

COMMUNITY INVESTMENTS

A Community • Economic Development Publication

VOLUME FOURTEEN NUMBER 3



THE COMMUNITY LAND TRUST AND SPECIAL NEEDS HOUSING

Land may be the most expensive element in the price of housing. What would happen if the land could be valued separately? Land trusts make this possible. Learn how land trusts are helping to maintain affordability and accessibility in communities for generations to come

FANNIE MAE'S SECTION 8 PROGRAM

Section 8 is most often associated with rent payment assistance. But that is changing. Public housing agencies now have the opportunity to turn renters into homeowners using Section 8. Understand how it works and who needs to be involved

THE MATURING SECONDARY MARKET FOR COMMUNITY DEVELOPMENT LOANS

Most everyone knows about the secondary market for housing. But did you know that there is a mature secondary market option for community development and small business loans? A pioneer in the industry explains the ins and outs of this innovative mechanism that expands community development finance

... Plus the Editor's Notebook announces changes for Community Affairs

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Community Investments

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NOTEBOOK by Joy Hoffmann

2002

2002 marks the silver anniversary of CRA legislation and the twenty-year anniversary for the Community Affairs function at the Fed. During this period the regulation has undergone a number of modifications to make it more responsive to the needs of the consumer and less burdensome for financial institutions. As the regulation has evolved, so have the products and services we have provided to help you understand and respond to the opportunities available for community reinvestment.

As community-based organizations and financial institutions have adjusted to revisions of the CRA, they have discovered symbiotic and innovative ways for reaching an important and profitable market segment. But with fewer and less dramatic changes to the regulation, will the CRA continue to stimulate the same kind of innovation? And what is our role in helping to make the CRA a tool for enhancement rather than a burden? It is these questions that have motivated us to reevaluate the resources we are providing and to make changes that will help take CRA to the next level.

Recently, the Community Affairs staff embarked on a strategic planning initiative aimed at ensuring we maintain a leadership role in promoting community reinvestment in the 12th District. A number of our products will continue as they are such as the National Community Development Lending School, sovereign lending initiatives and our leadership of the consortium trade organizations ARCH & EDCR. Others will undergo modifications to make them more inclusive and demand-driven. Following are some of the programmatic changes you can expect:

- ▶ Starting in the fourth quarter 2002, we plan to host *Community Development Forums* in place of the quarterly CRA Roundtables. These forums will expand our audience to local community and government leaders along with CRA officer and banker leaders to address specific community development goals
- ▶ In 2003, we will publish *Community Investments* magazine twice a year in hard copy. Additional editions dedicated to specific and timely topics will be released electronically
- ▶ The District Bulletin, a feature of *Community Investments*, will take on a regional focus and will be produced more frequently in an electronic format
- ▶ You will be able to customize a local directory of community-based organizations using our web-based database, CARD-Key, in place of our hard copy profiles

We feel that these changes will first and foremost allow us more time to be responsive to trends and issues as they emerge. They will also enable us to spend more time in the field assessing the needs of our communities and identifying the right partners and strategies required in an increasingly complex environment. As always, we welcome your input on the issues we tackle. Our goal as a Community Affairs function is to be actively engaged with projects that have a bottom-line impact for you and for the community.

Please take a moment to fill out the comment card in the centerfold to update or verify your email address so you can begin to receive updates, announcements and invitations electronically.



In early 2001, Transitional Living and Community Support (TLCS) of Sacramento, California, was at risk of losing one of its facilities. The facility housed a successful transitional housing program for formerly incarcerated, homeless and mentally ill individuals. TLCS had been leasing the property for one year when the landlord, in response to escalating real estate prices, decided to place the property on the market. Prior to moving into the facility, TLCS spent two years overcoming the opposition of the local neighborhood association, which eventually became a supporter of the program. Thus, as a result of a hot real estate market and after considerable time and effort spent locating the program, TLCS was in the unfortunate situation of losing its facility.

Around the same time, Nehemiah Corporation of California was forming the Nehemiah Urban Land Trust (NULT), a nonprofit corporation whose mission is to acquire, manage and preserve special needs housing facilities like the one operated by TLCS. NULT subsequently stepped in to purchase the TLCS property, and the property is now being held in perpetuity for the benefit of TLCS, its clients and the community. The bylaws of NULT provide for the property to be used for special needs housing by another social services agency in the event that TLCS were to cease using the property.

THE COMMUNITY LAND TRUST MODEL

The Nehemiah Urban Land Trust is based on the community land trust (CLT) model, a unique solution to the problem of permanently maintaining affordable housing for diverse populations. The CLT idea began 30 years ago when community residents began to seek options that gave them control and ownership of land and housing resources in their community. Active resident participation was a response to soaring home prices, growing displacement and disinvestment within communities largely made up of renters,

TLCS Southside House



Land Trusts

by Lisa Engle, Manager, Nehemiah Urban Land Trust (NULT) of Nehemiah Corporation of California

and a shift in national housing policy that reduced funding for government housing programs.

The Institute for Community Economics (ICE) of Massachusetts has been a leader in Community Land Trusts since 1967. ICE defines a community land trust as a private, nonprofit corporation created to acquire and hold land for the benefit of a community in order to provide secure affordable access to land and housing for community residents. A CLT may provide a range of options including single-family, rental and special needs housing that share the essential characteristics of permanent affordability, sustainability, community participation and ownership.

PERMANENT AFFORDABILITY AND SUSTAINABILITY

A CLT ensures permanent affordability of housing by retaining ownership of the land and providing a ground lease to a resident or tenant on a long-term basis—typically for 99 years. On a single-family home, a resident purchases the home with a mortgage loan and leases the land from the land trust.

The homebuyer's mortgage loan is more affordable than a traditional home purchase because it is for the building only, not including the land. Lease payments to the CLT are nominal. The land lease limits the resident's equity in the home and gives the CLT first right of refusal to purchase the home. In most cases, the resident's heirs are able to assume the resident's interest in the home. Restrictions applied to the resale of the home ensure that it will be sold to a low-income household at an affordable price.

These transfer restrictions are what make the CLT a sustainable model for homeownership, wealth creation for the homeowner and affordable housing for the community. The CLT's long-term ownership also contributes to sustainability. There are two components of ownership in the CLT model: the ground lease on the land and the individual ownership of the dwelling. Although CLT homeowners are not able to sell their homes for the full market value, they do receive a portion of the equity appreciation. They also receive other benefits not avail

able as renters such as tax consideration for the amortized portion of their mortgage debt, and in some cases improvements made by the CLT.

In addition to providing affordable single-family homeownership opportunities, some CLTs own and operate affordable rental housing units. Others, such as the Nehemiah Urban Land Trust, own and lease facilities to special needs housing organizations. Many of the community land trusts that ICE works with have developed special needs housing as part of their program. For instance, the Burlington CLT based in Vermont provides facilities for transitional housing and a family shelter.

COMMUNITY PARTICIPATION

In addition to ensuring long-term affordability and sustainability, democratic control is a unique characteristic of the community land trust compared to other affordable housing models. Most CLTs are governed democratically by an open membership and an elected board of trustees. In the case of the NULT program and other special needs housing, the organization that rents the facility offers the community an opportunity to participate in the governance of the program. A steering committee of local neighbors meets regularly to discuss any impact the program is having on the neighborhood.

THE CLT MODEL AT WORK IN NORTHERN CA

The San Francisco Bay area housing market is the least affordable in the nation: nearly 70% of households pay more than 30% of their income for housing. Since 1990, average rents have increased at a rate more than double that of median household income. Consequently, homeownership has become a dream that many Bay Area residents feel is beyond their reach. Patricia Duncan-Hall was excluded from the housing market for years, before finding permanent affordable housing with the help of the Northern

California Land Trust (NCLT), one of the oldest community land trusts in the nation. Rick Lewis, program manager of the NCLT, characterizes the community land trust model as “a long-term solution to the affordable housing crisis in the Bay Area that addresses a key barrier to permanent affordability.”

As a mother of three, a part-time student and employee on disability, Patricia moved five times in six years, each time uprooting her children to find a three-bedroom apartment that would accommodate her family and accept her Section 8 voucher. Patricia learned of NCLT through a friend and began the application process. Although skeptical, Patricia applied and was selected for her current home in one of the trust’s restored Victorian four-plexes. According to Patricia, “the best thing about my home is the security of not having to move on someone else’s terms and it’s great for the kids who are not on pins and needles any more waiting to move.”

The Oakland Community Land Trust identifies community participation as a key to their success. This CLT, which was started in May 2000 and sponsored by the City of Oakland, Fannie Mae and Community Bank of the Bay, is a more recent effort to address affordability in this high-cost area. Although the city of Oakland designated \$5 million to fund the development of CLT housing, according to Robert Arnold, executive director of the Oakland CLT, one of the greatest initial challenges his organization faced was accessing money for capacity-building and administrative costs. Community organizing was a way to overcome this. “What makes the CLT model unique and ultimately successful is the strength of the community participation involved in its creation. This type of neighborhood, grass-roots capacity building takes time and commitment.”

Arnold also attributes success in the early stages of his organization’s development to technical assistance from

ICE. ICE was recently awarded a two-year contract by HUD to continue its technical assistance in developing CLTs across the country and specifically in communities in northern California.

BENEFITS AND CHALLENGES

According to ICE executive director Sarah Page, “as expiring subsidy contracts exacerbate an already significant affordable housing crisis, it is increasingly apparent that creating affordable housing permanently rather than for 20-year periods is wise public policy. CLTs assist neighborhoods to gain control of their own land and ensure that a portion of their housing will always be affordable for persons of modest means while enabling residents to remain in their neighborhoods, build equity and share in the benefits of revitalization. At the same time, communities are strengthened and neighborhood residents become leaders in CLT governance.” CLTs also make it easier for people to move into homeownership. Ninety-five percent of CLT homeowners participating in a recent national study¹ agreed that their CLT enabled them to become homeowners more quickly.

One of the major challenges facing CLTs is acquiring property for a land trust in a market where real estate prices are escalating and where it is difficult to obtain donated property. Another challenge for CLTs is educating individuals to the concept of a ground lease. According to Karen Seabury, a program officer at The John D. and Catherine T. McArthur Foundation, “one of the biggest initial hurdles CLTs have to jump through [is] a psychological and cultural challenge. The American dream of homeownership for many includes ownership of the land under their home and resale at market

1 *Levinger, Dr. George. Owning a Community Land Trust Home: A Survey on Homeowner Satisfaction. A report prepared by Institute for Community Economics, April 2001.*

rate.” Seabury characterizes CLTs as a stepping stone that helps individuals move from rental housing to homeownership.

FUNDING SOURCES

As with many nonprofit organizations, funding is another significant challenge for CLTs. Although some CLTs may carry some initial debt on their properties, most receive the funds to purchase land, greatly reducing the burden and necessity of carrying long-term debt. These funds come from a variety of sources including local housing trust funds, government programs, philanthropic donations, HUD loans and grants, state housing finance agency dollars, tax credit dollars and pension fund investments.

ICE's revolving loan fund provides CLTs across the country access to initial and long-term financing. Capitalized at \$13 million, ICE's loan fund includes investments from 400 individuals, religious institutions and foundations. It is one of a network of community loan funds around the country that provides loans to CLTs and other nonprofit organizations for bridge and construction loans, short- and long-term mortgages and lines of credit.

During the early stages of development, mortgage financing also represented an ordeal for CLTs. However, as financial institutions have been educated on the land lease and limited equity structure of CLTs, the number of sources willing to provide long-term financing for CLT homeowners has grown. On the single-family mortgage side, the northern California Land Trust (NCLT) has worked predominately with Washington Mutual and CalFed Bank to acquire single-family mortgages for CLT homeowner properties and Mechanics Bank of Richmond for their construction loans in the northern California area. Fannie Mae has shown strong support for the CLT model in Northern California and offers a national mortgage program for CLT homeownership.

CRA CREDITS

Community land trusts are an excellent way for banks to meet their community lending and investment goals under the Community Reinvestment Act. CLTs meet the CRA criteria in that they most often operate in low- and moderate-income areas and are involved with affordable housing. CLT homeowners typically have incomes between 40 to 60 percent of area median income. According to Sarah Page, “banks may be more inclined to invest in CLT programs over other programs because of the impact a CLT can make on an entire neighborhood.”

CONCLUSION

Community land trusts offer an innovative tool for solving the affordable housing problem by addressing two key components of community development—permanence and resident participation. This unique tool has and will continue to grow in prevalence as cities, communities and neighborhoods draw on it as a solution to increase their stock of permanently affordable housing.

“As we continue to identify and acquire special needs housing properties in our first four target cities—Charlotte, Indianapolis, Baltimore and Atlanta—we will be expanding the reach of the Nehemiah Urban Land Trust and providing social service agencies with the peace of mind they need to provide quality supportive housing services to their clients,” said Scott Syphax, president and CEO of Nehemiah. With the technical assistance offered by Institute for Community Economics, organizations like the Oakland Community Land Trust will continue in their mission of addressing the affordable housing crisis in their community.

To learn more about Nehemiah Urban Land Trust and its work on special needs housing please visit:

www.nehemiahcorp.org. **CI**

ABOUT THE AUTHOR



LISA ENGEL is the manager of Nehemiah Urban Land Trust (NULT) of Nehemiah Corporation of California, a Sacramento based nonprofit founded in 1997. Nehemiah is one of the largest nonprofit community development organizations in the country. NULT, an affiliate of Nehemiah, acquires, manages and preserves affordable housing for special needs families and individuals. Lisa is responsible for developing and implementing NULT's policies and procedures as they pertain to the overall mission.

Lisa received her B.A. from University of California, Irvine in social ecology and her M.S. from University of California, Davis in community and regional development.

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Northern California Land Trust

PATRICIA DUNCAN-HALL, NCLT Resident

FANNIE MAE'S SECTION 8 PROGRAM

by Julie A. Gould, Vice President, Fannie Mae

In President Bush's radio address on June 15, 2002, he challenged real estate industry leaders to join with the government, nonprofit organizations and private sector financial institutions in a major nationwide effort to increase minority homeownership.

In response to Bush's challenge, our chairman and CEO, Franklin D. Raines, joined President Bush in Atlanta for White House-sponsored events to promote the Administration's proposal to expand minority homeownership. Raines announced Fannie Mae's new ten-point plan¹ to help advance the Bush administration's homeownership proposal and increase our own commitment to minority homeownership. Point three of our plan states, "Fannie Mae will leverage HUD Section 8 homeownership funding by providing secondary mortgage market financing for first mortgages where Section 8 is a source of repayment."

Fannie Mae's American Dream Commitment™, created in March 2000, is a ten-year, \$2 trillion commitment designed to help shrink the homeownership gaps for our diverse nation by serving 18 million targeted American families. As part of this plan, Fannie Mae is committed to working with public housing agencies (PHAs) to finance homeownership for households participating in the Section 8 Homeownership Program. Through our five regional and 52 partnership offices, we will partner with PHAs, lenders, and community groups to bring the benefits of homeownership to borrowers with Section 8 vouchers, also known as the housing assistance payment (HAP). As part of this initiative, we have placed a high priority on increasing homeownership opportunities for households with disabled family members.

1 www.fanniemae.com/media/issues/061802.html

The secondary market resources and know-how that Fannie Mae brings to the table are critical ingredients in making the Section 8 Homeownership Program a workable means of channeling affordable loans to those who dream of a home of their own. Loans that meet Fannie Mae's underwriting requirements may be sold on the secondary market, giving participating lenders access to additional capital to make more loans in their communities. These loans may also help lenders subject to Community Reinvestment Act (CRA) requirements meet their CRA goals.

FROM RENTING TO OWNING

The HUD Section 8 Housing Choice voucher program is administered by local public housing agencies and allows low-income families, the elderly and households with disabled family members to rent housing in the private rental market. The tenant is responsible for choosing a rental unit, which must meet an acceptable standard of health and safety. The participating landlord agrees to receive part of the monthly rental payment in the form of a federal housing assistance payment. According to HUD, 1.9 million people currently hold Section 8 vouchers.

Congress first introduced the idea of homeownership for Section 8 rental voucher holders in the early 1990s. In the Quality Housing and Work Responsibility Act of 1998, the earlier legislation was clarified, enabling the homeowner option to finally become a reality for families receiving Section 8 rental assistance. In September 2000, HUD issued a final rule implementing the Section 8 homeownership option. Fannie Mae was the first secondary market agency to accept these loans.

The rule permits PHAs to allow Section 8 voucher holders to use their HAP as a partial mortgage payment for a single-family home, manufactured home, condominium or interest in a cooperative. To be eligible for the Section 8 homeownership option, borrowers must:

- Be first-time homebuyers
- Have a minimum income of \$10,300
- Be employed for at least one year
- Complete a homebuyer education course

The HUD rule does not require PHAs to offer the homeownership option, nor does it provide any additional funding to PHAs for administering the program. And while HUD specified a number of mandatory requirements for local Section 8 programs, they allow PHAs a great deal of discretion to design plans that meet local needs. Experience to date has demonstrated that successful homeownership programs require the collaboration of multiple partners such as lenders, housing counseling services, real estate agencies and nonprofit organizations.

In pursuit of our commitment to this program, Fannie Mae decided not to create a separate Section 8 mortgage

product, but rather to allow Section 8 voucher payments to be used with our existing loan products², including MyCommunityMortgage™ and HomeChoice™. The underwriting guidelines developed specifically for the Section 8 Homeownership Program include three models:

MODEL 1: DEDUCT HAP FROM PITI (BOX 1)

Under this model, the borrower's HAP is applied directly to the monthly principal, interest, taxes and insurance (PITI) payment on the loan. The housing debt-to-income and total expense-to-income ratios are calculated on the "net housing obligation" of the borrower. This model requires that the HAP be sent directly to the lender and the borrower's underwriting ratios not exceed 28/36, regardless of the mortgage product.

A variation of the PITI deduction option is tailored to the needs of disabled borrowers and allows the use of our HomeChoice™ product, which has a single qualifying ratio of 50 (box 2).

Box 1

Working with California Federal Bank (Cal Fed), Fannie Mae's western regional office recently facilitated a Section 8 mortgage loan for a single, working mother. She and her five children had already been living in the home, which was owned by the San Joaquin Housing Authority. The purchase price was \$154,500 with PITI payments being partially offset by the monthly HAP. The PHA placed a silent third mortgage loan on the home and retains equity in the property while the borrower pays the first-lien loan. For the down payment, the borrower received cash assistance from the city of Stockton, California. Use of the PITI deduction underwriting model makes this the most affordable option for the borrower.

² MyCommunityMortgage™ is a suite of flexible mortgage options for low- and moderate-income borrowers. HomeChoice™ is a single-family mortgage loan designed to meet the underwriting needs of low- and moderate-income people who have disabilities or have family members with disabilities living with them.

Box 2

The HomeChoice Coalition³ serving Long Beach, California, has acquired a number of condominium units to house people with mental disorders who are receiving Section 8 assistance. Through a partnership with the Long Beach Housing Authority, facilitated by Fannie Mae's western regional office, several of the occupants who have Section 8 vouchers are purchasing the condo units using our HomeChoice™ mortgage product.

MODEL 2: ADD HAP TO INCOME

This underwriting option allows lenders to calculate the borrower's total income as a combination of the tax-exempt HAP and the borrower's income from employment. Underwriting ratios are based on the mortgage product being used. This model works best for lower cost housing.

³ HomeChoice Coalitions can include representatives of lending institutions, housing finance agencies, homeownership counseling agencies, nonprofit and government agencies serving people with disabilities.

MODEL 3: TWO-MORTGAGE OPTION (BOX 3)

Here the borrower uses both a purchase-money first mortgage from a Fannie Mae-approved lender and a second mortgage from a nonprofit organization or government agency. The borrower is qualified for the amount of the first mortgage on his or her earned income, and that loan is sold on the secondary market. The principal and interest on the second loan is paid off exclusively with the borrower's HAP. The term of the second mortgage is typically 15 years, the maximum term of the HAP. Because the second mortgage is typically large enough for the first mortgage to have a loan-to-value ratio of less than 80 percent, the borrower does not need to pay for private mortgage insurance.



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Box 3

With the assistance of Fannie Mae's western regional office and Cal Fed, the San Bernardino Housing Authority recently closed two Section 8 loans using the two-mortgage model: one for a single parent with two children and the other for a four-member immigrant family. A National Realtor Council (NRC) affiliate, Neighborhood Housing Services of the Inland Empire, provided funding for the second mortgage loans from the assets of a \$250,000 second mortgage loan pool. Down payments and closing costs come from individual development accounts and the Family Self-Sufficiency program.

OVERCOMING AFFORDABILITY BARRIERS

One of the most difficult barriers to homeownership for low-income borrowers is amassing enough savings for down payment and closing costs. Two sources of funds that Fannie Mae accepts for down payment assistance and closing costs are the Family Self-Sufficiency (FSS) program and individual development accounts (IDAs).

FSS programs administered by PHAs promote both employment and savings accumulation by families who receive Section 8 rental vouchers or live in public housing. As these households earn higher incomes, a portion of these earnings can be set aside in an escrow account, which can be used for down payment or closing costs.

IDAs are dedicated savings accounts that enable low-income families to purchase a home, pay for higher education or start a small business. An individual deposits a specific amount of money from earned income each month into an IDA at a financial institution. At the same time, matching funds from public or private sources, which may include the lending institution, are made to a separate, parallel account. The money that accumulates in these accounts may be withdrawn for specific purposes, including making a down payment on a home.

NARROWING THE GAP

This article illustrates some of the ways that Section 8 is becoming a viable tool for closing the homeownership gap in America. Our Section 8 lenders have had the foresight to understand the importance of this program in ensuring equal housing opportunities in our diverse nation. Fannie Mae is committed to seeing the gates of homeownership open to many more underserved households.

By bringing to bear the resources of the secondary mortgage market, Fannie Mae is helping make the Section 8 Homeownership Program more attractive to lenders and our other partners in the affordable housing market. At the same time, President Bush is adding his authority to the homeownership movement, giving real hope that the American Dream may soon be reachable by more low- and moderate-income families, minorities and people with disabilities.

For additional information, go to www.efanniemae.com and enter "Section 8" in the search box to identify the closest Fannie Mae partnership office or contact your customer account manager. *CI*

ABOUT THE AUTHOR



JULIE A. GOULD is Fannie Mae's vice president for community lending. She develops community reinvestment and community lending products and transactions for expanding homeownership opportunities. Her group designs new partnerships, products and transactions to meet Fannie Mae's American Dream Commitment for people and communities most in need by 2010.

Ms. Gould joined Fannie Mae as assistant director of low- and moderate-income housing in 1988, and became director of low- and moderate-income housing in 1989. She was elected vice president in November 1991. From February through August 1995, she was acting housing impact vice president in the midwestern regional office establishing a new division and three partnership offices. As vice president of community lending from 1991–1996, she designed the company's flagship affordable housing product—the Community Home Buyer's Program, the HomePath initiative to increase the quality of home buyer education nationally, and FannieMaps, a software application to encourage lenders to greenline.

She has co-chaired Fannie Mae's Help the Homeless annual fundraising campaign in the Washington, D.C. metro area for the last five years. She currently serves on the Mercy Housing, Inc. board; the Housing and Development Reporter advisory board; and the Arlington Community Temporary Shelter board in her hometown of Arlington, VA. She is a past board member of Christmas in April and Women in Housing and Finance. Since 1994, she has consulted with the South African Housing Ministry as part of a Fannie Mae project to increase community lending and home-buyer education to lower-income South Africans.

Ms. Gould received an M.A. in city planning from the University of California, Berkeley and a B.A. from Pitzer College in Claremont, California.

The MATURING Secondary Market for Community Development LOANS

by Michael Blumfield, Director of Marketing, Community Reinvestment Fund



Some 20 years ago, the engineers at Sony figured out how to make a battery-powered cassette player small enough to carry around in your hand. It was made of metal, had no radio and cost more than \$200. Those who bought the initial models got quizzical looks from strangers, not sure what to make of people who walked around with headphones on, listening to music privately in public places.

Now the Walkman and its equivalents are ubiquitous. Commuters tune in news shows on city buses, homeowners play tapes while cleaning their yards, kids nod their heads in sync to MP3 tunes as they trod off to school. What was once a product at the margins has become so commonplace that no one thinks twice about them.

The secondary market for community development loans isn't quite as mature, but it's getting there. What was once a novelty has become a widely accepted method of bringing fresh money in the doors of community development lenders nationwide.

Community Reinvestment Fund, Inc. (CRF) has been striving to make the secondary market for community development loans a well-established financial option since 1989. Through a lot of effort, plus as much imagination and flexibility as we could muster, we've moved the ball a good way down the field. That means not just more options for lenders and investors, but more dollars for the nation's disadvantaged communities.

Consider:

- In 1989, CRF bought just over a million dollars worth of economic development loans—all confined to CRF's home state of Minnesota. In the most recent fiscal year, CRF bought more than \$60 million in loans from lenders across the country
- Initial deals for CRF resembled a space docking, timed just right to link lenders with loans to sell and institutional investors (banks, insur

ance companies, pension funds) ready to buy. Now, with resources of its own, CRF can buy millions of dollars worth of loans and warehouse them until aggregating them into a debt security, issued at least once a year

- Previously, government agencies looked apprehensively on sales of loans that were made with money from government programs. Recently, the Economic Development Administration, the CDFI Fund, and two Federal Home Loan Banks have commissioned studies and pilot projects to review how the secondary market can help stretch scarce funding dollars

This article reviews some of the history of the secondary market for community development lending, as well as examples of how the products for serving such a market have developed. We specifically look at transactions that have occurred within the Federal Reserve Bank of San Francisco's District.

INITIAL WORK

CRF was formed at the end of the 1980s, as funds for government programs intended to promote community development lending began to dry up. A quick definition: community development lending is intended to provide not just financial returns, but social returns as well. It includes loans for job creation, economic development and community facilities, such as daycare centers and healthcare facilities. (Affordable housing is also part of the mix, although a better-established market because of the uniformity of its products.)

These loans are typically executed by government groups such as city, county or statewide lending agencies, community development nonprofits and increasingly tribal entities (box 1), all of whom have an express mission of stimulating economic development in their target areas.

Box 1: Overcoming Sovereign Immunity Issues

The need for new capital for economic development lending is felt most acutely by tribal governments, who face dauntingly high unemployment rates and scarce resources. Financial markets have had trouble reaching Indian Country in part because of sovereign immunity issues that limit an outside agency's ability to take action should a loan default.

CRF found a way to overcome those issues through a loan participation with the Hoopa Valley Tribe in Northern California. The tribe was trying to complete a \$1.55 million fire fighting station, which would employ more than 50 people to battle blazes in forests throughout the country. The tribe was short on cash—to the tune of more than \$400,000. CRF agreed to an advance. Getting there took tremendous dedication on the part of both parties, as well as significant legal work. In addition to the transaction itself, the tribe needed to waive tribal immunity and agree on which courts should settle any disputes. Then, the proposed transaction had to be reviewed by two federal agencies—the Bureau of Indian Affairs and the Economic Development Administration, which had provided key funding.

The hard work paid off, not only in helping the Hoopa Valley Tribe get its fire station, but also in paving the way for other tribal governments to take advantage of the secondary market for economic development lending.

Frank Altman, CRF's founder and president, saw an opportunity to use the securitization instrument that has worked so well in mortgage banking. By selling loans instead of holding them until maturity, lenders would have more cash to make more deals. Essentially, what Mr. Altman wanted to do was use private capital sources—institutional investors—to fund public needs.

CRF's core philosophy has remained consistent:

- **Investors need to earn a market rate for their money.** By asking investors to accept below-market rates, we would be curtailing the resources available for buying loans
- **Lenders need to have their individual situations understood.** Community development lending

varies tremendously in scope. CRF has bought everything from a beauty shop's micro-loan to a structured financing of multi-million dollar portfolios. We strive to create products that fit the varying needs of the lenders that come to us

- **Social purpose should always be at the forefront, but let the lender decide how to serve that purpose.**

As a nonprofit, CRF must be sure that at the end of the day our activities support a social purpose. So, we buy loans that clearly serve a greater good by creating new jobs and helping low-income borrowers enhance their economic status. Lenders need to show us how they will reuse the proceeds we give them, but the decision on how to best put the money to use is ultimately a local one, not one imposed by CRF

THE BASIC PRODUCT

In the beginning, there were simply loans that had been made and people who wanted to buy them. CRF calls this type of transaction an “existing purchase.” Initially, we worked exclusively in our home state of Minnesota, hitting the road to explain to community development lenders how they could raise more cash by selling the loans on their books.

Plenty of eyebrows and doubts were raised before the first loan was sold, but eventually the idea took. To be sure, those early customers were a group trying to find any method to get more money in the till—and in a hurry. One of those early adopters was Michael McPherson of the Oakland Business Development Corp. In 1992, McPherson’s fund was strapped for cash. McPherson had heard about CRF and gave us a call.

We looked over what he had in his portfolio and offered to buy three loans: an inner city printing company, a metal-castings concern and an arts and crafts cooperative. McPherson was handed a check for \$136,250 for the loans, then turned around and made more loans to a janitorial company, a computer company and another printing company. McPherson suddenly saw a new way of financing his operation. Since then, he’s returned to CRF repeatedly, selling a total of 23 loans worth \$867,000 in cash.

Sometimes, the transactions are more sweeping. For example, in 1999, the state of Arizona’s Department of Commerce sold CRF 15 loans for \$3 million. An assortment of commercial and manufacturing loans with face values ranging from \$70,000 to nearly \$500,000 and interest rates from 3% to 12%, the loans’ only commonality was in creating jobs for residents of the state of Arizona. By diligently reviewing each, CRF was able to buy them and provide the state the capital it needed to create more jobs.

GETTING FANCY

The chief advantage of selling existing loans is that it allows a lender to quickly raise money in a straightforward way, which may be all that is required for some lenders. Others see an ongoing need for tapping into the revenue that CRF can provide, such as for an ongoing program that will repeatedly make similar types of loans. We term these an “advance commitment.”

In Los Angeles, CRF has worked with the Los Angeles LDC on a program that complements the SBA 504 program¹ for deals that would not normally meet SBA requirements. CRF agrees to fund the 40% that would have been LALDC’s share in the transaction. Depending on the credit quality of the loan, CRF either takes a position on par with LALDC or senior to LALDC. LALDC typically adds a premium to the interest rate of between 0.5% and 1.0%, which adds operating dollars for LALDC.

Through this set-up, LALDC has been able to fund nearly \$5 million in loans due to CRF’s participation. The range of businesses supported has been vast including a community facility that provides drug counseling and rehabilitation assistance for inner-city residents, a silkscreen shop that employs ex-gang members and a chicken processing plant on Skid Row² that provides poultry to some of LA’s leading restaurants.

For some lenders, the major issue they need to work around is a discount on the loans they are selling. Because CRF prices loans relative to their market value (which is what our investors seek), those loans that carry a below-market interest rate earn less than their face value. The California Integrated Waste Management Board was look-

ing for such an approach—what we term “structured finance”—when it worked with CRF in 1996.

The Board, which encourages recycling in part by providing funds to businesses that work in recycled material, had a portfolio of loans all made significantly below market. CRF securitized 17 loans made to such borrowers as a manufacturer that converted recycled plastic milk cartons into toilet plungers and another that fashioned industrial buffing materials from recycled burlap coffee bags. The loans had a weighted average interest rate of 4.77%. CRF advanced \$4.7 million against a portfolio face value of \$6.1 million with California Integrated Waste Management Board holding a residual interest in the portfolio.

Finally, CRF can on occasion make a “loan to lender” by which CRF advances cash based on the strength of the lender itself, not the underlying loans. In 1996, the City of El Monte, CA was looking for a way to make more loans for rehabilitating affordable housing projects. The loans were made on a “due on sale” basis making the capital provided to borrowers essentially locked up and unavailable to lenders. CRF advanced the city \$1 million against the rehab loans, fully amortizing until 2003. With the deal, the city was able to make more loans for the same purpose—without waiting for the homes carrying the original loans to be sold.

WHAT’S AHEAD

The potential for selling community development loans is vast. Billions of dollars of loans have been made through programs intended to spur community and economic development. All signals suggest that the secondary market for such loans will grow dramatically over the next several years due to a number of reasons:

- Government cutbacks are forcing community development lenders to

1 *SBA Certified Development Company (504) Loan Program: www.sba.gov/financing/cert.html.*

2 *Skid Row borders Third Street on the North, Alameda Street on the East, Seventh Street on the South and Main Street in the West.*

look at alternative channels for recapitalization. Loans on their books are assets, which they can use in one form or another to bring more cash to their coffers

- Government agencies such as the Economic Development Agency are exploring how to best use the secondary market. The EDA conducted a pilot project recently that allowed lenders who had received EDA funding to sell the loans and CRF was able to buy more than \$5 million of such loans
- The New Markets Tax Credit—a brand-new federal incentive to target economically disadvantaged areas—potentially will provide a substantial injection of capital. Among the ways in which lenders can take advantage of the credit is through the secondary market (box 2)

Perhaps the most important rationale for the growth of the secondary market for community development loans is that lenders have gotten comfortable with the idea just as the public got comfortable with the people wearing headphones walking down the street. True, the secondary market for community development loans is unlikely to pique the interest of your average 16-year old the way the latest MP3 player might. But for an increasing number of community development lenders, having a ready source of capital is music to their ears.

ABOUT THE AUTHOR



MICHAEL BLUMFIELD is director of marketing for Community Reinvestment Fund, with responsibilities for creating awareness of the organization among community development lenders, investors and funders. His most recent work includes a series of teleconference educational seminars for lenders about how to take advantage of opportunities in the New Markets Tax Credit program.

Mr. Blumfield previously worked for American Express Financial Advisors in retirement plans marketing. He is a former journalist who worked for a variety of papers throughout the country. He received his B. A. from the University of Michigan and his M.B.A. from the University of Minnesota's Carlson School of Management.

Box 2: New Markets Tax Credit: “Going it alone” vs. “Teaming up”



For the first time, a tax credit is available to stimulate investment for economic development ventures that will benefit emerging markets. The New Markets Tax Credit provides investors seven years worth of tax credits and collectively could infuse \$15 billion in new capital during that timeframe. The credit goes into effect in early 2003.

The CDFI Fund, which is administering the program, has created several avenues through which the funds can get to the low-income businesses targeted for assistance. One way is for a lender that qualifies to participate in the program (called a “Community Development Entity” or CDE) to make direct loans or investments in businesses with the capital it receives from investors. To do this, that lender will need to receive his own tax-credit allocation. Think of this as the “go it alone” approach.

Alternatively, a lender can become a CDE and sell their loans to another CDE with a tax-credit allocation. Community Reinvestment Fund is currently a CDE and is applying for the tax-credit allocation. This is what CRF calls the “team up” approach.

CRF has lined up CDE-designated lenders from throughout the country to partner with in this “team up” style. We think it’s an effective way to leverage the expertise of both partners—CRF to handle the administration of the tax credit and local lenders to decide how to best put it to work.

DISTRICT BULLETIN

— REFERENCE, RESOURCES AND OTHER —

NCRC'S 2002 ANTI-PREDATORY LENDING TOOLKIT

NCRC's 2002 Anti-Predatory Lending Toolkit provides community groups and consumer advocates with the tools to challenge lending practices that contribute to the problem of predatory lending, including: defining subprime and predatory lending, identifying predatory lending scams, consensus building and NCRC's "Home Ownership and Equity Protection Act" fact sheet. The Toolkit can also be used by financial institutions and government agencies as a primer on predatory lending, including summaries of federal fair housing and fair lending laws, notable lawsuits and best practices and responsible lending.

The 2002 edition of the Toolkit has been significantly enhanced with the inclusion of detailed summaries of federal, state and local anti-predatory lending legislation introduced in the 2001–2002 legislative sessions. Furthermore, the updated Toolkit also includes NCRC's revised anti-predatory lending model bill, "Homeowners Protections from Predatory Lending Act of 2002." This model bill is intended to initiate discussion with legislators, provide guidance and a point of reference when drafting legislation at the various governing levels.

The toolkit is available in PDF format and can be purchased by calling NCRC at 202/628-8866.

MONEY SMART IN SPANISH

The Federal Deposit Insurance Corporation (FDIC) is pleased to announce the launch of the Spanish language version of its adult financial education curriculum, *Money Smart*. Latino-Hispanic communities have eagerly awaited the Spanish version, which has been available in English since July 2001. In addition to the English and Spanish versions now available, *Money Smart* is being translated into Korean and Chinese. Those versions are scheduled for release in 2003.

The curriculum has been widely adopted across the country and is an integral part of efforts to address the issues of predatory lending, lack of access to conventional banking services and financial education as an important component of comprehensive homeownership programs. Anyone interested in teaching financial education can use *Money Smart*. The materials are easily reproduced and have no copyright restrictions. Copies may be obtained from the FDIC and are free to the user.

For additional information, contact San Francisco Region Community Affairs Officer, Linda Ortega at 415/808-8115.

JOINT CENTER FOR HOUSING STUDIES RESEARCH

The Harvard University Joint Center for Housing Studies recently issued a research paper entitled, *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*. The report examines home purchase and refinance lending from 1993 to 2000, and compares the lending patterns of CRA-regulated entities with entities not covered by the CRA. Among the report's principal findings are that CRA has expanded access to mortgage capital, CRA-regulated lenders originate more home purchase loans to lower-income people and communities than they would if CRA did not exist, and the regulatory framework around the CRA has failed to keep pace with changing industry structure.

The paper can be downloaded from the Center's website at www.jchs.harvard.edu.

HMDA REVISIONS

On June 21, 2002, the Federal Reserve Board published revisions to Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). The amendments:

- ▶ Set the thresholds for determining the loans for which financial institutions must report loan pricing. Institutions will report the rate spread (between the annual percentage rate on a loan and the yield on comparable Treasury securities) if the spread equals or exceeds 3 percentage points for first-lien loans, and 5 percentage points for subordinate-lien loans
- ▶ Require lenders to report the lien status of applications and originated loans
- ▶ Require lenders to ask applicants their ethnicity, race and gender in applications taken by telephone

Compliance with the amendments relating to the thresholds and lien status is mandatory on January 1, 2004. The amendment requiring lenders to ask telephone applicants for monitoring information is effective for applications taken beginning January 1, 2003.

The June changes follow on other changes that were published January 23, 2002. Among those changes were the requirement that lenders identify loans subject to the Home Ownership and Equity Protection Act (HOEPA).

For more information, and for the complete text of these revisions, go to www.ffiec.gov/hmda.

— CONFERENCES AND SEMINARS —

OCTOBER 22–23

Interested in helping to revitalize distressed urban areas? If so, join bankers, investors and members of community development organizations from around the country at this special conference in East St. Louis, IL. The conference will be held at the Jackie Joyner-Kersey Center, one of the redevelopment success stories of this one-time poster child for down-and-out cities.

If you have questions about the conference or would like a registration form, call Linda Aubuchon at the Federal Reserve Bank of St. Louis at 314/444-8646 or e-mail her at Linda.A.Aubuchon@stls.frb.org. You can register online at: www.stlouisfed.org/community/rays_of_hope.html.

OCTOBER 30–NOVEMBER 2

Don't miss the premiere training event for CDFI practitioners and investors being held in Oakland, CA. The theme of this 18th annual conference, sponsored by the National Community Capital Association, is *Managing Change: The New CDFI Era*.

To obtain a brochure, call 215/923-4754 or visit the NCCA website at: www.communitycapital.org.

— CRA OPPORTUNITIES —



Operation HOPE, Inc., America's first non-profit social investment banking organization, and a leading provider of economic empowerment in underserved communities, **needs YOU** on October 29th 2002!

- ▶ Volunteer to teach youth about the basics of finance in the unified school districts of San Francisco, Oakland and East Palo Alto.
- ▶ We provide the materials, training and students. You provide a minimum of one hour of your time on October 29th 2002 or during the fall semester.
- ▶ Share your financial expertise with youth at one of 12 schools in these 3 communities and empower them to make educated financial choices for their futures!

To volunteer on 10/29/02 or after, call Emily Ausbrook as soon as possible at 415/860-0126 or email emily.ausbrook@operationhope.org

FILLING THE DIGITAL DIVIDE

Tech Start, a nonprofit corporation based in Nevada, is "filling the Digital Divide" by developing, maintaining and managing a network of community technology centers where new and refurbished computers are used to create programs that provide community service, social interaction and educational environments to low- and moderate-income communities.

Tech Start's mission is to break down the real and imagined barriers to greater success, enhanced educational opportunities and improved quality of life through the utilization of computers and related technology. In an effort to continue this mission, Tech Start has an ongoing need for new and used computers as well as financial support to purchase software and assist with program expenses.

Contact Joseph Sayles at 702/491-0351 or via email: techstart@lvcm.com for more information

COMMUNITY INVESTMENT ARCHIVES

The Community Land Trust and Special Needs Housing

Financing Special Needs Housing (Volume 11 #1, Spring 1999)

The Maturing Secondary Market for Community Development Loans

Credit Scoring for Small Business Lending (Volume 11 #3, December 1999)

SBIC: More Than An Equity Investment (Volume 9, #4, Fall 1997)

Community Development Lending—Thinking Through Your Bank's Approach (Volume 8, #1, Winter 1996)

[email lena.robinson@sf.frb.org to receive a reprint]

Free subscriptions and additional copies are available upon request from the Community Affairs Unit, Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, California 94105, or call (415) 974-2978.

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