loan purchase allows mortgage companies to gain understanding of unfamiliar areas and increase liquidity for the segments of loans with high information asymmetry, this increased loan purchase is concentrated in loans issued in the mortgage company's familiar LMI neighborhoods and made to safer borrowers. We also document immediately reversed LMI loan purchase after mortgage companies receive satisfactory CRA ratings when they are unlikely to be examined again. Importantly, we detect no increase in mortgage originations in LMI tracts either by affected lenders or in aggregate, but find a reduction in mortgage rates in MA LMI areas for safer borrowers. These findings suggest that mortgage companies manage CRA performance by trading safe LMI loans. While such performance management does not increase mortgage supply to LMI areas, increased secondary-market demand for safe loans in LMI areas benefits these borrowers through lower interest rates.